TAB 12

THIS DOCUMENT IS LOCATED AT

Affidavit of Adam Pritchard, sworn January 9, 2013

Plaintiffs' Motion Record, Tab 4

Court File No.: CV-12-9667-00CL

ONTARIO
SUPERIOR COURT OF JUSTICE

COMMERCIAL LIST

IN THE MATTER OF THE *COMPANIES' CREDITORS ARRANGEMENT ACT*, R.S.C. 1985, c. C-36, AS AMENDED, AND IN THE MATTER OF A PLAN OF COMPRISE OR ARRANGEMENT OF SINO-FOREST CORPORATION

Court File No.: CV-11-431153-00CP

ONTARIO
SUPERIOR COURT OF JUSTICE

B E T W E E N :

THE TRUSTEES OF THE LABOURERS' PENSION FUND OF CENTRAL AND EASTERN CANADA, THE TRUSTEES OF THE INTERNATIONAL UNION OF OPERATING ENGINEERS LOCAL 793 PENSION PLAN FOR OPERATING ENGINEERS IN ONTARIO, SJUNDE AP-FONDEN, DAVID GRANT and ROBERT WONG

Plaintiffs

- and -

SINO-FOREST CORPORATION, ERNST & YOUNG LLP, BDO LIMITED (formerly known as BDO MCCABE LO LIMITED), ALLEN T.Y. CHAN, W. JUDSON MARTIN, KAI KIT POON, DAVID J. HORSLEY, WILLIAM E. ARDELL, JAMES P. BOWLAND, JAMES M.E. HYDE, EDMUND MAK, SIMON MURRAY, PETER WANG, GARRY J. WEST, PÖYRY (BEIJING) CONSULTING COMPANY LIMITED, CREDIT SUISSE SECURITIES (CANADA), INC., TD SECURITIES INC., DUNDEE SECURITIES CORPORATION, RBC DOMINION SECURITIES INC., SCOTIA CAPITAL INC., CIBC WORLD MARKETS INC., MERRILL LYNCH CANADA INC., CANACCORD FINANCIAL LTD., MAISON PLACEMENTS CANADA INC., CREDIT SUISSE SECURITIES (USA) LLC and MERRILL LYNCH, PIERCE, FENNER & SMITH INCORPORATED (successor by merger to Banc of America Securities LLC)

Defendants

Proceeding under the *Class Proceedings Act, 1992*

AFFIDAVIT OF ADAM C. PRITCHARD

I, Adam C. Pritchard, of the City of Ann Arbor, in the State of Michigan, in the United States of America, MAKE OATH AND SAY:

I. INTRODUCTION AND SUMMARY OF OPINIONS

1. I am the Frances and George Skestos Professor of Law and Director of Empirical Legal Studies at the University of Michigan Law School in Ann Arbor. I have been retained by Siskinds LLP and Koskie Minsky LLP, co-counsel in the above-captioned securities litigation against Sino-Forest Corporation ("Sino-Forest") and others, to assess the claims asserted in *Leapard, et al., v. Chan, et al*., No. 12-cv-1726 (S.D.N.Y. removed Mar. 8, 2012) ("*Leapard*") against Sino-Forest's auditor, Ernst & Young LLP ("E&Y"), for the purposes of a hearing to approve a settlement with E&Y to resolve all claims against it in connection with Sino-Forest. The opinions expressed herein are based on the specific facts of this case. Thus, nothing expressed or concluded herein can be applied to any other litigation or controversy.

2. I understand the recognition of any order granted by an Ontario court approving a settlement will be sought from a court in the United States. Attached hereto as **Exhibit** "**A"** is a copy of the Amended Complaint filed in *Leapard* on September 28, 2012. Attached as **Exhibit "B"** is a copy of the Declaration of Richard A. Speirs ("Lead Plaintiff Materials") filed in support of David Leapard, IMF Finance SA, and Myong Hyon Yoo's motion for appointment as lead plaintiffs (the "Lead Plaintiffs") in that action. Attached as **Exhibit "C"** is the Order of the US District Court for the Southern District of New York ("Lead Plaintiff Order") appointing the Lead Plaintiffs and their counsel, Cohen Milstein Sellers and Toll PLLC as lead counsel in that action.

3. The primary claim against E&Y is based on Rule 10b-5 promulgated under section 10(b) of the Securities Exchange Act. A common law claim is also asserted against E&Y for aiding and abetting fraud. In my view, discussed more fully below, both claims face significant obstacles to any recovery. I understand E&Y denies all allegations against it. The principal

obstacles to success of the litigation are likely to be: 1) pleading *scienter* and reliance; 2) establishing market efficiency for the fraud-on-the-market presumption of reliance; and 3) limits on damages for third-party defendants.

4. For ease of exposition, I will consider obstacles to these claims that are likely to be raised at three points in the litigation: 1) the motion to dismiss stage; 2) the class certification stage; and 3) summary judgment and/or trial.

II. QUALIFICATIONS AND COMPENSATION

5. I teach corporate law and securities regulation at the University of Michigan. Among the topics that I cover in those classes are class action procedures, disclosure requirements under the federal securities laws, and securities fraud class actions. Securities fraud class actions are an important topic in my two books, as well as my principal research area. My articles include doctrinal, empirical and theoretical analysis of securities class actions. My curriculum vitae, including recent publications,is attached hereto as **Exhibit "D**.**"**

6. The opinions set forth in this affidavit are based on my knowledge of and experience with US securities laws and US class action securities litigation which I have acquired as a scholar and teacher in these areas, as well as an attorney at the Securities and Exchange Commission ("SEC").

7. My compensation is based on the number of hours worked on this assignment, as well as out-of-pocket expenses. My hourly rate is US$650.

III. MATERIALS REVIEWED

8. For the purpose of this expert opinion, I have reviewed the Amended Complaint, Lead Plaintiff Materials, and the Lead Plaintiff Order. Specific information relied upon are cited in the text of this affidavit.

IV. OPINION

1. The Claims

9. The Lead Plaintiffs assert claims on behalf of a class of persons who, from March 19, 2007 through August 26, 2011, purchased Sino-Forest's common stock on the Over-the-Counter ("OTC") market and/or purchased Sino-Forest's debt securities outside of Canada. Specifically excluded from the class are purchasers who purchased Sino-Forest securities on the Toronto Stock Exchange or in Canada.[1]

10. These proceedings are at an early stage. The court has recently approved the appointment of the Lead Plaintiffs and their counsel. After a lead plaintiff has been appointed, lawsuits are typically met with a motion to dismiss, meaning that the action is effectively stayed until the court decides the motion, which may take months or years. If the motion is granted, it will typically be granted without prejudice, affording the plaintiffs another opportunity to plead an adequate complaint. The amended complaint will typically be met with a motion to dismiss, which may again takes months or years to resolve. If the complaint survives the motion to dismiss, the case will then proceed to preliminary discovery with an eye toward issues likely to be raised at the class certification stage, which will also take months or years. Class certification

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1 Amended Complaint ¶ 267. Courts in the S.D.N.Y. have consistently held that transactions on foreign exchanges are not covered by Rule 10b-5. *See, e.g., In re UBS Sec. Litig.*, No. 07-11225, 2011 WL 4059356, at *4-6 (S.D.N.Y. Sept. 13, 2011); *In re Vivendi Universal, S.A. Sec. Litig.*, 765 F. Supp. 2d 512, 531 (S.D.N.Y. 2011); *In re Royal Bank of Scotland Group PLC Sec. Litig.*, 765 F. Supp. 2d 327, 336 (S.D.N.Y. 2011); *In re Alstom SA Sec. Litig.*, 741 F. Supp. 2d 469, 473 (S.D.N.Y. 2010); *In re Celestica Inc. Sec. Litig.*, No. 07-312, 2010 WL 4159587, at *1 n.1 (S.D.N.Y. Oct. 14, 2010); *Sgalambo v. McKenzie*, 739 F. Supp. 2d 453, 487 & n.216 (S.D.N.Y. 2010).

is the next significant hurdle for plaintiffs. If the class is certified, discovery on merits issues is then completed. After discovery is completed, motions for summary judgment would typically follow. If the case survives summary judgment, it can then be set for trial.

11. The primary claims asserted against E&Y are based on Rule 10b-5. To state a claim for fraud under Rule 10b-5, a private plaintiff must show: "(1) a material misrepresentation or omission by the defendant; (2) *scienter*; (3) a connection between the misrepresentation or omission and the purchase or sale of a security; (4) reliance upon the misrepresentation or omission; (5) economic loss; and (6) loss causation."[2]

12. The common law claim for fraud requires these elements under New York law: "(1) a material representation or omission of fact; (2) made with knowledge of its falsity; (3) with *scienter* or an intent to defraud; (4) upon which the plaintiff reasonably relied; and (5) such reliance caused damage to the plaintiff."[3]

13. Most of the requirements for establishing common law fraud overlap with the Rule 10b-5 claims' criteria.[4] Therefore, I will discuss them in the Rule 10b-5 claims context (with the exception of reliance, which I will discuss separately).

14. Aiding and abetting fraud requires the plaintiff to plead and prove: "(1) a violation by the primary wrongdoer, (2) knowledge of the wrongful conduct by the aider and abettor, and (3) substantial assistance by the aider and abettor in achieving the violation."[5] Thus, plaintiffs will

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2 *Matrixx Initiatives, Inc. v. Siracusano*, 131 S. Ct. 1309, 1317-18 (2011).
3 *Anwar v. Fairfield Greenwich, Ltd.*, 728 F. Supp. 2d 372, 414 (S.D.N.Y. 2010).
4 *In re Pfizer Inc. Sec. Litig.*, 584 F. Supp. 2d 621, 643 (S.D.N.Y. 2008) ("The elements of common law fraud under New York law are essentially the same as those required to state a claim under Section 10(b) and Rule 10b–5.") (quotations and citations omitted).
5 *Fezzani v. Bear, Stearns & Co.*, 592 F. Supp. 2d 410, 423 (S.D.N.Y. 2008).

need to establish liability for common law fraud before they can establish liability under the aiding and abetting fraud claim. In addition, plaintiffs will need to prove "substantial assistance," which requires proof that the "defendant affirmatively assist[ed], help[ed] conceal, or by virtue of failing to act when required to do so enable[d] the fraud to proceed."[6]

2. Motion to dismiss

15. In practice, complaints are routinely met by a motion to dismiss, and there is no reason to believe that E&Y will not move to dismiss the complaint in *Leapard.* Defendants have been very successful in gaining dismissal of complaints subject to these restrictions imposed by the PSLRA. Most estimates put the rate of dismissal at around 40%. Steve Choi, looking at lawsuits filed between 2003 and 2005, found a dismissal rate of 43%.[7] NERA, looking at cases filed between 2001 and 2006, found an overall dismissal rate in the US of around 45%.[8] In earlier work, looking at cases filed between 1996 and 2002, Hillary Sale and I found a dismissal rate of 36% for cases filed in the Second Circuit.[9]

16. In order to survive a motion to dismiss, plaintiffs must meet the standards explained in detail below.

a. Pleading standard

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6 *Fezzani* 592 F. Supp. at 423.

7 Stephen J. Choi, *Motions for Lead Plaintiff in Securities Class Actions*, Working Paper, NYU (February 2008).

8 NERA Economic Consulting, *Trends in Securities Class Actions: Annual Filings Are at the Highest Level in Six Years, Driven by the Credit Crisis, While Median Settlement Values Stay Steady*, at 7 (December 2008), available at http://www.nera.com/image/PUB_Recent_Trends_Report_1208.pdf.

9 A.C. Pritchard and Hillary Sale, *What Counts as Fraud? An Empirical Study of Motions to Dismiss Under the Private Securities Litigation Reform Act*, 2 Journal of Empirical Legal Studies 125, 142 Table 2 (2005).

17. In the US, plaintiffs are not required to seek leave of the court before filing an action, but their complaint must plead the facts relating to the alleged fraud. Complaints that do not plead facts sufficient to satisfy each of the elements noted above are subject to dismissal. Claims alleging fraud, which would include both the Rule 10b-5 and common law claims asserted in *Leapard*, "must state with particularity the circumstances constituting fraud."[10] To satisfy this particularity requirement, a plaintiff must "(1) specify the statements that the plaintiff contends were fraudulent, (2) identify the speaker, (3) state where and when the statements were made, and (4) explain why the statements were fraudulent."[11]

18. Rule 10b-5 claims face additional, more demanding pleading standards. The Private Securities Litigation Reform Act of 1995[12] ("PSLRA"), requires that facts "giving rise to a strong inference that the defendant acted with the required state of mind," must be pled with particularity.[13] The rule that fraud must be plead with particularity "is applied assiduously to securities fraud" in the Second Circuit Court of Appeals, which encompasses the S.D.N.Y.[14] The challenge posed for the plaintiff of pleading the alleged fraud with sufficient particularity is heightened by a stay of discovery that applies while a motion to dismiss is pending.[15] The discovery stay is particularly important with respect to claims against auditors, as it precludes access to the auditor's work papers and communications with the client, which makes it exceptionally difficult to collect the facts needed to demonstrate that the auditor acted with the requisite *scienter*.

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10 Fed. R. Civ. P. 9(b).
11 *Anschutz Corp. v. Merrill Lynch & Co.,* 690 F.3d 98, 108 (2d Cir.2012) (internal quotations omitted).
12 Pub. L. No. 104-67, 109 Stat. 737.
13 Securities Exchange Act § 21D(b)(1) & (2).
14 *Lentell v. Merrill Lynch & Co. Inc.*, 396 F.3d 161, 168 (2d Cir. 2005).
15 Securities Exchange Act § 21D(b)(3).

b. Material misstatement

19. The *Leapard* claim against E&Y is primarily based on Sino-Forest's alleged overstatement of its assets, revenues, and income. Materiality is an objective question "involving the significance of an omitted or misrepresented fact to a reasonable investor."[16] Specifically, materiality turns on whether a "'reasonable investor'" would view the misstatement or omission at issue as altering the "'total mix'" of available information.[17] Materiality thus trains on the objective importance of the misstatements (or omissions) made by the defendant to the reasonable investor.[18] Materiality determinations are disfavored on motions to dismiss, however, as they "determination require[] delicate assessments of the inferences a 'reasonable shareholder' would draw from a given set of facts and the significance of those inferences to him"—assessments that are "peculiarly . . . for the trier of fact."[19] Given that Sino-Forest has advised investors not to rely on its financial statements, a motion to dismiss based on materiality grounds is unlikely to succeed.

20. The plaintiff must show that the alleged misstatement was publicly attributed to the defendant at the time of the misstatement; the plaintiff cannot rely on allegations that the defendants assisted in its drafting or acquiesced in its dissemination.[20] E&Y expressed its opinion that Sino-Forest's financial statements presented fairly the financial position of Sino-Forest in accordance with generally accepted accounting principles, so the plaintiffs should not have difficulty satisfying this element for the purposes of a motion to dismiss.

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16 *TSC Indus., Inc. v. Northway, Inc*., 426 U.S. 438, 445 (1976)
17 *Matrixx*, 131 S. Ct. at 1318 (quoting Basic, 485 U.S. at 231-32).
18 See *Matrixx*, 131 S. Ct. at 1318 (courts view materiality through lens of a "'reasonable investor'") (quoting *Basic*, 485 U.S. at 231-32).
19 *TSC*, 426 U.S. at 450.
20 *Lattanzio v. Deloitte & Touch LLP*, 476 F.3d 147 (2d Cir. 2007). See also *Kalin v. Xanboo, Inc*., 2009 WL 92279 (S.D.N.Y. March 30, 2009) (rejecting attribution based on agency theory).

c. Scienter

21. In addition to the foregoing, the plaintiff must plead facts giving rise to a strong inference that the defendant made the misstatement with *scienter*, generally held to require at least recklessness.[21] Recklessness is defined as "an extreme departure from the standards of ordinary care to the extent that the danger was either known to the defendant or so obvious that the defendant must have been aware of it."[22] Complaints must be plead with particularity, which requires the plaintiff to "(1) specify the statements that the plaintiff contends were fraudulent, (2) identify the speaker, (3) state where and when the statements were made, and (4) explain why the statements were fraudulent."[23]

22. The *scienter* requirement poses potentially the greatest obstacle for the *Leapard* plaintiffs; motions to dismiss are commonly granted in securities fraud cases based on the failure to adequately plead *scienter*.

23. In the S.D.N.Y., "the standard for pleading auditor *scienter* is demanding."[24] In this context, recklessness is defined as "conduct that is highly unreasonable, representing an extreme departure from the standards of ordinary care" and "approximat[ing] an actual intent to aid in the fraud being perpetrated by the audited company."[25] Plaintiffs must allege sufficient facts to show that "[t]he accounting practices were so deficient that the audit amounted to no audit at all, or an egregious refusal to see the obvious, or to investigate the doubtful, or that the accounting

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21 Securities Exchange Act § 21D(b)(2).
22 *ECA & Local 134 IBEW Joint Pension Trust of Chi. v. JP Morgan Chase Co.*, 553 F.3d 187, 198 (2d Cir. 2009).
23 *Stevelman v. Alias Research, Inc.*, 174 F.3d 79, 84 (2d Cir.1999) (internal quotation marks and citation omitted).
24 *In re Marsh & McLennan Cos., Inc. Sec. Litig.*, 501 F.Supp.2d 452, 488 (S.D.N.Y.2006). See also *Anwar v. Fairfield Greenwich Ltd.*, 728 F. Supp. 2d 372 (S.D.N.Y. 2010).
25 *Rothman v. Gregor,* 220 F.3d 81, 98 (2d Cir. 2000).

judgments which were made were such that no reasonable accountant would have made the same decisions if confronted with the same facts."[26]

24. Although "allegations of accounting errors by themselves do not meet" the standard for pleading *scienter* "when coupled with sufficiently attention-grabbing 'red-flags,' pervasive 'GAAP and GAAS violations ... are sufficient to support a strong inference of *scienter*.'"[27] Thus, in order to withstand a motion to dismiss on *scienter* grounds, the *Leapard* plaintiff class will have to show that E&Y recklessly ignored "red flags" when conducting the audits and certifying the financial statements.

25. Recent cases from the S.D.N.Y. show that recklessness determinations with respect to auditors are extremely fact specific.

26. In *In re Bear Stearns Companies, Inc. Sec., Deriv., and ERISA Litig.*,[28] the court found that the plaintiffs' claims against Bear Stearns' outside auditor could survive a motion to dismiss. Deloitte had audited Bear Stearns' financial statements in the time period leading up to Bear Stearns' collapse. The court found that the complaint adequately alleged that Deloitte knowingly or recklessly ignored numerous signs that should have led it to question whether Bear Stearns was engaged in wrongdoing. The alleged red flags included allegations that Deloitte ignored warning signs that Bear Stearns (1) used mortgage valuation models that the SEC had criticized as inaccurate; (2) had been warned by the SEC that its valuation models did not reflect key housing indicators; (3) received collateral from one of its hedge funds that was worth far less than the value of the loan that Bear Stearns made to the fund; (4) lacked adequate internal

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26 *In re Refco, Inc. Sec. Litig.*, 503 F.Supp.2d 611, 657 (S.D.N.Y.2007).
27 *In re Tronox, Inc. Sec. Litig*., 2010 WL 2835545, at 20 (SDNY 2010) (quoting *In re AOL Time Warner and "ERISA" Litig.*, 381 F.Supp.2d 192, 240 (SDNY 2004.)
28 763 F. Supp. 2d 423 (S.D.N.Y. 2011).

controls, and (5) failed to disclose weaknesses in financial models and risk management procedures.

27. In *Stephenson v. PricewaterhouseCoopers, LLP*,[29] the court found that the plaintiff failed to adequately allege *scienter* against PricewaterhouseCoopers, the outside auditor of a Madoff feeder fund. The plaintiff alleged that PricewaterhouseCoopers ignored multiple red flags about the operation of Bernard L. Madoff Investment Securities, LLC—its client's general partner—that should have prompted closer scrutiny of the client's financial statements. The court rejected the plaintiff's alleged "red flags" as merely showing that PricewaterhouseCoopers had "access to information by which it *could* have discovered warning signs of fraud." The plaintiff did not adequately plead that PricewaterhouseCoopers actually knew of the red flags, and an auditor cannot intentionally or recklessly disregard red flags of which it is unaware.

28. In *Dobina v. Weatherford International Ltd.*, a district court in the S.D.N.Y. rejected a long list of purported red flags in connection with Rule 10b-5 claims asserted against Ernst & Young LLP.[30] The *Dobina* plaintiffs alleged that Ernst & Young LLP ignored the following issues with its audit client: "compliance: (1) the sudden drop in Weatherford's tax rate in 2007, (2) the magnitude of the error as ultimately revealed in 2010, (3) the frequency and consistency of the tax entries, (4) the fact that Weatherford's apparent tax rate was much lower than that of its rivals and permitted Weatherford to beat earnings forecasts, (5) the fact that Ernst & Young LLP received fees for "non-U.S. tax compliance, planning and U.S./non–U.S. tax related consultation," (6) Weatherford's prior history of accounting improprieties, (7) the discrepancy between Weatherford's cash tax rate and reported tax rate, (8) Ernst & Young LLP's access to a

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29 768 F. Supp. 2d 562 (S.D.N.Y. 2011), aff'd 2012 WL 1764191 (2d Cir. May 18, 2012).
30 2012 WL 5458148 (S.D.N.Y. Nov. 7, 2012).

spreadsheet containing intercompany reconciliations and (9) the discrepancy between Ernst & Young LLP's representations about internal controls and Weatherford's March 2011 admissions."[31] These red flags failed, according to the court, either because the plaintiffs failed to allege that Ernst & Young LLP was aware of the problems, or the issues failed to distinguish Weatherford from any other public company.

29. The most recent case from the S.D.N.Y. addressing *scienter* and auditors is also the one with the facts closest to those alleged in the *Leapard* Amended Complaint. In *Longtop Fin. Tech. Ltd. Sec. Litig*., the district court dismissed the Rule 10b-5 claims against Deloitte arising out of its audit of Longtop Financial, a Chinese information technology company.[32] The plaintiff alleged that Deloitte ignored red flags in not identifying related party transactions that Longtop was using to conceal costs, which had the effect of inflating Longtop's profits substantially above those of its peers. The complaint alleged that even a cursory audit would have uncovered the red flags, and that discovery of the red flags would have led to the unraveling of Longtop's alleged fraud. Despite the magnitude of the alleged fraud, the district court found that the complaint failed to plead a strong inference of *scienter* with respect to the auditors because it did not plead that Deloitte was actually aware of the red flags. According to the court, "[i]n order for a complaint founded on the theory that an auditor should have uncovered red flags to survive a motion to dismiss, the red flags must be 'so obvious that knowledge of them by the auditor can be presumed.'"[33] The alleged red flags in *Longtop* fell short of this standard.

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31 *Weatherford*, 2012 WL 5458148, at *13.
32 2012 WL 5512176 (S.D.N.Y. Nov. 14, 2012).
33 *Longtop*, 2012 WL 5512176, at *8 (quoting *Stephenson v. Citco Group Ltd.*, 700 F.Supp.2d 599, 623 (S.D.N.Y.2010)).

30. The Amended Complaint in *Leapard* alleges that "the fraudulent practices at Sino-Forest were so widespread and material that numerous red flags should have alerted E&Y to the materially misleading financial statements issued by Sino-Forest. That E&Y certified Sino-Forest's Financial Statements year after year and never once alerted investors or regulators to these fraudulent transactions shows that their audits were extremely reckless."[34]

31. These allegations may be found inadequate because there is little in the Amended Complaint to suggest that E&Y *knew* of the alleged fraudulent statements. To allege that the auditors "must have known" that the financial statements were fraudulent at the time of their preparation on the basis of their subsequent restatement – no matter how large the restatement – is conclusory. Conclusory allegations of this sort are a form of the "fraud by hindsight" that is recurringly rejected by district courts assessing the adequacy of securities fraud complaints.[35] In my opinion, these allegations of *scienter* against E&Y face a substantial risk of dismissal. The only countervailing consideration here is the sheer magnitude of the misstatements in the financial statements, but the pleading standard was adopted to discourage courts from being unduly swayed by such salient facts.

32. In my opinion, E&Y may well succeed with its motion to dismiss based on *scienter*.

d. Other elements

33. The other elements of the Rule 10b-5 claims – the "in connection" requirement, reliance, damages and loss causation – do not need to be plead with particularity in the complaint, they

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34 Amended Complaint ¶ 251.
35 *Xerion Partners I, LLC v. Resurgence Asset Mgmt., LLC,* 474 F.Supp.2d 505, 518 (S.D.N.Y.2007).

need only be "plausible."[36] In my view, the general allegations in the complaint meet this standard, although E&Y may move to dismiss the complaint on any one of them.

34. The same may not be true of the common law fraud claim. Courts in the S.D.N.Y. have construed common law fraud under New York law as requiring actual reliance, rejecting the use of the fraud-on-the-market presumption of reliance commonly invoked in Rule 10b-5 cases.[37] To the best of my knowledge, no state court has accepted the fraud-on-the-market presumption in connection with a common law cause of action for deceit. As the *Leapard* plaintiffs have not plead actual reliance, but only a presumption of reliance,[38] their common law claims of fraud, and thus, their claim against E&Y for aiding and abetting fraud, are likely to be dismissed.

3. Class Certification

35. If the complaint were to withstand a motion to dismiss, the next substantial obstacle would be class certification. The requirements for certifying a class action are set forth in Rule 23 of the Federal Rule Civil Procedure.

a. Certification standards

36. For all class actions, Rule 23 requires: (a) numerosity; (b) common questions of law or fact; (c) that claims of the class representative by typical of the claims of the class; (d) that the representative party fairly and adequately protect the class's interest.[39] In addition, for cases seeking primarily money damages (such as securities class actions like *Leapard*), the court must also find that "the questions of law or fact common to class members predominate over any questions affecting only individual members, and that a class action is superior to other available

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36 *Bell Atl. Corp. v. Twombly*, 550 U.S. 544, 570 (2007).
37 See *In re Pfizer Inc. Sec. Litig.*, 584 F. Supp. 2d 621, 643-644 (S.D.N.Y. 2008) (collecting cases).
38 See Amended Complaint ¶ 280.
39 Fed. R. Civ. P. 23(a).

methods for fairly and efficiently adjudicating the controversy."[40] In making this finding, courts are instructed to consider: (a) class members' interests in individually controlling a separate action; (b) any litigation already undertaken by class members; (c) whether the claims should be concentrated in a particular forum; and (d) difficulties likely to arise in managing a class action.[41]

37. The Second Circuit requires district judges to determine that each of the Rule 23 requirements have been met, resolving any factual disputes relevant to those requirements.[42] Moreover, the burden is on the plaintiff to demonstrate by a preponderance of the evidence that the Rule 23 requirements have been satisfied.[43] The defendant can appeal from a decision certifying a class if granted leave by the court of appeal.[44]

b. Typicality

38. There may be a typicality question with respect to the named plaintiff, David Leapard. His certification alleges that he purchased his Sino-Forest common shares on August 5, 2011.[45] Myong Hyong Yoo's certification alleges that he bought his Sino-Forest common shares in July and August of 2011.[46] The Amended Complaint alleges, however, that the facts of the fraud were largely known by June 18, 2011, when the *Globe and Mail* published an article raising numerous questions about the veracity of Sino-Forest's financial statements.[47] This raises the possibility that the class has been extended to include Leapard and Yoo as class members. If so,

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40 Fed. R. Civ. P. 23(b)(3).
41 *Id*.
42 *In re Initial Public Offering Securities Litigation*, 471 F.3d 24, 41 (2d Cir. 2006), clarified on reh'g denial, 483 F.3d 70 (2d Cir. 2007)
43 *Teamsters Local 445 Freight Division Pension Fund v. Bombardier, Inc.*, 546 F.3d 196, 202 (2d Cir. 2008).
44 Fed. R. Civ. P. 23(f).
45 Lead Plaintiff Materials, Exhibit B.
46 Lead Plaintiff Materials, Exhibit D.
47 Amended Complaint ¶ 224.

their ability to represent the class would be open to challenge at the class certification stage: "To establish typicality under Rule 23(a)(3), the party seeking certification must show that each class member's claim arises from the same course of events and each class member makes similar legal arguments to prove the defendant's liability."[48]

c. Fraud-on-the-market presumption of reliance

39. In a securities class action, among the elements that must be demonstrated at the class certification stage are the requirements of the fraud-on-the-market presumption of reliance.[49] Reasonable reliance by the plaintiff on the alleged misstatement is a requirement of Rule 10b-5.[50] The reliance element of a Rule 10b-5 private action, also called transaction causation, requires proof of a "'connection between a defendant's misrepresentation and a plaintiff's injury.'"[51] The fraud-on-the-market presumption, adopted by the Supreme Court in *Basic, Inc. v. Levinson*,[52] allows plaintiffs to plead and prove the reliance required for the private cause of action under Rule 10b-5 of the Securities Exchange Act without alleging that the plaintiff read or heard the misstatement alleged to have caused the loss.

40. As noted above, it is plaintiffs' burden to show that common questions of reliance predominate over reliance questions affecting individual class members. Demonstrating applicability of the fraud-on-the-market presumption is therefore plaintiffs' burden.[53] In order to invoke the presumption, the plaintiff must demonstrate by a preponderance of the evidence that

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48 *In re Flag Telecom Holdings, Ltd. Securities Litigation*, 574 F.3d 29, 35 (2d Cir.2009) (quoting *Robidoux v. Celani*, 987 F.2d 931, 936 (2d Cir. 1993)).
49 *In re Initial Public Offering*, 471 F.3d at 42-43.
50 *Emergent Capital Inv. v. Stonepath Group, Inc.*, 343 F.3d 189, 195 (2d Cir. 2003).
51 *Erica P. John Fund, Inc. v. Halliburton*, 131 S. Ct. 2179, 2184 (2011) (quoting *Basic Inc. v. Levinson*,485 U.S. 224, 243 (1988).
52 485 U.S. 224 (1988).
53 See *In re Salomon Analyst Metromedia Litig.*, 544 F.3d 474, 485 (2d Cir. 2008) (discussing whether "plaintiffs had met their burden for invoking the fraud-on-the-market presumption").

the defendant has "(1) publicly made (2) a material misrepresentation (3) about stock traded on an impersonal, well-developed (i.e., efficient) market" and that the plaintiff traded the shares during the period that the material misrepresentation was influencing the market.[54] This showing must be made before certification.[55]

41. Critically, in the Second Circuit, a plaintiff must demonstrate that the alleged misstatements were material; a prima facie showing will not suffice.[56] Moreover, plaintiffs are required to demonstrate market "efficiency" at the class-certification stage.[57] Defendants have successfully opposed the application of the presumption at the class-certification stage by demonstrating that the relevant market is not efficient.[58]

42. Lower courts applying *Basic* have developed various multi-factor tests to determine whether a particular market is efficient.[59] The best known of these cases, *Cammer*, examined the following proxies for market efficiency: the percentage of shares traded weekly; whether "a significant number" of analysts follow and report on the stock; the existence of market makers trading the stock; whether the issuer was qualified to use an S-3 registration statement with the SEC; and whether the plaintiff can "allege empirical facts showing a cause and effect

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54 *Salomon* 544 at 481.
55 See *Szabo* v. *Bridgeport Machs., Inc.*, 249 F.3d 672, 676 (7th Cir. 2001).
56 *Salomon*, 544 F.3d at 486 n. 9. This requirement may change; the Supreme Court is considering this question in *Amgen Inc. v. Conn. Ret. Plans & Trust Funds*, No. 11-1085 (OT-2012). The Court heard oral argument in this case on November 5, 2012. A decision should be handed down sometime early in 2013.
57 See, e.g., *Gariety* v. *Grant Thornton, LLP*, 368 F.3d 356, 368 (4th Cir. 2004). Allegations of efficiency are sufficient at the motion to dismiss stage. *Tronox*., 2010 WL 2835545, at 24, n. 166.
58 See, e.g., *Initial Pub. Offerings.*, 471 F.3d at 42-43 (denying class certification because market was not efficient). See also *Wal-Mart Stores, Inc.* v. *Dukes*, 131 S. Ct. 2541 (2011) (holding that all matters relevant to certification must be examined at the certification stage).
59 See, e.g., *Cammer* v. *Bloom*, 711 F. Supp. 1264, 1286-1287 (D.N.J. 1989) (articulating five factors).

relationship between unexpected corporate events or financial releases and an immediate response in the stock price."[60] The Second Circuit has approved the use of the *Cammer* factors.[61] Other courts have also looked to other proxies, including market capitalization, bid-ask spread, percentage of stock held by insiders,[62] and volume of trading by institutional investors.[63] These factors have been widely relied upon by a variety of courts.[64]

43. The Second Circuit has emphasized the critical importance of "[e]vidence that unexpected corporate events or financial releases cause an immediate response in the price of a security," and observed that "[w]ithout the demonstration of such a causal relationship, it is difficult to presume that the market will integrate the release of material information about a security into its price."[65]

44. Based on these factors, the stock of large companies trading on major exchanges (NYSE, NASDAQ), have been routinely held to satisfy the market efficiency required to invoke the fraud-on-the-market presumption. The presumption does not apply, however, in markets lacking in informational efficiency, thereby excluding smaller companies in thinly-traded markets from substantial exposure to securities fraud class actions.[66] Class certification has been denied for common stock trading in less developed markets[67] even when the false statement at issue is

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60 *Cammer*,711 F. Supp. at 1286-87.
61 See *Bombardier,* 546 F.3d at 204, n. 11, 210–11 (citing *Cammer*).
62 *Krogman* v. *Sterritt*, 202 F.R.D. 467, 478 (N.D. Tex. 2001) (adding three more factors).
63 *O'Neil* v. *Appel*, 165 F.R.D. 479, 503 (W.D. Mich. 1996).
64 See *Unger v. Amedisys Inc.*, 401 F.3d 316, 323 (5th Cir. 2005) (noting that the *Cammer*/*Krogman* factors "have been used by many courts throughout the country").
65 *Bombardier Inc.*, 546 F.3d at 207.
66 See *Binder v. Gillespie*, 184 F.3d 1059 (9th Cir. 1999) (*Basic* presumption does not apply to issuer whose stock was traded in the "pink sheets").
67 See *Krogman,* 202 F.R.D. at 474-78. But see *In re Parmalat Sec. Litig.*, 375 F.Supp.2d 278, 303–05 (S.D.N.Y. 2005) (securities actively traded on the Luxembourg, Milan and Uruguayan stock exchanges, and in the OTC market in the United States).

significant. As a result, a class-action remedy is frequently unavailable because the class cannot show informational efficiency in the relevant market.

45. The need to show market efficiency poses a substantial obstacle for the *Leapard* plaintiffs. They must establish that the over-the-counter ("OTC") market where they purchased Sino-Forest stock and the private placement context in which they purchased Sino-Forest notes constitute open and efficient markets before benefiting from the fraud-on-the-market presumption. The OTC market is generally not regarded by the courts as satisfying *Basic*'s requirement of informational efficiency.[68] This issue is complicated, however, by the fact that Sino-Forest's stock also traded on the Toronto Stock Exchange. The TSX is closer to the model of the NYSE and NASDAQ, which are generally regarded as informationally efficient. It is an empirical question, however, how closely the OTC market for Sino-Forest's shares tracked trading on the TSX.

46. In addition, under prevailing case law in the lower courts, *Basic*'s presumption of reliance has been held to be unavailable to investors in newly issued securities,[69] which would seem to preclude any purchaser of the Sino-Forest notes in the private placement from relying on the fraud-on-the-market presumption. Moreover, the obstacle of showing market efficiency has also precluded certification of a class in cases involving mortgage-backed bonds,[70] and other

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68 *Alki Partners, LP v. Vatas Holding GMBH*, 769 F. Supp. 2d 478, 493 (SDNY 2011).
69 See *Initial Pub. Offerings*, 471 F.3d at 42; *Freeman* v. *Laventhol & Horwath*, 915 F.2d 193, 199 (6th Cir. 1990).
70 See *Bombardier*, 546 F.3d at 210. But see *In re Dynex Capital, Inc. Sec. Litig.*, 2011 WL 781215 (SDNY 2011) (distinguishing *Bombardier* and finding particular market for mortgage-backed securities to be informationally efficient).

types of debt securities.[71] These holdings will make it difficult for the *Leapard* plaintiffs to show that the secondary market for the Sino-Forest notes was informationally efficient.

47. If the plaintiff succeeds in establishing the presumption, the defendant is entitled to rebut that presumption at the class certification stage.[72] This opens the door for potentially far-ranging factual inquiries, including arguments "that the market price was not affected by the alleged misstatements, other statements in the 'sea of voices' of market commentary were responsible for price discrepancies, or particular plaintiffs may not have relied on market price."[73] If the defendant succeeds in rebutting the presumption, a class cannot be certified because individual questions of reliance would predominate over common ones.[74]

4. Summary Judgment/Trial

48. If the case is certified as a class action, E&Y would have the option of making a motion for summary judgment after the close of discovery. The standard for summary requires that the movant establish "that there is no genuine dispute as to any material fact and the movant is entitled to judgment as a matter of law."[75] Summary judgement allows for entry of judgment "against a party who fails to make a showing sufficient to establish the existence of an element essential to that party's case, and on which that party will the burden of proof at trial."[76] Thus, it would be open to E&Y to challenge every element of the plaintiffs' case at the summary judgment stage. Such motions, however, infrequently result in a victory for defendants in

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71 *In re AIG Inc., Sec. Litig.*, 265 F.R.D. 157 (SDNY 2010) (denying class certification for bondholders of AIG)
72 *Salomon*, 544 F.3d at 485.
73 *Salomon*, 544 F. 3d at 485.
74 *Salomon*, 544 F.3d at 485 ("a successful rebuttal defeats certification by defeating the Rule 23(b)(3) predominance requirement.") (emphasis omitted).
75 Fed. R. Civ. P. 56(a).
76 Celotex Corp. Catrett, 477 U.S. 317, 322 (1986).

securities fraud class actions; in research that I conducted with Stephen Choi, we found that between 2003 and 2007, only 1.2% of cases resulted in summary judgment for the defendants.[77]

49. According to one recent study, a verdict is reached in only about one-third of one percent of securities-fraud class actions.[78] So a trial verdict is an unlikely outcome for the *Leapard* litigation. However, should the case get past a motion to dismiss and be certified as a class, the bargaining over a settlement would be in the shadow of a hypothetical trial outcome. Even if the plaintiff withstands the motion to dismiss, it would be required to prove each of the elements of its Rule 10b-5 claim to the jury's satisfaction, including loss causation and damages, which would not face much scrutiny earlier in the proceedings. Moreover, the plaintiffs would need to establish E&Y's *scienter* by a preponderance of the evidence. On this point, the PSLRA give defendants such as E&Y an important procedural protection by entitling them to a specific finding by the jury that the state of mind element has been satisfied as to him or her.[79]

50. The other provision of the PSLRA relevant to E&Y's potential legal exposure in *Leapard* is the damages provision. The PSLRA adopts proportionate, rather than joint and several, liability for defendants who are not found to have knowingly violated the securities laws.[80] That protection is most important for secondary defendants, such as accountants, lawyers and investment bankers, who may be implicated in frauds that will typically be orchestrated by the insiders of their corporate clients. If those secondary defendants can show that they did not know of the fraud, their liability exposure will be limited substantially.

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77 *The Supreme Court's Impact on Securities Class Actions: An Empirical Assessment of* Tellabs, 28 J. L., ECON., & ORG. 850, Table 1, Panel B (2012).
78 See Cornerstone Research, *Securities Class Action Filings: 2010 Year in Review* at 14 (2011).
79 Securities Exchange Act § 21D(d).
80 Securities Exchange Act § 21D(f)(2).

51. In my view, proportionate liability would be the most likely conclusion if this case were to go to trial and the auditors were to be found to have violated Rule 10b-5. Assessing the comparative fault of E&Y against the culpability of Sino-Forest's insiders – who are likely to be found to have engaged in knowing and intentional fraud – as well as Sino-Forest's underwriters, suggests that E&Y's percentage of the damages might be relatively modest. Given that Sino-Forest is insolvent, however, E&Y could face an additional fifty percent surcharge on the audit firm's assessed damages to help compensate the plaintiffs for Sino-Forest's uncollectible share of the liability.[81] If E&Y's percentage of fault is modest, however, adding another 50% to that figure is unlikely to make a significant difference.

I certify that, to the best of my knowledge and belief:

-- the statements of fact contained in this affidavit are true and correct;

-- the reported analyses, opinions and conclusions are limited only by the reported assumptions and limiting conditions, and are my personal, unbiased professional analyses, opinions and conclusions;

-- I have reviewed Rule 4.1 of the Ontario *Rules of Civil Procedure*, and I have prepared this affidavit having regard to the duty described therein;

-- I have no present or prospective interest in the parties to this case, and I have no personal interest or bias with respect to the parties involved; and

-- my compensation is not contingent on an action or event resulting from the analyses, opinions or conclusions in, or the use of, this affidavit.

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81 Securities Exchange Act § 21D(f)(4).

January 9, 2013

A. C. Pritchard

Adam C. Pritchard

Sworn before me at the City of Ann Arbor, in the State of Michigan, in the United States of America, this 9th day of January 2013.

Janice L. Abbott

Commissioner of Oaths

JANICE L. ABBOTT
NOTARY PUBLIC, STATE OF MI
COUNTY OF LIVINGSTON
MY COMMISSION EXPIRES Oct 10, 2015
ACTING IN COUNTY OF Washtenaw

TAB 13

THIS DOCUMENT IS LOCATED AT

Affidavit of Frank Torchio, sworn January 11, 2013

Plaintiffs' Motion Record, Tab 5

ONTARIO
SUPERIOR COURT OF JUSTICE

Court File No.: CV-11-431153-00CP

BETWEEN:

THE TRUSTEES OF THE LABOURERS' PENSION FUND OF CENTRAL AND EASTERN CANADA, THE TRUSTEES OF THE INTERNATIONAL UNION OF OPERATING ENGINEERS LOCAL 793 PENSION PLAN FOR OPERATING ENGINEERS IN ONTARIO, SJUNDE AP-FONDEN, DAVID GRANT and ROBERT WONG

Plaintiffs

- and-

SINO-FOREST CORPORATION, ERNST & YOUNG LLP, BDO LIMITED (formerly known as BDO MCCABE LO LIMITED), ALLEN T.Y. CHAN, W. JUDSON MARTIN, KAI KIT POON, DAVID J. HORSLEY, WILLIAM E. ARDELL, JAMES P. BOWLAND, JAMES M.E. HYDE, EDMUND MAK, SIMON MURRAY, PETER WANG, GARRY J. WEST, PÖYRY (BEIJING) CONSULTING COMPANY LIMITED, CREDIT SUISSE SECURITIES (CANADA), INC., TD SECURITIES INC., DUNDEE SECURITIES CORPORATION, RBC DOMINION SECURITIES INC., SCOTIA CAPITAL INC., CIBC WORLD MARKETS INC., MERRILL LYNCH CANADA INC., CANACCORD FINANCIAL LTD., MAISON PLACEMENTS CANADA INC., CREDIT SUISSE SECURITIES (USA) LLC and MERRILL LYNCH, PIERCE, FENNER & SMITH INCORPORATED (successor by merger to Banc of America Securities LLC)

Defendants

Proceeding commenced under the *Class Proceedings Act*, 1992

AFFIDAVIT OF FRANK C. TORCHIO

(sworn January 11, 2013)

CANADA
PROVINCE OF QUEBEC
DISTRICT OF QUÉBEC
SUPERIOR COURT
NO: 200-06-000132-111

GUINING LIU,

Petitioner

- and -

SINO-FOREST CORPORATION, ERNST & YOUNG LLP, ALLEN T.Y. CHAN, W. JUDSON MARTIN, KAI KIT POON, DAVID J. HORSLEY, WILLIAM E. ARDELL, JAMES P. BOWLAND, JAMES M.E. HYDE, EDMUND MAK, SIMON MURRAY, PETER WANG, GARRY J. WEST, PÖYRY (BEIJING) CONSULTING COMPANY LIMITED, and BDO MCCABE LO LIMITED,

Defendants

AFFIDAVIT OF FRANK C. TORCHIO

I, Frank C. Torchio, of the City of Rochester, in the State of New York, SWEAR:

I. INTRODUCTION AND SUMMARY OF OPINIONS

1. I am the President of Forensic Economics, Inc. and have been retained by Siskinds LLP and Koskie Minsky LLP, Co-Counsel for Plaintiffs in this Action ("Co-Counsel"). I have previously submitted on November 30, 2011 an Affidavit in this matter regarding the number of potentially damaged shares during two proposed class periods (the "Torchio November 2011 Affidavit").[1] I have also previously submitted on April 2, 2012 an Affidavit in this matter regarding the efficiency of the market for Sino-Forest Corporation ("Sino-Forest") common stock (the "Torchio April 2012 Affidavit"),[2] I have attached as Exhibit "**A**" my updated resume since the Torchio April 2012 Affidavit.

2. For this Affidavit, I have been asked to provide an opinion as to the number of damaged shares and a measure of the potential aggregate dollar damages under the Ontario Securities Act ("OSA"). The claims alleged are for all investors who purchased shares of the common stock of Sino-Forest between March 19, 2007 and June 2, 2011, inclusive (the "Class Period")[3] that were traded: (i) in Canada on the Toronto Stock Exchange (the "TSX") and other secondary markets in Canada; (ii) in the United States over-the-counter market; and (iii) in Germany on various German exchanges.[4] I have also been asked to provide an opinion on a

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[1] In the Torchio November 2011 Affidavit, I found 220.6 million potentially damaged shares for the time period from August 17, 2004 through June 2, 2011 and, of those potentially damaged shares, 219.8 million shares were purchased during the Class Period. *See* Torchio November 2011 Affidavit, ¶39.

[2] In the Torchio April 2012 Affidavit, I opined that "…during the Class Period, Sino-Forest common stock traded in what economists refer to as an efficient market with regard to publicly disclosed information." *See* Torchio April 2012 Affidavit, ¶2.

[3] Proposed Fresh as Amended Statement of Claim dated January 26, 2012 that forms part of the Plaintiffs' motion record for leave pursuant to Part XXIII.1 of the *Securities Act* (the "Amended Claim"), ¶1(n).

[4] I note that the Plaintiffs represent Canadian investors who purchased shares in the U.S.

measure of the potential aggregate dollar damages for investors who purchased various notes issued by Sino-Forest during the Class Period.

3. The damages calculated in this Affidavit are based on the statutory formulas contained in Section 138.5(1) of the OSA. Those formulas have been used for both securities purchased in offerings or on the secondary market, although I understand that these statutory formulas only apply to Class Members' secondary market claims. I have also been asked to provide a measure of aggregate damages for Sino-Forest common stock under Section 138.5(3) of the OSA, wherein it is Defendants' burden to demonstrate, in order to reduce damages, that any potential declines in Sino-Forest's stock price are not related to the alleged misrepresentation or failure to make a timely disclosure. For Section 138.5(3) damages, I anticipate that the Defendants may argue that the Plaintiffs are entitled to damages based solely on the price movements on June 2, 2011 and June 3, 2011. I have been asked by Co-Counsel to assume that Defendants will be unable to demonstrate that any of the excess stock price declines on June 2, 2011 and June 3, 2011 are not related to the misrepresentations.[5] That is, I have been asked to assume that 100% of the excess stock price declines on June 2, 2011 and June 3, 2011 were caused by the correction of the alleged misrepresentations and/or disclosure failures. Thus, this aggregate damages measure represents the maximum potential damages based on the two-day event window in response to the alleged corrective disclosure and not necessarily the aggregate damages that might be obtained from a comprehensive loss causation analysis.

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and Germany. However, without the actual trading records for these investors, I am unable to ascertain what portion of my damages estimates relate to Canadian investors on the U.S. and German exchanges.

[5] An excess price decline is the change in price of a stock after removing general market and industry effects. *See* Torchio April 2012 Affidavit, Appendix A, ¶21.

4. Damaged shares are calculated using a multi-trader model. I calculate Section 138.5(1) damages of C$3,233.9 million for Sino-Forest common stock purchased during the Class Period (excluding those shares issued in the public offerings in June 2007, June 2009, and December 2009). For shares issued in the public offerings in June 2007, June 2009 and December 2009, I estimate damages, using the Section 138.5(1) formula, to be C$0.7 million, C$33.4 million and C$44.4 million, respectively.

5. Using a multi-trader model and 100% of the excess price declines on June 2, 2011 and June 3, 2011, I calculate Section 138.5(3) damages of C$2,997.5 million for Sino-Forest common stock purchased during the Class Period (excluding those issued in the public offerings in June 2007, June 2009, and December 2009). For shares issued in the public offerings in June 2007, June 2009 and December 2009, I estimate the damages, using the Section 138.5(3) formula, to be C$0.7 million, C$33.1 million, and C$42.9 million, respectively.

6. I estimated maximum obtainable damages for the Sino-Forest Notes of US$703.5 million. This measure is based on the difference between the par value and the 10-day average trading price following the two-day event window on June 2, 2011 and June 3, 2011 in response to the alleged corrective disclosure.

7. I also estimated maximum obtainable damages for the Sino-Forest Notes of US$1,281.2 million. This measure is based on the difference between the par value and the value of the Sino-Forest Notes measured as of May 9, 2012, the date of the auction to settle the credit derivative trades for Sino-Forest credit default swaps ("CDSs").

8. I have also been asked to provide the additional damages and damaged shares due to an additional damages period that runs from March 31, 2006 to March 16, 2007 (the "Additional

Damages Period").[6] I have also been asked to separate the damages for Class Members who purchased Sino-Forest notes between those that purchased in the various Sino-Forest note offerings ("Primary Notes Damages") and those that purchased various Sino-Forest notes in the secondary market ("Secondary Notes Damages").

9. Detailed explanations and the bases for these opinions are provided in the sections that follow.

10. Counsel has directed my attention to Rule 4.1 of the *Ontario Rules of Civil Procedure*, which provides as follows:

> RULE 4.1 DUTY OF EXPERT
>
> DUTY OF EXPERT
> 4.1.01 (1) It is the duty of every expert engaged by or on behalf of a party to provide evidence in relation to a proceeding under these rules,
> (a) to provide opinion evidence that is fair, objective and non-partisan;
> (b) to provide opinion evidence that is related only to matters that are within the expert's area of expertise; and
> (c) to provide such additional assistance as the court may reasonably require to determine a matter in issue. O. Reg. 438/08, s. 8.
>
> *Duty Prevails*
> (2) The duty in subrule (1) prevails over any obligation owed by the expert to the party by whom or on whose behalf he or she is engaged. O. Reg. 438/08, s. 8.

11. I have prepared this Affidavit having regard to the duty described therein.

12. I reserve the right to amend this Affidavit to reflect new information available to me in the discovery process, future rulings from the Court in this Action, and trial proceedings.

13. At this time, I have not been asked to offer any opinions related to materiality or loss causation in this Action, and I therefore have not undertaken analyses of these issues. I have not sought to determine what disclosure(s) was(were) in fact corrective of the alleged

[6] March 16, 2007 is a Friday and the Class Period begins on Monday, March 16, 2007.

misrepresentations.[7] I expect to offer opinions on these issues at an appropriate time as requested by Co-Counsel. Other additional materials, beyond those cited in the Torchio November 2011 Affidavit and/or the Torchio April 2012 Affidavit, that I reviewed for this Affidavit are cited in the text of this Affidavit, Appendix A and exhibits.

II. BACKGROUND ON SINO-FOREST

14. According to its 2010 Annual Report, Sino-Forest:

> … is a leading commercial forest plantation operator in China. Its principal businesses include the ownership and management of plantation forests, the sale of standing timber and wood logs and the complementary manufacturing of downstream engineered-wood products. The majority of our plantations and operations are located in southern and eastern China, primarily in inland regions suitable for large-scale replanting. Sino-Forest also holds a majority interest in Greenheart Group Limited ("Greenheart Group"), a company listed on the Hong Kong Stock Exchange (HKSE: 00094) involved in log harvesting, lumber processing, and marketing and sale of logs and lumber products to China and other countries.[8]

15. Sino-Forest described its business strategy as follows:

> 1. Locking in access to tree plantations at capped prices through long-term contractual agreements,
>
> 2. Selling fibre at attractive margins either as standing timber or logs,
>
> 3. Increasing plantation yields through advanced scientific research and development and silviculture techniques,

[7] An analysis of materiality, loss causation and a determination of what disclosures were corrective of the alleged misrepresentations would most likely require the use of an event study, which I have not performed in this matter.

[8] *See* 2010 Annual Report filed with SEDAR on May 10, 2011, cover page. This description of Sino-Forest's business operations has not changed materially from the description in its 2006 Annual Report filed with SEDAR on May 4, 2007, cover page.

> 4. Developing economies of scale and diversifying revenue with geographically widespread operations, and
>
> 5. Maximizing the use and value of fibre through our complementary manufacturing operations.[9]

16. Sino-Forest common stock has traded on the TSX since 1995 under the symbol "TRE"[10] until trading ceased pursuant to an order from the Ontario Securities Commission before the market opened on August 26, 2011.[11] Sino-Forest also trades on German exchanges under different symbols,[12] as well as over-the-counter in the United States under the symbol "SNOFF."[13,14] According to its various SEDAR filings, Sino-Forest had approximately 138 million common shares outstanding as of December 31, 2006,[15] and had approximately 246 million common shares outstanding as of April 29, 2011.[16]

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[9] *See* 2010 Annual Report filed with SEDAR on May 10, 2011, p. 1.

[10] *See* 2010 Annual Report filed with SEDAR on May 10, 2011, cover page. Since 2008, Sino-Forest has also traded on other Canadian exchanges based on a comparison of Bloomberg volume data for exchange codes "TRE CT" and "TRE CN." CT denotes data for TSX trading and CN denotes Canadian composite trading.

[11] Trading was halted pursuant to a Temporary Order in IN THE MATTER OF THE SECURITIES ACT R.S.O. 1990, c.S.5, as amended - and -IN THE MATTER OF SINO-FOREST CORPORATION, ALLEN CHAN, ALBERT IP, ALFRED C.T. HUNG, GEORGE HO AND SIMON YEUNG, dated August 26, 2011. Source: Ontario Securities Commission. The order to cease trading on the TSX occurred before the markets opened on August 26, 2011. *See* "ZIIROC CN: Investment Industry Regulatory Organization of Canada," Market News Publishing, August 26, 2011, 8:41 am.

[12] Approximately 3.0 million shares traded on the various German exchanges during the Class Period. *See* Torchio November 2011 Affidavit, Exhibit "**B**."

[13] Source: Bloomberg. Approximately 42.9 million shares traded over-the-counter in the United States during the Class Period. *See* Torchio November 2011 Affidavit, Exhibit "**B**."

[14] Approximately 1.3 billion total shares traded in Canada, Germany and the United States during the Class Period, and approximately 96.5% of these 1.3 billion shares were traded on various Canadian exchanges. *See* Torchio November 2011 Affidavit, ¶19, Exhibit "**B**."

[15] *See* 2006 Annual Report filed with SEDAR on May 4, 2007, p. 23.

[16] *See* 2011 Management Information Circular filed with SEDAR on May 10, 2011, p. 3.

17. Attached as Exhibit "**B**" is a table of daily Sino-Forest common stock prices, volume and returns for the Canadian, U.S. and German Exchanges. Attached as Exhibit "**C**" is a chart showing the Canadian composite closing price and reported volume on the Canadian, U.S. and German exchanges.

III. ASSUMPTIONS ABOUT THE CORRECTIVE DISCLOSURE

18. In the Amended Claim, Plaintiffs allege that the Defendants made misrepresentations throughout the Class Period.[17] The Plaintiffs allege that the misrepresentations relate to:

> A. Sino's history and fraudulent origins;
> B. Sino's forestry assets;
> C. Sino's related party transactions;
> D. Sino's relationships with forestry bureaus and its purported title to forestry assets in the PRC [People's Republic of China];
> E. Sino's relationships with its "Authorized Intermediaries;"
> F. Sino's cash flows;
> G. Certain risks to which Sino was exposed; and
> H. Sino's compliance with GAAP and the Auditors' compliance with GAAS.[18]

19. The Plaintiffs allege that these misrepresentations were corrected when a research firm, Muddy Waters Research ("Muddy Waters"), issued a report on Sino-Forest on June 2, 2011.[19] The June 2, 2011 Muddy Waters report stated:

> Sino-Forest Corp (TSE: TRE) is the granddaddy of China RTO [reverse takeover] frauds. It has always been a fraud – reporting excellent results from one of its early joint ventures – even though, because of TRE's default on its investment obligations, the JV never went into operation. TRE just lied.

[17] *See* Amended Claim, Section VI.

[18] *See* Amended Claim, ¶70.

[19] *See* Amended Claim, ¶¶204-206.

> The foundation of TRE's fraud is a convoluted structure whereby it claims to run most of its revenues through "authorized intermediaries" ("AI"). AIs are supposedly timber trader customers who purportedly pay much of TRE's value added and income taxes. At the same time, these AIs allow TRE a gross margin of 55% on standing timber merely for TRE having speculated on trees. The sole purpose of this structure is to fabricate sales transactions while having an excuse for not having the VAT invoices that are the mainstay of China audit work. If TRE really were processing over one billion dollars in sales through AIs, TRE and the AIs would be in serious legal trouble. No legitimate public company would take such risks – particularly because this structure has zero upside. …
>
> On the other side of the books, TRE massively exaggerates its assets. TRE significantly falsifies its investments in plantation fiber (trees). It purports to have purchased $2.891 billion in standing timber under master agreements since 2006. We have smoking gun evidence from Yunnan province that it overstated its purchases there by over $800 million. Of the five agents we have been able to identify (TRE does not provide Chinese names), Yunnan appears to have the only legitimate agent. The other agents have histories and connections to TRE that make it obvious they did not purchase billions of dollars in timber for TRE. Further, the other agents appear to be laundering money for TRE – moving large amounts of money to an undisclosed subsidiary of TRE and a trading company that TRE does business with. We also see clear evidence that TRE has falsified its books – Chinese government records make clear that TRE would have had a capital hole of $377 million to $922 million if it were making the investments it claims.…
>
> Because TRE has $2.1 billion in debt outstanding, which we believe exceeds the potential recovery, we value its equity at less than $1.00 per share.[20]

20. The Plaintiffs allege that, after the release of the June 2, 2011 Muddy Waters report, the stock price of Sino-Forest dropped on June 2, 2011 before a trading halt, and dropped even

[20] Muddy Waters Analyst Report, June 2, 2011.

further on June 3, 2011.[21] Therefore, I use the event window of June 2, 2011 to June 3, 2011 as the basis for estimating damages for investors in Sino-Forest common stock and notes.

IV. AGGREGATE COMMON STOCK DAMAGES

A. Overview of Methodology for Estimating Common Stock Damages

21. Damaged shares are generally characterized as shares purchased during the Class Period that are held by the investor until after the date of a stock price decline caused by a correction of a prior misrepresentation. Trading volume cannot be directly used to compute damaged shares because trading volume will also include the turnover of shares purchased in a class period. For example, 10 shares of stock purchased in a class period may create 25 shares of trading volume because those shares turn over (*i.e.,* are purchased and then sold to another investor) during a class period.[22] But, in this example, only 10 shares would be damaged (using a single corrective disclosure) because that is the total number of shares that were purchased and held by some investor until after the operative price decline. So, regardless of how many times each of the ten shares turned over before that price decline, only ten shares are retained and therefore potentially damaged as defined above.

22. Because damages experts generally do not have access to all the trading records of investors during a class period, the number of damaged shares is estimated from total trading volume by use of a mathematical model called a "trading model." The trading model uses certain algorithms and statistical analyses to separate traded volume into shares that were purchased during the Class Period and held through the end of the Class Period (the "retained"

[21] *See* Amended Claim, ¶206.

[22] *See* Larry Harris, Trading & Exchanges, Oxford University Press, 2003, pp. 487-489.

volume) from those that were purchased during the Class Period and sold before the end of the Class Period (the "in-and-out" volume).

23. I next provide a brief overview of trading models, followed by the methodology I used to compute aggregate damages.

B. Trading Models

24. Trading models are mathematical models that estimate the portion of total trading volume during the relevant period that is retained and the portion of trading volume that represents the turnover of those retained shares.[23]

25. The most commonly used trading model has been the proportional trading model, which contains a proportionality assumption about trading turnover or trading propensities.[24] The proportional trading model assumes that the probability of turnover for any traded share is the same as other shares in the float, where float is generally defined as the portion of total shares outstanding that were available to have been traded.

26. The proportional trading model can be explained by a simple example of a three-day period for Company A, which has a total float of 1,000 shares. Assume the trading volume equals 100 shares on Day 1, 300 on Day 2, and 200 shares on Day 3. Thus, investors who held

[23] *See* Dean Furbush and Jeffrey W. Smith, "Estimating the Number of Damaged Shares in Securities Fraud Litigation: An Introduction to Stock Trading Models," *The Business Lawyer* 49, 1994, 527-543; Jon Koslow, "Estimating Aggregate Damages in Class-Action Litigation Under Rule 10b-5 for Purposes of Settlement," *Fordham Law Review* 59, 1991, 811-842; and Craig J. McCann, David Hsu, and Jennifer Yoon, "Demystifying Stock Trading Models in Securities Class Action Lawsuits," KPMG Peat Marwick LLP, August 1997, for details on the computation.

[24] *See* Dean Furbush and Jeffrey W. Smith, "Estimating the Number of Damaged Shares in Securities Fraud Litigation: An Introduction to Stock Trading Models," *The Business Lawyer* 49, 1994, 527-543; and Brian P. Murray and Eric J. Belfi, "The Proportionate Trading Model: Real Science or Junk Science?" *Cleveland State Law Review* 52, 2004-2005, 391-412. This model is sometimes called the proportional decay model or the single trader model.

before the three-day period sold 100 shares on Day 1. On Day 2, trading volume is 300 shares, which implies that the average probability of any share in the float trading on day 2 is 30 percent (300 divided by the 1,000 share float). Thus, 30 out of the 100 shares sold on Day 1 are traded or turned over on Day 2, leaving 70 shares that did not turn over. Based on trading volume of 200 shares on Day 3, the probability of any share trading is 20 percent. Thus, 14 of the 70 shares (20%) from Day 1 that did not trade on Day 2 are sold on Day 3 and 60 of the 300 shares (20%) from Day 2 turned over on Day 3. Thus, based on the proportional trading model, 104 shares out of the total volume of 600 shares in the three-day period result from the turnover of shares during the period (44 sold on Day 1 and sold again on Days 2 and 3 and 60 shares sold on Day 2 are sold again on Day 3). 496 (600 minus 104) of the volume, therefore, represents the portion of the 1,000 share float that were purchased during the period and still held after the three-day period. Additionally, 504 of the 1,000 share float held at the beginning of the three-day period are still held at the end of the three-day period.

27. Since the 1990s, the proportionality assumption has received criticism. The critics of the proportional trading model have characterized the proportionality assumption as an assumption that all investors have exactly the same propensity to trade or, alternatively, the same turnover rate. To respond to the criticism that the proportional model is not appropriate if there are investors with differing turnover rates, I have used a multi-trader model to compute damaged share volume and turnover volume for Sino-Forest.[25]

[25] Several researchers have advanced and advocated use of a multi-trader model as superior to the proportional trading model and more representative of actual trading behavior, including researchers associated with firms such as NERA and Cornerstone Research. *See* William H. Beaver and James K. Malernee, "Estimating Damages in Securities Fraud Cases," Cornerstone Research, 1990; William H. Beaver, James K. Malernee and Michael C. Keeley, "Potential Damages Facing Auditors in Securities Fraud Cases," *Accountants' Liability: The*

28. Multi-trader models are similar to the proportional trading model, except that multi-trader models are not restricted by the proportionality assumption discussed earlier. Rather, multi-trader models allow the specification of differing turnover rates for investors.

i) Volume

29. The first step in developing inputs for a trading model is to determine investor volume. Reported volume may overstate the investor volume by the class because it includes trades by specialists on the NYSE[26] or the TSX,[27] or market makers on NASDAQ, or other middlemen who buy from one investor and sell to another. Therefore, an adjustment to reported

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Need for Fairness, National Legal Center for the Public Interest, 1994, 112-132; Marcia Kramer Mayer, "Best-Fit Estimation of Damaged Volume in Shareholder Class Actions: The Multi-Sector, Multi-Trader Model of Investor Behavior," National Economic Research Associates, Third Edition, October 2000; William M. Bassin, "A Two Trader Population Share Retention Model for Estimating Damages in Shareholder Class Action Litigations," *Stanford Journal of Law, Business & Finance* 6(1), 2000, 49-83; and John Finnerty and George Pushner, "An Improved Two-Trader Model for Measuring Damages in Securities Fraud Class Actions," *Stanford Journal of Law, Business & Finance* 8(213), Spring 2003.

[26] During the Class Period, NYSE switched to a designated market maker system. *See* "NYSE Completes Rollout of Phase I of the Next-Generation Market Model to all its Securities," NYSE Euronext press release date November 13, 2008; "The Next Generation Model," NYSE Euronext, 2008; and "Designated Market Makers," 2009, NYSE Euronext. Source: www.nyse.com.

[27] In Canada, Sino-Forest common stock traded primarily on the TSX, which uses a market maker system. The TSX describes on its website the role of the market maker (http://www.tmx.com/en/trading/products_services/market_system.html):

> The role of the Market Maker on Toronto Stock Exchange (TSX) is to augment liquidity, while maintaining the primacy of an order driven continuous auction market based on price-time priority. TSX's Market Maker system maximizes market efficiency and removes the interfering influence of a traditional specialist. In the TSX environment, a Market Maker manages market liquidity through a passive role. Market Makers are visible only when necessary to provide a positive influence when natural market forces cannot provide sufficient liquidity.

volume is used to remove these trades. Published research suggests suitable corrections can be accomplished by reducing NYSE reported volume or reducing NASDAQ volume.[28]

30. For Sino-Forest, reported volume on the Canadian exchanges is reduced based on the NYSE monthly average specialist participation rate, which ranged from 2.5% to 10.2% during the Class Period.[29] I have also used the same adjustments for shares traded on various German exchanges. For shares traded over-the-counter in the U.S, I reduced reported volume by 27.4%. The over-the-counter market employs a market maker system similar to NASDAQ,[30] so I used a NASDAQ adjustment.[31]

31. Next, to calculate investor purchase volume, I added shares issued by Sino-Forest in various offerings and I subtracted Sino-Forest insider stock purchases from volume (after accounting for market makers and specialists).[32,33] To calculate investor sales volume, I subtracted Sino-Forest insider stock sales from volume (after accounting for market makers and

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[28] For example, *see* Fernando Avalos and Marcia Kramer Mayer, "Dealer Participation on the New York Stock Exchange and Nasdaq," NERA Economic Consulting working paper, May 2002; and John F. Gould and Allan W. Kleidon, "Market Maker Activity on Nasdaq: Implications for Trading Volume," *Stanford Journal of Law, Business & Finance* 1, 1994, 1-17.

[29] I use the published NYSE monthly specialist participation rate as a proxy for the TSX market maker participation rate, which I was unable to obtain. Source: NYSE Euronext: http://www.nyxdata.com/Data-Products/Facts-and-Figures, Market Activity, link to Specialist Activity.

[30] *See* http://www.sec.gov/answers/mktmaker.htm.

[31] I obtained information regarding market maker activity on shares traded on NASDAQ from NASDAQ via e-mail. I have assumed that a similar amount of shares are traded by market makers in securities traded over-the-counter in the U.S.

[32] Insider transactions were obtained from SEDI. SEDI is an acronym for the "System for Electronic Disclosure by Insiders." SEDI "…is Canada's on-line, browser-based service for the filing and viewing of insider reports as required by various provincial securities rules and regulations." *See* https://www.sedi.ca/sedi/SVTWelcome?locale=en_ca&pageName=splashPage.

[33] According to SEDI data, Sino-Forest insiders purchased 586,945 common shares during the Class Period.

specialists).[34] Attached as Exhibit "**D**" is a table of reported and adjusted volume used in the multi-trader model for the Class Period.

32. After adjusting the total reported volume to remove market maker/specialist trades and insider purchases, as well as adding shares issued by Sino-Forest during the Class Period, I calculate that approximately 1.27 billion shares were purchased by investors and approximately 1.19 billion shares were sold by investors during the Class Period.

ii) Float

33. The next step in developing the inputs required for a trading model is to estimate float. Float, which is defined as the number of shares that were available for trading and potentially damaged during the Class Period, was estimated by deducting from total shares outstanding shares that can be independently determined to have not been traded in the Class Period and generally include: (i) shares held by insiders (Directors and Officers)[35] and (ii) shares held by institutional investors determined to have been purchased before the beginning of the Class Period and held throughout the Class Period on a quarterly basis.[36,37] Exhibit "**E**" shows the daily float for Sino-Forest.

[34] According to SEDI data, Sino-Forest insiders sold 10,797,140 common shares during the Class Period.

[35] The Directors and Officers holdings were obtained from FactSet and from SEDAR filings.

[36] These are shares that I determined were held by an institution before the Class Period began and still held by that institution after each quarter during the Class Period. On a quarterly basis, if an institution sells shares during a class period, I deduct those shares from its holdings, which necessarily increases the float of shares available to trade. Source for quarterly institutional holdings: FactSet.

[37] I increased the float on the dates when Sino-Forest issued shares, either privately or publicly.

iii) Trading Groups

34. I used a multi-trader model to estimate the timing of purchases and sales. A multi-trader model divides the defined float into groups – shares held by traders with higher turnover rates ("active traders") and shares held by traders with lower turnover rates ("passive traders"). Daily trading volume is then apportioned across the trader groups. The fraction of daily volume that is attributed to each trader group is determined by the fraction of the float that is owned by traders in each group and their relative propensity to trade. The relative propensity to trade measures how often a share of one investor group will turn over compared to another investor group.

35. Given the assumptions about the fraction of total float held by each trader group, and the fraction of total volume attributed to each group, the multi-trader model calculates the number of the retained shares and the in-and-out shares over the Class Period.

36. To determine the fraction of the float held by each trader group, and the relative trading turnover, I used annual turnover rates for investors in the float that encompass relative turnovers rates of up to 201.[38] Put another way, the trading model assumes that the most active trader turns over shares 201 times more than the most passive trader. This range encompasses reasonable estimates of relative turnover rates.[39]

37. Rather than subjectively assigning amounts of total float to relative turnover rates evenly, I have relied on generally accepted statistical properties of large samples of data.

[38] The result is generally insensitive to the mean and standard deviation of the distribution. *See* Michael Barclay and Frank C. Torchio, "A Comparison of Trading Models Used for Calculating Aggregate Damages in Securities Litigation," *Law & Contemporary Problems* 64(2&3), Spring-Summer 2001, 105-136.

[39] *See* B. Barber and T. Odean, "Trading Is Hazardous to Your Wealth: The Common Stock Investment Performance of Individual Investors," *Journal of Finance* 55(2), April 2000, 773-806, Figure 1.

Specifically, it is reasonable and objective to assume that the statistical distribution for the turnover rates for Sino-Forest retail investors can be described by a bell-shaped normal distribution.[40] This is a common assumption used in mathematics based on the statistical properties of large samples, which applies to the case here in which large amounts of Sino-Forest shares[41] were traded daily by hundreds, if not thousands of investors.[42] I created 51 trader groups.

38. Because of the potential presence of day traders for Sino-Forest during the Class Period, I have estimated that 15% of reported volume is attributable to intraday turnover of Sino-Forest shares.[43] This parameter effectively eliminates from the distribution of investor turnover discussed above those investors who have extremely high turnover, which is generally associated with day traders.

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[40] For example, *see* Mutual fund turnover data as of December 31, 1999 published in January 2000. Source: Morningstar Principia Pro for Mutual Funds.

[41] The average daily trading volume for Sino-Forest common stock was approximately 1.2 million shares during the Class Period.

[42] "There is a very intimate connection between the size of a sample, *n*, and the extent to which a sampling distribution approaches the normal form. Many sampling distributions based on large *n* can be approximated by the normal distribution even though the population distribution itself is definitely not normal. This is the extremely important principle that we will call the central limit theorem. The normal distribution is the *limiting form* for large *n* for a very large variety of sampling distributions. This is one of the most remarkable and useful principles to come out of theoretical statistics." Robert L. Winkler and William L. Hays, Statistics Probability, Inference and Decision, Second Edition, Holt Rinehart and Winston, 1975, p. 245. According to the central limit theorem and the law of large numbers, if a finite sample is a random sample from any probability with a finite mean and finite variance, the sample's average approximately follows a normal distribution. William H. Greene, Econometric Analysis 2nd Edition, Prentice Hall 1993, p. 104.

[43] *See* David Tabak, "Intraday Trading Rates in Shareholder Class Actions," *Securities & Finance Insights*, June 2002.

C. Results

i) Trading Model

39. Exhibit "**F**" shows sales of total investor purchase volume separated out as in-and-out shares and retained shares (those sold between June 3, 2011 and August 25, 2011, the last trading day in Canada for Sino-Forest common stock before trading ceased pursuant to an order from the Ontario Securities Commission, and those still held at the close of trading on August 25, 2011). Based on the multi-trader model, approximately 1,048.5 million shares were in-and-out and approximately 225.1 million shares were retained (*i.e.*, purchased during the Class Period, and still held after trading was halted on June 2, 2011, the last day of the Class Period).[44]

ii) Damages under OSA Section 138.5(1)

40. I calculate damages for Sino-Forest common stock in accordance with the formulas set forth in Section 138.5(1) of the OSA, which requires a calculation of the number of shares purchased during the Class Period and then sold on each day on or after June 2, 2011, the date of the alleged corrective disclosure through August 25, 2011, the last trading day in Canada for Sino-Forest common stock before trading ceased pursuant to an order from the Ontario Securities Commission.

41. For shares purchased during the Class Period and sold between June 2, 2011 and June 16, 2011, Section 138.5(1) damages are calculated as the difference between the purchase price and the sale price.[45] For shares purchased during the Class Period and sold after June 16,

[44] I note that the retained shares are greater than reported in the Torchio November 2011 Affidavit primarily due to the inclusion of reported volume from the U.S. and German exchange, and also due, to a lesser extent, from adjustments to assumptions for the multi-trader model.

[45] Since individual level transaction data are not available to me, my estimate of damages does not account for any hedging or other risk limitation transactions. It also does not account

2011 (the tenth trading day following the two-day event window of June 2, 2011 to June 3, 2011), Section 138.5(1) damages are calculated as the lesser of: (i) the purchase price minus the sale price; and (ii) the purchase price minus the C$4.49 per share average closing price from June 3, 2011 through June 16, 2011.

42. Based on the trading model methodology discussed previously, and the damages methodology described above, I calculate Section 138.5(1) damages of C$3,233.9 million for shares purchased during the Class Period (excluding those issued in public offerings in June 2007, June 2009, and December 2009) and not sold prior to June 2, 2011, the date of the alleged corrective disclosure. Of this C$3,233.9 million, C$3,056.2 million are from shares purchased on various Canadian exchanges, C$174.4 million are for shares purchased over-the-counter in the U.S., and C$3.2 million are for shares purchased on German exchanges.[46] *See* Exhibits "**G-1**" and "**G-2**" for a summary of Section 138.5(1) damages.[47]

43. I have also been asked to estimate damages using the Section 138.5(1) formula to Sino-Forest investors who received shares in various offerings of common shares throughout the Class Period pursuant to Section 130 of the OSA.[48] During the Class Period, Sino-Forest issued

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for any commissions paid. To the extent that there were any hedging or other risk limitation transactions, they would lower the damages estimate by the gains from the risk limiting transactions

[46] It is my understanding that only shares purchased in the U.S. and/or Germany by a Canadian investor have recognizable claims in this matter. Because I do not have the individual level transaction data, I cannot estimate what portion of the damages from the U.S. and/or German exchanges have a recognizable claim in this matter.

[47] This calculation does not take into account possible gains that can occur when an investor has a loss on one round-trip transaction and also has a gain on a separate round-trip transaction during a class period. A round-trip transaction occurs when a purchase is sold (*i.e.*, in a trading model, a purchase is matched with a subsequent sale).

[48] Section 130 of the OSA does not provide a formula to estimate the damages for securities issued during a class period. For the purposes of this Affidavit, I have been asked to

common shares in June 2007, June 2009, and December 2009. Using the trading model described above, I estimate how many shares issued in an offering were still held as of the alleged corrective disclosure on June 2, 2011, and therefore damaged. For the shares offered in June 2007, I estimate the damages to be C$0.7 million. For the shares offered in June 2009, I estimate the damages to be C$33.4 million. For the shares issued in December 2009, I estimate the damages to be C$44.4 million. *See* Exhibit "**G-1**." Exhibit "**F**" also shows the damaged shares and the damages under Section 138.5(1) as computed by the multi-trader model.

iii) Damages under OSA Section 138.5(3)

44. I have also been asked to calculate damages under Section 138.5(3) wherein "…damages shall not include any amount that the defendant proves is attributable to a change in the market price of securities that is unrelated to the misrepresentation or the failure to make timely disclosure."[49] I anticipate that the Defendants may argue that the Plaintiffs are entitled to damages based solely on the price movements on June 2, 2011 and June 3, 2011. The following Section 138.5(3) damage estimates would be the result of a successful argument by Defendants that the damages are limited to the price declines on June 2, 2011 and June 3, 2011.

45. In order to estimate Section 138.5(3) damages, I have been asked to assume that the artificial inflation is based on 100% of the excess price movements on June 2, 2011 and June 3, 2011, the two-day event window following the alleged corrective disclosure. Thus, this aggregate damages measure represents the potential damages based on the two-day event window following the alleged corrective disclosure and not necessarily the aggregate damages that might be obtained from a comprehensive loss causation analysis. Using the market model

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estimate damages based on the formulas contained in Section 138.5 of the OSA.

[49] Section 138.5(3) of the OSA.

from the Torchio April 2012 Affidavit, I compute the excess (net of market and industry) price declines on these two dates, which I use to compute Section 138.5(3) damages. The excess price movements in Sino-Forest common stock on June 2, 2011 and June 3, 2011 are detailed in Exhibit "**H**."

46. I estimate Section 138.5(3) damages based on 100% of the excess stock price declines on June 2, 2011 and June 3, 2011 using the Constant Percentage method of determining artificial inflation. *See* Appendix A for a description of the Constant Percentage method.

47. I estimate damages for the shares purchased during the Class Period and sold on or after June 2, 2011, the first alleged corrective disclosure, as follows. For shares purchased during the Class Period and sold on June 2, 2011, Section 138.5(3) damages are calculated as the lesser of: (i) artificial inflation at purchase less the artificial inflation remaining in Sino-Forest common stock on June 2, 2011; and (ii) the difference between the purchase price and the sale price.[50] For shares purchased during the Class Period (excluding shares acquired in an offering) and sold between June 3, 2011 and June 16, 2011 (the tenth trading day following the two-day event window of June 2, 2011 to June 3, 2011), Section 138.5(3) damages are calculated as the lesser of: (i) the artificial inflation at purchase; and (ii) the difference between the purchase price and the sale price. For shares purchased during the Class Period and sold after June 16, 2011, Section 138.5(3) damages are calculated as the lesser of: (i) the artificial inflation at purchase; (ii) the purchase price minus the sale price; and (iii) the purchase price minus the C$4.49 per share average closing price from June 3, 2011 through June 16, 2011.

[50] Since individual level transaction data are not available to me, my estimate of damages does not account for any hedging or other risk limitation transactions. It also does not account for any commissions paid. To the extent that there were any hedging or other risk limitation transactions, they would lower the damages estimate by the gains from the risk limiting transactions.

48. Based on the trading model methodology discussed previously, and the damages methodology described above, I calculate Section 138.5(3) damages of C$2,997.5 million for shares purchased during the Class Period (excluding those issued in public offerings in June 2007, June 2009, and December 2009) and not sold prior to June 2, 2011, the date of the alleged corrective disclosure. Of this C$2,997.5 million, C$2,832.7 million are from shares purchased on various Canadian exchanges, C$161.9 million are for shares purchased over-the-counter in the U.S., and C$3.0 million are for shares purchased on German exchanges. *See* Exhibits "**I-1**" and "**I-2**" for a summary of Section 138.5(3) damages.[51]

49. I have also been asked to estimate damages, using the Section 138.5(3) formula, to Sino-Forest investors who received shares in various offerings of common shares throughout the Class Period pursuant to Section 130 of the OSA. During the Class Period, Sino-Forest issued common shares in June 2007, June 2009, and December 2009. Using the trading model described above, I estimate how many shares issued in an offering were still held as of the alleged corrective disclosure on June 2, 2011, and therefore damaged. For the shares offered in June 2007, I estimate the damages to be C$0.7 million. For the shares offered in June 2009, I estimate the damages to be C$33.1 million. For the shares issued in December 2009, I estimate the damages to be C$42.9 million. *See* Exhibit "**I-1**."

50. Exhibit "**J**" shows the daily damaged shares and the daily damages under Section 138.5(3) as computed by the multi-trader model.

[51] This calculation does not take into account possible gains that can occur when an investor has a loss on one round-trip transaction and also has a gain on a separate round-trip transaction during the class period. A round-trip transaction occurs when a purchase is sold (*i.e.*, in a trading model, a purchase is matched with a subsequent sale).

V. DAMAGES TO SINO-FOREST NOTEHOLDERS

51. During the Class Period, Sino-Forest had five notes outstanding with a total amount issued of US$2.10 billion as detailed in the table below.

Notes Offered	Date[52]	Amount Issued
9.125% Guaranteed Senior Notes[53]	8/10/2004	US$300,000,000
5% Convertible Senior Notes[54]	7/17/2008	US$345,000,000
10.25% Guaranteed Senior Notes[55]	7/27/2009	US$399,517,000
4.25% Convertible Senior Notes[56]	12/10/2009	US$460,000,000
6.25% Guaranteed Senior Notes[57]	10/14/2010	US$600,000,000

52. I computed damages using two different methods for four of the five notes.[58] First, I estimated damages based on a Section 138.5(1) measure of damages. Second, at the request of

[52] Announcement Date for each offering. Source: Bloomberg.

[53] *See* Sino-Forest 2004 Annual Report.

[54] "Sino-Forest Corporation Closes Convertible Senior Note Offering," Sino-Forest Press Release, July 23, 2008.

[55] US$212.33 million of the 10.25% Senior Notes were offered in exchange for the 9.125% Senior Notes issued on August 17, 2004. "SINO-FOREST ANNOUNCES SUCCESSFUL COMPLETION OF BOND EXCHANGE OFFER AND CONSENT SOLICITATION," Sino-Forest Press Release, July 27, 2009. Sino-Forest issued US$187.2 million of the 10.25% Senior Notes in connection with its acquisition of Mandra Forestry Holdings Limited. "SINO-FOREST COMPLETES ACQUISITION OF MANDRA FORESTRY," Sino-Forest Press Release, February 8, 2010.

[56] "SINO-FOREST COMPLETES US$460 MILLION CONVERTIBLE NOTE AND CDN$367 MILLION COMMON SHARE OFFERINGS," Sino-Forest Press Release, December 17, 2009.

[57] "SINO-FOREST ANNOUNCES COMPLETION OF US$600 MILLION NOTES OFFERING," Sino-Forest Press Release, October 21, 2010.

[58] For the 9.125% Guaranteed Senior Notes, in the Torchio November 2011 Affidavit, I estimated maximum obtainable damages of US$3.2 million based upon the face amount of US$87.7 million of notes remaining (after the exchange of US$213.3 million for new notes on July 27, 2009) that were sold between the assumed corrective disclosure date of June 2, 2011 and the August 17, 2011 maturity date of the notes. *See* Torchio November 2011 Affidavit, pp. 17-19 for details on the computation of estimated damages. I have not been asked to update my damages analysis for this note. I note that, without all of the transaction detail in the 9.125% Guaranteed Senior Notes, I am unable to ascertain what notes were purchased before the start of the Class Period compared with those purchased during the Class Period.

Co-Counsel, I estimated damages based on the value of the notes on May 9, 2012, the date of the auction to settle the credit derivative trades for Sino-Forest CDSs.

53. For the first method, based on a Section 138.5(1) measure of damages, I assumed that the measure of damages should be the difference between the assumed price paid for the notes (par price) and the 10-day average trading price following the two-day event window of June 2, 2011 to June 3, 2011.[59] Under this method, a measure of total maximum obtainable damages for the four notes currently outstanding is US$703.5 million.[60] *See* Exhibit "**K**."

54. For the second method, I have been asked by Co-Counsel to use the value of the four outstanding notes as of May 9, 2012, the date of the auction to settle the credit derivative trades for Sino-Forest credit default swaps,[61] to compute total damages for the four notes

[59] For two of the four notes, I used daily note prices available from FINRA TRACE to calculate damages. For the two notes where FINRA TRACE prices were not available, I used the average of the price declines from the two notes with available pricing data to calculate damages. *See* Exhibit "**K**."

[60] I note that the damages for the Sino-Forest noteholders could be greater or lower depending on the noteholder's actual purchase price and/or selling price.

[61] On March 30, 2012, Sino-Forest announced that:

> … it has reached agreement with an ad hoc committee of its noteholders (the "Ad Hoc Committee") on the material terms of a transaction (the "Transaction") which would involve either a sale of the Company to a third party or a restructuring under which the noteholders would acquire substantially all of the assets of the Company, including the shares of all of its direct subsidiaries which own, directly or indirectly, all of the business operations of the Company. The Ad Hoc Committee represents a significant portion of the holders of the Company's 5% Convertible Senior Notes due 2013, 10.25% Guaranteed Senior Notes due 2014, 4.25% Convertible Senior Notes due 2016 and 6.25% Guaranteed Senior Notes due 2017 (collectively, the "Notes" and holders of Notes, the "Noteholders"). The Company is initiating proceedings today in the Ontario Superior Court of Justice (the "Court") under the Companies' Creditors Arrangement Act (the "CCAA") seeking approval for a Court supervised restructuring process to implement

currently outstanding. This method is based upon the face amount of the notes minus the value of the notes on May 9, 2012. The auction to settle the CDSs set a final price of 29% of the face amount for the notes. Therefore, I computed the value of the notes as 29% multiplied by the face amount of each note outstanding.[62] Under this method, a measure of total maximum obtainable damages for the four notes currently outstanding is US$1,281.2 million.[63] *See* Exhibit "**L**."

VI. ADDITIONAL DAMAGE CALCULATIONS

A. Additional Damages Period

55. Based on the methodology described above, I have also calculated damages under Sections 138.5(1) and 138.5(3) of the OSA for the Additional Damages Period. Thus, I provide the additional damages for shares purchased from March 31, 2006 through March 16, 2007, the

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> the Transaction, including the immediate initiation of a sale solicitation process and a stay of certain creditor claims. ("Sino-Forest Announces CCAA Filing to Pursue Third Party Sale Transaction Or Restructuring with Noteholders; Commences Action Against Muddy Waters," Sino-Forest News Release, March 30, 2012.)

On April 10, 2012, the International Swap Dealers Association announced that: "… its Asia Ex-Japan Credit Derivatives Determinations Committee resolved that a Bankruptcy Credit Event occurred in respect of Sino-Forest Corporation. The Committee determined that an auction will be held in respect of outstanding CDS transactions." "ISDA Credit Derivatives Determinations Committee: Sino-Forest Corporation Credit Event," ISDA News Release, April 10, 2012. The CDS auction was held on May 9, 2012. Source: Markit (available at www.creditfixings.com/CreditEventAuctions/results.jsp?ticker=SIFO).

[62] Source of pricing: Markit (available at www.creditfixings.com/CreditEventAuctions/results.jsp?ticker=SIFO). *See* also "Sino-Forest CDS payout determined, asset value still unknown," *The Globe and Mail*, May 9, 2012, 1:35 pm. For an example of pricing credit default swaps after a credit event, *see* John Hull and Alan White, "Valuing Credit Default I: No Counterparty Default Risk," NYU Working Paper No. FIN-00-021, April 2000, 3-4. I also note that the 29% CDS auction price was consistent with bid-evaluated prices for the notes that ranged from 28.25% to 29.17% on May 9, 2012. Source: Bloomberg.

[63] I note that the damages for the Sino-Forest noteholders could be greater or lower depending on the noteholder's actual purchase price and/or selling price.

last trading day before the start of the Class Period. I find additional damages of C$644,200 for 194,036 damaged shares under both Section 138.5(1) and Section 138.5(3).

B. Note Purchaser Damages: Primary vs. Secondary Market Damages

56. As discussed above, I estimated maximum obtainable damages for the Sino-Forest Notes of US$703.5 million. This measure is based on the difference between the par value and the 10-day average trading price following the end of the Class Period. Co-Counsel has also asked that I separate the estimated damages of US$703.5 million for Sino-Forest note holders into those note holders that purchased Sino-Forest notes in the initial offerings and those that acquired Sino-Forest notes in the secondary market. In order to separate the estimated damages between the two groups of damaged investors, I use a proportional trading model as described in the Torchio November 2011 Affidavit. I assume that turnover for the notes was 4% per month.[64] Based on a turnover of 4%, I estimate Primary Notes Damages for note holders who purchased notes in the initial offering of Sino-Forest notes to be US$357.1 million, and Secondary Notes Damages for note holders who purchased notes in the secondary market to be US$346.4 million. The table below summarizes the results:

Sino-Forest Primary and Secondary Market Bond Damages

Description	Primary Damages (US$)	Secondary Damages (US$)
10.25% Guaranteed Senior Notes (144A)	$56,361,979	$82,000,746
6.25% Guaranteed Senior Notes (144A)	$183,824,493	$70,995,507
5.00% Convertible Senior Notes (144A)	$31,867,700	$101,134,113
4.25% Convertible Senior Notes (144A)	$85,050,817	$92,284,933
TOTAL	*$357,104,988*	*$346,415,299*

[64] For example, *see* Jack Bao, Jun Pan, and Jiang Wang, "The Illiquidity of Corporate Bonds," *The Journal of Finance*, Vol. LXVI, No. 3, June 2011, 911-946.

I certify that, to the best of my knowledge and belief:

-- the statements of fact contained in this Affidavit are true and correct;

-- the reported analyses, opinions and conclusions are limited only by the reported assumptions and limiting conditions, and are my personal, unbiased professional analyses, opinions and conclusions;

-- I have reviewed Rule 4.1 of the Ontario *Rules of Civil Procedure*, and I have prepared this Affidavit having regard to the duty described therein;

-- I have no present or prospective interest in the parties to this case, and I have no personal interest or bias with respect to the parties involved; and

-- my compensation is not contingent on an action or event resulting from the analyses, opinions or conclusions in, or the use of, this Affidavit.

1/11/2013
Date

Frank C. Torchio

Sworn to me this 11th day of January, 2013

Notary Public

DEREK B. LAVARNWAY
Notary Public, State of New York
Qualified in Wyoming County
No. 01LA6207948
Commission Expires June 22, 2013

List of Exhibits

TAB 14

THIS DOCUMENT IS LOCATED AT

Claims Procedure Order dated May 14, 2012

Plaintiffs' Book of Authorities, Tab 38

Court File No. CV-12-9667-00CL

ONTARIO
SUPERIOR COURT OF JUSTICE
COMMERCIAL LIST

THE HONOURABLE MR.	)	MONDAY, THE 14th
	)	
JUSTICE MORAWETZ	)	DAY OF MAY, 2012

IN THE MATTER OF THE *COMPANIES' CREDITORS ARRANGEMENT ACT*, R.S.C. 1985, c. C-36, AS AMENDED

AND IN THE MATTER OF A PLAN OF COMPROMISE AND ARRANGEMENT OF SINO-FOREST CORPORATION

CLAIMS PROCEDURE ORDER

THIS MOTION, made by Sino-Forest Corporation (the "Applicant") for an order establishing a claims procedure for the identification and determination of certain claims was heard this day at 330 University Avenue, Toronto, Ontario.

ON READING the Applicant's Notice of Motion, the affidavit of W. Judson Martin sworn on May 2, 2012, the Second Report of FTI Consulting Canada Inc. (the "Monitor") dated April 30, 2012 (the "Monitor's Second Report") and the Supplemental Report to the Monitor's Second Report dated May 12, 2012 (the "Supplemental Report"), and on hearing the submissions of counsel for the Applicant, the Applicant's directors, the Monitor, the *ad hoc* committee of Noteholders (the "Ad Hoc Noteholders"), and those other parties present, no one appearing for the other parties served with the Applicant's Motion Record, although duly served as appears from the affidavit of service, filed:

SERVICE

1. THIS COURT ORDERS that the time for service of the Notice of Motion, the Motion Record, the Monitor's Second Report and the Supplemental Report is hereby abridged and

Person holding a Claim, a D&O Claim or a D&O Indemnity Claim, and without limitation, neither the Monitor nor the Applicant shall have any obligation to send notice to any Person having a security interest in a Claim, D&O Claim or D&O Indemnity Claim (including the holder of a security interest created by way of a pledge or a security interest created by way of an assignment of a Claim, D&O Claim or D&O Indemnity Claim), and all Persons (including Known Claimants) shall be bound by any notices published pursuant to paragraphs 12(a) and 12(d) of this Order regardless of whether or not they received actual notice, and any steps taken in respect of any Claim, D&O Claim or D&O Indemnity Claim in accordance with this Order.

15. THIS COURT ORDERS that the delivery of a Proof of Claim, D&O Proof of Claim, or D&O Indemnity Proof of Claim by the Monitor to a Person shall not constitute an admission by the Applicant or the Monitor of any liability of the Applicant or any Director of Officer to any Person.

CLAIMS BAR DATES

Claims and D&O Claims

16. THIS COURT ORDERS that (i) Proofs of Claim (but not in respect of any Restructuring Claims) and D&O Proofs of Claim shall be filed with the Monitor on or before the Claims Bar Date, and (ii) Proofs of Claim in respect of Restructuring Claims shall be filed with the Monitor on or before the Restructuring Claims Bar Date. For the avoidance of doubt, a Proof of Claim or D&O Proof of Claim, as applicable, must be filed in respect of every Claim or D&O Claim, regardless of whether or not a legal proceeding in respect of a Claim or D&O Claim was commenced prior to the Filing Date.

17. THIS COURT ORDERS that any Person that does not file a Proof of Claim as provided for herein such that the Proof of Claim is received by the Monitor on or before the Claims Bar Date or the Restructuring Claims Bar Date, as applicable, (a) shall be and is hereby forever barred from making or enforcing such Claim against the Applicant and all such Claims shall be forever extinguished; (b) shall be and is hereby forever barred from making or enforcing such Claim as against any other Person who could claim contribution or indemnity from the Applicant; (c) shall not be entitled to vote such Claim at the Creditors' Meeting in respect of the

Plan or to receive any distribution thereunder in respect of such Claim; and (d) shall not be entitled to any further notice in, and shall not be entitled to participate as a Claimant or creditor in, the CCAA Proceedings in respect of such Claim.

18. THIS COURT ORDERS that any Person that does not file a D&O Proof of Claim as provided for herein such that the D&O Proof of Claim is received by the Monitor on or before the Claims Bar Date (a) shall be and is hereby forever barred from making or enforcing such D&O Claim against any Directors or Officers, and all such D&O Claims shall be forever extinguished; (b) shall be and is hereby forever barred from making or enforcing such D&O Claim as against any other Person who could claim contribution or indemnity from any Directors or Officers; (c) shall not be entitled to vote such D&O Claim at the Creditors' Meeting or to receive any distribution in respect of such D&O Claim; and (d) shall not be entitled to any further notice in, and shall not be entitled to participate as a Claimant or creditor in, the CCAA Proceedings in respect of such D&O Claim.

D&O Indemnity Claims

19. THIS COURT ORDERS that any Director of Officer wishing to assert a D&O Indemnity Claim shall deliver a D&O Indemnity Proof of Claim to the Monitor so that it is received by no later than fifteen (15) Business Days after the date of receipt of the D&O Proof of Claim by such Director or Officer pursuant to paragraph 12(g) hereof (with respect to each D&O Indemnity Claim, the "D&O Indemnity Claims Bar Date").

20. THIS COURT ORDERS that any Director of Officer that does not file a D&O Indemnity Proof of Claim as provided for herein such that the D&O Indemnity Proof of Claim is received by the Monitor on or before the D&O Indemnity Claims Bar Date (a) shall be and is hereby forever barred from making or enforcing such D&O Indemnity Claim against the Applicant, and such D&O Indemnity Claim shall be forever extinguished; (b) shall be and is hereby forever barred from making or enforcing such D&O Indemnity Claim as against any other Person who could claim contribution or indemnity from the Applicant; and (c) shall not be entitled to vote such D&O Indemnity Claim at the Creditors' Meeting or to receive any distribution in respect of such D&O Indemnity Claim.

Excluded Claims

21. THIS COURT ORDERS that Persons with Excluded Claims shall not be required to file a Proof of Claim in this process in respect of such Excluded Claims, unless required to do so by further order of the Court.

PROOFS OF CLAIM

22. THIS COURT ORDERS that (i) each Person shall include any and all Claims it asserts against the Applicant in a single Proof of Claim, provided however that where a Person has taken assignment or transfer of a purported Claim after the Filing Date, that Person shall file a separate Proof of Claim for each such assigned or transferred purported Claim, and (ii) each Person that has or intends to assert a right or claim against one or more Subsidiaries which is based in whole or in part on facts, underlying transactions, causes of action or events relating to a purported Claim made against the Applicant shall so indicate on such Claimant's Proof of Claim.

23. THIS COURT ORDERS that each Person shall include any and all D&O Claims it asserts against one or more Directors or Officers in a single D&O Proof of Claim, provided however that where a Person has taken assignment or transfer of a purported D&O Claim after the Filing Date, that Person shall file a separate D&O Proof of Claim for each such assigned or transferred purported D&O Claim.

24. THIS COURT ORDERS that the 2013 and 2016 Trustee is authorized and directed to file one Proof of Claim on or before the Claims Bar Date in respect of each of the 2013 Notes and the 2016 Notes, indicating the amount owing on an aggregate basis as at the Filing Date under each of the 2013 Note Indenture and the 2016 Note Indenture.

25. THIS COURT ORDERS that the 2014 and 2017 Trustee is authorized and directed to file one Proof of Claim on or before the Claims Bar Date in respect of each of the 2014 Notes and the 2017 Notes, indicating the amount owing on an aggregate basis as at the Filing Date under each of the 2014 Note Indenture and the 2017 Note Indenture.

26. Notwithstanding any other provisions of this Order, Noteholders are not required to file individual Proofs of Claim in respect of Claims relating solely to the debt evidenced by their

Notes. The Monitor may disregard any Proofs of Claim filed by any individual Noteholder claiming the debt evidenced by the Notes, and such Proofs of Claim shall be ineffective for all purposes. The process for determining each individual Noteholder's Claim for voting and distribution purposes with respect to the Plan and the process for voting on the Plan by Noteholders will be established by further order of the Court.

27. THIS COURT ORDERS that the Ontario Plaintiffs are, collectively, authorized to file, on or before the Claims Bar Date, one Proof of Claim and, if applicable, one D&O Proof of Claim, in respect of the substance of the matters set out in the Ontario Class Action, notwithstanding that leave to make a secondary market liability claim has not be granted and that the National Class has not yet been certified, and that members of the National Class may rely on the one Proof of Claim and/or one D&O Proof of Claim filed by the counsel for the Ontario Plaintiffs and are not required to file individual Proofs of Claim or D&O Proofs of Claim in respect of the Claims forming the subject matter of the Ontario Class Action.

28. THIS COURT ORDERS that the Quebec Plaintiffs are, collectively, authorized to file, on or before the Claims Bar Date, one Proof of Claim and, if applicable, one D&O Proof of Claim, in respect of the substance of the matters set out in the Quebec Class Action, notwithstanding that leave to make a secondary market liability claim has not be granted and that the Quebec Class has not yet been certified, and that members of the Quebec Class may rely on the one Proof of Claim and/or one D&O Proof of Claim filed by the counsel for the Quebec Plaintiffs and are not required to file individual Proofs of Claim or D&O Proofs of Claim in respect of the Claims forming the subject matter of the Quebec Class Action.

REVIEW OF PROOFS OF CLAIM

29. THIS COURT ORDERS that any Claimant filing a Proof of Claim, D&O Proof of Claim or D&O Indemnity Proof of Claim shall clearly mark as "Confidential" any documents or portions thereof that that Person believes should be treated as confidential.

30. THIS COURT ORDERS that with respect to documents or portions thereof that are marked "Confidential", the following shall apply:

TAB 15

TAB A

Summary of All Objections Received by FTI and Responses [1]

Nature of Objection	#	Response
Non-Kim Orr Objectors		
The settlement quantum is inadequate.	21[2]	• Largest auditor settlement in Canadian history, fifth largest all-time. • Settlement reflects legal impediments to recovery, which may limit recovery to less than $10 million for all secondary market class members. • Settlement is more than 13 x E&Y fees from its Sino-Forest related work.
Settlement is premature: • No settlement should be reached until there is a global settlement. • No settlement before OSC hearing and decision on SFC fraud. • Settlement does not resolve claims against SFC or other defendants. • There has not been enough disclosure.	13[3]	• Consecutive settlements are common and increase pressure on other defendants. • OSC does not allege fraud against E&Y. • Class counsel considered extensive public and private disclosure.
Various issues with distribution: • Post-June 2, 2011 share purchasers have been ignored; • Distribution should not be at the discretion of counsel; • Lawyers should publically disclose	10[4]	• Distribution will be addressed at a later motion.

[1] Forty-one (41) objection forms were submitted containing no reasons for objection: George Harrison; Ilona Hayden; Mario Guay; Robin Singh; Ted Szamecz; Nina Bode; Win Jian Guo; Suzanne Theberge; Alex Tocher; Andre Cloutier; Chang Teng; Jean-Francois Champagne; June McDonald; Lorraine Dahl; Luc Proulx; Michael Teng; Nicole Dahl; Richard Dahl; Wolfgang Glasmacher; Bruno Jacques; Carmel Gangon; Diane Berberon; Harlow Ardene McIntosh; John Elias; Ralf Weber; Rene Pelliteri; Richard Janson; Sydney Pettit; William McDowell; Joe Corcoran; 101045342 Saskatchewan Ltd.; Cecil Rideout; Dolores Van Severen; J. Gordon Wilder; Joe Micieli; Larry van Severen; Linda Scholz; Michael Scholz; Valerie Rideout; Chin Chen & Alice Liu; David Thompson.

[2] Alain Vallée; Charles Roussel; Darlene Murray; Hubert Hicks; Ilan Toledano; Jeffrey Boivin; John T. McAteeer; Joseph Campbell; Layne Boivin; Muhammed & Sajedah Datoo; Oliver Schaeffer; Reginald G. Garnett; Reginald McDonald; Remi Gaudreault; Revi Plante; Sadiq Bin Huda; Suzanne Rochon; Qin Jian Go; Lupapa Lor; Mario Giacomo; Yungsoon Lee.

[3] Hubert Hicks; Michael Bailey; Wing Yu; Paul Lechtzier; Samar Aljawhiri; Yicheng Bao; Annie Kwok; Chun-Kim Lim; Erik Chong; Jason Evdoxiadis; Sonja Chong; Ted Goodie; Gary Brooks.

[4] Annie Kwok; Chun-Kim Lim; Erik Chong; Ilan Toledano; Jason Evdoxiadis; Meng Try; Sonja Chong; Ted Goodie; Mervyn A. Kroeker; David Gander.

fees prior to approval of distribution; • Independent arbitrator should determine allocation after hearing submissions from all interested parties; • The settlement is not in the benefit of all shareholders; and • Lawyers are overcompensated. • Shareholders who purchased before March 31, 2006 are unable to participate in this settlement.		
Various issues with Sino-Forest's restructuring and the Plan of Compromise and Arrangement.	9[5]	• This motion does not concern the restructuring.
E&Y should not be allowed to settle.	6[6]	• This is contrary to the longstanding principle of Ontario courts to encourage reasonable settlements.
E&Y should not be released from claims made by post-June 2 share purchasers.	2[7]	• E&Y has agreed to settle all claims against it, not merely a portion of the claims against it.
Received late notice of settlement.	4[8]	• Notice was distributed in accordance with court order.
Devastated by the fraud.	2[9]	• Settlement will provide compensation.
Not satisfied with the resolution.	2[10]	• Objection not sufficiently specific to be addressed.
E&Y misled shareholders.	1[11]	• Settlement will provide compensation.
Loss of trust.	1[12]	• Settlement will provide compensation.
To recuperate from the loss	1[13]	• Settlement will provide compensation.

[5] Annie Kwok; Chun-Kim Lim; Erik Chong; Jason Evdoxiadis; Michael Bailey; Qing Yu; Samar Aljawhiri; Sonja Chong; Ted Goodie.
[6] Arde Bont; Zhonge Yu; Pierre Drolet; Charles Clark; Janak Gupta; Charles Binks.
[7] Daniel Lam; Senthivel Kanagaratnam;
[8] Wolfgang Glasmacher; Robert Smith; Jane Cartwright; Jeff Weatherhead.
[9] Dean Wittig; Colleen Wittig.
[10] Edith Kong; Francis Kong.
[11] Valerie Levesque
[12] Rui Alberto Faria.
[13] Nicholas Vadasz

		•
E&Y did not admit any wrongdoing or liability.	1[14]	• It is very rare for a defendant to admit liability in a settlement, and in this circumstance, there will be no settlement if such an admission is required, particularly in light of the outstanding proceedings before the OSC.
Kim Orr Objectors		
Releases under the Plan are improper, and were improperly exchanged for a "substantial premium" amount in settlement.	8[15]	• E&Y entered this settlement because it sought to settle all claims against it related to Sino-Forest. The plaintiffs considered this an entirely reasonable position and it allowed for a higher settlement for the benefit of all securities claimants.
Settlement should allow opt out of persons who opted out during Pöyry opt out period or should allow further opt outs.	8[16]	• One cannot opt out of the CCAA. • The class action procedure has never altered the CCAA process.
Representation order is improper.	8[17]	• Representation order required to give effect to the settlement.
In the absence of plan of distribution, objectors cannot evaluate sufficiency of settlement.	8[18]	• This motion addresses whether a global settlement is adequate. • There will be an additional motion to decide distribution where objectors can make additional submissions.

[14] Joseph Campbell.
[15] Comité Syndical National de Retraite Bâtirente Inc.; Benjamin Lin; Clara Chow; Gestion Férique; Invesco Canada Ltd.; Matrix Asset Management Inc.; Montrusco Bolton Investments Inc.; Northwest and Ethical Investments L.P.;
[16] Comité Syndical National de Retraite Bâtirente Inc.; Benjamin Lin; Clara Chow; Gestion Férique; Invesco Canada Ltd.; Matrix Asset Management Inc.; Montrusco Bolton Investments Inc.; Northwest and Ethical Investments L.P.;
[17] Comité Syndical National de Retraite Bâtirente Inc.; Benjamin Lin; Clara Chow; Gestion Férique; Invesco Canada Ltd.; Matrix Asset Management Inc.; Montrusco Bolton Investments Inc.; Northwest and Ethical Investments L.P.;
[18] Comité Syndical National de Retraite Bâtirente Inc.; Benjamin Lin; Clara Chow; Gestion Férique; Invesco Canada Ltd.; Matrix Asset Management Inc.; Montrusco Bolton Investments Inc.; Northwest and Ethical Investments L.P.;

TAB B

Summary of Timely Objections Received by FTI and Responses [1]

Nature of Objection	#	Response
Non-Kim Orr Objectors		
The settlement quantum is inadequate.	17[2]	• Largest auditor settlement in Canadian history, fifth largest all-time. • Settlement reflects legal impediments to recovery, which may limit recovery to less than $10 million for all secondary market class members. • Settlement is more than 13 x E&Y fees from its Sino-Forest related work.
Settlement is premature: • No settlement should be reached until there is a global settlement. • No settlement before OSC hearing and decision on SFC fraud. • Settlement does not resolve claims against SFC or other defendants. • There has not been enough disclosure.	13[3]	• Consecutive settlements are common and increase pressure on other defendants. • OSC does not allege fraud against E&Y. • Class counsel considered extensive public and private disclosure.
Various issues with distribution: • Post-June 2, 2011 share purchasers have been ignored; • Distribution should not be at the discretion of counsel; • Lawyers should publically disclose fees prior to approval of distribution; • Independent arbitrator should determine allocation after hearing submissions from all interested parties;	10[4]	• Distribution will be addressed at a later motion.

[1] Nine (9) timely objection forms were submitted containing no reasons for objection: George Harrison; Ilona Hayden; Mario Guay; Robin Singh; Ted Szamecz; Nina Bode; Win Jian Guo; Suzanne Theberge; Joe Corcoran.
[2] Alain Vallée; Charles Roussel; Darlene Murray; Hubert Hicks; Ilan Toledano; Jeffrey Boivin; John T. McAteeer; Joseph Campbell; Layne Boivin; Muhammed & Sajedah Datoo; Oliver Schaeffer; Reginald G. Garnett; Reginald McDonald; Remi Gaudreault; Revi Plante; Sadiq Bin Huda; Suzanne Rochon.
[3] Hubert Hicks; Michael Bailey; Wing Yu; Paul Lechtzier; Samar Aljawhiri; Yicheng Bao; Annie Kwok; Chun-Kim Lim; Erik Chong; Jason Evdoxiadis; Sonja Chong; Ted Goodie; Gary Brooks.
[4] Annie Kwok; Chun-Kim Lim; Erik Chong; Ilan Toledano; Jason Evdoxiadis; Meng Try; Sonja Chong; Ted Goodie; Mervyn A. Kroeker; David Gander

• The settlement is not in the benefit of all shareholders; and • Lawyers are overcompensated. • Shareholders who purchased before March 31, 2006 are unable to participate in this settlement.		
Various issues with Sino-Forest's restructuring and the Plan of Compromise and Arrangement.	9[5]	• This motion does not concern the restructuring.
E&Y should not be allowed to settle.	3[6]	• This is contrary to the longstanding principle of Ontario courts to encourage reasonable settlements.
E&Y should not be released from claims made by post-June 2 share purchasers.	2[7]	• E&Y has agreed to settle all claims against it, not merely a portion of the claims against it.
Devastated by the fraud.	1[8]	• Settlement will provide compensation.
E&Y did not admit any wrongdoing or liability.	1[9]	• It is very rare for a defendant to admit liability in a settlement, and in this circumstance, there will be no settlement if such an admission is required, particularly in light of the outstanding proceedings before the OSC.
Kim Orr Objectors		
Releases under the Plan are improper, and were improperly exchanged for a "substantial premium" amount in settlement.	8[10]	• E&Y entered this settlement because it sought to settle all claims against it related to Sino-Forest. The plaintiffs considered this an entirely reasonable position and it allowed for a higher settlement for the benefit of all securities claimants.
Settlement should allow opt out of	8[11]	• One cannot opt out of the CCAA.

[5] Annie Kwok; Chun-Kim Lim; Erik Chong; Jason Evdoxiadis; Michael Bailey; Qing Yu; Samar Aljawhiri; Sonja Chong; Ted Goodie.
[6] Arde Bont; Zhonge Yu; Pierre Drolet.
[7] Daniel Lam; Senthivel Kanagaratnam.
[8] Dean Wittig; Colleen Wittig.
[9] Joseph Campbell.
[10] Comité Syndical National de Retraite Bâtirente Inc.; Benjamin Lin; Clara Chow; Gestion Férique; Invesco Canada Ltd.; Matrix Asset Management Inc.; Montrusco Bolton Investments Inc.; Northwest and Ethical Investments L.P.;

persons who opted out during Pöyry opt out period or should allow further opt outs.		• The class action procedure has never altered the CCAA process.
Representation order is improper.	8[12]	• Representation order required to give effect to the settlement.
In the absence of plan of distribution, objectors cannot evaluate sufficiency of settlement.	8[13]	• This motion addresses whether a global settlement is adequate. • There will be an additional motion to decide distribution where objectors can make additional submissions.

[11] Comité Syndical National de Retraite Bâtirente Inc.; Benjamin Lin; Clara Chow; Gestion Férique; Invesco Canada Ltd.; Matrix Asset Management Inc.; Montrusco Bolton Investments Inc.; Northwest and Ethical Investments L.P.;

[12] Comité Syndical National de Retraite Bâtirente Inc.; Benjamin Lin; Clara Chow; Gestion Férique; Invesco Canada Ltd.; Matrix Asset Management Inc.; Montrusco Bolton Investments Inc.; Northwest and Ethical Investments L.P.;

[13] Comité Syndical National de Retraite Bâtirente Inc.; Benjamin Lin; Clara Chow; Gestion Férique; Invesco Canada Ltd.; Matrix Asset Management Inc.; Montrusco Bolton Investments Inc.; Northwest and Ethical Investments L.P.;

TAB 16

1.1.2 CSA Notice 53-302

Canadian Securities Administrators Notice 53-302
Report of the Canadian Securities Administrators

Proposal for a Statutory Civil Remedy for Investors in the Secondary Market and Response to the Proposed Change to the Definitions of "Material Fact" and "Material Change"

EXECUTIVE SUMMARY

(1) Purpose

The Canadian Securities Administrators (the "CSA") have developed proposed amendments to securities legislation that would give investors in the secondary market the right to sue any public company and key related persons for making public misrepresentations about the company or for failing to make required timely disclosure. The amendments would provide a limit on the amount of money that can be claimed. The proposed amendments are being published for information purposes only. The CSA is not seeking further comment on the proposed amendments. Certain members of the CSA will recommend the amendments to their respective governments. **At this time, the respective governments of the CSA have made no decision to proceed with the amendments.**

(2) Key Features of the Proposed Remedies

(a) Scope of remedy

The proposed legislative remedy would provide secondary market investors with a limited right of action against an issuer of securities, its directors, responsible senior officers, "influential persons" (for example large shareholders with influence over the disclosure), auditors and other responsible experts. Secondary market investors would have the right to seek limited compensation for damages suffered at a time when the issuer had made, and not corrected, public disclosure (either written or oral) that contained an untrue statement of a material fact or failed to make required material disclosure.

(b) Reliance

Investors would have the right to sue whether or not they actually relied on the misrepresentation or failure to make timely disclosure. This provision is intended to remove the necessity to prove reliance and to reflect the fact that they may suffer damage indirectly because of the effect a misrepresentation has on the market price of a security.

(c) Standards of proof and potential defences

The issuer and other potential defendants would have varying defences based on their responsibility for the disclosure. For some types of disclosure, the person has a defence if that person conducted due diligence. For other types of disclosure, the person is not liable unless the plaintiff proves that the person knew about the misrepresentation in the document, deliberately avoided acquiring knowledge or was guilty of gross misconduct in making the statement containing the misrepresentation.

(d) Liability cap

The proposal is primarily directed to providing an effective deterrent to misrepresentations and failures to make timely disclosure. Providing compensation for investor damages is a secondary objective, which should be balanced against the interests of long term security holders of the issuer, who effectively pay the cost of any damage awards. In order to achieve this balance, the proposed legislation would limit the potential exposure of issuers and other potential defendants. The limits vary between different categories of defendants. For an issuer, the liability cap is set at the greater of $1 million or 5% of market capitalization. For potential defendants other than the issuer, the liability caps do not apply if the person "knowingly" made the misrepresentation or "knowingly" failed to make required timely disclosure.

(e) National application of liability cap

To ensure that the liability cap is not exceeded when there are multiple actions regarding the same misrepresentation or failure to make timely disclosure across Canada, the statutory limit on the total amount of damages received considers damage awards in other jurisdictions. Specifically, the amount of damages a defendant must pay are reduced by the amount of any prior award made against, or settlement paid by, the defendant relating to the same misrepresentation or failure to make timely disclosure under a similar action in any Canadian jurisdiction.

(f) Screening mechanism

One of the risks of creating statutory liability for misrepresentations or failures to make timely disclosure is the potential for

investors to bring actions lacking any real basis in the hope that the issuer will pay a settlement just to avoid the cost of litigation. To limit unmeritorious litigation or strike suits, plaintiffs would be required to obtain leave of the court to commence an action. In granting leave, the court would have to be satisfied that the action (i) is being brought in good faith, and (ii) has a reasonable possibility of success.

(g) Court approval of settlement agreements

A further discouragement to abusive litigation would be the requirement for court approval of any proposed settlement of an action under these provisions. The court would be expected to refuse approval where the terms or circumstances of the settlement indicate that the litigation was a "strike suit".

(h) Proportionate liability

Another concern about securities litigation is the prospect of defendants with "deep pockets" being forced to pay for damages caused primarily by others. The proposed legislation would make the liability of each defendant proportionate to that defendant's share of responsibility for the misrepresentation or the failure to make timely disclosure. However, in the case of a "knowing" misrepresentation or failure to make timely disclosure, the liability would be joint and several.

(3) Responses to 1998 Published Proposal

In May 1998, certain members of the CSA published its first civil remedies proposal, which was designed to implement the main recommendations of the Final Report of the Toronto Stock Exchange Committee on Corporate Disclosure. The comments received expressed two main concerns:

- & the need for civil remedies for secondary market investors has not been demonstrated; and
- & these remedies would produce costs that outweigh its benefits, primarily by forcing public companies and others to settle unmeritorious litigation commonly known as "strike suits".

The new proposal as described above attempts to address these concerns.

(4) The Rationale for Limited Secondary Market Civil Remedies

(a) Need for improved continuous disclosure

The quality of continuous disclosure in Canada can and should be improved. Institutional investors have characterized the quality of continuous disclosure in Canada as inadequate and inferior to that in the United States. As most trading now takes place in the secondary market in reliance upon continuous disclosure documents, it is important to proceed with civil remedies for investors in the secondary market. The CSA's proposal complements and supports other CSA initiatives aimed at improving the quality of continuous disclosure. These include the proposed integrated disclosure system and the CSA's increased focus on continuous disclosure review.

(b) Combined public and private enforcement

The CSA disagree with the comment that deficient continuous disclosure is not an appropriate subject for a civil remedy and should be dealt with only through regulatory enforcement measures.

Private enforcement and public regulation together provide effective and complementary incentives to public companies and others involved with their disclosure to ensure accurate and reliable primary and continuous disclosure.

A statutory right of action for secondary market investors, which is comparable to that already available to primary market prospectus investors, is desirable and appropriate.

(c) Limited compensation model

The CSA's new proposal is based on the belief that significant but limited liability would be an effective deterrent to misrepresentations and would significantly improve the quality of corporate disclosure. The new proposal keeps the limited compensation model, except in the case of a "knowing" misrepresentation or failure to make timely disclosure. In those cases, the liability caps do not apply.

Questions may be referred to any of:

Brenda Benham
Director, Policy & Legislation

British Columbia Securities Commission
(604) 899-6636
e-mail: bbenham@bcsc.bc.ca

Sheryl Thomson
Senior Policy Advisor
British Columbia Securities Commission
(604) 899-6778
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Stephen Murison
Legal Counsel
Alberta Securities Commission
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Barbara Shourounis
Director
Saskatchewan Securities Commission
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I. INTRODUCTION

In May 1998 certain members of the Canadian Securities Administrators (the "CSA") published for comment proposed amendments to securities legislation (the "1998 Draft Legislation") which would create a limited statutory civil liability regime for continuous disclosure. These amendments, if implemented, would enable investors who purchase securities in the secondary markets to bring a civil action against issuers and other responsible parties for misrepresentations in disclosure documents and other statements relating to the issuer or its securities or for failure to make timely disclosure when required.[1] The 1998 Draft Legislation arose out of the CSA's review and support of The Toronto Stock Exchange Committee on Corporate Disclosure's (the "Allen Committee") final report issued in March 1997 (the "Final Report"). The Allen Committee was established to review continuous disclosure by public companies in Canada and assess the adequacy of such disclosure. The Allen Committee was also asked to consider whether additional remedies ought to be available, either to regulators or to investors, if companies fail to observe the continuous disclosure rules.

The 1998 Draft Legislation also included proposed changes to the definitions of "material fact" and "material change". The amended definitions were first published for comment on November 7, 1997[2] (the "Request for Comment") and did not form part of the recommendations contained in the Final Report.[3] The CSA received several submissions in response to this Request for Comment. At the time the 1998 Draft Legislation was published, the CSA were still considering the comments received on the proposed amended definitions and no decision had been made to revise the definitions as proposed. In the meantime, a decision was made to reflect the proposed revised definitions in the 1998 Draft Legislation and publish the entire package for comment.

The CSA received 28 comment letters on the 1998 Draft Legislation. A summary, in tabular form, of the comments received and the CSA's response to those comments is contained in Appendix A. A summary of the comments received on the Request for Comment is contained in Appendix B.

As a result of these comments and further deliberation by the CSA, the CSA have made a number of changes to the 1998 Draft Legislation. This report (the "CSA Report") provides a background discussion on the proposal to introduce civil liability for continuous disclosure. In addition to those comments summarized in Appendix A, this CSA Report also summarizes the major concerns raised by the commenters, the CSA's responses and the substantive changes, if any, that have been made to the 1998 Draft Legislation in response to these concerns.

The summary of public comments and CSA responses in Appendix A is supplemented by Appendix C which sets out, for information only, the consolidated revised text of the prosposed amendments to securities legislation (the "2000 Draft Legislation"). The CSA is not soliciting further comment on the proposed amendements.

Certain members of the CSA will recommend the 2000 Draft Legislation to their respective governments and are hopeful that it will be tabled for legislative consideration at the first opportunity. **At this time, however, the respective governments of the CSA have made no decision to proceed with the amendments.**

II. BACKGROUND

(i) The Allen Committee

The Toronto Stock Exchange (the "TSE") established the Allen Committee to review continuous disclosure by public companies in Canada and to comment on the adequacy of such disclosure and determine whether additional remedies ought to be available, either to regulators or to investors, if companies fail to observe the rules. The TSE initiative to establish the Allen Committee was the result of a number of factors. These included several high profile and well publicized incidents of alleged misrepresentations and questionable disclosure by public companies in Canada which illustrated the anomalous gap between statutory civil liability for prospectus disclosure and the absence of such liability for continuous disclosure. This gap was underscored by the fact that primary issuances of securities under a prospectus accounted for only about 6% of all capital markets trading while secondary market trading constituted the remaining 94% of such activity. Also, there was a growing recognition that private rights of action were a necessary complement to the enforcement activities of securities regulators. In addition, the primary focus on the prospectus as the cornerstone of issuer communication was becoming an increasingly outmoded notion in today's electronic media-driven environment. Lastly, there were perceived differences between the Canadian and U.S. liability regimes as well as

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1 The 1998 Draft Legislation was published for comment by the British Columbia, Alberta, Saskatchewan and Ontario Securities Commissions. In Ontario, at (1998) 21 O.S.C.B. 3367.

2 In Ontario, Request for Comments #51-901, (1997) 20 OSCB 5751 ("Request for Comment").

3 With the exception of one aspect of the proposed change to the definition of "material fact" to remove the retroactive aspect of the current definition which was recommended by the Allen Committee.

perceived gaps in the standard and quality of disclosure in the two countries.[4]

The Allen Committee began its deliberations based on the accepted premise that continuous disclosure is necessary to ensure that investors receive meaningful, timely, complete and accurate information concerning public companies.

> "The entire capital market system in Canada is built on a foundation of information - full, true and plain disclosure of all material facts in a prospectus and continuous disclosure of material changes and information...Information is really the lifeblood of trading on securities markets".[5]

Following an extensive series of meetings with market participants and their advisers (including securities regulators) and research, analysis and discussion, the Allen Committee released its Interim Report (the "Interim Report") in December 1995. The Interim Report made several recommendations including that a limited statutory regime be created whereby issuers and others responsible for misleading continuous disclosure could be held liable in civil actions brought by injured investors to recover their damages.[6]

The reaction by market participants to the Interim Report was strong. With some exceptions, issuers tended to feel that a problem with disclosure did not exist, or that, if there was a problem, statutory civil liability was an excessive remedy. On the other hand, representatives of the investor community tended to feel, also with some exceptions, that there was a disclosure problem and that those who are responsible for misleading disclosure should be accountable.

In the summer of 1996, after the comment period, the Allen Committee resumed its meetings with, as stated in the Final Report, the objective of "testing the validity of the conclusions reached against the submissions, to obtain evidence that would either validate or refute the conclusions reached and to listen with care to the concerns expressed -- both the concern that the Committee had erred in going too far and the concern that it had erred in not going far enough".[7]

Having engaged in this process, the Allen Committee concluded in the Final Report that its original recommendations should remain, with certain changes to reflect some of the concerns expressed by market participants in their letters of comment. The Allen Committee found that there was evidence of a significant number of incidents of disclosure violations and a perception that problems existed with the adequacy of disclosure in Canada. The Allen Committee expressed concern that these circumstances could result in the capital markets falling into disrepute with attendant loss of investor confidence. The risk of this happening would have direct cost of capital implications for all companies that participate in our capital markets. Specifically, the Allen Committee concluded that:

> "(i) There is a sufficient degree of non-compliance with the current continuous disclosure rules in Canada to cause concern.
>
> (ii) The current sanctions available to regulators charged with the task of monitoring and enforcing compliance with Canada's continuous disclosure rules provide inadequate deterrent.

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4 The Allen Committee determined that empirical research was needed to establish whether those who receive, use and rely on disclosure in making investment decisions believe there is a problem with continuous disclosure. To assist the Allen Committee, the TSE commissioned two surveys of investor groups, entitled "Corporate Disclosure Survey Conducted for The Toronto Stock Exchange", February 1995 (the "Analysts Survey") and "Survey of Retail Investors", February 1995. The Analysts Survey results indicated that of those respondents that also analysed firms subject to U.S. reporting requirements, 88% found that disclosure was better in the U.S.

5 Interim Report, page iii.

6 A number of proposals to extend statutory civil liability to continuous disclosure preceded the recommendations of the Allen Committee. In 1979, a Task Force released a report entitled "Federal Proposals for a Securities Market Law of Canada" (P. Anisman, J. Howard, W. Grover & J.P. Williamson, "Proposals for a Securities Market Law for Canada", 1979). The authors of this report proposed, among other things, a statutory civil liability regime with respect to continuous disclosure (the "Federal Proposal"). These proposals were followed some years later by a proposal of the Ontario Securities Commission in 1984 which was published for comment (the "OSC Proposal") and which also suggested the adoption of a liability regime for continuous disclosure ("Civil Liability for Continuous Disclosure Documents Filed under the Securities Act - Request for Comments", 7 OSCB 4910 (1984)). While both the Federal Proposal and the OSC Proposal stimulated a considerable amount of public debate at the time and elicited significant public comment (most of which were opposed to the idea of civil liability for continuous disclosure) neither led to legislative change. Finally, in 1993, the Québec Government recommended a limited version of the proposed regime aimed at small investors (*Quinquennial Report on the Implementation of the Securities Act*, Minister of Finance, Louise Robic, Gouvernement du Québec, ministère des Finances, December 1993), whereas in 1994, the B.C. Government also developed a proposal to introduce a limited scheme of civil liability for certain disclosure in response to the Matkin Inquiry and recommendations reflected in the Matkin Report (J.G. Matkin & D.G. Cowper, *Restructuring for the Future; Towards a Fairer Venture Capital Market*, Report of the Vancouver Stock Exchange & Securities Regulation Commission (1994)). However, by this point in time, the Allen Committee had been established and so the Québec and B.C. Governments agreed to await the outcome of their report in the hopes that any eventual recommendations could be adopted nationally.

7 Final Report, page ii.

(iii) Similarly, the remedies available to investors in secondary trading markets who are injured by misleading disclosure are so difficult to pursue and to establish, that they are as a practical matter largely academic.

(iv) We believe that civil liability should attach to issuers and others for their continuous disclosure to investors in secondary markets, subject to reasonable limitations.

(v) Faced with the task of designing recommendations from the perspective of strengthening deterrence (conclusion (ii)) or creating a route to meaningful compensation of injured investors (conclusion (iii)), the Committee has adopted improved deterrence as its goal in the belief that effective deterrence will logically reduce the need for investor compensation.

(vi) The rules by which class actions are conducted in those provinces where class actions are permitted are sufficiently different from those in the United States that there is no practical risk that the establishment of statutory civil liability in Canada will facilitate extortionate class action in Canada.

(vii) Capital markets are moving to a fully integrated disclosure system in which companies will be able to issue new securities at any time based on the information in their continuous disclosure record rather than information in a prospectus connected with a particular transaction."[8]

In sum, the majority of the Allen Committee members approached the task of designing a statutory civil liability regime for continuous disclosure from a "deterrence" perspective. Moreover, the Allen Committee felt that their recommendations, if implemented, would significantly deter misleading disclosure by providing a remedy for injured investors to obtain some measure of compensation for disclosure violations, without unduly penalizing remaining shareholders in the company or other innocent market participants and without adding unreasonably to the cost of good disclosure.

(ii) The CSA Civil Remedies Committee

Following the release of the Final Report, the CSA Chairs publicly indicated their support of the Allen Committee's recommendations and established a committee comprised of staff from the securities commissions of British Columbia, Alberta, Saskatchewan, Ontario and Québec (the "CSA Civil Remedies Committee") to consider the Allen Committee recommendations and draft legislation (which resulted in the 1998 Draft Legislation).[9]

The 1998 Draft Legislation differed from the existing prospectus remedy found in provincial securities legislation in its focus on deterring misrepresentations and encouraging good disclosure practices without necessarily providing full compensation to aggrieved investors. In this context, the 1998 Draft Legislation followed closely the model that had been adopted by the Allen Committee. The Allen Committee sought to create a system of statutory liability which would contain enough checks and balances (through the availability of due diligence defences and through limitations on liability by means of damage caps) so that issuers and their directors and officers would be deterred from inadequate or untimely disclosure without, at the same time, creating a regime that would favour short term over long term investor interests. This focus on deterrence rather than compensation of secondary market investors was, in part, a recognition of who ultimately bears the economic burden of providing compensation.[10]

The CSA Civil Remedies Committee has been reconsidering the 1998 Draft Legislation, taking into account both formal and informal comments received since its publication.[11] While a number of significant changes have been made to the legislation, the 2000 Draft Legislation continues to be based on a deterrence model.

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8 Final Report, page vii. The recommendations in the Final Report reflected the unanimous views of 11 of the 12 members of the Allen Committee. The dissenting member of the Committee did not disagree with the primary recommendation that civil liability for continuous should be introduced. The dissenting member would, however, have struck a different balance than the majority in the design of the civil liability regime; a balance generally more favourable to investor compensation.

9 Staff members of the Commission des valeurs mobilières du Québec are also taking steps to ensure that the resulting legislation will satisfy Québec civil law requirements.

10 Compensation of a prospectus investor would generally involve the culpable issuer returning subscription money that it received from the aggrieved investors, restoring both the issuer and the investor to their respective original positions. By contrast, compensation of aggrieved secondary market investors (who trade with other investors, not the issuer) would generally involve payment by a culpable issuer that did not in fact receive money from the secondary market investors; by diminishing the issuer's assets, the compensation payment would in effect come at the expense of other innocent investors, in particular the issuer's continuing shareholders.

11 In this context, the CSA Civil Remedies Committee has been reviewing and comparing existing Canadian provincial class action regimes and has met with outside counsel to discuss various aspects of civil procedure particularly in the context of class action litigation in Canada and the U.S. The CSA Civil Remedies Committee has also reviewed recent legislative changes in the United States which were intended to address perceived abuses in securities class action litigation against publicly held companies as well as the development of the case law under Rule 10b-5 of the *Securities Exchange Act of 1934*.

III. SUMMARY OF COMMENTS AND SUBSTANTIVE CHANGES TO THE 1998 DRAFT LEGISLATION

The CSA received submissions from 28 commenters on the 1998 Draft Legislation. This section describes the main issues that were raised by the commenters, the CSA's responses, and the substantive changes, if any, that have been made to the 1998 Draft Legislation in response to these comments.[12]

There were several recurring themes in the comments received by the CSA on the 1998 Draft Legislation:

- & the need for a statutory civil liability regime with respect to continuous disclosure (the "Proposal") has not been demonstrated;
- & the Proposal would produce costs disproportionate to its benefits, primarily by exposing issuers and others to coercion to settle unmeritorious litigation (often referred to as "strike suits");
- & the 1998 Draft Legislation gives plaintiffs an incentive to unfairly target large issuers because the damage cap is tied to market capitalization;
- & the application of the damage caps will be problematic where parallel actions are launched in more than one Canadian province or territory;
- & the 1998 Draft Legislation goes beyond the U.S. implied right of action under Rule 10b-5.

1. IS THERE A PROBLEM?

The comment letters illustrate that the issuer community, in particular, remains unconvinced as to the need for the Proposal. In particular, the commenters question the basis upon which the Allen Committee concluded that there was a sufficient degree of non-compliance with continuous disclosure obligations to justify concern.

(i) Deficient Disclosure

The Allen Committee noted that institutional investors had characterized the quality of continuous disclosure in Canada as inadequate and inferior to that in the United States. Based on the CSA's collective experience, the CSA remain persuaded by the Final Report that the quality of continuous disclosure in Canada can and should be improved. Increased focus on continuous disclosure review will be helpful in improving the quality of this type of information provided it is accompanied by effective enforcement effort where disclosure violations are identified. In addition, improving standards of continuous disclosure will be an important component of an integrated disclosure regime.[13] However, the CSA remain committed to seeking implementation of the Proposal so that investors are empowered with the tools to seek redress when they suffer damages as a result of misrepresentative disclosure, resulting in improved continuous disclosure in Canada.

(ii) Asymmetry of Regulatory Scheme

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12 For a detailed summary of the contents of the 1998 Draft Legislation, reference should be made to the Notice which was published in 1998. In Ontario, at (1998) 21 O.S.C.B. 3367.

13 For example, the Ontario Securities Commission (the "OSC") recently approved two rules and companion policies designed to improve disclosure of financial information by public companies. The rules will increase significantly the extent and quality of information provided in quarterly reports. OSC Rule 52-501, Financial Statements, introduces a new requirement for all public companies to include in interim financial statements an income statement and a cash flow statement for each three-month period of its financial year, other than the last three-month period of the year. Companies will also be required for the first time to provide an interim balance sheet and explanatory notes to the interim financial statements. Under the rule, a company's board of directors will be required to review the interim financial statements before they are filed with the OSC and distributed to shareholders. The rule permits the board to satisfy this review obligation through delegation of the review to the audit committee of the board. The companion policy to Rule 52-501 urges boards, in discharging their responsibilities for ensuring the reliability of interim financial statements, to consider retaining external auditors to review the statements. Rule 52-501 is expected to come into effect on December 27, 2000 (unless approved earlier by the Minister).

OSC Rule 51-501 reformulates existing OSC Policy 5.10 and introduces a new requirement for management to provide a narrative discussion and analysis (MD&A) of interim financial results with the interim financial statements. This will facilitate investors gaining an understanding of past corporate performance and future prospects on a more timely basis. The Rule will replace OSC Policy 5.10 and give the OSC greater ability to enforce compliance with annual and interim MD&A content requirements. Rule 51-501 is expected to come into effect on January 1, 2001.

In addition to the Rules, the OSC intends to continue to consider other steps that might be taken to enhance the quality and reliability of public company financial reporting. Matters under consideration include; the role and responsibilities of audit committees generally, the qualifications of audit committee members, to what extent the audit committee should be mandated and to what extent external auditors should be involved in interim reports.

The CSA also consider the Proposal to be justified, in principle, from a broader policy perspective. Primary market investors benefit from both:

& *public regulation* - regulatory review of the prospectus offering document, with discretion to withhold the necessary receipt, and potential enforcement action; and

& *private rights of action* - a statutory right to seek compensation from issuers and others, who bear direct personal liability for losses attributable to a misrepresentation in a prospectus without having to prove reliance which is required under existing common law rights of action.

In the view of the CSA, private rights of action and public regulation together provide important, effective and complementary incentives to issuers and others involved in the prospectus process to ensure sound disclosure (or disincentives to poor disclosure) and generally produce a high standard of prospectus disclosure.

Secondary market investors, by contrast, have:

& generally not benefited from regulatory review of continuous disclosure material and follow up enforcement action for breaches. This is because the limited regulatory resources have been focussed on prospectus disclosure and also because the volume and timeliness of continuous disclosure is incompatible with prior regulatory review; and

& no effective redress is available through private rights of action.

The CSA consider the disparity between the regulation of primary and secondary markets to be unjustifiable and continue to believe that a statutory right of action should be extended to secondary market investors.

The CSA are committed to recent steps to expand and intensify review of continuous disclosure (necessarily *ex post facto,* in most instances) and enforcement follow-up where appropriate. This move is being facilitated by the self-funding status of several members of the CSA.[14] At the same time, the CSA continue to recommend that secondary market investors be given an effective mechanism involving private rights of action based on a "deterrent model", as recommended by the Allen Committee, which would serve as an incentive to issuers to follow good disclosure practices.

2. STRIKE SUIT EXPOSURE

The CSA have carefully considered concerns raised in comments on the 1998 Draft Legislation and, before that, in the course of the deliberations of the Allen Committee, about the potential under the Proposal of exposing issuers and their long term shareholders to frivolous, coercive and costly litigation ("strike suits").[15] The concern, simply put, is that cost rules and other procedural protections included in the 1998 Draft Legislation would not deter plaintiffs from commencing meritless actions with a view to extracting an early settlement. This is the most prevalent concern raised by those who oppose the Proposal.

The concern about strike suits must be addressed regardless of whether, and to what extent, one believes this will be the result if the legislation is adopted. Strike suits could expose corporate defendants to proceedings that cause real harm to long-term shareholders and resulting damage to our capital markets.

The Allen Committee concluded that statutory civil liability for misleading continuous disclosure would have little effect without the mechanism of the class action suit. Throughout its deliberations, the Allen Committee focussed on the "strike suit" phenomenon in the U.S. in the securities litigation context. The Allen Committee compared the litigation environment in the U.S. to that in Canada and concluded that they are sufficiently different to make it unlikely that meritless class actions will be brought in Canada.

In response to comments received on the Interim Report, the Allen Committee again reviewed its recommendations and concluded that there was little practical risk that they would, if implemented, open the door to strike suits. Indeed, the Allen

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[14] For example, a number of commissions have created continuous disclosure teams which are responsible for monitoring and assessing the continuous disclosure record of reporting issuers. These teams will be reviewing the continuous disclosure record of all reporting issuers in their jurisdictions on a periodic basis through a combination of targeted and random reviews.

[15] "The term "strike action" or "strike suit" has emerged in the context of certain class proceedings litigation in the United States. The term connotes the commencement and pursuit of a class proceeding where the merits of the claim are not apparent but the nature of the claim and targeted transaction is such that a sizeable settlement can be achieved with some degree of probability. The term suggests a class proceedings that is properly regarded as an abuse of process. ... As the American experience suggests, "strike suits", which are lawyer rather than client driven, are disconcerting for two reasons. First, they often severely and unacceptably interfere with standard corporate governance practices, creating unnecessary inefficiencies and bypassing existing regulatory devices. Second, "strike suits" may effectively transform the class-action mechanism from a shield into a sword. When fashioned into a sword by profit-motivated lawyers and shareholder-plaintiffs posing as class representatives, the class proceedings becomes a means of harassing corporate defendants". (Justice Cumming in *Epstein v. First Marathon Inc.* 2000 CarswellOnt 346).

Committee was concerned that there are too many disincentives built into the litigation system in Canada that tend to discourage even actions with merit. One example is the standard Canadian "loser pays" costs rules.[16]

The CSA Civil Remedies Committee in 1998 had been largely persuaded by the Allen Report's conclusion that the litigation environment in Canada differs sufficiently from that in the United States that strike suits are not likely to be a problem in Canada.[17] The depth of public concern on the part of the issuer community, however, coupled with some recent examples of entrepreneurial litigation in Canada, have led the CSA to recommend further measures to deter the potential for strike suits. These measures are discussed below.

(i) Court Approval of any Settlement

Much of the concern about strike suits stems from uncertainty about the likely response of Canadian courts to strike suit litigation and the coerced settlements that may be the real objective of strike suit litigation. The recent decision of the Ontario Superior Court of Justice in *Epstein* v. *First Marathon Inc.*[18] ("*Epstein*") provides a strong indication of judicial disapproval of any effort to import strike suit litigation on the American pattern. In *Epstein*, the Court had been asked to approve a settlement agreement between the parties pursuant to the *Class Proceedings Act, 1992* (Ontario) (the "CPAO"). The settlement agreement at issue involved the payment of fees and disbursements to plaintiff's counsel with no benefit conferred on any shareholders of the corporation. In declining to grant approval, the Court held that the plaintiff's class proceeding was in the nature of a "strike suit" in that it was brought to benefit "entrepreneurial lawyers" and nominal plaintiffs not shareholders in the class and thus constituted an abuse of process. The Court not only declined to approve the proposed settlement but went on to exercise its discretion under the CPAO to dismiss the action without costs and specifically prohibited any payment to the plaintiff's counsel under the settlement agreement or otherwise.

The *Epstein* decision represents a strong denunciation of strike suits and a clear indication that Canadian courts, if given statutory authority, will exercise that authority to discourage strike suits.

To ensure that courts have the opportunity, as did the Court in *Epstein*, to consider a proposed settlement of an action launched under the proposed civil right of action, the CSA have introduced in the 2000 Draft Legislation a provision requiring court approval before any action can be stayed, discontinued, settled or dismissed (section 9 of the 2000 Draft Legislation).[19]

(ii) Screening Mechanism

The CSA have also introduced in the 2000 Draft Legislation a new provision designed to screen out, as early as possible in the litigation process, unmeritorious actions (section 7 of the 2000 Draft Legislation). This screening mechanism is designed not only to minimize the prospects of an adverse court award in the absence of a meritorious claim but, more importantly, to try to ensure that unmeritorious litigation, and the time and expense it imposes on defendants, is avoided or brought to an end early in the litigation process. By offering defendants the reasonable expectation that an unmeritorious action will be denied the requisite leave to be commenced, the 2000 Draft Legislation should better enable defendants to fend off coercive efforts by plaintiffs to negotiate the cash settlement that is often the real objective behind a strike suit.

The new screening provision would require a plaintiff to obtain leave of the court in order to bring an action. Before granting leave,

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16 Whereas in the U.S., each party to a lawsuit is responsible for its own costs, the Canadian "loser pays" costs rules act as a discipline on frivolous actions. Under Ontario's and Quebec's class proceeding legislation "loser pays" is the normal rule (subject to discretion in the trial judge to depart from the rule in specified circumstances). By contrast, the B.C. *Class Proceedings Act*, adopts the U.S. costs rule. In light of this discrepancy in costs rules under applicable class action legislation, the Allen Committee recommended that the "loser pays" costs rules be mandated for purposes of class actions predicated on statutory civil liability for a misrepresentation in continuous disclosure (Final Report, page 27). The 1998 Draft Legislation largely followed this recommendation.

17 The Allen Committee reviewed the procedural provisions and other elements of the litigation environment that facilitate meritless class actions in the U.S. and concluded that many of these elements are not present in Canada. For example, the Allen Committee noted that pre-trial discovery rules have traditionally been more liberal in the U.S. than in Canada which in turn have allowed U.S. plaintiffs to engage in fishing expeditions. The Allen Committee also noted that jury trials for securities actions, while prevalent in the U.S., are rare in Canada. In this context, the Allen Committee concluded that defendants should be better able to assess their likelihood of success and should be less inclined to settle actions lacking merit and plaintiffs should be less inclined to commence lawsuits in the search for a "shakedown" settlement (see the Final Report pps. 30-33 for further examples).

18 February 16, 2000 (2000 CarswellOnt 346).

19 This provision mirrors the provision in the Ontario *Class Proceedings Act* but is somewhat different from the provision in the B.C. class proceeding statute and the Québec *Code of Civil Procedure*.

the court must be satisfied that the action (i) is being brought in good faith and (ii) has a reasonable prospect of success at trial.[20]

This screening mechanism, coupled with the new provision described earlier that would require court approval of a settlement agreement are procedural protections that supplement the "loser pays" cost and proportionate liability provisions retained from the 1998 Draft Legislation.[21] Taken together, these elements of the 2000 Draft Legislation should ensure that any exercise of the statutory right of action occurs in a litigation environment different from that in the United States and less conducive to coercive strike suits.

3. EFFECT ON LARGER ISSUERS

Some commenters suggested that the 1998 Draft Legislation went beyond "deterrence" in terms of the impact it will have on larger issuers because the damages cap is tied to market capitalization and thereby gives plaintiffs an incentive to unfairly target larger issuers.[22]

The CSA considered several alternative approaches to the damage caps proposed under the 1998 Draft Legislation but has ultimately decided to retain the original approach.[23] The CSA remain of the view that damage exposure must, if the system is to have deterrent value, be sufficient to make it worthwhile for a plaintiff to undertake an action but, on the other hand, reflect an issuer's ability to pay and recognize that it is the non-plaintiff shareholders who ultimately bear the economic burden of providing compensation. The CSA believe that the procedural safeguards described previously will reduce the risk of coercive application of the statutory right of action and render it unnecessary to alter the damage caps as originally proposed.

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[20] The screening provision is based on a test that was recommended by the Ontario Law Reform Commission (the "OLRC") in its 1982 *Report on Class Actions.* In its report, the OLRC paid particular attention to the certification of a class action. The OLRC identified the motion for certification as one of the most important parts of the proposed procedure. The OLRC recommended that a court should be able to certify an action as a class action only if it finds that five conditions are satisfied by the representative plaintiff including proof of the substantive adequacy of the action.

[21] The 2000 Draft Legislation retains from the 1998 Draft Legislation the provision for the payment of costs by the unsuccessful party, further diminishing the burden on a successful defendant.

The CSA is recommending that the limited statutory civil remedy regime include a "loser-pays" cost provision in any jurisdiction where class proceedings legislation does not already include a "loser-pays " cost rule. The inclusion of a "loser-pays" cost provision in the proposed legislation would serve as a deterrent to unmeritorious litigation, thereby reducing the risk of U.S. style strike suits against public issuers.

The *Class Proceedings Act* in British Columbia provides for a "no costs" rule. This provision generally prohibits the court from awarding costs to any party in a class proceeding except in special circumstances. Specifically, the *Class Proceedings Act* (British Columbia) permits a court to award costs only where the court considers that:

- & there has been vexatious, frivolous or abusive conduct on the part of any party to the action;
- & an improper or unnecessary application or other step has been made or taken for the purpose of delay or increasing costs or for any other improper purpose; or
- & there are exceptional circumstances that make it unjust to deprive the successful party of costs.

Excluding the application of the "no costs" rule in the British Columbia *Class Proceedings Act* and including a "loser-pays" cost rule similar to that contained in the Ontario *Class Proceedings Act* in the proposed amendments would avoid a significant discrepancy between the proposed civil liability regime in British Columbia and that proposed in other provinces that provide for class actions. As with other aspects of the draft legislation, the government has not made any decision on the implementation of a "loser-pays" costs provision for securities class action lawsuits.

[22] The liability caps proposed in the 1998 Draft Legislation tied maximum liability to an issuer's market capitalization, at the rate of 5% of market capitalization (or $1 million, whichever is greater). In this context, the 1998 Draft Legislation followed closely the recommendations of the Allen Committee.

[23] One alternative approach fixed a single universal liability cap that would not vary with an issuer's market capitalization. The CSA were concerned, however, that any universal liability cap would either be so high as to shift the balance too far in favour of compensation or so low as to undermine the compensatory and deterrence objectives of the Proposal. Such an approach would also inevitably be perceived as inequitable by smaller issuers. The second approach applied a mathematical formula that smoothed out the differences in aggregate liability between issuers with different market caps (i.e., the damage caps increase but, at a decreasing rate). The CSA were concerned, however, that this approach would shift the balance so far away from compensation that it would undermine the deterrent impact of the Proposal. To the extent that liability caps increase less quickly than market capitalization, the amount recoverable by any single investor would diminish the larger the issuer (on the reasonable assumption that issuers with large market capitalization also have large numbers of shareholders), eventually reaching the point at which an individual investor would have no motivation to commence an action, however meritorious, simply because the amount recoverable by the investor would be too small to justify the effort. The CSA accept that deterrence should outweigh compensation but, at the same time, any deterrent effect requires a plausible element of compensation.

4. APPLICATION OF THE LIABILITY CAPS

It has been suggested that the application of the liability caps will be problematic where multiple actions are launched in respect of a single misrepresentation.[24] The CSA remain of the view that the dollar caps on liability are an essential factor in achieving the desired focus on deterring poor disclosure, rather than providing full compensation. The CSA believe that this practical difficulty can be addressed by courts and litigants who understand the legislative intent underlying the liability caps. In this context, the CSA have also revised the draft legislation to incorporate an express statement that the amount of damages that a defendant must pay is to be reduced by the amount of any prior award made against, or settlement paid by, the defendant relating to the same misrepresentation under an action under similar legislation in any Canadian jurisdiction (section 6).

5. THE PROPOSAL CONTRASTED WITH RULE 10B-5

Some of the commenters submitted that the 1998 Draft Legislation went beyond Rule 10b-5 in the U.S. while others submitted that the CSA should simply adopt a Rule 10b-5 approach.

As a starting point, it is important to recognize that the 2000 Draft Legislation (and previously the 1998 Draft Legislation) is fundamentally different from Rule 10b-5. The 2000 Draft Legislation is a specific and comprehensive code whereas Rule 10b-5 is a general anti-fraud rule from which U.S. courts have implied a right of action and which has evolved and been variously interpreted by U.S. courts over the past several decades.[25] In fact, there has been considerable litigation in the U.S. over what could be considered strictly threshold issues such as who bears liability and what is the nature of such liability.

In a Rule 10b-5 action, a plaintiff must prove that the defendant acted with "*scienter*", defined by the U.S. Supreme Court as a "mental state embracing intent to deceive, manipulate or defraud", with most courts agreeing that recklessness constitutes *scienter* as well. Reliance, and to some extent causation, have been made easier to prove in the U.S. as a result of U.S. courts' decision to adopt a "fraud-on-the-market" theory. Essentially, this theory creates the presumption that because most publicly available information is reflected in the market price of an issuer's securities, an investor's reliance on any public material misrepresentations may be presumed.[26] In this context, Rule 10b-5 has developed into a fully compensatory model.[27]

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[24] In our federal system, in which 13 jurisdictions might have parallel legislation specifying identical liability caps, it is possible that at least that number of lawsuits may follow from a single misrepresentation, with unintended multiplication of possible damage awards and serious erosion of the intended caps on liability.

[25] Rule 10b-5 provides that "It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of the mails or of any facility of any national securities exchange:

a. To employ any device, scheme or artifice to defraud,

b. To make any untrue statement of material fact or to omit to state a material fact necessary in order to make the statements made, in light of the circumstances in which they were made, not misleading, or

c. To engage in any act, practice or cause of business which operates or would operate as a fraud or deceit upon any person, in connection with the purchase or sale of any security."

[26] The seminal U.S. authority on the "fraud on the market" theory is the U.S. Supreme Court decision in *Basic Inc. v. Levinson* (485 U.S. 224 (U.S. Ohio 1988)). Mr. Justice Blackmun, writing for the majority, adopted the following description of the theory at 241-242:

> The "fraud-on-the-market" theory is based on the hypothesis that, in an open and liquid market, the price of a company's stock is determined by the company and its business...Misleading statements will therefore defraud purchasers of stock even if the purchaser does not directly rely on the misstatements...The causal connection between the plaintiffs' purchase of stock in such a case is no less significant than in the case of direct reliance on misrepresentations.

A defendant can rebut the presumption by proving that there was no causation in fact, that is: (i) that the statements in question did not affect the market price; (ii) other information was available that negated the statements such that the market price appropriately discounted the statements (the "truth in the market" defence); or (iii) the plaintiff did not rely on the market price (e.g. the plaintiff was aware of the misrepresentation but bought or sold the shares for other reasons). Prior to the availability of the (rebuttable) presumption, it was extremely difficult in the U.S. to prove that a plaintiff relied on given misrepresentations. This problem was particularly significant where multiple plaintiffs attempted to have a class certified for the purpose of a class action, because questions of reliance, damages, and causation were clearly not common question of fact or law as amongst the class members.

[27] In December 1995, U.S. Congress passed the *Private Securities Litigation Reform Act of 1995* (the "Reform Act") which amended both the *Securities Act of 1933* (the "Securities Act") and the *Securities Exchange Act of 1934* (the "Securities Exchange Act"). The Reform Act was intended to curb what Congress perceived as burgeoning abuse of the litigation process by securities plaintiff's lawyers by adopting procedural and substantive provisions that were intended to make it more difficult to bring claims under the Securities Act or the Securities Exchange Act. One such protection was the Reform Act's heightened pleading standard. The Reform Act provides that in any private action under the Securities Exchange Act for misrepresentations or omissions, the complaint must specify the allegedly false statements and explain why they are false. The complaint must also allege with particularity facts giving rise to a strong inference that the defendant acted

In a recent Ontario court decision the U.S. "fraud-on-the-market" theory was rejected.[28] The plaintiffs' claim for "deemed reliance" based on the "fraud on the market" theory was an attempt to establish a common issue in order to gain certification as a class proceeding in Ontario. In general, claims which require proof of individual reliance are unlikely to be certified as class actions under Ontario class proceedings legislation.[29] The Court rejected the notion of deemed reliance, and rejected the "fraud-on-the-market" theory in Canada. The Court held that in the U.S., deemed reliance is inextricably bound up with the statutory action under U.S. securities law. The Court confirmed that in Canada, where an investor is claiming loss based on negligent or fraudulent misrepresentation, proof of actual reliance by the individual investor is a key element. In the Court's view, "to import such a presumption would amount to a redefinition of the torts themselves". The CSA view the decision as being significant because it illustrates the limitations inherent in class actions in the context of securities litigation based on the common law.

Unlike Rule 10b-5, the 2000 Draft Legislation includes two liability standards, absence of due diligence and gross misconduct, based on a matrix of factors, including the importance and nature of the document (i.e., purpose and the time constraints applicable to the preparation of the document) and the person responsible for it. The legislation puts the onus on the defendant to establish due diligence unless knowledge or gross misconduct is required to establish liability. In those cases, the plaintiff will have to prove that the defendant was aware of the misrepresentation or the failure to make timely disclosure (or deliberately avoided acquiring knowledge) or was otherwise guilty of gross misconduct. Moreover under the 2000 Draft Legislation a plaintiff has a right of action without regard to whether the plaintiff relied on the misrepresentation or on the responsible issuer having complied with its disclosure requirements. [30]

The CSA recognize that a due diligence standard is a more rigorous liability standard than the fraud based standard under Rule 10b-5. The key element of intent or recklessness which a plaintiff must establish to succeed in a Rule 10b-5 action need not be proved to establish liability on the basis of an absence of due diligence. The rationale for the allocation of the burden is twofold. The first reason is to provide a deterrent to poor continuous disclosure. By requiring the defendant to prove due diligence, there is a much greater incentive to exercise due diligence. The second reason is access to evidence. The necessary information to establish that an officer or director, for example, was or was not duly diligent would be under the control of that officer or director. In this context, the 2000 Draft Legislation, unlike Rule 10b-5, is essentially a deterrent model.

The 2000 Draft Legislation attempts to strike a fair balance between the interests of responsible issuers and plaintiffs (for example, through the imposition of liability caps). The 2000 Draft Legislation effectively creates a presumption of causation if the market price following the correction of the misrepresentation is different from the market price at the time the misrepresentation was made (or the time at which the disclosure should have been made, in the case of an omission). The 2000 Draft Legislation does, however, exclude liability for any portion of the plaintiff's damages which does not represent a change in value of the security resulting from the misrepresentation or failure to make timely disclosure. The 2000 Draft Legislation also provides that no person or company is liable if that person or company proves that the plaintiff acquired or disposed of the security with knowledge of the misrepresentation or material change.

IV. DEFINITIONS OF "MATERIAL FACT" AND "MATERIAL CHANGE"

(i) Background

The 1998 Draft Legislation included proposed amended definitions of "material fact" and "material change" to be used for all

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with the required state of mind. Complaints that fail to meet these requirements are required to be dismissed.

Since the passage of the Reform Act there has been considerable debate as to whether the Reform Act's pleading provision changed the standard of liability under Rule 10b-5 and whether the Reform Act adopted the most stringent existing pleading standard, the Second Circuit's, or a higher standard. The Second Circuit standard requires a plaintiff to plead a "strong inference" of *scienter* either by alleging (i) facts showing that the defendant had both a motive and an opportunity to commit fraud; or (ii) strong circumstantial evidence of conscious misbehaviour or recklessness. U.S. courts still seem to be divided on this issue, with some courts holding that a plaintiff must plead, at a minimum, particular facts demonstrating deliberate or conscious recklessness.

28 See *Carom v. Bre-X Minerals Ltd.,* (1998) 41 O.R. (3d) 780 (Ontario Court of Justice).

29 See for example, *Carom v. Bre-X Minerals Ltd.*, (1999) 46 B.L.R. (2d) 247 (Ontario Superior Court of Justice), where the Court refused to let a class action proceed against certain brokerage firms and analysts who had prepared research reports and provided recommendations. The Court held that class actions were not the preferable mode of litigating these issues, because of the significant individual issues of proof relating to, among other things, the reliance placed by an individual on the research and recommendations of a broker or analyst.

30 It should be noted that the CSA will also consider recommending changes to the existing statutory rights of action for primary market investors to deal with the issue of reliance in a manner comparable to that set out in the 2000 Draft Legislation.

purposes under securities legislation.[31] The Allen Committee's Final Report had recommended that the definition of "material fact" exclude the current *ex post facto* examination of the effects of the disclosure on the market price or the value of the security. In the course of considering the Allen Committee's recommendations, the CSA identified further concerns regarding the definition of "material fact" and "material change" in securities legislation:

& The terms do not have the same meaning throughout Canada. In this context, the *Securities Act* (Québec) does not define "material fact" and Québec courts have looked to United States jurisprudence to develop a different formulation of the materiality standard from that found in the legislation in other provinces of Canada. The standard articulated in the seminal U.S. case of *TSC Industries Inc., et al. V. Northway, Inc.*, 426 U.S. 438 (1976) has been used in Québec with approval. According to that standard, facts are material when they would be substantially likely to be considered important to a reasonable investor in making an investment decision.

& The current definitions are not easily applied in the context of mutual funds. National Instrument 81-102 concerning mutual funds[32] addressed this concern by incorporating a new defined term, "significant change", similar conceptually to the Québec interpretation of "material fact".

The CSA accordingly considered amending the definitions of "material fact" and "material change" to reflect the approach taken in Québec and the U.S. This would not only have removed the currently required ex post facto examination of market price or value of securities, as recommended in the Final Report, but also have produced a legal standard for disclosure that is uniform throughout Canada and consistent with that in the U.S.

(ii) Public Comment and CSA Responses

The CSA received 7 submissions in response to the original Request for Comment. A summary of all the comment letters that the CSA received is contained in Appendix B to this CSA Report.

In general, the majority of commenters expressed support for a consistent definition of materiality against which disclosure and other securities law obligations may be assessed. These commenters cautioned, however, that this cannot be accomplished merely by changing the definitions addressed in the Request for Comments, as securities laws contain requirements reflecting standards of materiality not based on the definitions of "material fact" and "material change". A change in the standard of materiality would need to address all of the materiality standards in securities laws to avoid creating unintended ambiguities.

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[31] In the 1998 Draft Legislation, "material change" was defined to mean

(a) if used in relation to an issuer other than an investment fund,

(i) a change in the business, operations, capital, assets or affairs of the issuer which would be substantially likely to be considered important to a reasonable investor in making an investment decision, or

(ii) a decision to implement a change referred to in subparagraph (a)(i) made by

A. senior management of the issuer who believe that confirmation of the decision by the directors is probable, or

B. the directors of the issuer, and

(b) if used in relation to an issuer that is an investment fund,

(i) a change in the business, operations or affairs of the issuer which would be substantially likely to be considered important to a reasonable investor in making an investment decision, or

(ii) a decision to implement a change referred to in subparagraph (b)(i) made by

A. senior management of the issuer or by senior management of the investment fund manager who believe that confirmation of the decision by the directors or trustees of the issuer or the directors of the investment fund manager is probable, or

B. the directors or trustees of the issuer or the directors of the investment fund manager;

Similarly, "material fact" was defined to mean, "if used in relation to the affairs of an issuer or its securities, a fact or group of related facts which would be substantially likely be considered important to a reasonable investor in making an investment decision".

[32] National Instrument 81-102 Mutual Funds has been adopted as a rule in each of British Columbia, Alberta, Manitoba, Ontario and Nova Scotia, a Commission regulation in Saskatchewan, and a policy in all other jurisdictions represented by the CSA and came into force on February 1, 2000.

Conversely, some commenters expressed concern that the materiality standard in the 1998 Draft Legislation raised too many issues of interpretation and would introduce an unacceptable level of subjectivity and uncertainty into the determination. The commenters believed that this would be particularly troubling in a new statutory civil liability regime.[33]

In light of these comments, the CSA do not propose at this time to proceed with the amendments to the definitions of "material change" and "material fact" other than to:

a) tailor the definitions for application to mutual funds and non-redeemable investment funds by largely parallelling the terminology of the definition of "significant change" in National Instrument 81-102;[34] and

b) follow the recommendation of the Allen Committee to remove the retroactive element from the definition of "material fact" as it applies outside Québec.[35]

V. CONFIDENTIAL DISCLOSURE FILINGS

The CSA have also introduced in the 2000 Draft Legislation changes to the provisions of securities legislation which permit an issuer to make disclosure of material changes to securities regulators on a confidential basis. Currently, the securities legislation of most jurisdictions permits reporting issuers to file a "confidential" material change report with the applicable securities regulatory authority in lieu of making public disclosure where an issuer believes that disclosure of a "material change" would be unduly detrimental to its interests. Confidentiality can be maintained so long as an issuer reaffirms the need for confidentiality every ten days. The 2000 Draft Legislation would amend this confidential filing mechanism to:

& require that the issuer's decision that it would be unduly detrimental to its interests to make public disclosure must be arrived at a reasonable manner; and

& make clear that the issuer may not maintain disclosure in confidence if there are reasonable grounds to believe that the market is trading on leaked information.

These changes were recommended by the Allen Committee in both its Interim and Final Reports [36] and largely mirrors the safe harbour provision for confidential disclosure contained in subsection 3(8) of the 2000 Draft Legislation.[37]

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[33] Interestingly, one commenter noted that in the context of timely disclosure obligations U.S. courts have adopted a "market impact" test in applying the *TSC Industries* standard (i.e., whether or not the information in question would likely be price sensitive). The commenter cautioned against a change in Canada which would simply obfuscate the likely meaning to be given to such language in the courts. In this context, the commenter also questioned why Canadian regulators would move away from the "market impact" test (which is the current test in Canada, other than Québec under the current definitions) when U.S. courts appear to be moving towards it.

[34] Under the 2000 Draft Legislation "material change" when used in relation to an issuer that is an investment fund, means,

(i) a change in the business, operations or affairs of the issuer that would be considered important by a reasonable investor in determining whether to purchase or continue to hold securities of the issuer, or

(ii) a decision to implement a change referred to in subparagraph (i) made,

(A) by the board of directors of the issuer or the board of directors of the investment fund manager of the issuer or other persons acting in a similar capacity,

(B) by senior management of the issuer who believe that confirmation of the decision by the board of directors or such other persons acting in a similar capacity is probable, or

(C) by senior management of the investment fund manager of the issuer who believe that confirmation of the decision by the board of directors of the investment fund manager of the issuer or such other persons acting in a similar capacity is probable;

[35] Under the 2000 Draft Legislation "material fact", when used in relation to securities issued or proposed to be issued, means a fact that would reasonably be expected to have a significant effect on the market price or value of the securities;

[36] See Interim Report at page 93 and Final Report at page 80.

[37] It should be noted that in order for a responsible issuer to avail itself of the safe harbour provision contained in subsection 3(8) of the 2000 Draft Legislation, the responsible issuer must have a reasonable basis for making the disclosure on a confidential basis.

Appendix A

**Proposal for a Statutory Civil Remedy
for Investors in the Secondary Market
(the "Proposal")**

Published in May 1998

**Summary of Written Comments Received on the Proposal
and the Responses of the CSA**

The following table provides a summary of the written comments received on the draft legislation published in May 1998 (the "1998 Draft Legislation") and the responses of the CSA. Defined terms are given alphabetically. Unless otherwise indicated, section references in this Appendix are references to the 1998 Draft Legislation. The CSA have included the names of the commenters for ease of reference. It should be noted, however, that the following information is a summary only. The CSA encourage readers to consult the comment letters, copies of which are maintained on the public file of the various Commissions.

1998 Draft Legislation	Public Comments	CSA Response
"control person" means, (a) a person or company who holds a sufficient number of the voting rights attached to all outstanding voting securities of an issuer, or (b) each person or company in a combination of persons or companies, acting in concert by virtue of an agreement, arrangement, commitment or understanding, which holds in total a sufficient number of the voting rights attached to all outstanding voting securities of an issuer, to affect materially the control of the issuer, and, where a person or company, or combination of persons or companies, holds more than twenty per cent of the voting rights attached to all outstanding voting securities of an issuer, the person or company, or combination of persons or companies, shall, in the absence of evidence to the contrary, be deemed to hold a sufficient number of the voting rights to affect materially the control of the issuer; **[included in Ontario version of the Proposal]**	**The Toronto Stock Exchange** (28/08/98): Definition of "control person" unnecessary, can be folded into definition of "influential person".	The OSC incorporated the definition for the purpose of consistency, because "control person" is defined in Alberta and British Columbia. The OSC does not propose to revise this definition.
"correction of the failure to make timely disclosure" means, where there has been a failure to make timely disclosure, the disclosure of the material change in the manner required under the Act;	**The Toronto Stock Exchange** (28/08/98): The definitions of "correction of the failure to make timely disclosure" and "failure to make timely disclosure" unnecessarily confuse "timely disclosure" and failure to disclose a "material change". Eliminate the reference to "timeliness" (page 1).	The CSA consider "timeliness" an important element of the Proposal -- both in determining whether liability exists and, if so, in limiting liability through correction. Elimination of the concept could have two undesirable consequences. First, given that securities legislation requires prompt but not necessarily instantaneous disclosure of a material change, a failure to refer to the "timeliness" requirements of

1998 Draft Legislation	Public Comments	CSA Response
		securities legislation could expose an issuer to liability, even if it made disclosure as and when required by securities legislation, for the period between the occurrence of the material change and the disclosure. This would be contrary to the objectives of the CSA. The CSA do not intend to impose civil liability unless there has been non-compliance with securities legislation. Second, without reference to "timeliness of disclosure", it might be argued that eventual late disclosure of a material change, however long after the disclosure was required to have been made under securities legislation, would cure the issuer's default. This would deprive investors of a remedy and eliminate a deterrent to non-compliance with timely disclosure obligations. The CSA believe, however, that the defined phrase ("correction of the failure to make timely disclosure") is unnecessary and propose to move the "timeliness" concept to the operative provisions of the legislation as set out in section 2(4) as follows: "2(4) Where there is a failure to make timely disclosure by a responsible issuer, a person or company who acquires or disposes of an issuer's security between the time when the material change was required to be disclosed and the ***subsequent disclosure of the material change in the manner required under this Act*** has, without regard to whether the person or company relied on the responsible issuer having complied with its disclosure requirements, a right of action for damages against..." (emphasis added).
"derivative security of a responsible issuer" means a derivative security, the value of which is derived primarily from or by reference to securities of the responsible issuer, and which is created by a person or company on behalf of the responsible issuer or is guaranteed by the responsible issuer;	**The Toronto Stock Exchange** (28/08/98): The definition is redundant -- see Ontario Securities Commission Rule 14-501. It is also confusing in that it incorporates guaranteed securities (page 2).	The CSA propose to modify the definition to incorporate concepts from an existing definition used in Ontario, and remove a redundancy by deleting the word "derivative" from the text, as follows: **"derivative security"** means, in respect of a responsible issuer, a security, (a) the market price or value of which, or payment obligations under which, are derived from or based on a security of the responsible issuer; and (b) which is created by a person or company on behalf of the responsible issuer or is guaranteed by the responsible issuer; The CSA do not consider the definition to be otherwise redundant, and consider the reference to guaranteed securities to be appropriate. The definition must be read in context: its purpose is not merely to describe what is meant by "derivative security", but more importantly to provide that the issuer of a

1998 Draft Legislation	Public Comments	CSA Response
		security underlying a derivative security would not have liability under the Proposal except to the extent that the issuer itself participated in the creation of, or guaranteed, the derivative security.
"designated securities" means, for the purpose of the definition of "private issuer" (a) voting securities, or (b) securities other than debt securities carrying a residual right to participate in the earnings of the issuer or, upon the liquidation or winding-up of the issuer, in its assets;	**The Toronto Stock Exchange** (28/08/98): Replace the definitions of "private issuer", "responsible issuer" and "designated securities" with a simpler definition of responsible issuer. (page 2)	The CSA agree with the comment and propose to simplify the Proposal by eliminating the defined terms "private issuer" and "designated securities" and amending the definition of "responsible issuer" (see the discussion of that term).
"document" means any document, including a document that is transmitted in electronic form only, (a) that is filed or required to be filed with the Commission, or (b) that is, (i) filed or required to be filed with a government or an agency thereof under applicable securities or corporate law or any stock exchange under its by-laws, rules, or regulations, or (ii) a document the purpose of which makes it likely that it would contain information substantially likely to be considered important to a reasonable investor in making an investment decision in relation to a specified security, but does not include a document not reasonably likely to be released;	**The Toronto Stock Exchange** (28/08/98 (page 3): The commenter suggests a simpler definition. Subparagraphs (a) and (b)(i) overlap and can be combined. Subparagraph (b)(ii) loses track of the focus by looking to the purposes of the document, not its content.	The CSA propose to amend this definition: 1. to make clear the distinction between: (a) a document required to be filed with the Commission (for which, generally, public release can be presumed and civil liability under the Proposal is appropriate); and (b) a document filed with the Commission voluntarily, or filed or required to be filed with another agency under securities or corporate law, or any other communication the contents of which would be likely to affect the value of a security. In the case of documents described in (b), the CSA consider that civil liability under the Proposal would be inappropriate unless public release was or should reasonably have been expected. 2. to clarify the definition as it relates to documents neither filed nor required to be filed, for which the focus should be their likely effect on market price or value rather than the purpose of the document; and 3. to simplify the definition by removing the concluding phrase, the substance of which is reflected in a specific defence to civil liability as set out in subsection 3(13) of the Proposal.
"document" (continued)	**The Toronto Stock Exchange** (28/08/98): (continued) The commenter also suggests that a defence be available for leaked confidential documents.	The CSA agree with this comment and have provided for a specific defence in subsection 3(13) in respect of an unexpected public release or "leak" of a document: "**3(13)** No person or company is liable in an action under section 2 in respect of a misrepresentation in a document, other than a

1998 Draft Legislation	Public Comments	CSA Response
		document required to be filed with the Commission, if the person or company proves that, at the time of release of the document, the person or company did not know and had no reasonable grounds to believe that the document would be released."
"expert" means a person or company whose profession or practice gives authority to a statement made by the person in the person's professional capacity and includes an accountant, an actuary, an appraiser, an auditor, an engineer, a geologist and a solicitor;	**The Toronto Stock Exchange** (28/08/98): Do not define -- rely on Courts. If the qualification of acting in a "professional capacity" is meant to distinguish persons acting in multiple capacities, do so not in this definition but in the liability provisions (page 3).	The CSA believe that a definition is useful given the specific liability and defence provisions applicable to experts. The CSA propose to amend this definition to substitute the common term "lawyer" for "barrister and solicitor", a more formal term not used in all Canadian jurisdictions, and also to refer specifically to a "financial analyst". The definition has been amended as follows: **"expert"** means a person or company whose profession gives authority to a statement made in a professional capacity by the person or company including, without limitation, an accountant, actuary, appraiser, auditor, engineer, financial analyst, geologist and lawyer; The CSA also propose clarifications in the operative provisions of the Proposal (section 2(1)(e)(iii) and in the defences (section 3(12)) to ensure that an expert=s liability is predicated on unrevoked consent: "**3(12)** No expert is liable in an action under section 2 with respect to any part of a document or public oral statement that includes, summarizes or quotes from a report, statement or opinion made by the expert, if the expert proves that, the written consent previously provided was withdrawn in writing before the release of the document or making of the public oral statement."
"failure to make timely disclosure" means a failure to disclose a material change as and when required to do so by the Act;	**The Toronto Stock Exchange** (28/08/98): The definitions of "correction of the failure to make timely disclosure" and "failure to make timely disclosure" unnecessarily confuse "timely disclosure" and failure to disclose a material change. Eliminate the reference to "timeliness" (page 1).	The CSA consider "timeliness" an important element of the Proposal and propose to retain the concept. See the discussion above concerning the defined term "correction of the failure to make timely disclosure". The CSA have made, however, minor drafting changes to the definition, as follows: **"failure to make timely disclosure"** means a failure to disclose a material change in the manner and when required under this Act;"
"influential person" means, in respect of a responsible issuer, (a) a control person of the responsible issuer,	**Canadian Bankers Association** (21/09/98): A lender may become an "influential person" under this definition upon realizing on security for a loan; lender "will need to protect itself from potential liability...and ensure it does not	While the circumstance described in the comment could indeed render a person an "influential person", liability would attach only to an influential person who actually made the

1998 Draft Legislation	Public Comments	CSA Response
(b) a promoter of the responsible issuer, (c) an insider of the responsible issuer, or (d) an investment fund manager where the responsible issuer is an investment fund;	'knowingly influence' a violation...under the Proposal" (page 5).	misrepresentation or who "knowingly influenced" the making of a misrepresentation or failure to make timely disclosure. The concept of "knowingly influence" was chosen to ensure that the liability of influential persons is conditional on their deliberate involvement in the making of the misrepresentation. The CSA remain of the view that this is the correct standard.
"influential person" (continued)	**Osler Hoskin & Harcourt** (27/08/98): (page 1). Inclusion of "promoter", although not inappropriate, would pick up anyone who ever acted as a promoter. Limit this to those who acted as promoters within the preceding two years. Inclusion of insiders would pick up 10% voting securityholders whether or not in a control position -- too remote.	While the commenter is correct in noting that there is no time period to limit the inclusion of persons under the statutory definition of "promoter", this will not cause a problem under the Proposal as liability will attach to "promoters" only to the extent that they knowingly influenced the misleading disclosure. The extension to insiders was deliberate, and tempered (as the commenter notes) by the requirement to have "knowingly influenced".
"MD&A" means the section of an annual information form, financial statement, annual report or other document that contains management's discussion and analysis of financial condition and results of operations of a responsible issuer as required under Ontario securities law;	**The Toronto Stock Exchange** (28/08/98): The term is better defined in Rule 14-501 (page 4).	The commenter refers to a definition in Ontario Securities Commission Rule 14-501*Definitions*. The CSA prefer, for the purpose of the Proposal, the published definition, which limits the scope of the term to identifiable documents.
"market capitalization" in respect of an issuer means the aggregate of (i) in relation to its securities traded on a published market, an amount that is the sum of the products of multiplying the total number of outstanding securities of each such class by the market price at which a security of the class traded, on the principal market on which the securities trade, during the ten trading days before the day on which the misrepresentation was made or there was a failure to make timely disclosure, and (ii) in relation to its securities not traded on a published market, an amount equal to the fair market value thereof, as determined by a court, as at the time of the making of the misrepresentation or the failure to make timely disclosure.	**Canadian Bar Association (Ontario) Securities Subcommittee** (03/11/98): Change the 10 trading day test to 30 days, to conform with the reformulation of the short form prospectus distribution system.	The commenter notes that NI 44-101 *Short Form Prospectus Distributions* applies a market value test at any time during a 60 day period prior to the filing of a preliminary prospectus. That test, however, is used for a very different purpose than under the Proposal, namely as the basis for determining eligibility to file a short form prospectus. Under the Proposal, market capitalization must be a more precise figure determined much closer to the relevant time, because it forms the basis of quantifying potential liability of the measured entity. The CSA propose to retain the substance of the published definition but have made some drafting changes to clarify the mechanics of the calculation and to specify that market capitalization is calculated on the basis of an issuer's equity securities. In this context, a definition of "equity securities" has been added to the Proposal.
"market price" means for the securities of a class for which there is a published market (a) except as provided in paragraphs (b) or (c),	**Osler Hoskin & Harcourt** (27/08/98): (page 2). The weighting of closing prices to determine "market price" is inappropriate. Suggested alternatives: follow Allen Committee approach	The CSA=s approach was chosen deliberately, in recognition of the relevance of trading volume in assessing the importance of a

1998 Draft Legislation	Public Comments	CSA Response
(i) if the published market provides a closing price, an amount equal to the weighted average of the closing price of securities of that class on the published market for each trading day on which there was a closing price for the period during which the market price is being determined, and (ii) if the published market does not provide a closing price, but provides only the highest and lowest prices of securities traded, an amount equal to the average of the weighted averages of the highest and lowest prices of the securities of that class for each of the trading days on which there were highest and lowest prices for the period during which the market price is being determined, (b) if there has been trading of the securities of the class in the published market on fewer than half of the trading days for the period during which the market price is being determined, the average, weighted by number of trading days, of the following amounts established for each trading day of the period during which the market price is being determined (i) the simple average of the bid and ask price for each trading day on which there was no trading, and (ii) either (A) the weighted average of the closing price of the securities of that class for each trading day on which there has been trading, if the published market provides a closing price, or (B) the weighted average of the highest and lowest prices of the securities of that class for each trading day on which there has been trading, if the published market provides only the highest and lowest prices of securities traded on a trading day, or (c) if there has been no trading of the securities of the class in the published market on any of the trading days during which the market price is being determined, the fair market value thereof as determined by a court;	or section 183 of the Regulations to the *Securities Act* (Ontario).	particular price. Use of a weighted average is compatible with the approach suggested by the Allen Committee for determining market capitalization.
"market price" (continued)	**The Toronto Stock Exchange** (28/08/98): A weighted average of all trading prices rather than of closing prices is superior (page 4).	While the CSA agree with this comment in principle, they are concerned that it would be difficult to apply in practice. The CSA propose no change to the definition other than minor drafting changes.

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"material change" means, (a) if used in relation to an issuer other than an investment fund, (i) a change in the business, operations, capital, assets or affairs of the issuer which would be substantially likely to be considered important to a reasonable investor in making an investment decision, or (ii) a decision to implement a change referred to in subparagraph (a)(i) made by A. senior management of the issuer who believe that confirmation of the decision by the directors is probable, or B. the directors of the issuer, and (b) if used in relation to an issuer that is an investment fund, (i) a change in the business, operations or affairs of the issuer which would be substantially likely to be considered important to a reasonable investor in making an investment decision, or (ii) a decision to implement a change referred to in subparagraph (b)(i) made by A. senior management of the issuer or by senior management of the investment fund manager who believe that confirmation of the decision by the directors or trustees of the issuer or the directors of the investment fund manager is probable, or B. the directors or trustees of the issuer or the directors of the investment fund manager;	**Canadian Investor Relations Institute** (28/09/98): Recommends that the definitions "capture more fully the standard proposed in *TSC Industries Inc.*". Displeased with incomplete move toward Québec/US standard.	The CSA do not propose at this time to proceed with the amendment to this definition as published in November 1997 and in the Proposal in May 1998. The CSA at that time were proposing to amend the definition to move from the current "market impact" standard of materiality (outside of Québec) to an investment decision approach (i.e., a change would be a "material change" only if the disclosure would be substantially likely to be considered important to a reasonable investor in making an investment decision). Please see the Notice for a more complete discussion of this issue.
"material fact" means, if used in relation to the affairs of an issuer or its securities, a fact or a group of related facts which would be substantially likely to be considered important to be reasonable investor in making an investment decision.		The CSA do not propose at this time to proceed with the amendment to this definition as published in November 1997 and in the Proposal in May 1998. Please see the discussion noted immediately above as well as the Notice for a more complete discussion of this issue.
"material change" & "material fact" (continued)	**Canadian Bankers Association** (21/09/98) (page 4): Use the concept of "significant change" for mutual funds, using the definition under proposed NI 81-102.	In response to this comment, the CSA propose, as in the proposed amendments published in November 1997, to tailor the definition for application to investment funds by parallelling the terminology of the definition of "significant change" in National Instrument 81-102 *Mutual Funds*.

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		The CSA also propose to follow the recommendation of the Allen Committee to remove the retroactive element from the definition of "material fact" as it applies outside Québec. The proposed definitions, which would apply for all purposes of securities legislation, follow: **"material change"** , (a) when used in relation to an issuer other than an investment fund, means, (i) a change in the business, operations or capital of the issuer that would reasonably be expected to have a significant effect on the market price or value of any of the securities of the issuer, or (ii) a decision to implement a change referred to in subparagraph (i) made by the board of directors or other persons acting in a similar capacity or by senior management of the issuer who believe that confirmation of the decision by the board of directors or such other persons acting in a similar capacity is probable, and (b) when used in relation to an issuer that is an investment fund, means, (i) a change in the business, operations or affairs of the issuer that would be considered important by a reasonable investor in determining whether to purchase or continue to hold securities of the issuer, or (ii) a decision to implement a change referred to in subparagraph (i) made, (A) by the board of directors of the issuer or the board of directors of the investment fund manager of the issuer or other persons acting in a similar capacity, (B) by senior management of the issuer who believe that confirmation of the decision by the board of directors or such other persons acting in a similar capacity is probable, or (C) by senior management of the investment fund manager of the issuer who believe that confirmation of the decision by the board of directors of the investment fund manager of the issuer or such other persons acting in a similar capacity is

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		probable; **"material fact",** when used in relation to securities issued or proposed to be issued, means a fact that would reasonably be expected to have a significant effect on the market price or value of the securities;
"material change" & "material fact" (continued)	**Canadian Investor Relations Institute** (28/09/98): Pleased with removal of retroactive aspect of the current definitions.	See the discussion immediately above.
"material change" & "material fact" (continued)	**KPMG** (28/08/98): The commenter expressed concern about the application of these terms to misstatements in audited financial statements. The commenter recommends that, in that context, the terms refer specifically to a "material departure from GAAP" or, in the alternative, that they move toward the definition of "material misstatement" in the CICA Handbook section 5130.05. (page 5) The commenter believes that the proposed definition of material fact would shift the burden of proof in respect of an alleged misrepresentation away from the plaintiff onto the defendant. (page 6)	See the discussion above. The CSA do not propose to adopt different definitions applicable specifically to the accounting presentation. As previously noted, the CSA do not propose to amend the defined terms in question and, in any event, do not agree with the comment. The defined terms describe concepts; burdens of proof are contained in operative provisions of securities legislation and this Proposal.
"person or company who acquires or disposes of a specified security" means a person or company who acquires or disposes of a specified security, other than (a) a person or company who acquires a specified security under a prospectus, (b) a person or company who acquires a specified security in a distribution pursuant to an exemption from the prospectus requirement under the Act except as may be prescribed by regulation for the purposes of this definition, (c) a person or company who acquires or disposes of a specified security in connection with or pursuant to a take-over bid or issuer bid except as may be prescribed by regulation for purposes of this definition, or (d) such other person or company or class of persons or companies as may be prescribed by regulation for the purposes of this definition;	**The Toronto Stock Exchange** (28/08/98): The definition is cumbersome. All that is needed are definitions of "acquires" and "disposes". The Proposal's list of exclusions is more limited than the Allen Committee's. (pages 4-5).	The CSA remain of the view that the concepts embodied in the definition are necessary. The CSA have moved the concepts, however, to section 1(2) of the legislation which section specifies the transactions that are not subject to the Proposal. Acquisitions and dispositions of securities under a prospectus, pursuant to exemptions from the prospectus requirements or pursuant to a take-over bid or issuer bid are generally excluded from the operation of the civil remedy on the basis that investors in such transactions are not viewed as secondary market investors and already afforded a comparable remedy under securities legislation. Section 1(2) (formerly in the definition section) contemplates in paragraphs (b) and (c) the authority to include by Rule investors who acquire or dispose of securities in transactions which are otherwise excluded from the operation of the civil liability regime. The accompanying proposed Rules currently identify investors purchasing from a control person or from a creditor selling securities held

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		as collateral for a debt, and those acquiring or disposing of securities under take-over bids and issuer bids that are made (i) through the facilities of a recognized exchange, (ii) for not more than 5% of a class of securities or, (iii) in reliance on a de minimus exemption. In these cases, the transactions are in substance more analogous to a secondary market transaction rather than a private transaction.
"principal market" means, for a class of securities of an issuer in respect of which there has been a misrepresentation or a failure to make timely disclosure, (a) if there is only one published market in Canada, that market, (b) if there is more than one published market in Canada, the published market in Canada on which the greatest volume of trading in the particular class of securities occurred during the ten trading days immediately before the day on which the misrepresentation was made or there was a failure to make timely disclosure, or (c) if there is no published market in Canada, the market on which the greatest volume of trading in the particular class of securities occurred during the ten trading days immediately before the day on which the misrepresentation was made or there was a failure to make timely disclosure;	**The Toronto Stock Exchange** (28/08/98): The definition is redundant and unnecessary; item (a) is completely redundant (page 5).	The CSA consider the defined term useful but have moved the definition to the regulations and amended the proposed definition to read: **"'principal market'** means, for a class of securities of a responsible issuer (i) the published market in Canada on which the greatest volume of trading in securities of that class occurred during the 10 trading days immediately before the day on which the misrepresentation was made or on which the failure to make timely disclosure first occurred, or (ii) if there is no published market in Canada, the market on which the greatest volume of trading in securities of that class occurred during the 10 trading days immediately before the day on which the misrepresentation was made or on which the failure to make timely disclosure first occurred;
"private issuer" means a person or company, other than a reporting issuer, that is (a) an issuer in whose constating documents, or in one or more agreements between the issuer and the holders of its designated securities (i) the right to transfer the designated securities of the issuer is restricted, (ii) the number of beneficial holders of the designated securities of the issuer, exclusive of persons who are in its employment and exclusive of persons who, having been formerly in the employment of the issuer, were, while in that employment, and have continued after termination of that employment to be, holders of designated securities of the issuer, is limited to not more than fifty, two or more persons who are the joint registered owners of one or more designated securities being counted as one beneficial security holder, and (iii) any invitation to the public to subscribe for securities of the issuer or any securities convertible into or exchangeable for securities of the	**Osler Hoskin & Harcourt** (27/08/98): (page 2). The Proposal extends liability to issuers whether or not they are reporting issuers and whether or not their securities are publicly traded, as soon as they cease to be a "private issuer", seriously affecting the ability of issuers in the pre-IPO transitional stage to raise capital.	The CSA agree with the comment. In light of proposed change to the definition of "responsible issuer" this definition is unnecessary. See the discussion of comments on the defined term “responsible issuer”.

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issuer is prohibited, or (b) a private mutual fund.		
"private issuer" (continued)	**The Toronto Stock Exchange** (28/08/98): Replace the definitions of "private issuer", "responsible issuer" and "designated securities" with a simpler definition of responsible issuer. (page 2)	See the comment immediately above.
"public oral statement" [new - No definition in the 1998 Draft Legislation]	**Canadian Investor Relations Institute** (28/09/98): Oral misrepresentations: "Oral communications are more easily capable of misinterpretation and, without recording each encounter..., defending...will be difficult at best". Scope of oral disclosure [should] be clearly defined, limited to "conference calls with financial analysts and/or the media" (page 5).	The CSA propose to introduce a definition of "public oral statement" to clarify that liability will only arise where a reasonable person would expect that the statement will become generally disclosed. The proposed definition will read as follows: **"public oral statement"** means an oral statement made in circumstances in which a reasonable person would believe that information contained in the statement will become generally disclosed.
	Canadian Bar Association (Ontario) Securities Subcommittee (03/11/98): Amend the definitions to ensure that only public oral statements containing information substantially likely to be important should attract potential liability.	Under the Proposal, liability only arises for a misrepresentation in any statement, including an oral statement, if it was reasonable to expect that the misrepresentation would have an impact on the market price or value of a security of the responsible issuer.
"published market" means, for a class of securities, a market on which the securities of the class are traded that is (a) a stock exchange, or (b) an over-the-counter market if the prices at which securities of the class have been traded on that market are regularly published in a publication of general and regular paid circulation;	**The Toronto Stock Exchange** (28/08/98): The definition is unnecessary (page 4).	The CSA propose to eliminate the definition because the term as used in the Proposal is not meant to connote an exhaustive list of published markets but only to make clear that market capitalization, for example, should be determined where possible by reference to published trading prices.
"release", if used in relation to a document, means to publish, make available or disseminate to the public;	[No public comment]	The term "release" is used to clarify that liability will only arise where it is reasonable to expect that a document will be made available to the public. See also the new related defence in subsection 3(13). However, the CSA consider the term "publish" to be unnecessary in this definition and have amended it accordingly.

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"responsible issuer" means an issuer that is not a private issuer;	**Canadian Bankers Association** (21/09/98): Include a specific exemption for NP 39 mutual funds, for which there is no secondary market and which are typically issued under a prospectus, "to ensure there is no confusion" (page 4)	The CSA intended no automatic exemption for mutual funds or any other type of issuer. The CSA recognize that few circumstances would likely arise in which a mutual fund could have liability under the Proposal, but if such circumstances do arise the CSA perceive no justification for special treatment for investment fund issuers.
"responsible issuer" (continued)	**Canadian Bar Association (Ontario) Securities Subcommittee** (03/11/98): The Proposal should apply only to issuers with shares that are actually publicly traded, rather than focussing on whether the private company restrictions are in their articles.	The CSA agree with this comment and have amended the definition as noted below.
"responsible issuer" (continued)	**Osler Hoskin & Harcourt** (27/08/98): (page 2). The Proposal extends liability to issuers whether or not they are reporting issuers and whether or not their securities are publicly traded, as soon as they cease to be a "private issuer", seriously affecting the ability of issuers in the pre-IPO transitional stage.	The CSA agree with this comment.
"responsible issuer" (continued)	**The Toronto Stock Exchange** (28/08/98): Replace the definitions of "private issuer", "responsible issuer" and "designated securities" with a simpler definition of responsible issuer. (page 2)	The CSA propose to simplify the Proposal by eliminating the defined terms "private issuer" and "designated securities" and amending the definition of "responsible issuer" to reflect the general approach in the original Allen Committee recommendation. The revised definition of "responsible issuer" will state: **"responsible issuer"** means, (i) a reporting issuer, or (ii) any other issuer with a substantial connection to Ontario any securities of which are publicly traded;
1(2) For the purposes of this Part, (a) multiple misrepresentations that have sufficient common features, including the persons or companies responsible for releasing the documents or making the public oral statements in which misrepresentations are contained and the content of the misrepresentations may in the discretion of the court be treated as a single misrepresentation, and (b) multiple instances of a failure to make timely disclosure that have sufficient common features, including the persons or companies responsible for failures to	**Canadian Bankers Association** (21/09/98): (page 6): "Further refinement of these provisions is necessary."	The CSA have revised and moved the proposed provision to read: **"2(6)** In an action under this section, (a) multiple misrepresentations having common subject matter or content may, in the discretion of the court, be treated as a single misrepresentation; and (b) multiple instances of failure to make timely disclosure of a material change or material changes concerning common

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make timely disclosure and the subject matter of the information that was required to be disclosed, may in the discretion of the court be treated as a single failure to make timely disclosure.		subject matter may, in the discretion of the court, be treated as a single failure to make timely disclosure.@
Operative provisions creating "right of action": **2(1)** Where a responsible issuer or a person or company with actual, implied or apparent authority to act on behalf of a responsible issuer releases a document that contains a misrepresentation, a person or company who acquires or disposes of a specified security during the period between the time when the document was released and the time when the misrepresentation contained in the document was publicly corrected, is deemed to have relied on the misrepresentation and has a right of action for damages against (a) the responsible issuer, (b) each director of the responsible issuer, (c) each officer of the responsible issuer who authorized, permitted or acquiesced in the release of the document, (d) each influential person or director or officer of an influential person, who is not also an officer or director of the responsible issuer, and who knowingly influenced (i) the responsible issuer or any person or company on behalf of the responsible issuer to release the document, or (ii) a director or officer of the responsible issuer to authorize, permit or acquiesce in the release of the document, and (e) each expert where (i) the misrepresentation is also contained in a report, statement or opinion made by the expert, (ii) the document includes, refers to or quotes from the report, statement or opinion of the expert, and (iii) the written consent of the expert to the use of the expert's report, statement or opinion in the document has been obtained.		
2(2) Where a person with actual, implied or apparent authority to speak on behalf of a responsible issuer makes a public oral statement that relates directly or indirectly to		

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the business or affairs of the responsible issuer and that contains a misrepresentation, a person or company who acquires or disposes of a specified security during the period between the time when the public oral statement was made and the time when the misrepresentation contained in the public oral statement was publicly corrected is deemed to have relied on the misrepresentation and has a right of action for damages against (a) the responsible issuer, (b) the person who made the public oral statement, (c) each director and officer of the responsible issuer who authorized, permitted or acquiesced in the making of the public oral statement, (d) each influential person, or director or officer of the influential person who is not also an officer or director of the responsible issuer, and who knowingly influenced (i) the person who made the public oral statement to make the public oral statement, or (ii) a director or officer of the responsible issuer to authorize, permit or acquiesce in the making of the public oral statement; and (e) each expert where (i) the misrepresentation is also contained in a report, statement or opinion made by the expert, (ii) the person making the public oral statement includes, refers to or quotes from the report, statement or opinion of the expert, and (iii) the written consent of the expert to the use of the expert's report, statement or opinion in the public oral statement has been obtained. **(3),(4)** [Similar liability for other misrepresentations.]		
2 (Operative "right of action" section, generally; see text above)	**Canadian Bankers Association** (21/09/98): "...we are concerned [that] the vagueness of the term 'knowingly influence' will make it difficult for financial institutions to manage potential risk under the Proposal." "...consider excluding financial institutions that acquire a position in a corporate borrower's holdings in connection with a financing from the definition of 'influential person'."	The CSA do not agree that the term "knowingly influence" presents unmanageable uncertainty, nor that any "influential person" who does "knowingly influence" another person or company to make a misrepresentation or a failure to make timely disclosure should be automatically exempt from liability. The concept of "knowingly influence" was deliberately chosen by the CSA to denote a

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	"...the term 'knowingly influence' should be re-examined."	high degree of awareness. The CSA remain of the view that it is the correct standard and do not consider that exemption would be necessary or appropriate for particular categories of issuers or institutions.
2 (Operative "right of action" section, generally; see text above)	**Canadian Investor Relations Institute** (28/09/98): Excessively broad net of liability, far exceeding that applicable to prospectus liability. "Officer" is an expansive term. "Permitting" and "acquiescing in" are broad and uncertain terms. "Little attention...paid to ...legitimate concerns of corporate officers of all levels of management". (page 4) Oral misrepresentations: "Oral communications are more easily capable of misinterpretation and, without recording each encounter..., defending...will be difficult at best". Scope of oral disclosure [should] be clearly defined, limited to "conference calls with financial analysts and/or the media" (page 5).	The issues raised in this comment were considered in detail both by the Allen Committee and by the CSA. The CSA are of the view that the proposed right of action must be comprehensive in scope, but should balance legitimate needs and expectations of investors, issuers and issuers= management. The CSA remain of the view that the Proposal does properly address legitimate concerns of diligent management. Section 2 must be read (i) together with definitions that incorporate elements of reasonable expectation ("document", "public oral statement"), (ii) in light of the element of awareness inherent in each of the words "authorized, permitted or acquiesced", (iii) in light of the positive action implied by the words "authorized" and "permitted", (iv) recognizing that a plaintiff would bear the burden of demonstrating, to the satisfaction of a court, all the elements of the right of action under section 2, and (v) having regard to the available defences, which include "due diligence" that, under section 3(7), would take into account the circumstances surrounding the impugned disclosure, the existence, if any, and the nature of any system to ensure that the responsible issuer meets its continuous disclosure obligations and; the reasonableness of reliance by the person or company on the disclosure compliance systems in place at the time. The cumulative effect of these provisions should restrict liability to instances in which an individual has failed to act reasonably.
2 (Operative "right of action" section, generally; continued)	**Davies, Ward & Beck** (28/08/98): "...[I]ssuers will be exposed to liability... in a much wider range of circumstances than ...under US federal securities laws (page 8). [Under section 10(b)-5,] the plaintiff must prove... "scienter". The Proposal establishes much lower pleading thresholds...the plaintiff will not have to plead...the defendant's state of mind" (pages 8-9).	The CSA understand the commenter to refer to the difference between the long-standing requirement under Canadian securities legislation for timely disclosure of all material changes and the more limited requirements under US federal securities laws. The Proposal should, in the view of the CSA, apply in respect of all disclosure of material changes required under Canadian securities legislation. The US provision is an anti-fraud measure that has been developed through jurisprudence into a compensatory scheme. The Proposal, by contrast, is designed as an incentive to good corporate disclosure practices, rather than a fully compensatory scheme. As such, the CSA believe the standards encouraged by the Proposal -- Adue diligence@ in respect of core documents on the part of those responsible for them, and absence of gross misconduct in other cases -- to be appropriate.

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	Davies, Ward & Beck (28/08/98) (continued): "...[T]hese exceptionally low pleading thresholds will invite strike suits..." (pages 8-9). "...[L]oser pays' cost rules...will not deter judgment-proof plaintiffs...nor...meritless claims commenced in the expectation that they will be settled..." (page 13). "[L]awyer-driven" class action litigation motivated by contingency fees (page 14).	Rules of civil procedure give courts an important role in screening out unmeritorious claims early in the litigation process in response to defence motions to strike out actions. The CSA have also made significant changes to the Proposal to (i) require that a plaintiff obtain leave of the court before commencing an action, which leave will only be granted if there is evidence of good faith and the plaintiff has a reasonable chance of success; and (ii) require court approval of any settlement agreement.
2 (Operative "right of action" section, generally; continued)	**Davies, Ward & Beck** (28/08/98) (continued): "Terms of uncertain meaning": C "public oral statement" by individuals "whose status as 'authorized' representatives ... may be questionable". C "...the Proposal fails to define the term 'knowledge'" (page 14).	The CSA have added a definition of "public oral statement" (discussed above). With that addition, the CSA consider these terms sufficiently clear to enable issuers, investors and others, as well as the courts, to understand the scope and purpose of the Proposal and apply it appropriately.
2 (Operative "right of action" section, generally; continued)	**The Fraser Institute: Law and Markets Project** (28/08/98): "...Canadian standards for notice pleading have never been tested in securities class actions". Contingency fees: available in some jurisdictions, "providing another incentive for forum shopping". (page 35) "...underestimates the degree to which plaintiff attorneys [sic] could shop between provinces". The Proposal would "invite the Courts to take a greater role in securities rule-making... the unleashing of Courts into questions of disclosure". (page 37) Discovery: "ability to compel testimony from directors" is "troubling" (page 35).	In respect of the Proposal specifically, see the CSA=s comment above on procedural measures and revisions to the Proposal. The CSA infer from these comments a general concern about the role of courts in monitoring the performance by issuers, their directors and others of their public responsibilities. Established rules of civil procedure are designed to prevent the use of the discovery process by plaintiffs to conduct Afishing expeditions@, against directors or others, to establish whether they might have the basis of a claim.
2 (Operative "right of action" section, generally; continued)	**Goodman Phillips & Vineberg** (26/08/98): (page 7). ..."[P]roposal does not encompass some of the most active players in the secondary market, namely dealers and brokers, who ... have Rule 10(b-5) liability in the United States...".	Both the Allen Committee and the CSA specifically considered whether the Proposal, should apply to registrants. Both decided that the civil remedy would not appropriately extend to registrants acting only in that capacity. This is largely a reflection of the underlying purpose of the Proposal, the encouragement of high quality disclosure on the part of issuers, and a

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		recognition that registrants do not generally have a significant role in preparing continuous disclosure. Note, however, that a registrant could fall within the definition of "influential person" in certain circumstances, in which case, if the person knowingly influenced a misrepresentation or a failure to make timely disclosure, liability would attach under the Proposal. Note also that the definition of “expert” has been expanded to refer specifically to financial analysts.
2 (Operative "right of action" section, generally; continued)	**Goodman Phillips & Vineberg** (26/08/98) (page 7) (continued): The Proposal is much stricter than US 10(b-5) liability which "requires evidence of 'scienter'". The Proposal is predicated on 'deemed reliance' whereas US jurisprudence only presumes reliance, the presumption being "rebuttable by, among others, a 'truth on the market' defence where sufficient current information is present in the marketplace" (citing Apple Computer).	See the CSA response to a similar comment by Davies, Ward & Beck, above. The CSA have amended the 1998 Draft Legislation to clarify that a person or company has a right of action for a misrepresentation without regard to whether the plaintiff relied on the misrepresentation. In this context, the revised legislation creates a purely statutory right of action. Section 4(3), however, allows the defendant to show that all or part of the loss to the plaintiff was caused by factors other than the misrepresentation or failure to disclose. This provision could arguably allow a defendant to raise a "truth in the market" defence.
2 (Operative "right of action" section, generally; continued)	**Investment Dealers Association of Canada** 29/09/98 to 02/10/98: (page 2) The Proposal "imposes strict liability" whereas US Rule 10b-5 requires "the plaintiff [to] prove intent on the part of the defendant". Rather than providing a remedy to investors, regulators should: C upgrade continuous disclosure rules to US standards; and C implement uniformly an equivalent to *Securities Act* (Ontario) section 128.	See the CSA response to a similar comment by Davies, Ward & Beck, above. The CSA agree with the commenter that continuous disclosure requirements should be upgraded and note that enhancements to continuous disclosure requirements are under consideration as part of separate CSA initiatives. These initiatives include the proposed Integrated Disclosure System, which was the subject of a Concept Proposal published for comment on January 28, 2000. The Proposal is designed to encourage practices that ensure compliance with disclosure requirements. That purpose would, in the view of the CSA, remain valid irrespective of changes in particular disclosure requirements. The commenter refers to a provision enabling the regulator to apply to a court for a remedial order. While some CSA members have such authority, the CSA do not consider that the availability or otherwise of such a provision would have a bearing on the appropriateness of a civil remedy available directly to investors.
2 (Operative "right of action" section, generally;	**McCarthy Tétrault** (28/08/98):	

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continued)	"The Proposal [section 2] contemplates strict liability...significantly tougher ...than in the United States where a *scienter* standard applies" (page 13). The commenter points to contingency fees and the practice of plaintiff firms financing class action litigation.	See the CSA response to a similar comment by Davies, Ward & Beck, above. See the CSA response to a similar comment by Davies, Ward & Beck, above.
2 (Operative "right of action" section, generally; continued)	**Ontario Municipal Employees Retirement Board** 30/09/98: "Tighten and improve the text of the Proposed Legislation".	The CSA have taken this comment into account in revising the Proposal.
2 (Operative "right of action" section, generally; continued)	**Osler Hoskin & Harcourt** (2708/98): (page 4). The Proposal fails to carry forward the Allen Committee recommendations to exclude professional advisers acting in that capacity, and to require actual awareness on the part of influential persons.	The change from the Allen Report recommendation was deliberate. In view of the CSA=s objective of encouraging sound disclosure by issuers, and the almost universal involvement of external advisors in at least some aspects of issuer disclosure, the suggested exclusion is unjustifiable. Note, however, that an external advisor who is an "influential person" would be liable only for a misrepresentation or failure to make timely disclosure that the adviser "knowingly influenced", or if the influential person actually released the document or made the public oral statement containing the misrepresentation. This, in the view of the CSA, is the correct result and not inconsistent with the commenter=s objective.
2 (Operative "right of action" section, generally; continued)	**The Toronto Stock Exchange** (28/08/98): The Proposal fails to carry forward the Allen Committee's recommended distinct liability of a professional advisor acting in that capacity.	See the comments immediately above.
	The Toronto Stock Exchange (28/08/98) (continued): The Proposal does not achieve its objectives in that an investor who acquired securities after the correction would not have a cause of action (page 7).	The CSA are of the view that the Proposal is correct in not extending a cause of action to an investor who acquires securities after a misrepresentation has been corrected. The CSA generally agree with the conclusion of the Allen Committee as to who should have a cause of action.
Operative section 2 -- specific elements: **2 (2)** (See above.)	**Canadian Bar Association (Ontario) Securities Subcommittee** (03/11/98): There should be a defence for an issuer that publicly disavows a public statement by a person with apparent but not actual authority.	The CSA are sympathetic to the suggestion. In an effort to more clearly balance the legitimate interests of issuers and investors, and in view of the underlying purpose of the Proposal, namely the encouragement of good disclosure practices on the part of issuers, the CSA have modified the Acorrection" defence as follows: **"2(7)** In an action under subsection (2) or

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		subsection (3), if the person or company that made the public oral statement had apparent, but not implied or actual, authority to speak on behalf of the issuer, no person is liable with respect to any of the responsible issuer's securities acquired or disposed of before that person became, or should reasonably have become, aware of the misrepresentation."
Operative section 2 -- specific elements: (continued) **2 (2)** (See above.)	**Global Strategy Investment Fund** (30/09/98): The term "public oral statement" could describe the commenter's periodic market overview and, if so, the commenter is uncertain whether a genuinely-held, but ultimately inaccurate, view would relate "directly or indirectly to the business or affairs of an Issuer" and constitute a "misrepresentation". If excluded, the definitions need to be clearer. If intended to create liability, the legislation must more clearly distinguish between types of disclosure. Concern was also expressed about potential liability for a misrepresentation through omission, for example in a focussed discussion that does not cover certain areas.	The CSA do not consider a specific exclusion of "market overviews" either practical or necessary. The CSA are of the view that the circumstances in which a publicly stated misrepresentation of facts could give rise to liability are appropriately limited under the Proposal. Liability under the Proposal would not attach merely by reason of an inaccuracy in a public oral statement. The statement, as noted, must amount to a "misrepresentation", which in turn under securities legislation constitutes either an untrue statement of a material fact or an omission to state a material fact that is either required to be stated or that must be stated to ensure that a statement is not misleading in the light of the circumstances in which it was made. A "material fact" refers, in most jurisdictions, to something that would reasonably be expected to have a significant effect on the market price or value of a security. In Québec, the term refers to something reasonably likely to have a significant effect on an investment decision. An "overview" of market conditions would not likely be considered a statement constituting a material fact. Moreover, a positive statement of an issuer's genuine and reasonable belief as to market conditions, characterized as such, would not likely be considered "untrue", if indeed it would constitute a material fact. Note also that the Proposal provides defences for all persons and companies that, after reasonable investigation ("due diligence"), reasonably believed that there had not been a misrepresentation, and for forward looking information that is accompanied by appropriate cautions and for which the person or company has a reasonable basis for making the forward-looking disclosure.
Operative section 2 -- specific elements: (continued)		

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2 (4) Where there is a failure to make timely disclosure by a responsible issuer, a person or company who acquires or disposes of a specified security between the time when the material change was required to be disclosed and the correction of the failure to make timely disclosure is deemed to have relied on the responsible issuer having complied with its disclosure requirements under the Act and has a right if action for damages against (a) the responsible issuer, (b) each director and officer of the responsible issuer who authorized, permitted or acquiesced in the failure to make timely disclosure, and (c) each influential person or director or officer of an influential person, who is not also an officer or director of the responsible issuer, and who knowingly influenced (i) the responsible issuer or any person or company acting on behalf of the responsible issuer in the failure to make timely disclosure, or (ii) a director or officer of the responsible issuer to authorize, permit or acquiesce in the failure to make timely disclosure.	**Canadian Investor Relations Institute** (28/09/98): Liability for failure to make “timely” disclosure is criticized as an extension beyond US standards. There is no de minimus delay allowed and no reflection of the difficult judgements required for determining when disclosure becomes necessary or material. The commenter calls for "...a very expansive safe harbour" (page 6).	The CSA propose no Asafe harbour" for failures to make timely disclosure. The Proposal does not alter existing requirements for timely disclosure, which the CSA consider fundamental to the existing disclosure regime under Canadian securities law. The Proposal does, however, recognize the need on occasion to balance demands for reliability and timeliness of disclosure, primarily through the defence, available to all persons and companies, of reasonable investigation ("due diligence"). The legislation allows the court to consider a number of factors in assessing the reasonableness of investigation or whether the person or company is guilty of gross misconduct, including the time period within which the disclosure was required to be made.
3 (4) In determining whether an investigation was reasonable, or whether any person or company has been grossly negligent, regard shall be had to all of the circumstances, including (a) the nature of the responsible issuer, (b) the knowledge, experience and function of the person or company, (c) the office held if the person was an officer, (d) the presence or absence of another relationship with the responsible issuer if the person was a director, (e) the reasonableness of reliance on the responsible issuer's disclosure compliance system and on the responsible issuer's officers, employees and others whose duties should have given them knowledge of the relevant facts, (f) the time period within which disclosure was required to be made, (g) in the case of a misrepresentation, the role and responsibility of the person or company in the preparation and release of the document or the making of the public oral statement containing the misrepresentation or the ascertaining of the facts contained in that document or	**KPMG** (28/08/98): The commenter expressed concern that the defence of "reasonable investigation" could be onerous for auditors, exposing them to judicial second-guessing as to the reasonableness of their audit investigation and the inevitable judgements that auditors must make about whether, and how far, to insist on changes to financial statements (page 7). The Proposal should specify what procedures constitute a "reasonable investigation" to support the auditor's belief that a released document fairly represents the auditor's report (page 8).	The CSA do not consider that any professional=s participation in public disclosure should automatically be exempt from judicial review. Concerning the commenter=s second point, the Proposal reflects the CSA view that guidance ought not to take the form of a procedural handbook. However, reference to relevant professional standards would give an appropriate degree of guidance to courts and certainty to experts. To clarify the role of the court, the CSA have changed the preamble to read: **"3(7)** In determining whether an investigation was reasonable under subsection (6), or whether any person or company is guilty of gross misconduct under subsection (1) or (3), the court shall consider all relevant circumstances, including..." To address the specific issue raised by the commenter, the CSA have also revised the provision by adding the following after paragraph: "(h) in respect of a report, statement or opinion of an expert, any professional standards applicable to the expert; " The requirement for the expert's written consent to the particular use to which the expert=s work is put should go some way to address the commenter's concerns. In a

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public oral statement, and (h) in the case of a failure to make timely disclosure, the role and responsibility of the person or company in a decision not to disclose the material change.		similar vein, the CSA propose to add to the Proposal the following (not limited to expert statements): "(i) the extent to which the person or company knew or should reasonably have known the content and medium of dissemination of the document or public oral statement,"
3 (5) No person or company is liable under section 2 where there has been a failure to make timely disclosure if the material change was disclosed by the responsible issuer on a confidential basis to the Commission and, (a) the responsible issuer had a reasonable basis for making the disclosure on a confidential basis, (b) if the information contained in the confidential filing remains material, disclosure of the material change was made public promptly upon the end of the basis for confidentiality, and (c) the person or company or responsible issuer does not release a document or make a public oral statement that, due to the undisclosed material change, constitutes a misrepresentation, provided that, upon the material change becoming public, the responsible issuer promptly discloses the material change in the manner required under the Act.	**Canadian Bankers Association** (21/09/98): (page 5): Clarify which party has the burden of proof.	The CSA propose to revise the provision to make clear that the burden of demonstrating the grounds of this defence to liability rests with the defendant: "**3(8)** No person or company is liable in an action under section 2 in respect of a failure to make timely disclosure if, (a) the person or company proves that the material change was disclosed by the responsible issuer in a report filed on a confidential basis with the Commission under subsection 75(3) of this Act;..." The CSA consider this defence and the related burden of proof to be appropriate: knowledge concerning the existence or nonexistence of a confidential filing will rest with the issuer and other responsible persons acting on its behalf, and not with a plaintiff.
3 (5) (continued)	**The Toronto Stock Exchange** (28/08/98): The concluding words are circular because it is the issuer that will make the information public (page 6).	The comment assumes that confidential information can become public only by the issuer's action. This may not always be the case. The provision was meant to ensure that, if information is leaked, however justified confidentiality might have been, the information should be formally made public to ensure broad dissemination. The CSA propose to make several minor drafting changes to the section to clarify its operation. The CSA have revised the section to read as follows: "**3(8)** No person or company is liable in an action under section 2 in respect of a failure to make timely disclosure if, (a) the person or company proves that the material change was disclosed by the responsible issuer in a report filed on a confidential basis with the Commission under subsection 75(3) of this Act; (b) the responsible issuer had a reasonable basis for making the disclosure on a confidential basis;

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		(c) if the information contained in the report filed on a confidential basis remains material, disclosure of the material change was made public promptly when the basis for confidentiality ceased to exist; (d) the person or company or responsible issuer did not release a document or make a public oral statement that, due to the undisclosed material change, contained a misrepresentation, and (e) if the material change became publicly known in a manner other than as required under this Act, the responsible issuer promptly disclosed the material change in the manner required under this Act.
3 (6) No person or company is liable under section 2 for a misrepresentation in forward-looking information if, (a) the person or company proves that (i) the forward-looking information contained reasonable cautionary language proximate to the forward-looking information and, where reasonably practicable, an analysis of the sensitivity of the information to variations in the material factors or assumptions that were applied in reaching a conclusion or forecast contained in the forward-looking information, and (ii) the person or company had a reasonable basis for the conclusion or forecast, (b) securities of the responsible issuer are traded on a published market, and (c) the forward-looking information is not contained in the prospectus or securities exchange take-over bid circular of the responsible issuer filed in connection with the initial public distribution of securities of the responsible issuer.	**Canadian Bankers Association** (21/09/98): Remove the requirement for a sensitivity analysis owing to the uncertainty of the "where reasonably practicable" language. Give more guidance on cautionary language. (page 5)	The CSA propose revisions that would clarify and broaden the defence to liability in respect of forward-looking information, by (i) making clear that the requisite cautionary language must be proximate to but need not be part of the forward-looking information; (ii) clarifying elements of the requisite cautionary language; (iii) eliminating the requirement for a sensitivity analysis; and (iv) eliminating the condition relating to trading of the responsible issuer-s securities. In this context, the CSA also propose to make some drafting changes to the definition of “forward looking information” to clarify its scope. The proposed definition would read as follows: **“forward-looking information”** means all disclosure regarding possible events, conditions or results including future oriented financial information with respect to prospective results of operations, financial position or changes in financial position, based on assumptions about future economic conditions and courses of action, and presented as either a forecast or a projection;
3 (6) (continued)	**Canadian Investor Relations Institute** (28/09/98): "Safe harbour" for forward-looking information: Concerned about difficulty of establishing a “reasonable basis”. "recommend instead...US standard” offering	The CSA propose to remove the requirement for a sensitivity analysis and have proposed other modifications to the provision. See the response to the comment from the Canadian Bankers Association, immediately above.

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	safe harbour with cautionary language and absence of “actual knowledge that the statements were false or misleading”. Utility of sensitivity analysis doubted (page 7).	The CSA do not, however, consider that a defence conditional on a "reasonable basis" for a statement is unduly restrictive. The CSA do not agree with the proposition that forward-looking information should, in effect, be protected whether or not the maker has any basis for making the statement, unless the plaintiff can prove actual knowledge that the statement was false. To do so would be tantamount to sanctioning fraudulent misrepresentations.
3 (6) (continued)	**Goodman Phillips & Vineberg** (26/08/98): "Safe harbour" under the Proposal for forward-looking information shifts onto defendants the burden of proving a reasonable basis for the forecast information while in the US the plaintiff must prove that the defendant actually knew that the information is misleading (page 8).	The CSA consider the proposed defence, with the modifications described above, to be appropriate.
3 (6) (continued)	**Osler Hoskin & Harcourt** (27/08/98): (page 5). The proposed "safe harbour" is not available to issuers whose securities are not traded on a public market, although they would be subject to general liability under the Proposal as soon as their "private company" restrictions are removed.	The CSA share the commenter’s concern and have amended both the safe harbour and the definition of "responsible issuer" to address this concern. More broadly, however, the CSA do not consider the trading status of the responsible issuer=s securities integral to this defence, and propose to remove that condition. See the response to comments of the Canadian Bankers Association, above.
3 (7) Where the report, statement or opinion of an expert is included, referred to or quoted from in a document or in a public oral statement, the written consent of the expert to such use being made of the report, statement, or opinion shall be obtained by the responsible issuer prior to, (a) the document being filed with the Commission, or with a government or an agency thereof under applicable securities or corporate law, or any stock exchange under its by-laws, rules or other regulatory instruments or policies, (b) the document being released if the document has not already been filed with the Commission, or with a government or an agency thereof under applicable securities or corporate law, or any stock exchange under its by-laws, rules or other regulatory instruments or policies, or (c) the person making the public oral statement.	**The Canadian Institute of Chartered Accountants** (03/09/98) (page 1): An expert should have a defence upon becoming "aware that the information on which they carried out services is altered".	Under the Proposal an expert would only be liable if the expert’s report, statement or opinion contains a misrepresentation at the time the report, statement or opinion is made. If information changes after the report, statement or opinion is made, the expert would not be liable. Further, in order to attract liability, the expert must have given his consent to use the report, statement or opinion and not subsequently withdrawn his consent. For post-publication corrections, see the discussion below concerning subsection 4(1) of the 1998 Draft Legislation (now section 3(15) in the revised legislation).
3 (7) (continued)	**The Toronto Stock Exchange** (28/08/98): The requirement for written consent of the	The CSA agree with the comments and have

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	expert is criticized as superfluous and unnecessary, in that issuers and experts will obtain and give consents anyway (page 6).	removed the requirement from the Proposal. It should be noted, however, that any existing requirements under securities legislation for written consents in respect of specific disclosure documents are unaffected by the Proposal.
Derivative Information [new - No counterpart in the 1998 Draft Legislation]		The use by an issuer in its disclosure documents of information, containing a misrepresentation, that was derived from public disclosure by another issuer could expose the first issuer to liability. To make clear that disclosure, by or for a responsible issuer, of information in respect of another issuer that is derived from public disclosure by that other issuer, where the use of that information by or on behalf of the first issuer is not unreasonable, will not render the responsible issuer liable for a misrepresentation in the disclosure of the other issuer, the CSA have revised the Proposal by adding the following provision: **"3(14)** No person or company is liable in an action under section 2 for a misrepresentation in a document or a public oral statement, if the person or company proves that: (a) the misrepresentation was also contained in a document filed by or on behalf of another person or company, other than the responsible issuer, with the Commission or any other securities regulatory authority in Canada or a stock exchange and not corrected in another document filed by or on behalf of that other person or company with the Commission or that other securities regulatory authority in Canada or stock exchange before the release of the document or the public oral statement made by or on behalf of the responsible issuer; (b) the document or public oral statement contained a reference identifying the document that was the source of the misrepresentation; and (c) at the time of release of the document or the making of the public oral statement, the person or company did not know and had no reasonable grounds to believe that the document or public oral statement contained a misrepresentation. "
4 (1) No person or company, other than the responsible issuer, is liable under section 2 in respect of a misrepresentation or a failure to make timely disclosure that was made without the knowledge or consent of the person or company, for any loss or damage incurred by a plaintiff after (a) the person or company became aware of a misrepresentation or a failure to make timely disclosure,	**The Toronto Stock Exchange** (28/08/98): The commenter notes that the provision, which differs somewhat from the equivalent proposed by the Allen Committee, while perhaps intended to promote early third-party correction of a misrepresentation could actually discourage third-party correction (page 6).	The CSA are not convinced that the provision would, in fact, discourage third-party correction but do propose to revise the provision to make clear that, as under the Allen Committee**:** s proposal, qualifying defendants would have no liability: "**3 (15)** No person or company, other than the responsible issuer, is liable in an action under

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(b) the person or company promptly notified the board of directors of the responsible issuer of the misrepresentation or the failure to make timely disclosure, and (c) if no correction of the misrepresentation or no correction of the failure to make timely disclosure was made by the responsible issuer within two days after the notification under paragraph (b), the person or company (unless prohibited by law or by professional confidentiality rules) promptly and in writing notified the Commission of the misrepresentation or failure to make timely disclosure.		section 2 if the misrepresentation or failure to make timely disclosure was made without the knowledge or consent of the person or company and, if, after the person or company became aware of the misrepresentation before it was corrected, or the failure to make timely disclosure before it was disclosed in the manner required under this Act, (a) the person or company promptly notified the board of directors of the responsible issuer or such other persons acting in a similar capacity of the misrepresentation or the failure to make timely disclosure, and (b) if no correction of the misrepresentation or no subsequent disclosure of the material change in the manner required under this Act was made by the responsible issuer within two business days after the notification under paragraph (a), the person or company, unless prohibited by law or by professional confidentiality rules, promptly and in writing notified the Commission of the misrepresentation or failure to make timely disclosure.
4 (2) In an action under section 2 in respect of a misrepresentation or a failure to make timely disclosure, if the plaintiff acquired or disposed of specified securities on or before the tenth trading day after the public correction of the misrepresentation or the correction of the failure to make timely disclosure, the amount recoverable shall not exceed the amount of the plaintiff's actual loss, calculated taking into account the result of hedging or other risk limitation transactions undertaken by the plaintiff.	**The Toronto Stock Exchange** (28/08/98): The Proposal fails to distinguish between a plaintiff who sells before and one who sells after correction (page 7).	The comment is correct. The CSA do not consider it necessary to make such a distinction. These provisions do make a distinction in the computation of the loss recoverable depending on when, if ever, the loss is crystallized, in essence requiring that the loss be computed on the basis of a market price not more than 10 days after public correction, because it was considered that the variety of influences on market price during any longer period would tend to detract from the link between a later market price and the effect of the misrepresentation and its correction. The CSA do, however, propose revisions to make this distinction clearer: **"4(1)** Damages shall be assessed in favour of a person or company that acquired an issuer's securities after the release of a document or the making of a public oral statement containing a misrepresentation or after a failure to make timely disclosure as follows: (a) in respect of any of the securities of the responsible issuer that the person or company subsequently disposed of on or before the 10th trading day after the public correction of the misrepresentation or the disclosure of the material change in the manner required under this Act, assessed damages shall equal the difference between the average price paid for those securities (including any commissions paid in respect thereof) and the price received upon the disposition of those securities (without deducting any commissions paid in respect of

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		such disposition), calculated taking into account the result of hedging or other risk limitation transactions; (b) in respect of any of the securities of the responsible issuer that the person or company subsequently disposed of after the 10th trading day after the public correction of the misrepresentation or the disclosure of the material change in the manner required under this Act, assessed damages shall equal the lesser of, (i) an amount equal to the difference between the average price paid for those securities (including any commissions paid in respect thereof) and the price received upon the disposition of those securities (without deducting any commissions paid in respect of such disposition), calculated taking into account the result of hedging or other risk limitation transactions, and (ii) an amount equal to the number of securities that the person disposed of, multiplied by the difference between the average price per security paid for those securities (including any commissions paid in respect thereof determined on a per security basis) and, (A) if the issuer's securities trade on a published market, the trading price of the issuer's securities on the principal market (as such terms are defined in the regulations) for the 10 trading days following the public correction of the misrepresentation or the disclosure of the material change in the manner required under this Act, or (B) if there is no published market, then the amount the court considers just; and (c) in respect of any of the securities of the responsible issuer that the person or company has not disposed of, assessed damages shall equal the number of securities acquired, multiplied by the difference between the average price per security paid for those securities (including any commissions paid in respect thereof determined on a per security basis) and, (i) if the issuer's securities trade on a published market, the trading price of the issuer's securities on the principal market (as such terms are defined in the regulations) for the 10 day trading days following the public correction of the misrepresentation or the disclosure of the material change in the manner required under this Act, or

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		(ii) if there is no published market, then the amount that the court considers just.
4 (3) In an action under section 2 in respect of a misrepresentation or a failure to make timely disclosure, other than by a plaintiff described in subsection 4(2), the amount recoverable shall not exceed the aggregate of commissions paid in respect of the original acquisition or disposition and the lesser of, (a) where the plaintiff has subsequently acquired or disposed of the specified securities, the plaintiff's actual loss, calculated taking into account any hedging or other risk limitation transactions undertaken by the plaintiff, and (b) a loss amount calculated on the basis of the difference between the price paid or received by the plaintiff at the time of the initial transaction in which the plaintiff acquired or disposed of the specified securities in question and (i) where the specified securities trade on a published market, the market price of the specified securities on the principal market for the specified securities during the ten trading days following the public correction of the misrepresentation or the correction of the failure to make timely disclosure, or (ii) if there is no published market, then such amount as a court may deem just.	**The Toronto Stock Exchange** (28/08/98) (continued): Proposal fails to distinguish between a plaintiff who sells before and one who sells after correction (page 7).	See the comment immediately above concerning subsection 4(1).
4 (4) In an action under section 2 in respect of a misrepresentation or a failure to make timely disclosure, no amount shall be recoverable for any loss or damage that the defendant proves was not caused by the misrepresentation or the failure to make timely disclosure.	**Goodman Phillips & Vineberg** (26/08/98) (page 7): Proposal shifts burden of proving "causation" to the defendant; the burden rests on the plaintiff under 10b-5 (citing Huddleston).	The provision parallels, as intended, securities legislation governing liability for misrepresentations in a prospectus. The Proposal is fundamentally different than Rule 10b-5. The former is a specific and comprehensive code whereas the latter is a general anti-fraud rule which leaves to determination by the courts matters such as the elements of the cause of action and apportionment of damages. The Proposal attempts to strike a fair balance between the interests of responsible issuers and plaintiffs. The plaintiff is not required to prove that a misrepresentation or failure to file caused him damage. It is assumed from the element of materiality inherent in the definition of "misrepresentation" and in the requirement to file a material change report that the misrepresentation or failure to file would be expected to affect the price at which the plaintiff purchases or sells the security. However subsection 4(3) excludes liability for

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		any portion of the plaintiff's damages which do not represent a change in value of the security resulting from the misrepresentation or failure to file.
4 (4) (continued)	**Canadian Bankers Association** (21/09/98): (page 6): The Proposal "goes too far by relieving the Plaintiff of the burden of proving... any cause or factors" -- "low pleading threshold will encourage ...strike suits...".	See the CSA response to similar comments by Davies, Ward & Beck in connection with section 2, above. The CSA have amended the Proposal to require that a plaintiff obtain leave of the court before commencing an action, which leave will only be granted if there is evidence of good faith and the plaintiff has a reasonable chance of success.
4 (5) The total liability of a person or company in an action under section 2 in respect of a misrepresentation or a failure to make timely disclosure in respect of, (a) a responsible issuer, shall not exceed the greater of (i) 5% of its market capitalization, and (ii) $1 million, (b) each director or officer of a responsible issuer, shall not exceed the greater of (i) $25 000, and (ii) 50% of the aggregate of the director's or officer's total compensation from the responsible issuer and its affiliates, (c) an influential person, where the influential person is not an individual, shall not exceed the greater of (i) 5% of its market capitalization, and (ii) $1 million, (d) an influential person where the influential person is an individual, shall not exceed the greater of (i) $25 000, and (ii) 50% of the aggregate of the influential person's total compensation from the responsible issuer and its affiliates, (e) each director or officer of an influential person, shall not exceed the greater of (i) $25 000, and (ii) 50% of the aggregate of the director's or officer's total compensation from the influential person and its affiliates,	**The Fraser Institute: Law and Markets Project** (28/08/98): The proposed caps on damages will penalize "Canada's largest and arguably most successful companies" (page 39).	The CSA do not propose to modify the damage caps. The CSA remain of the view that damage exposure must, if the system is to have deterrent value be sufficient to make it worthwhile for a plaintiff to undertake an action but, on the other hand, reflect an issuer's ability to pay and recognize that it is the non-plaintiff shareholders who ultimately bear the economic burden of providing compensation. In this context, the CSA have amended the legislation to introduce a "gatekeeper" mechanism (section 7) and a requirement to seek court approval for settlements (section 9). The CSA believe that these procedural safeguards coupled with the "loser pay" cost provision (section 10) and the provision apportioning liability among defendants (section 5) included in the 1998 Draft Legislation will reduce the risk of strike suits.

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(f) an expert, shall not exceed the greater of (i) $1 million, and (ii) the revenue that the expert and its affiliates have earned from the responsible issuer and its affiliates during the twelve months preceding the misrepresentation, and (g) each person, other than a person or company under subsections 4(5)(a), (b), (c), (d), (e) or (f), who made a public oral statement where the person is an individual, shall not exceed the greater of (i) $25 000, and (ii) 50% of the aggregate of each person's total compensation from the responsible issuer and its affiliates; unless, in the case of a person or company other than the responsible issuer, the plaintiff proves that the person or company 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 a failure to make timely disclosure.		
4 (5) (continued)	**Goodman Phillips & Vineberg** (26/08/98) (page 10): "By linking the limits on total liability of individual defendants to their compensation, the Proposal will lead to the anomalous result that an individual [with]... the greatest responsibility for the misleading disclosure could pay less in damages than a less 'culpable' individual who happens to be better compensated". Similar result for corporate defendants with differing capitalization. Multiple categories of defendants, defences and documents: "Proposal is unduly complex". The effectiveness of the Proposal hinges on class actions, not available across Canada.	This result follows from the emphasis on deterrence rather than full compensation. No change is proposed. See the CSA response to a similar comment raised by The Fraser Institute above Difficult to further simplify categories of defendant. Class actions are not a prerequisite of the Proposal. It should be noted, however, that B.C. class proceeding legislation permits the inclusion of plaintiffs that reside outside B.C. on an "opt-in" basis as a sub-class. Moreover, Ontario courts have recently decided that the absence of an explicit mention of foreign plaintiffs in the Ontario class proceeding

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		legislation does not preclude their participation under that statute unless they specifically "opt out" (see, *Carom v. Bre-X Minerals Ltd.*, 43 O.R. (3d) 441).
4 (5) (continued)	**McCarthy Tétrault** (28/08/98): "The Proposal is unfair to large cap issuers with significant share equity" (page 2). "The gate keeping of provincial securities administrators should not be altered" by supplementing regulatory oversight with private enforcement (page 9). There is little reason to believe that Canadians are truly less litigious than their American brethren. It is more likely that our system of justice has simply not allowed... the ... approach taken in the United States. This may be changing..." (page 11).	See the CSA response to a similar comment raised by The Fraser Institute above. The CSA view a so-called "gatekeeping role" as an important element of the role of a court in assessing any motion to dismiss an action before it, or in considering a motion to join plaintiffs or to certify a class action. The CSA do not consider that it would be appropriate for a securities regulatory authority to be obligated, in essence, to intervene in and possibly terminate an action before it reaches the courts. Securities regulatory authorities would, however, be notified of actions and entitled to intervene where such intervention would be in the public interest.
4(5)	[No public comment]	The CSA have clarified in the Proposal that the proposed caps on damages are aggregate amounts that apply to all actions commenced across Canada. Specifically, the amount of damages a defendant must pay are reduced by the amount of any prior award made against, or settlement paid by, the defendant relating to the same misrepresentation under a similar action in any Canadian jurisdiction (see section 6 of the revised legislation).
5 (1) In an action under section 2, where damages have been caused or contributed to by the fault or neglect of two or more defendant persons or companies, the court shall determine each defendant=s responsibility for the damage or loss incurred by all plaintiffs in the action, expressed as a percentage of all defendants= responsibility, and each defendant shall be liable to the plaintiffs only for that percentage of the aggregate amount of damages awarded to the plaintiffs. **5 (2)** Despite subsection (1), if, in an action under section 2 in respect of a misrepresentation or a failure to make timely disclosure, a court determines that a particular defendant (other than the responsible issuer) authorized, permitted or acquiesced in the making of the misrepresentation or the failure to make timely disclosure while knowing it to be a misrepresentation or a failure to make timely disclosure, that defendant will be liable jointly and severally with each other defendant, other than the responsible issuer, in respect of whom the court has made a similar determination, for the aggregate amount of damages awarded in	**KPMG** (28/08/98): Because audited financial statements are the joint responsibility of auditors, directors and management, C the liability of auditors should never exceed 50%; and C directors and officers should not be able to assert as a defence reliance on the auditor. (page 8)	The CSA do not agree with the comment and do not believe that an arbitrary apportionment of liability as between auditors and others is appropriate. The recommendations would remove from the courts the decision deliberately left to them under the Proposal, a decision to be made on the basis of all relevant circumstances of a particular case.

1998 Draft Legislation	Public Comments	CSA Response
the action.		
6 Notwithstanding anything to the contrary in the *Courts of Justice Act* (Ontario) and the *Class Proceedings Act* (Ontario), the prevailing party in an action under section 2 shall be entitled to costs determined by a court in accordance with applicable rules of civil procedure.	**Canadian Bankers Association** (21/09/98): (page 6): The CBA supports the Proposal but calls for its extension to existing prospectus liability provisions.	The CSA may consider this comment separately from this Proposal.

Appendix B
Summary of Comments Received on the
Request for Comments
Proposed Changes to the
Definitions of "Material Fact" and "Material Change"

Certain members of the Canadian Securities Administrators (the "CSA") published for comment proposed changes to the definitions of "material fact" and "material change". The amended definitions were first published for comment in November 1997[1] (the "Request for Comment") and did not form a part of the recommendations contained in the Allen Committee's Final Report.[2] The CSA received the following 7 submissions in response to this Request for Comment:

1. Securities Advisory Committee (Ontario) by letter dated December 4, 1997.
2. Canadian Bankers Association by letter dated December 17, 1997.
3. Osler, Hoskin & Harcourt (Corporate Department) by letter dated December 19, 1997.
4. Phillip Anisman on behalf of The Toronto Stock Exchange by letter dated December 22, 1997.
5. McCarthy Tétrault by letter dated December 29, 1997.
6. CBAO Securities Law Sub-Committee of the Business Law Section by letter dated January 23, 1998 (subsequent submission dated April 19, 1998).
7. Aur Resources Inc. by letter dated January 27, 1998.

At the time the 1998 Draft Legislation was being published the CSA were still considering the comments received on the proposed amended definitions and a final decision had not been made to recommend to our respective governments that the definitions be revised as proposed. In the meantime, a decision was made to reflect the proposed revised definitions in the 1998 Draft Legislation and publish the entire package for comment.

The CSA thank all the commenters for providing their comments. The comments provided in these submissions have been considered by the CSA. However, as the CSA do not propose at this time to proceed with the amendments to these two definitions as published in the 1998 Draft Legislation (other than the changes noted previously in the CSA Report), the CSA is only providing a summary of the comments received without a specific response to each of these comments. The summary has been organized by topic. In this context, it should be noted that the CSA received a number of drafting comments on the proposed definitions which have not been specifically included in this summary.

A. Single and Uniform Materiality Standard

Four commenters supported the proposed changes in principle and agreed that a single and uniform standard of materiality for all purposes under securities laws would be desirable. However, one commenter noted that this cannot be accomplished merely by changing the two definitions addressed in the Request for Comments, as Canadian securities laws contain requirements reflecting materiality standards not based on the definitions of "material fact" and "material change".[3] It was the commenter's view that a change in the standard of materiality must address all of the materiality standards in Canadian securities laws to avoid creating unintended ambiguities. The commenter's support of the proposed changes was premised on the assumption that the consequential amendments necessary to ensure a single standard of materiality for all purposes would be made to the securities acts, regulations, rules and policies of each province when the new definitions are enacted. If the review necessary to ensure a consistent standard of materiality throughout Canada could not be accomplished within the CSA's time frame for implementation of the Allen Report's civil liability regime, the commenter noted that it would be preferable to amend the definition of "material fact" only to remove its retroactive element when the civil liability regime is enacted and defer the remaining changes to a later date.

B. Effect of Proposed Reasonable Investor Standard

Commenters were divided as to the likely impact on disclosure obligations if the CSA moved from a market impact standard of materiality to a reasonable investor standard.

One commenter expressed concern that the proposed definitions will make determining whether a material change or material fact has occurred very difficult and will make the threshold more subjective. In this context, the commenter suggested that the

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1 In Ontario, Request for Comments #51-901, (1997) 20 OSCB 5751.

2 With the exception of one aspect of the proposed change to the definition of "material fact" to remove the retroactive aspect of the current definition which was recommended by the Allen Committee.

3 For example, the commenter noted that in contrast to the proposed definitions, a takeover bid circular describes matters, in addition to material facts, which "would reasonably be expected to affect the decision" of the offeree security holders with respect to the bid. In addition, concepts of materiality are often used to require disclosure of events, transactions and contracts in a statutory context in which the current definition of "material facts" does not apply (common instances are in the forms specifying disclosure under securities legislation).

implementation of the new materiality/disclosure standard be delayed until Canadian capital markets adjust to the implementation of the limited statutory civil liability regime for continuous disclosure.

One commenter was of the view that the disclosure obligations imposed by the current definitions and those proposed would not differ in practice in most cases. In this context, the commenter noted that a perceived impact of information on share prices invariably influences and is influenced by its importance to investors. Information that is significant to investors will almost always be likely to affect the market price of an issuer's securities (except with respect to mutual funds). In the commenter's view, it is difficult to envisage circumstances in which a fact that would not be likely to affect the market price would be material under the proposed standard. If the CSA intends the new standard to encompass facts that do not have financial consequences for issuers and their securities, the commenter suggested that the CSA define such circumstances and the intended purpose of including them, and in doing so, should proceed with caution. If the proposed changes are enacted, the commenter suggested that an interpretive policy be published addressing the practical implications of the new standard for issuers.

Finally, one commenter expressed doubt about whether the adoption of an "investment decision" standard would advance things much. The commenter noted that while *Basic Inc. v. Levinson* extended the *TSC Industries* standard of materiality in the U.S. from voting decisions to timely disclosure obligations, ultimately, the essential test is whether the information in question would likely be price sensitive. The commenter argued that the price impact test is the true test in the United States, at least for disclosure purposes and insider trading purposes. Therefore, the commenter cautioned against a change in Canada that would obfuscate the likely meaning to be given to such language in the courts. The commenter noted that the preferred route would be to remove the *ex post facto* test and apply a test based on the current approach which focuses on expected price impact.

C. Scope of proposed materiality standard

Commenters were divided as to whether the proposed materiality standard should be applied to all disclosure obligations and to insider trading.

Offering Documents

One commenter expressed the view that the proposed definitions are appropriate for offering documents, such as prospectuses, offering memoranda, take-over bid circulars and directors circulars.

Conversely, another commenter expressed concern that amending the definition of "material fact" could result in extremely lengthy prospectus documents disclosing facts which would be material to a wide spectrum of reasonable investors in making an investment decision. To the extent that the CSA is concerned that the length of prospectuses is not conducive to allowing investors to make reasoned investment decisions, the proposed amendments could further serve to exacerbate the situation.

Proxy Circulars

Two commenters recommended that the materiality standard not apply to information in a management information circular ("proxy circular"). In this context, one of the commenters expressed concern that applying the proposed standard misconstrues the purpose of the proxy circular, which is to provide all relevant information to investors in order for them to be able to make a reasoned decision about the matters to be submitted to the meeting. The commenter was concerned that the proposed materiality standard will cause the information to extend beyond information about a proposal to information as to the likelihood of success of the proposal (which would be of primary concern to some market participants).

One commenter believed that the proposed standard must be applied to proxy circulars, as documents used by a corporation for one purpose may be used by investors for another. For example, a proxy circular issued in connection with an amalgamation may influence investment decisions and the information in the circular will likely affect the price of the issuer's securities. A misrepresentation in the circular would affect the validity of the shareholders' meeting and could give rise to civil liability. The materiality standard should be the same for both purposes. However, in other contexts, a misrepresentation that affects the validity of a meeting or specific resolution may not be likely to influence an investment decision but rather may affect a voting decision (for example, information with respect to a nominee to the board of directors). The proposed standard of materiality must be applied in the context of the decision to which it relates. To make it clear that this is the intended approach, the definition of "material fact" should provide that the standard inherent in the definition is to be applied in the relevant circumstances.

Insider Information

One commenter believes that the proposed standard is appropriate for the purpose of preventing insiders from buying or selling securities if they have knowledge of a material fact or material change that has not been generally disclosed. The commenter believes that the proposed standard should simplify the decision about whether disclosure is required because there is no longer a requirement to focus on market reactions. Further, if the proposed definitions lower the threshold and more information is disclosed, the possibility of inadvertent trading on non-disclosed information should be reduced.

Conversely one commenter was of the view that the move from a market standard to a reasonable investor standard, as proposed, could potentially be problematic when applied to insider trading provisions. For example, it was in the commenter's

view, a questionable proposition as to whether someone should be prohibited from trading with knowledge of undisclosed information which would not affect the market price of the securities.

Continuous Disclosure

One commenter expressed the view that the current "move the market" test is inappropriate for continuous disclosure obligations. The commenter believes that it forces a consideration of the operations of the market and for some issuers, a difficult admission of the potentially negative effect of adverse developments, both of which may result in decisions about disclosure that are inconsistent with an investor's interest in the information. The commenter believes that some issuers are reluctant to make the decision to disclose potentially adverse information as this is tantamount to a determination by the issuer that the information negatively affects shareholder value. The proposed new definition of "material change" will result in less stigma associated with determining that a material change has occurred in the business of a reporting issuer.

D. "Total mix" concept

One commenter questioned whether the new materiality standard incorporated the "total mix concept.[4] Under that concept, there is no liability under U.S. securities laws because of an alleged failure to disclose information that is already available to the public and therefore is part of the "total mix" of available information. The commenter felt that the standard would have to presume that a reasonable investor would not consider an omitted fact or change important if the information was already in the market from other sources. However, this presumption requires the recognition of the efficient market theory by our courts which has not been done yet. The commenter suggested that the "total mix" concept be expressly included in the civil liability section as a defence.

E. Timely Disclosure Obligations

One commenter provided comments directed at extending the timely disclosure obligations to both "material facts" and "material changes" (i.e. to "material information" generally).[5] The commenter did not object to expanding the reporting obligations to "material facts", but noted that there would also have to be an expansion of the confidential material change report filing procedure because, in the commenter's view, the provision is too narrow.

F. Loser-Pay Costs Rules

One commenter recommended that in order to protect issuers from meritless claims, a "loser-pays" cost rule should be adopted by British Columbia and uniform rules for securities class action litigation should be included in the legislation across the country. The commenter also expressed concern that the "loser-pays" rules would not deter all meritless claims and that additional protection is required to ensure that issuers are not subject to "strike suits".

[4] The U.S. court in *TSC Industries, Inc v. Northway Inc*. ("*TSC Industries*") stated that the issue of materiality turned on whether there is "substantial likelihood that the disclosure of the omitted fact would have been viewed by the reasonable investor as having significantly altered the 'total mix' of information available.

[5] Although the interim report of the Allen Committee included this recommendation, the final report of the Allen Committee is silent on this issue.

Appendix C
CIVIL LIABILITY FOR SECONDARY MARKET DISCLOSURE

INTERPRETATION

Delete and substitute the following definitions in s.1(1) of the Act

"material change"

(a) when used in relation to an issuer other than an investment fund, means,

(i) a change in the business, operations or capital of the issuer that would reasonably be expected to have a significant effect on the market price or value of any of the securities of the issuer, or

(ii) a decision to implement a change referred to in subparagraph (i) made by the board of directors or other persons acting in a similar capacity or by senior management of the issuer who believe that confirmation of the decision by the board of directors or such other persons acting in a similar capacity is probable, and

(b) when used in relation to an issuer that is an investment fund, means,

(i) a change in the business, operations or affairs of the issuer that would be considered important by a reasonable investor in determining whether to purchase or continue to hold securities of the issuer, or

(ii) a decision to implement a change referred to in subparagraph (i) made,

(A) by the board of directors of the issuer or the board of directors of the investment fund manager of the issuer or other persons acting in a similar capacity,

(B) by senior management of the issuer who believe that confirmation of the decision by the board of directors or such other persons acting in a similar capacity is probable, or

(C) by senior management of the investment fund manager of the issuer who believe that confirmation of the decision by the board of directors of the investment fund manager of the issuer or such other persons acting in a similar capacity is probable;

"material fact", when used in relation to securities issued or proposed to be issued, means a fact that would reasonably be expected to have a significant effect on the market price or value of the securities;

"mutual fund" includes,

(a) an issuer,

(i) whose primary purpose is to invest money provided by its securityholders, and

(ii) whose securities entitle the holder to receive on demand, or within a specified period after demand, an amount computed by reference to the value of a proportionate interest in the whole or in part of the net assets, including a separate fund or trust account, of the issuer, or

(b) an issuer or a class of issuers that is designated as a mutual fund by an order of the Commission in the case of a single issuer or otherwise in a regulation which is made for the purposes of this definition,

but does not include,

(c) an issuer or a class of issuers that is designated not to be a mutual fund by an order of the Commission in the case of a single issuer or otherwise in a regulation which is made for the purposes of this definition.

Add the following definitions to s. 1(1) of the Act

"investment fund" means,

(a) a mutual fund, or

(b) a non-redeemable investment fund;

"investment fund manager" means a person or company who has the power and exercises the responsibility to direct the affairs of an investment fund;

"non-redeemable investment fund" includes,

(a) an issuer,

(i) whose primary purpose is to invest money provided by its security holders,

(ii) that does not invest for the purpose of exercising or seeking to exercise control of an issuer or for the purpose of being actively involved in the management of the issuers in which it invests, other than other mutual funds or non-redeemable investment funds, and

(iii) that is not a mutual fund, or

(b) an issuer or a class of issuers that is designated as a non-redeemable investment fund by an order of the Commission, in the case of a single issuer, or otherwise in a regulation which is made for the purposes of this definition,

but does not include,

(c) an issuer or a class of issuers that is designated not to be a non-redeemable investment fund by an order of the Commission, in the case of a single issuer, or otherwise in a regulation which is made for the purposes of this definition.

Delete and substitute the following section 75 of the Act

75 (1) Subject to subsection (3), where a material change occurs in the affairs of a reporting issuer, it shall promptly issue and file a news release authorized by a senior officer disclosing the nature and substance of the change.

(2) Subject to subsection (3), the reporting issuer shall file a report of such material change in accordance with the regulations as soon as practicable and in any event within ten days of the date on which the change occurs.

(3) Where,

(a) in the opinion of the reporting issuer, provided that such opinion is arrived at in a reasonable manner, the disclosure required by subsection (2) would be unduly detrimental to the interests of the reporting issuer; or

(b) the material change consists of a decision to implement a change made by senior management of the issuer who believe that confirmation of the decision by the board of directors is probable and senior management of the issuer has no reason to believe that person with knowledge of the material change have made use of such knowledge in purchasing or selling securities of the issuer, the reporting issuer may, in lieu of compliance with subsection (1), forthwith file with the Commission the report required under subsection (2) marked so as to indicate that it is confidential, together with written reasons for non-disclosure.

(4) Where a report has been filed with the Commission under subsection (3), the reporting issuer shall advise the Commissioner in writing where it believes the report should continue to remain confidential within ten days of the date of filing of the initial report and every ten days thereafter until the material change is generally disclosed in the manner referred to in subsection (1) or, if the material change consists of a decision of the type referred to in clause (3)(b), until that decision has been rejected by the board of directors of the issuer.

(5) Notwithstanding a report has been filed with the Commission under subsection (3), the reporting issuer shall promptly generally disclose the material change in the manner referred to in subsection (1) upon the reporting issuer becoming aware or having reasonable grounds to believe that persons or companies are purchasing or selling securities of the reporting issuer with knowledge of the material change that has not been generally disclosed.

Add the following clauses to subsection 143(1) of Part XXIV of the Act

143.(1) Rules. - The Commission may make rules in respect of the following matters:

57. Prescribing exemptions from the prospectus requirement under this Act for the purposes of clause (b), take-over bids and issuer bids for the purposes of clause (c) and transactions or classes of transactions for the purposes of clause (d) of subsection 1(2) of PART I (Civil Liability for Secondary Market Disclosure) of this Act.

58. Prescribing documents for the purposes of the definition of "core document" in PART I (Civil Liability for Secondary Market Disclosure) of this Act.

59. Prescribing the meaning of “market capitalization”, “trading price” and “principal market” and such other defined terms as are used in Part I (Civil Liability for Secondary Market Disclosure) and are not otherwise defined in this Act.

PART I

CIVIL LIABILITY FOR SECONDARY MARKET DISCLOSURE

1(1). Definitions. - In this Part,

"compensation" means compensation received during the 12 month period immediately preceding the day on which the misrepresentation was made or on which the failure to make timely disclosure first occurred, together with the fair market value of all deferred compensation including, without limitation, options, pension benefits and stock appreciation rights, granted during the same period, valued as of the date that such compensation is awarded;

"control person" means,

(a) a person or company who holds a sufficient number of the voting rights attached to all outstanding voting securities of an issuer, or

(b) each person or company in a combination of persons or companies, acting in concert by virtue of an agreement, arrangement, commitment or understanding, which holds in total a sufficient number of the voting rights attached to all outstanding voting securities of an issuer,

to affect materially the control of the issuer, and, where a person or company, or combination of persons or companies, holds more than twenty per cent of the voting rights attached to all outstanding voting securities of an issuer, the person or company, or combination of persons or companies, shall, in the absence of evidence to the contrary, be deemed to hold a sufficient number of the voting rights to affect materially the control of the issuer;

"core document" means,

(a) where used in relation to,

(i) a director of a responsible issuer who is not also an officer of the responsible issuer,

(ii) an influential person, other than an officer of the responsible issuer or an investment fund manager where the responsible issuer is an investment fund, or

(iii) a director or officer of an influential person, other than an officer of an investment fund manager, who is not also an officer of the responsible issuer, a prospectus, a take-over bid circular, an issuer bid circular, a directors' circular, a rights offering circular, MD&A, an annual information form, an information circular, and annual financial statements of the responsible issuer, or

(b) where used in relation to,

(i) an officer of a responsible issuer,

(ii) an investment fund manager where the responsible issuer is an investment fund, or

(iii) an officer of an investment fund manager where the responsible issuer is an investment fund, a prospectus, a take-over bid circular, an issuer bid circular, a directors' circular, a rights offering circular, MD&A, an annual information form, an information circular, annual financial statements, interim financial statements, and a report required under subsection 75(2) of this Act, of the responsible issuer, and

(c) such other documents as may be prescribed by regulation for the purposes of this definition;

"derivative security" means, in respect of a responsible issuer, a security,

(a) the market price or value of which, or payment obligations under which, are derived from or based on a security of the responsible issuer, and

(b) which is created by a person or company on behalf of the responsible issuer or is guaranteed by the responsible issuer;

"document" means any written communication, including a communication prepared and transmitted only in electronic form, that is,

(a) required to be filed with the Commission,

(b) other than a communication referred to in clause (a),

(i) filed with the Commission,

(ii) filed or required to be filed with a government or an agency of a government under applicable securities or corporate law or with any stock exchange or quotation and trade reporting system under its by-laws, rules, or regulations, or

(iii) any other communication the content of which would reasonably be expected to affect the market price or value of a security of the responsible issuer;

"expert" means a person or company whose profession gives authority to a statement made in a professional capacity by the person or company including, without limitation, an accountant, actuary, appraiser, auditor, engineer, financial analyst, geologist and lawyer;

"failure to make timely disclosure" means a failure to disclose a material change in the manner and when required under this Act;

"forward-looking information" means all disclosure regarding possible events, conditions or results including future oriented financial information with respect to prospective results of operations, financial position or changes in financial position, based on assumptions about future economic conditions and courses of action, and presented as either a forecast or a projection;

"influential person" means, in respect of a responsible issuer,

(a) a control person,

(b) a promoter,

(c) an insider, other than a director or senior officer of the responsible issuer, or

(d) an investment fund manager if the responsible issuer is an investment fund;

"issuer's security" means a security of the responsible issuer and includes, without limitation, a derivative security;

"liability limit" means, in the case of

(a) a responsible issuer, the greater of

(i) 5% of its market capitalization (as such term is defined in the regulations), and

(ii) $1 million,

(b) a director or officer of a responsible issuer, the greater of

(i) $25,000, and

(ii) 50% of the aggregate of the director's or officer's compensation from the responsible issuer and its affiliates,

(c) an influential person that is not an individual, the greater of

(i) 5% of its market capitalization (as such term is defined in the regulations), and

(ii) $1 million,

(d) an influential person who is an individual, the greater of

(i) $25,000, and

(ii) 50% of the aggregate of the influential person's compensation from the responsible issuer and its affiliates,

(e) a director or officer of an influential person, the greater of

(i) $25,000, and

(ii) 50% of the aggregate of the director's or officer's compensation from the influential person and its affiliates,

(f) an expert, the greater of

(i) $1 million, and

(ii) the revenue that the expert and its affiliates have earned from the responsible issuer and its affiliates during the twelve months preceding the misrepresentation,

(g) each person or company who made a public oral statement, other than an individual under clauses (a), (b), (c), (d), (e) or (f), the greater of

(i) $25,000, and

(ii) 50% of the aggregate of the person or company's compensation from the responsible issuer and its affiliates;

"MD&A" means the section of an annual information form, annual report or other document that contains management's discussion and analysis of the financial condition and results of operations of a responsible issuer as required under Ontario securities law;

"public oral statement" means an oral statement made in circumstances in which a reasonable person would believe that information contained in the statement will become generally disclosed;

"release" means,

(i) to file with the Commission or any other securities regulatory authority in Canada or a stock exchange, or

(ii) to otherwise make available to the public;

"responsible issuer" means,

(i) a reporting issuer, or

(ii) any other issuer with a substantial connection to Ontario any securities of which are publicly traded; and

"trading day" means a day during which the principal market (as such term is defined in the regulations) for the security is open for trading.

1(2). Application. - This Part does not apply to,

(a) the acquisition of an issuer's security under a prospectus;

(b) the acquisition of an issuer's security pursuant to an exemption from sections 53 or 62 of this Act, except as may be prescribed by regulation;

(c) the acquisition or disposition of an issuer's security in connection with or pursuant to a take-over bid or issuer bid, except as may be prescribed by regulation; or

(d) such other transactions or class of transactions as may be prescribed by regulation.

2. Liability for Secondary Market Disclosure

Documents Released by Responsible Issuer

(1) Where a responsible issuer or a person or company with actual, implied or apparent authority to act on behalf of a responsible issuer releases a document that contains a misrepresentation, a person or company who acquires or disposes of an issuer's security during the period between the time when the document was released and the time when the misrepresentation contained in the document was publicly corrected has, without regard to whether the person or company relied on the misrepresentation, a right of action for damages against,

(a) the responsible issuer;

(b) each director of the responsible issuer at the time the document was released;

(c) each officer of the responsible issuer who authorized, permitted or acquiesced in the release of the document;

(d) each influential person, and each director and officer of an influential person, who knowingly influenced,

(i) the responsible issuer or any person or company on behalf of the responsible issuer to release the document, or

(ii) a director or officer of the responsible issuer to authorize, permit or acquiesce in the release of the document; and

(e) each expert where,

(i) the misrepresentation is also contained in a report, statement or opinion made by the expert,

(ii) the document includes, summarizes or quotes from the report, statement or opinion of the expert, and

(iii) if the document was released by a person or company other than the expert, the expert consented in writing to the use of the report, statement or opinion in the document.

Public Oral Statements by Responsible Issuer

(2) Where a person with actual, implied or apparent authority to speak on behalf of a responsible issuer makes a public oral statement that relates to the business or affairs of the responsible issuer and that contains a misrepresentation, a person or company who acquires or disposes of an issuer's security during the period between the time when the public oral statement was made and the time when the misrepresentation contained in the public oral statement was publicly corrected has, without regard to whether the person or company relied on the misrepresentation, a right of action for damages against,

(a) the responsible issuer;

(b) the person who made the public oral statement;

(c) each director and officer of the responsible issuer who authorized, permitted or acquiesced in the making of the public oral statement;

(d) each influential person, and each director and officer of the influential person, who knowingly influenced,

(i) the person who made the public oral statement to make the public oral statement, or

(ii) a director or officer of the responsible issuer to authorize, permit or acquiesce in the making of the public oral statement; and

(e) each expert where,

(i) the misrepresentation is also contained in a report, statement or opinion made by the expert,

(ii) the person making the public oral statement includes, summarizes or quotes from the report, statement or opinion of the expert, and

(iii) if the public oral statement was made by a person other than the expert, the expert consented in writing to the use of the report, statement or opinion in the public oral statement.

Documents or Public Oral Statements by Influential Persons

(3) Where an influential person or a person or company with actual, implied or apparent authority to act on behalf of the influential person releases a document or makes a public oral statement that relates to a responsible issuer and that contains a misrepresentation, a person or company who acquires or disposes of an issuer's security during the period between the time when the document was released or the public oral statement was made and the time when the misrepresentation contained in the document or public oral statement was publicly corrected has, without regard to whether the person or company relied on the misrepresentation, a right of action for damages against,

(a) the responsible issuer, if a director or officer of the responsible issuer, or where the responsible issuer is an investment fund, the investment fund manager, authorized, permitted or acquiesced in the release of the document or the making of the public oral statement;

(b) the person who made the public oral statement;

(c) each director and officer of the responsible issuer who authorized, permitted or acquiesced in the release of the document or the making of the public oral statement;

(d) the influential person;

(e) each director and officer of the influential person who authorized, permitted or acquiesced in the release of the document or the making of the public oral statement; and

(f) each expert where,

(i) the misrepresentation is also contained in a report, statement or opinion made by the expert,

(ii) the document or public oral statement includes, summarizes or quotes from the report, statement or opinion of the expert, and

(iii) if the document was released or the public oral statement was made by a person other than the expert, the expert consented in writing to the use of the report, statement or opinion in the document or public oral statement.

Failure to Make Timely Disclosure

(4) Where there is a failure to make timely disclosure by a responsible issuer, a person or company who acquires or disposes of an issuer's security between the time when the material change was required to be disclosed and the subsequent disclosure of the material change in the manner required under this Act has, without regard to whether the person or company relied on the responsible issuer having complied with its disclosure requirements, a right of action for damages against,

(a) the responsible issuer;

(b) each director and officer of the responsible issuer who authorized, permitted or acquiesced in the failure to make timely disclosure; and

(c) each influential person, and each director and officer of an influential person, who knowingly influenced,

(i) the responsible issuer or any person or company acting on behalf of the responsible issuer in the failure to make timely disclosure, or

(ii) a director or officer of the responsible issuer to authorize, permit or acquiesce in the failure to make timely disclosure.

Multiple Roles

(5) In an action under this section, a person that is a director or officer of an influential person is not liable in that capacity if the person is liable in their capacity as a director or officer of the responsible issuer.

Multiple Misrepresentations

(6) In an action under this section,

(a) multiple misrepresentations having common subject matter or content may, in the discretion of the court, be treated as a single misrepresentation; and

(b) multiple instances of failure to make timely disclosure of a material change or material changes concerning common subject matter may, in the discretion of the court, be treated as a single failure to make timely disclosure.

No Implied or Actual Authority

(7) In an action under subsection (2) or subsection (3), if the person that made the public oral statement had apparent, but not implied or actual, authority to speak on behalf of the issuer, no other person is liable with respect to any of the responsible issuer's securities acquired or disposed of before that person became, or should reasonably have become, aware of the misrepresentation.

3. Burdens of Proof and Defences

Standard for Non-Core Documents and Public Oral Statements

(1) In an action under section 2 in relation to a misrepresentation in a document that is not a core document, or a misrepresentation in a public oral statement, no person or company is liable, subject to subsection (2), unless the plaintiff proves that the person or company,

(a) knew, at the time that the document was released or public oral statement was made, that the document or public oral statement contained the misrepresentation;

(b) at or before the time that the document was released or public oral statement was made, deliberately avoided acquiring knowledge that the document or public oral

(c) was, through action or failure to act, guilty of gross misconduct in connection with the release of the document or the making of the public oral statement that contained the misrepresentation.

(2) A plaintiff is not required to prove any of the matters set out in subsection (1) in an action under section 2 in relation to an expert.

Standard for Failure to Make Timely Disclosure

(3) In an action under section 2 in relation to a failure to make timely disclosure, no person or company is liable, subject to subsection (4), unless the plaintiff proves that the person or company,

(a) knew, at the time that the failure to make timely disclosure first occurred, of the change and that the change was a material change;

(b) at the time of or before the failure to make timely disclosure first occurred, deliberately avoided acquiring knowledge of the change or that the change was a material change; or

(c) was, through action or failure to act, guilty of gross misconduct in connection with the failure to make timely disclosure.

(4) A plaintiff is not required to prove any of the matters set out in subsection (3) in an action under section 2 in relation to,

(a) a responsible issuer;

(b) an officer of a responsible issuer;

(c) an investment fund manager; or

(d) an officer of an investment fund manager.

Knowledge of the Misrepresentation or Material Change

(5) No person or company is liable in an action under section 2 in relation to misrepresentation or a failure to make timely disclosure if that person or company proves that the plaintiff acquired or disposed of the issuer's security with knowledge,

(a) that the document or public oral statement contained a misrepresentation; or

(b) of the material change.

Reasonable Investigation

(6) No person or company is liable in an action under section 2 in relation to

(a) a misrepresentation if that person or company proves that,

(i) before the release of the document or the making of the public oral statement containing the misrepresentation, the person or company conducted or caused to be conducted a reasonable investigation, and

(ii) at the time of the release of the document or the making of the public oral statement, the person or company had no reasonable grounds to believe that the document or public oral statement contained the misrepresentation; or

(b) a failure to make timely disclosure if that person or company proves that,

(i) before the failure to make timely disclosure first occurred, the person or company conducted or caused to be conducted a reasonable investigation, and

(ii) the person or company had no reasonable grounds to believe that the failure to make timely disclosure would occur.

Factors to be Considered

(7) In determining whether an investigation was reasonable under subsection (6), or whether any person or company is guilty of

gross misconduct under subsection (1) or (3), the court shall consider all relevant circumstances, including,

(a) the nature of the responsible issuer;

(b) the knowledge, experience and function of the person or company;

(c) the office held if the person was an officer;

(d) the presence or absence of another relationship with the responsible issuer if the person was a director;

(e) the existence, if any, and the nature of any system to ensure that the responsible issuer meets its continuous disclosure obligations;

(f) the reasonableness of reliance by the person or company on the responsible issuer's disclosure compliance system and on the responsible issuer's officers, employees and others whose duties would in the ordinary course have given them knowledge of the relevant facts;

(g) the time period within which disclosure was required to be made under applicable law;

(h) in respect of a report, statement or opinion of an expert, any professional standards applicable to the expert;

(i) the extent to which the person or company knew, or should reasonably have known, the content and medium of dissemination of the document or public oral statement;

(j) in the case of a misrepresentation, the role and responsibility of the person or company in the preparation and release of the document or the making of the public oral statement containing the misrepresentation or the ascertaining of the facts contained in that document or public oral statement; and

(k) in the case of a failure to make timely disclosure, the role and responsibility of the person or company involved in a decision not to disclose the material change.

Confidential Disclosure

(8) No person or company is liable in an action under section 2 in respect of a failure to make timely disclosure if,

(a) the person or company proves that the material change was disclosed by the responsible issuer in a report filed on a confidential basis with the Commission under subsection 75(3) of this Act;

(b) the responsible issuer had a reasonable basis for making the disclosure on a confidential basis;

(c) if the information contained in the report filed on a confidential basis remains material, disclosure of the material change was made public promptly when the basis for confidentiality ceased to exist;

(d) the person or company or responsible issuer did not release a document or make a public oral statement that, due to the undisclosed material change, contained a misrepresentation, and

(e) if the material change became publicly known in a manner other than as required under this Act, the responsible issuer promptly disclosed the material change in the manner required under this Act.

Forward-Looking Information

(9) No person or company is liable in an action under section 2 for a misrepresentation in forward-looking information if the person or company proves that,

(a) the document or public oral statement containing the forward-looking information contained, proximate to the forward-looking information,

(i) reasonable cautionary language identifying the forward-looking information as such and identifying material factors that could cause actual results to differ materially from a forecast or projection in the forward-looking information, and

(ii) a statement of the material factors or assumptions that were applied in making a forecast or projection in the forward-looking information; and

(b) the person or company had a reasonable basis for making the forecasts or projections in the forward-looking information.

(10) Subsection 3(9) does not apply to a person or company in respect of forward-looking information contained in the prospectus of the responsible issuer filed in connection with the initial public distribution of securities of the responsible issuer or contained in financial statements prepared by the responsible issuer.

Expert Report, Statement or Opinion

(11) No person or company, other than an expert, is liable in an action under section 2 with respect to any part of a document or public oral statement that includes, summarizes or quotes from a report, statement or opinion made by the expert in respect of which the written consent of the expert to the use of the report, statement or opinion was obtained by the responsible issuer and that consent had not been withdrawn in writing prior to the release of the document, or the making of the public oral statement, if the person or company proves that,

(a) the person or company did not know and had no reasonable grounds to believe that there had been a misrepresentation in the part of the document or public oral statement made on the authority of the expert; and

(b) the part of the document or public oral statement fairly represented the report, statement or opinion made by the expert.

(12) No expert is liable in an action under section 2 with respect to any part of a document or public oral statement that includes, summarizes or quotes from a report, statement or opinion made by the expert, if the expert proves that, the written consent previously provided was withdrawn in writing before the release of the document or making of the public oral statement.

Release of Documents

(13) No person or company is liable in an action under section 2 in respect of a misrepresentation in a document, other than a document required to be filed with the Commission, if the person or company proves that, at the time of release of the document, the person or company did not know and had no reasonable grounds to believe that the document would be released.

Derivative Information

(14) No person or company is liable in an action under section 2 for a misrepresentation in a document or a public oral statement, if the person or company proves that,

(a) the misrepresentation was also contained in a document filed by or on behalf of another person or company, other than the responsible issuer, with the Commission or any other securities regulatory authority in Canada or a stock exchange and not corrected in another document filed by or on behalf of that other person or company with the Commission or that other securities regulatory authority in Canada or stock exchange before the release of the document or the public oral statement made by or on behalf of the responsible issuer;

(b) the document or public oral statement contained a reference identifying the document that was the source of the misrepresentation; and

(c) at the time of release of the document or the making of the public oral statement, the person or company did not know and had no reasonable grounds to believe that the document or public oral statement contained a misrepresentation.

Where Corrective Action Taken

(15) No person or company, other than the responsible issuer, is liable in an action under section 2 if the misrepresentation or failure to make timely disclosure was made without the knowledge or consent of the person or company and, if, after the person or company became aware of the misrepresentation before it was corrected, or the failure to make timely disclosure before it was disclosed in the manner required under this Act,

(a) the person or company promptly notified the board of directors of the responsible issuer or such other persons acting in a similar capacity of the misrepresentation or the failure to make timely disclosure; and

(b) if no correction of the misrepresentation or no subsequent disclosure of the material change in the manner required under this Act was made by the responsible issuer within two business days after the notification under paragraph (a), the person or company, unless prohibited by law or by professional confidentiality rules, promptly and in writing notified the Commission of the misrepresentation or failure to make timely disclosure.

4. Assessment of Damages

(1) Damages shall be assessed in favour of a person or company that acquired an issuer's securities after the release of a document or the making of a public oral statement containing a misrepresentation or after a failure to make timely disclosure as follows:

(a) in respect of any of the securities of the responsible issuer that the person or company subsequently disposed of on or before the 10th trading day after the public correction of the misrepresentation or the disclosure of the material change in the manner required under this Act, assessed damages shall equal the difference between the average price paid for those securities (including any commissions paid in respect thereof) and the price received upon the disposition of those securities (without deducting any commissions paid in respect of such disposition), calculated taking into account the result of hedging or other risk limitation transactions;

(b) in respect of any of the securities of the responsible issuer that the person or company subsequently disposed of after the 10th trading day after the public correction of the misrepresentation or the disclosure of the material change in the manner required under this Act, assessed damages shall equal the lesser of,

(i) an amount equal to the difference between the average price paid for those securities (including any commissions paid in respect thereof) and the price received upon the disposition of those securities (without deducting any commissions paid in respect of such disposition), calculated taking into account the result of hedging or other risk limitation transactions, and

(ii) an amount equal to the number of securities that the person disposed of, multiplied by the difference between the average price per security paid for those securities (including any commissions paid in respect thereof determined on a per security basis) and,

(A) if the issuer's securities trade on a published market, the trading price of the issuer's securities on the principal market (as such terms are defined in the regulations) for the 10 trading days following the public correction of the misrepresentation or the disclosure of the material change in the manner required under this Act, or

(B) if there is no published market, then the amount the court considers just; and

(c) in respect of any of the securities of the responsible issuer that the person or company has not disposed of, assessed damages shall equal the number of securities acquired, multiplied by the difference between the average price per security paid for those securities (including any commissions paid in respect thereof determined on a per security basis) and,

(i) if the issuer's securities trade on a published market, the trading price of the issuer's securities on the principal market (as such terms are defined in the regulations) for the 10 trading days following the public correction of the misrepresentation or the disclosure of the material change in the manner required under this Act, or

(ii) if there is no published market, then the amount that the court considers just.

(2) Damages shall be assessed in favour of a person or company that disposed of securities after the release of a document or the making of a public oral statement containing a misrepresentation or after a failure to make timely disclosure as follows:

(a) in respect of any of the securities of the responsible issuer that the person or company subsequently acquired on or before the 10th trading day after the public correction of the misrepresentation or the disclosure of the material change in the manner required under this Act, assessed damages shall equal the difference between the average price received upon the disposition of those securities (deducting any commissions paid in respect of such disposition) and the price paid for those securities (without including any commissions paid in respect thereof), calculated taking into account the result of hedging or other risk limitation transactions;

(b) in respect of any of the securities of the responsible issuer that the person or company subsequently acquired after the 10th trading day after the public correction of the misrepresentation or the disclosure of the material change in the manner required under this Act, assessed damages shall equal the lesser of,

(i) an amount equal to the difference between the average price received upon the disposition of those securities (deducting any commissions paid in respect of such disposition) and the price paid for those securities (without including any commissions paid in respect thereof), calculated taking into account the result of hedging or other risk limitation transactions, and

(ii) an amount equal to the number of securities that the person disposed of, multiplied by the difference between the average price per security received upon the disposition of those securities (deducting any commissions paid in respect of such disposition determined on a per security basis) and,

(A) the issuer's securities trade on a published market, the trading price of the issuer's securities on the principal market (as such terms are defined in the regulations) for the 10 trading days following the public correction of the misrepresentation or the disclosure of the material change in the manner required under this Act, or

(B) if there is no published market, then the amount the court considers just,

(c) in respect of any of the securities of the responsible issuer that the person or company has not acquired, assessed damages shall equal the number of securities that the person or company disposed of, multiplied by the difference between the average price per security received upon the disposition of those securities (deducting any commissions paid in respect of such disposition determined on a per security basis) and

(i) if the issuer's securities trade on a published market, the trading price of the issuer's securities on the principal market (as such terms are defined in the regulations) for the 10 trading days following the disclosure of the material change in the manner required under this Act, or

(ii) if there is no published market, then the amount that the court considers just.

(3) Notwithstanding subsections (1) and (2), assessed damages shall not include any amount that the defendant proves is attributable to a change in the market price of securities unrelated to the misrepresentation or the failure to make timely disclosure.

5. Proportionate Liability

(1) In an action under section 2, the court shall determine, in respect of each defendant found liable in the action, the defendant's responsibility for the damages assessed in favour of all plaintiffs in the action, and each such defendant shall be liable, subject to the limits set out in subsection 6(1), to the plaintiffs only for that portion of the aggregate amount of damages assessed in favour of the plaintiffs that corresponds to that defendant's responsibility for the damages.

(2) Despite subsection (1), where, in an action under section 2 in respect of a misrepresentation or a failure to make timely disclosure, a court determines that a particular defendant, other than the responsible issuer, authorized, permitted or acquiesced in the making of the misrepresentation or the failure to make timely disclosure while knowing it to be a misrepresentation or a failure to make timely disclosure, the whole amount of the damages assessed in the action may be recovered from such defendant.

(3) Each defendant in respect of whom the court has made a determination under subsection (2) is jointly and severally liable with each other defendant in respect of whom the court has made a determination under subsection (2).

(4) Any defendant against whom recovery is obtained under subsection (2) is entitled to claim contribution from any other defendant who is found liable in the action.

6. Limits on Damages

(1) Despite section 4, the damages payable by a person or company in an action under section 2 is the lesser of,

(a) the aggregate damages assessed against the person or company in the action, and,

(b) the liability limit for such person or company less the aggregate of all damages assessed after appeals, if any, against the person or company in all other actions brought under section 2, and under comparable legislation in other provinces or territories in Canada, in respect of that misrepresentation or failure to make timely disclosure, and less any amounts paid in settlement of any such actions.

(2) Subsection (1) does not apply to a person or company, other than the responsible issuer, if the plaintiff proves that the person or company 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 a failure to make timely disclosure.

7. Leave to Proceed

(1) No action may be commenced under section 2 without leave of the court granted upon motion with notice to each defendant. The court shall only grant leave where it is satisfied that (a) the action is being brought in good faith; and (b) there is a reasonable possibility that the action will be resolved at trial in favour of the plaintiff.

(2) Upon an application under this section 7 the plaintiff and each defendant shall serve and file one or more affidavits setting forth the material facts upon which each intends to rely.

(3) The maker of such an affidavit may be examined thereon in accordance with the rules of court as to discovery.

(4) A copy of the application for leave to proceed and any affidavits filed in connection therewith shall be sent to the Commission

when filed.

8. Notice

A person or company that has been granted leave to commence an action under section 2 shall:

(a) promptly issue a news release disclosing that leave has been granted to commence an action under section 2;

(b) within seven days send a written notice to the Commission together with a copy of the news release; and

(c) send a copy of the statement of claim or other originating document to the Commission when filed.

9. Court Approval to Settle

An action brought under section 2 shall not be stayed, discontinued, settled or dismissed for delay without the approval of the court given on such terms as the court thinks fit, including, without limitation, as to costs, and in determining whether to approve the settlement of an action brought under section 2, the court shall consider, among other things, whether there are any other actions outstanding which have been brought under section 2 or under comparable legislation in the other provinces or territories in Canada in respect of the same misrepresentation or failure to make timely disclosure.

10. Costs

Notwithstanding anything to the contrary in the *Courts of Justice Act* (Ontario) and the *Class Proceedings Act* (Ontario), the prevailing party in an action under section 2 shall be entitled to costs determined by a court in accordance with applicable rules of civil procedure.

11. Power of the Commission

The Commission may intervene in an action under section 2 and in an application for leave under section 7.

12. No Derogation from Other Rights

The right of action for damages and the defences to an action under section 2 are in addition to and without derogation from any other rights or defences the plaintiff or defendant may have in an action brought other than under this Part.

13. Limitation Period

No action shall be commenced under section 2:

(a) in the case of misrepresentation in a document, later than the earlier of,

(i) three years after the date on which the document containing the misrepresentation was first released; and

(ii) six months after the issuance of a news release disclosing that leave has been granted to commence an action under section 2 or under comparable legislation in the other provinces or territories in Canada in respect of the same misrepresentation;

(b) in the case of a misrepresentation in a public oral statement, later than the earlier of,

(i) three years after the date on which the public oral statement containing the misrepresentation was made; and

(ii) six months after the issuance of a news release disclosing that leave has been granted to commence an action under section 2 or under comparable legislation in another province or territory of Canada in respect of the same misrepresentation;

(c) in the case of a failure to make timely disclosure, later than the earlier of,

(i) three years after the date on which the requisite disclosure was required to be made; and

(ii) six months after the issuance of a news release disclosing that leave has been granted to commence an action under this section 2 or under comparable legislation in another province or territory of Canada in respect of the same failure to make timely disclosure.

Securities Rules

PART ž
CIVIL LIABILITY FOR SECONDARY MARKET DISCLOSURE

1. For the purposes of clause 1(2)(b) in PART ž of the Act, the exemption from sections 53 and 62 of the Act prescribed is the exemption contained in clause 72(7)(b) of the Act.

2. For the purposes of clause 1(2)(c) in PART ž of the Act, the take-over bids prescribed are those described in clauses 93(1)(a), (b) and (e) and, the issuer bids prescribed are those described in clauses 93(3)(e), (f) and (h) of the Act.

Regulations to the Securities Act

PART ž

CIVIL LIABILITY FOR SECONDARY MARKET DISCLOSURE

1. For the purposes of PART ž of the Act, "equity securities" means securities of an issuer that carry a residual right to participate in earnings of the issuer and, on liquidation or winding up of the issuer, in its assets.

2. For the purposes of PART ž of the Act, "market capitalization" means, in respect of an issuer, the aggregate of the following:

   (a) for each class of equity securities for which there is a published market, the amount calculated by multiplying (i) the average of the number of outstanding securities of the class at the close of trading on each of the 10 trading days immediately before the day on which the misrepresentation was made or before the day on which the failure to make timely disclosure first occurred by (ii) the trading price of the securities of the class, on the principal market on which the securities trade, as determined in accordance with this Part, for the 10 trading days before the day on which the misrepresentation was made or before the day on which the failure to make timely disclosure first occurred; and

   (b) for each class of equity securities not traded on a published market, the fair market value of the outstanding securities of that class as of the day on which the misrepresentation was made or on which the failure to make timely disclosure first occurred.

3. For the purposes of PART ž of the Act, "trading price" means, for a security of a class for which there is a published market,

   (a) except as provided in clauses (b) or (c),

      (i) if the published market provides a closing price, the average of the closing prices of securities of that class on the published market for each trading day on which there was a closing price for the period during which the trading price is being determined, weighted by the volume of securities traded on each day, and

      (ii) if the published market does not provide a closing price, but provides only the highest and lowest prices of securities traded, the average of the weighted averages of the highest and lowest prices of the securities of that class for each of the trading days on which there were highest and lowest prices for the period during which the trading price is being determined;

   (b) if there has been trading of the securities of the class in the published market on fewer than half of the trading days for the period during which the trading price is being determined, the average of the following amounts established for each trading day of the period during which the trading price is being determined,

      (i) the average of the highest bid and lowest ask prices as of the close of trading for each trading day on which there was no trading, and

      (ii) either

         (A) the average of the closing price of the securities of that class for each trading day on which there has been trading, if the published market provides a closing price, or

         (B) the weighted average of the highest and lowest prices of the securities of that class for each trading day on which there has been trading, if the published market provides only the highest and lowest prices of securities traded on a trading day; or

   (c) if there has been no trading of the securities of the class in the published market on any of the trading days during which the trading price is being determined, the fair market value of the security.

4. For the purposes of PART ž of the Act, "principal market" means, for a class of securities of a responsible issuer,

   (a) the published market in Canada on which the greatest volume of trading in securities of that class occurred during the 10 trading days immediately before the day on which the misrepresentation was made or on which the failure to make timely disclosure first occurred; or

   (b) if there is no published market in Canada, the market on which the greatest volume of trading in securities of that class occurred during the 10 trading days immediately before the day on which the misrepresentation was made or on which the failure to make timely disclosure first occurred.

The Trustees of the Labourer's Pension Fund of Central and Eastern Canada, et al.	and	Sino-Forest Corporation, et al.
Plaintiffs		Defendants

Superior Court File No.: CV-10-414302
Commercial Court File No.: CV-12-9667-00CL

ONTARIO
SUPERIOR COURT OF JUSTICE

Proceeding commenced at Toronto

Proceeding under the *Class Proceedings Act, 1992*

COMPENDIUM OF THE AD HOC COMMITTEE OF THE PURCHASERS OF THE APPLICANT'S SECURITIES, INCLUDING THE CLASS ACTION PLAINTIFFS (SETTLEMENT APPROVAL)
(Returnable February 4, 2013)

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