

1.1.3 OSC Staff Notice 45-705 – Interpretation of Section 130.1 of the Securities Act

**ONTARIO SECURITIES COMMISSION STAFF NOTICE
45-705 – INTERPRETATION OF SECTION 130.1
OF THE SECURITIES ACT**

Section 130.1 (*Liability for misrepresentation in offering memorandum*) was introduced in the *Securities Act* through the *More Tax Cuts for Jobs, Growth and Prosperity Act, 1999*. The section was intended to replace the contractual rights of action required by the Regulation under the *Securities Act* to be conferred by issuers upon investors who purchase securities pursuant to certain prospectus exemptions for misrepresentations in an offering memorandum. Section 130.1 also created, for the first time, a statutory right of action for damages or rescission against "a selling security holder on whose behalf the distribution is made".

We understand that some securities practitioners are taking the view that the reference in Section 130.1 to "a selling security holder on whose behalf the distribution is made" could be read to include an underwriter where it purchases securities for resale on a private placement basis. Under this interpretation, the underwriter in an underwritten private placement would be liable to purchasers for a misrepresentation in the offering memorandum and, incidentally, would not have a due diligence defence under Section 130.1. The term "selling security holder" is not defined in the Act.

Staff have been asked for their views on this question. Staff discussed the issue with a group of senior securities lawyers and considered that it would be helpful to underwriters, issuers and their advisors to set forth our views on this matter.

- The extension of rights of action to include both issuers and selling security holders as defendants was intended to overcome a long standing problem under the contractual rights of action provision of the Regulations which, in effect, required that purchasers be given a right against an issuer even in circumstances where the private placement was entirely a secondary offering by a selling shareholder.
- Had the legislation intended to include underwriters in the defendant class, it would have done so expressly, as does Section 130(1)(b) of the *Securities Act*.
- There is no apparent policy rationale for drawing a distinction, as the suggested interpretation of Section 130.1 would require, between underwriters who purchase as principal securities for distribution by private placement and underwriters who act merely as agents in a distribution by private placement. It is noteworthy that under Section 130, underwriters' liability does not turn on whether the underwriter purchases as

principal, or sells as agent, but rather whether the underwriter signs the certificate in the prospectus.

- As a matter of statutory interpretation, Section 130.1 must be read in the context of the entire *Securities Act*, including Section 130. Section 130 has always included in the defendant class a selling security holder. It has never been suggested, however, that an underwriter (including one that did not sign the prospectus) might be liable under Section 130(1)(a) as a selling security holder rather than under Section 130(1)(b) as an underwriter. The significance of the distinction under Section 130 is that if the underwriter were liable under (a) it would have no due diligence defence but would have such a defence under (b). The common interpretation of a "selling security holder" and "underwriter" under Section 130 is that they are mutually exclusive.
- Had the intention been to create underwriter liability under Section 130.1, the legislation would have included a due diligence defence for underwriters as there would be no policy basis for subjecting underwriters to a higher standard of liability in the private placement context than in the public offering context.

For the foregoing reasons, Staff is of the view that Section 130.1 was not intended to impose liability for misrepresentations in an offering memorandum on an underwriter in an underwritten private placement.

Questions may be referred to:

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