

## Chapter 6

# Request for Comments

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### 6.1.1 Request for Comments – Notice of Proposed Ontario Securities Policy 51-604 *Defence for Misrepresentations in Forward-Looking Information*

#### NOTICE OF PROPOSED ONTARIO SECURITIES POLICY 51-604 DEFENCE FOR MISREPRESENTATIONS IN FORWARD-LOOKING INFORMATION

#### I. Introduction

The Commission is publishing for comment proposed OSC Policy 51-604 – *Defence for Misrepresentations in Forward-Looking Information* (the “Policy”). The proposed Policy relates to the defence available under the *Securities Act* in an action for damages for misrepresentations in forward-looking information contained in an issuer’s disclosure. The purpose of the proposed Policy is to outline the Commission’s views on some of the policy considerations underlying the defence for misrepresentations in forward-looking information and explain how the Commission approaches the interpretation of certain aspects of the defence.

#### II. Background

##### ***Statutory Civil Liability for Secondary Market Disclosures***

On December 31, 2005 amendments to the *Securities Act* which introduced a statutory civil liability regime for secondary market disclosure came into force. The new regime provides a statutory right of action in favour of secondary market investors against public companies and key related persons (like directors and officers) for making public misrepresentations about the company or for failing to disclose material changes as required by Ontario securities laws.

The new statutory civil liability regime is based on draft legislation that the Commission, together with certain other members of the CSA, proposed for public comment.<sup>1</sup> The draft legislation arose out of the Commission’s review and support of The Toronto Stock Exchange Committee on Corporate Disclosure’s (the “Allen Committee”) final report issued in March 1997.<sup>2</sup>

##### ***Defence for Misrepresentations in Forward-Looking Information***

The new statutory civil liability regime contains a number of defences including a defence for misrepresentations in forward-looking information. Forward-looking information includes, but is not limited to, future-oriented financial information with respect to prospective results of operations, financial position and/or cash flows that is presented as either a forecast or a projection.<sup>3</sup> Earnings guidance is an example of forward-looking information. MD&A may also contain forward-looking information.

Under the *Securities Act*, a defendant is not liable for a misrepresentation in forward-looking information if the defendant proves that the document or oral statement containing the information included, “proximate to” the information: (a) reasonable cautionary language identifying the information as forward-looking and identifying material factors that could cause results to diverge materially from a conclusion, forecast or projection in it; and (b) a statement of the material factors or assumptions on which it is based. In addition, the defendant must prove that it had a reasonable basis for the conclusion, forecast or projection.<sup>4</sup> A similar defence is also available for primary market disclosure, like prospectuses, which contain forward-looking information.<sup>5</sup>

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<sup>1</sup> See CSA Notice 53-302 – Proposal for a Statutory Civil Remedy for Investors in the Secondary Market and Response to the Proposed Change to the Definition of “Material Fact” and “Material Change” (2000), 23 OSCB 7383. The draft legislation was published for comment in May 1998 (see (1998), 21 OSCB 3367).

<sup>2</sup> “Responsible Corporate Disclosure – A Search for Balance (Final Report)”, Toronto Stock Exchange Committee on Corporate Disclosure (March 1997).

<sup>3</sup> *Securities Act*, s. 1(1). “Forward-looking information” means “disclosure regarding possible events, conditions or results of operations that is based on assumptions about future economic conditions and courses of action and includes future oriented financial information with respect to prospective results of operations, financial position or cash flows that is presented either as a forecast or a projection”.

<sup>4</sup> *Securities Act*, s. 138.4(9). If the forward-looking information is contained in an oral statement, the cautions must be stated orally, in general terms, along with a reference to an available document that discloses the factors and assumptions; *Securities Act*, 138.4(9.1).

<sup>5</sup> *Securities Act*, s. 132.1.

**III. Purpose and Summary of the Proposed Policy**

Following the recent proclamation of the amendments to the *Securities Act* introducing statutory civil liability for secondary market disclosure, Commission Staff have received a number of enquiries from various issuers and counsel who have expressed uncertainty with respect to the requirements of the defence for misrepresentations in forward-looking information. In June 2005 the Commission also received a written submission on behalf of a number of issuers requesting that the Commission issue guidance in connection with the defence (the "Submission"). In light of the recurring questions we have received on this subject, we are issuing the proposed Policy to outline the Commission's views on some of the policy considerations underlying the defence. The proposed Policy also explains how the Commission approaches the interpretation of certain aspects of the defence, including: (i) the "proximate" requirement; (ii) the required content of applicable risk factor and assumption disclosure; (iii) the "reasonable basis" requirement; and (iv) the operation of the defence with respect to oral statements containing forward-looking information.

**IV. Related Instruments**

The proposed Policy is related to subsection 132.1(1) and subsections 138.4(9), (9.1) and (9.2) of the *Securities Act* which provide a defence in an action for damages for misrepresentations in forward-looking information. Forward-looking information is defined under the *Securities Act* in subsection 1(1)

**V. Unpublished Materials**

In proposing the Policy, the Commission has not relied on any significant unpublished study, report, decision or other written materials. In proposing the Policy, however, the Commission considered the questions and issues raised in the Submission.

**VI. Comments**

Interested parties are invited to make written submissions with respect to the proposed Policy. Submissions received by August 2, 2006 will be considered.

Submissions should be addressed to the Commission at the following address:

John Stevenson  
Secretary to the Commission  
Ontario Securities Commission  
20 Queen Street West,  
Suite 1903, Box 55  
Toronto, Ontario M5H 3S8  
Fax: (416) 593-2318  
e-mail: [jstevenson@osc.gov.on.ca](mailto:jstevenson@osc.gov.on.ca)

If you are not sending your comments by e-mail, please send a diskette containing your comments (in DOS or Windows format, preferably Word).

We cannot keep submissions confidential because securities legislation requires that a summary of the written comments received during the comment period be published.

Questions may be referred to any of:

Monica Kowal  
General Counsel  
Ontario Securities Commission  
Phone: (416) 593-3653  
Fax: (416) 593-3681  
e-mail: [mkowal@osc.gov.on.ca](mailto:mkowal@osc.gov.on.ca)

Rossana Di Lieto  
Associate General Counsel  
Ontario Securities Commission  
Phone: (416) 593-8106  
Fax: (416) 593-3681  
e-mail: [rdilieto@osc.gov.on.ca](mailto:rdilieto@osc.gov.on.ca)

**OSC POLICY 51-604 –DEFENCE FOR MISREPRESENTATIONS  
IN FORWARD-LOOKING INFORMATION**

Part I – Introduction

1.1 Background – (1) Ontario securities law provides public issuers, directors, officers and other parties with a defence from statutory civil liability for misrepresentations in forward-looking information. The defence for misrepresentations in forward-looking information was first introduced into Ontario securities law in December 2002 and came into force on December 31, 2005 as part of the introduction of a statutory civil liability regime in favour of secondary market investors.<sup>1</sup> A similar defence exists in those parts of the *Securities Act* that provide a statutory right of action for damages for misrepresentations in primary market offering documents.<sup>2</sup> The defence contained in the *Securities Act* is based on draft legislation that the Commission, together with certain members of the Canadian Securities Administrators, proposed for public comment.

(2) Ontario securities law defines forward-looking information as disclosure about possible events, conditions or results of operations that is based on assumptions about future economic conditions and courses of action.<sup>3</sup> Forward-looking information includes, but is not limited to, future-oriented financial information with respect to prospective results of operations, financial position and/or cash flows that is presented as either a forecast or a projection. Earnings guidance is forward-looking information. MD&A may also contain forward-looking information.

(3) Forward-looking information is, by its very nature, information that carries with it a level of uncertainty. There is a concern that attaching statutory civil liability to information that contains inherent uncertainties will discourage issuers from providing forward-looking information. Such a “disclosure chill” would not be constructive. Understanding management’s assessment of the future prospects and potential of a company is valuable to shareholders and prospective investors. Indeed, some forward-looking information, for example in the form of MD&A, is required. The policy objective behind the provision of the defence is to facilitate responsible and balanced disclosure about an issuer’s anticipated future prospects.

(4) This policy statement expresses the Commission’s views on some of the policy considerations underlying the defence for misrepresentations in forward-looking information and explains how the Commission approaches the interpretation of certain aspects of the defence. It is being issued under subsection 143.8(1)(b) of the *Securities Act*.

This policy statement represents the views of the Commission. These views do not have the force of law. These views are also not legal advice and should not be relied on as such.

We expect that disclosure practices in this area will vary among issuers and will evolve over time.

Part II – Defence for Misrepresentations in Forward-Looking Information

2.1 Legislative scheme - Under the defence, written and oral forward-looking information is protected from statutory civil liability if:

- (a) the document or public oral statement contains:
  - (i) reasonable cautionary language identifying the forward-looking information as such (the “identifier”);
  - (ii) reasonable cautionary language identifying material factors that could cause actual results to differ materially from a conclusion, forecast or projection in the forward-looking information (“risk factors”); and
  - (iii) a statement of the material factors or assumptions that were applied in drawing a conclusion or in making a forecast or projection set out in the forward-looking information (“assumptions”);
- (b) the identifier and disclosure of risk factors and assumptions appear proximate to the forward-looking information; and
- (c) the person or company had a reasonable basis for drawing the conclusions or making the forecast or projection.<sup>4</sup>

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<sup>1</sup> See paragraphs (9), (9.1), (9.2) and (10) of section 138.4 of the *Securities Act*.

<sup>2</sup> See section 132.1 of the *Securities Act*.

<sup>3</sup> See subsection 1(1) of the *Securities Act*.

<sup>4</sup> See subsection 138.4(9) of the *Securities Act*.

2.2 Animating Principles - The principles animating the defence include:

- (a) an investor who reads a disclosure document or listens to an oral statement containing forward-looking information should be able to readily:
  - (i) understand that forward-looking information is being provided in the document or statement;
  - (ii) identify the forward-looking information; and
  - (iii) inform himself or herself of the material assumptions underlying the forward-looking information and the material risk factors associated with a particular conclusion, forecast or projection; and
- (b) effective disclosure is based on clarity of presentation and simplicity of language and style.

2.3 The “proximate” requirement - (1) Concerns have been expressed that the word “proximate” may be interpreted so as to require immediate juxtaposition in every instance. If this were the case, each statement of forward-looking information would need to be individually identified as such and all of the material risk factors and assumptions applicable to the statement immediately included, irrespective of the fact that these risk factors and assumptions may apply to various statements of forward-looking information in the same disclosure. The Commission does not interpret the “proximate” requirement to require immediate juxtaposition in every instance.

(2) MD&A, for example, frequently has threads of forward-looking information throughout. These threads of forward-looking information may be subject to common assumptions and risk factors. Breaking the flow of the discussion to indicate each time that a particular statement is forward-looking and to then identify in a meaningful way the factors that could affect its outcome introduces complexity in presentation that could frustrate an investor’s ability to readily follow the MD&A discussion and appreciate the nature of the forward-looking information. If a reader may be better served by a single broader reference prefacing or following, as appropriate, the MD&A identifying and setting out the applicable assumptions and risk factors, the Commission believes that such placement should generally satisfy the “proximate” requirement of the defence.

(3) There may be situations where particular assumptions and risk factors apply equally to multiple instances of forward-looking information in a single document. In these cases, the Commission expects that issuers will use their judgment and balance the value of brevity accomplished by cross-referencing with the user-friendliness of having all relevant information stated in full in each instance. In the Commission’s opinion, the use of cross-referencing in a manner that supports the principles animating the defence is consistent with the “proximate” requirement of the defence. We expect that practices with respect to the use and extent of cross-referencing will vary among issuers and will vary depending on the circumstances and the nature of the particular disclosure.

(4) In the Commission’s view, the animating principles underlying the defence suggest that, as a general principle, the more closely-tied a particular risk factor or assumption is to a particular conclusion, forecast or projection, the more “proximate” it should be to the forward-looking information. For example, where the disclosure of risk factors and assumptions is particularly tied to a forward-looking statement but does not immediately precede or follow the forward-looking statement, it may be necessary to provide a cross-reference or footnote that ties the risk factor or assumption to the specific conclusion, forecast or projection.

2.4 Risk factor disclosure – (1) The defence for misrepresentations in forward-looking information requires the material factors that could cause actual results to differ materially from a conclusion, forecast or projection in the forward-looking information to be identified (“risk factors”). The risk factors identified in the cautionary language should be relevant to the conclusion, forecast or projection and should not be boilerplate in nature.

(2) The use of the word “material” underscores, in the Commission’s view, that the cautionary statements should identify significant and reasonably foreseeable factors that could reasonably cause results to differ materially from those projected in the forward-looking statement. We do not believe that the defence should be interpreted as requiring an issuer to anticipate and discuss everything that could conceivably cause results to differ. It follows that failure to include the particular factor that ultimately causes the forward-looking statement not to materialize as predicted should not necessarily mean that the disclosure is not protected by the defence. The defence does not, in the Commission’s view, require companies to warn of every risk factor that, with the benefit of hindsight, ultimately could or might cause the forward-looking information not to come true.

2.5 Assumption disclosure – The defence for misrepresentations in forward-looking information requires a statement to be included of the material factors or assumptions that were applied in drawing a conclusion or making a forecast or projection set out in the forward-looking information. The requirement for a statement of the material factors or assumptions that were applied requires, in the Commission’s view, the factors or assumptions to be relevant to the conclusion, forecast or projection. The use of the word “material” underscores, in the Commission’s view, that the defence does not require an exhaustive statement of every factor or assumption applied – a materiality standard applies.

2.6 Reasonable Basis – In order to benefit from the defence, a company must have a reasonable basis for drawing the conclusion or making the forecast or projection set out in the forward-looking information. When interpreting “reasonable basis”, we believe that relevant factors would include: the reasonableness of the assumptions applied in drawing the conclusion or making the forecast or projection; and the inquiries made and the process followed in preparing and reviewing forward-looking information.

### Part III – Defence for Misrepresentations in Oral Statements Containing Forward-Looking Information

3.1 Legislative Scheme - The *Securities Act* provides that in the case of a public oral statement containing forward-looking information, a person or company is deemed to have satisfied the requirements of the defence in paragraph 1 of subsection 138.4(9) (which are discussed in section 2.1 of this Policy) if the person making the public oral statement states that:

- a) the oral statement contains forward-looking information;
- b) actual results could differ materially from a conclusion, forecast or projection in the oral forward-looking information;
- c) certain material factors or assumptions were applied in drawing the conclusions or making the forecasts or projections included in the oral forward-looking information; and
- d) additional information about the applicable risk factors and assumptions are contained in a “readily available” document and identifies that document.<sup>5</sup>

For purposes of the defence, a document filed with the Commission or otherwise generally disclosed is deemed to be “readily available”.<sup>6</sup>

3.2 A more flexible approach – (1) The *Securities Act* recognizes that it may be unwieldy to make oral disclosures containing forward-looking information that satisfy all of the requirements of the defence contained in subsection 138.4(9). Instead, the *Securities Act* provides for a more flexible approach for oral statements containing forward-looking information that will facilitate these types of oral communications by an issuer while still providing to the public information it would have received if the forward-looking information was contained in a written disclosure document.

(2) The deeming provision in subsection 138.4 (9.1) specifically refers to the requirements of the defence being satisfied in the case of public oral statements when the person making the public oral statement makes the required cautionary statements. In the Commission’s view, subsection 138.4 (9.1) should not be interpreted as exhaustive; the requirements of the defence may be satisfied in appropriate circumstances by one person making the required cautionary statements on behalf of another person making the forward-looking statement. The animating principles underlying the defence support a pragmatic interpretation.

### Part IV – Duty to Update

4.1 We do not interpret the defence for misrepresentations in forward-looking information as imposing upon any person or company a duty to update forward-looking information beyond any duty imposed under Ontario securities law or otherwise.

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<sup>5</sup> See subsection 138.4(9.1) of the *Securities Act*.

<sup>6</sup> See subsection 138.4(9.2) of the *Securities Act*.