CITATION: Paniccia v. MDC Partners Inc., 2018 ONSC 3470
COURT FILE NO.: 16-CV-564034-00CP
DATE: 20180604

ONTARIO
SUPERIOR COURT OF JUSTICE

BETWEEN:	
ROBERTO PANICCIA Plaintiff	*Andrew J. Morganti* and *Hadi Davarinia* for the Plaintiff
– and –	
MDC PARTNERS INC., MILES S. NADAL, MICHAEL C. SABATINO, DAVID DOFT Defendants	*Peter F.C. Howard* and *Samaneh Hosseini* for the Defendants MDC Partners Inc. and David Doft *Dana M. Peebles* and *Shane D'Souza* for the Defendant Miles S. Nadal *Wendy Berman* and *Lara Jackson* for the Defendant Michael C. Sabatino
Proceedings under the *Class Proceedings Act, 1992*	**HEARD**: May 15, 2018

PERELL, J.

REASONS FOR DECISION

A. Introduction

[1] Pursuant to the *Class Proceedings Act, 1992*,[1] Roberto Paniccia brings a proposed class action against MDC Partners Inc. and certain of its officers; namely: Miles S. Nadal, Michael C. Sabatino, and David Doft. The action is brought on behalf of Canadian-resident purchasers of MDC's securities from October 28, 2013 up to and including April 27, 2017 (the "Class Period").

[2] On August 7, 2015, Mr. Paniccia commenced a global class action in Ontario for both a common law negligent misrepresentation claim and also a statutory misrepresentation claim

[1] S.O. 1992, c. 6.

under Part XXIII.1 of Ontario's *Securities Act*.[2] Initially, Mr. Paniccia brought his claim on behalf of all purchasers on the TSX (Toronto Stock Exchange) and on the U.S.'s NASDAQ (National Association of Securities Dealers Automated Quotations) Stock Market. Subsequently, Mr. Paniccia amended his proposed class definition to comprise the class to be Canadian purchasers on the TSX and NASDAQ. Thus, he abandoned a global class action.

[3] With respect to the statutory cause of action, the putative Class Members seek damages for misrepresentations of material facts in three statements made between October 29, 2014 and March 2, 2015 that were allegedly corrected by a news release on April 27, 2015.

[4] This is a motion for leave to proceed with the putative Class Members' claim pursuant to Part XXIII.1 of the Ontario *Securities Act*. For the reasons that follow, Mr. Paniccia's motion is dismissed.

B. Facts

[5] MDC is a federally incorporated Canadian company[3] with its registered office in Toronto, Ontario but with its head office and investor relations group in the State of New York. It is a worldwide marketing, communications, and public relations enterprise. Mr. Nadal founded MDC in 1986, and it grew into one of the largest and most successful marketing and communications firms in the world.

[6] MDC's shares traded on the TSX and on NASDAQ, where 98.2% of the trading occurred. Presently, an unknown number of shareholders reside in Canada, and they hold between 0.8% and 2.6% of MDC's shares.

[7] Up until November 11, 2015, when the listing on the TSX was voluntarily delisted, MDC's Class A subordinate shares were listed on both the TSX and NASDAQ. MDC is a reporting issuer in British Columbia, Alberta, Saskatchewan, Manitoba, Ontario, Québec, New Brunswick, Nova Scotia, Prince Edward Island, and Newfoundland and Labrador. It is a "responsible issuer" under the Ontario *Securities Act* and in the concordant securities statutes across Canada.

[8] Under the securities statutes in Canada and in the U.S., MDC has continuous disclosure obligations. In the U.S., the securities regulator is the Securities and Exchange Commission ("SEC"). In the U.S., MDC files and releases documents on EDGAR (the Electronic Data Gathering, Analysis, and Retrieval system). In Canada, MDC files documents on SEDAR (the System for Electronic Document Analysis and Retrieval).

[9] As an SEC issuer under National Instrument 51-102 ("NI 51-102"), MDC relies on public disclosure documents filed in the U.S., in accordance with U.S. federal securities laws and regulations, to meet its continuous disclosure obligations under Ontario law.

[10] During the Class Period, Mr. Nadal was MDC's president, CEO (chief executive officer), and chairperson of its Board of Directors. He resigned on July 20, 2015. Mr. Nadal certified MDC's annual and interim filings on Form 10-K and Form 10-Q, and he authorized the dissemination of the news releases on Form 8-K.

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[2] R.S.O. 1990, c. S.5.
[3] *Canada Business Corporations Act*, R.S.C., 1985, c. C-44.

[11] During the Class Period, Mr. Doft was MDC's CFO (chief financial officer). He certified MDC's annual and interim filings on Form 10-K and Form 10-Q, and authorized the dissemination of the news releases on Form 8-K.

[12] During most of the Class Period, Mr. Sabatino was MDC's CAO (chief accounting officer).

[13] MDC's auditor is BDO USA LLP. BDO was originally named as a defendant in this action. Mr. Paniccia, however, discontinued the claim with prejudice as against BDO in 2016.

[14] MDC reported its financial results in accordance with U.S. GAAP (U.S. Generally Accepted Accounting Principles). From 2012 to 2016, BDO provided an unqualified or "clean" audit each year of MDC's financial statements, as follows (with minor variations):

> We have audited the accompanying consolidated balance sheets of MDC Partners Inc. as of December 31, 2016 and 2015 and the related consolidated statements of operations, comprehensive loss, shareholders' deficit, and cash flows for each of the three years in the period ended December 31, 2016. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.
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> We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the consolidated financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall consolidated financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.
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> In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of MDC Partners Inc. at December 31, 2016 and 2015, and the results of its operations and its cash flows for each of the three years in the period ended December 31, 2016, in conformity with accounting principles generally accepted in the United States of America.

[15] In its annual reports, MDC is required to publish an assessment of the effectiveness of its ICFR (internal controls over financial reporting). MDC's auditors are required to attest and report on management's assessment of ICFR.

[16] In every relevant year, MDC reported that it maintained effective ICFR, and BDO confirmed this.

[17] BDO provided the following report from 2012 to 2016 (with minor variations) about MDC's ICFR:

> We have audited MDC Partners Inc.'s internal control over financial reporting as of December 31, 2016, based on criteria established in *Internal Control — Integrated Framework* (2013) issued by the Committee of Sponsoring Organizations of the Treadway Commission (the COSO criteria).
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> MDC Partners Inc.'s management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting, included in the accompanying "Item 9A - Management's Report on Internal Control Over Financial Reporting." Our responsibility is to express an opinion on the company's internal control over financial reporting based on our audit.
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> We conducted our audit in accordance with the standards of the Public Company Accounting

> Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our audit included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, and testing and evaluating the design and operating effectiveness of internal control based on the assessed risk. Our audit also included performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.
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> A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.
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> Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.
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> In our opinion, MDC Partners Inc. maintained, in all material respects, effective internal control over financial reporting as of December 31, 2016, based on the COSO criteria.

[18] BDO has not withdrawn their unqualified audit opinions nor required a restatement of MDC's financial statements for any of the years 2012 to 2016. BDO has not withdrawn its ICFR reports for any of the years 2012 to 2016.

[19] On May 9, 2014, MDC received a letter from the SEC requesting that it use the qualifier "adjusted" with respect to EBITDA (earnings before interest, taxes, depreciation and amortization) in future filings. MDC responded by letter dated May 19, 2014 confirming that it would comply with the SEC's request. This correspondence was publicly filed on EDGAR at the time it was made.

[20] On October 5, 2014, the SEC served a subpoena on MDC requiring it to produce documents and testimony with respect to an investigation relating to: (a) reimbursement of expenses incurred by Mr. Nadal; (b) accounting for goodwill; (c) certain other accounting practices; and (d) the trading in its securities by third parties.

[21] In response to the service of the subpoena, MDC cooperated in the investigation, and it began its own internal investigation.

[22] MDC did not immediately publicly announce the service of the subpoena, and on October 29, 2014, it released a News Release entitled, "*MDC Partners Inc. Reports Strong Results for the Three and Nine Months ended September 30, 2014*." There was an accompanying Management Presentation.

[23] The News Release indicated that: (a) MDC's "adjusted EBITDA" for the quarter was $42.5 million, "an increase of 7.9%" and its goodwill amounted to $928.2 million; (b) Mr. Nadal had stated that MDC was "on pace to deliver on all of its financial objectives" and had "established a solid foundation for …an even better year in 2015"; and (c) Mr. Doft had stated

that MDC's "performance this quarter positions [it] well to achieve industry leading organic revenue growth, strong EBITDA growth and operating leverage, and solid cash generation for the year".

[24] Mr. Paniccia submits that the October 29, 2014 Statement contained misrepresentations because: (a) the Statement omitted to disclose the service of the SEC subpoena; (b) it omitted to disclose MDC's Special Committee about internal controls over accounting; (c) it omitted to disclose that MDC was reporting "adjusted EBITDA" because the SEC had taken exception and had required the qualification "adjusted"; (d) it omitted to disclose the true amount of Mr. Nadal's compensation; and (e) it misstated how MDC presented its "segments," which is to say how MDC grouped its partner firms into reporting units as later reflected in the exchange of correspondence between MDC and the SEC dated September 18, 2015 and October 18, 2017.

[25] On November 6, 2014, MDC released its Q3 2014 quarterly report, financial statements, MD&A (Management Discussion and Analysis) as certified by Messrs. Nadal and Sabatino.

[26] The documents indicated that: (a) the net loss for the quarter was $4.92 million and the comprehensive loss for the quarter was $1.44 million; (b) MDC manages the business by monitoring several financial and nonfinancial performance indicators, with the key indicators focussing on the areas of revenues and operating expenses, and focusing on capital expenditures and EBITDA; and (c) based upon Messrs. Nadal's and Sabatino's knowledge, the Quarterly Report, financial statement, and MD&A did not contain any untrue statement of a material fact or omit to state a material fact in order to make the statements made, in the light of the circumstances under which they were made, not misleading.

[27] Mr. Paniccia submits that the November 6, 2014 Statement contained misrepresentations because: (a) the Statement omitted to disclose the service of the SEC subpoena; (b) it omitted to disclose MDC's Special Committee about internal controls over accounting; (c) it omitted to disclose that the SEC had taken exception and had required the qualification "adjusted" for the reporting of EBITDA; (d) it referred to EBITDA, rather than "adjusted EBITDA", which was used by MDC in its Q3 earnings release (*i.e.*, its October 29, 2014 Statement); (e) it omitted to disclose the true amount of Mr. Nadal's compensation; and (f) it misstated how MDC presented its segments of partner firms.

[28] On March 2, 2015, MDC released its 2014 Annual Reports, audited financial statements, and MD&A as certified by Messrs. Nadal and Sabatino.

[29] The March 2, 2015 Statement indicated that: (a) the net loss attributable to MDC for the 2014 fiscal year was $24.1 million and that its goodwill at the end of 2014 amounted to $851.4 million; (b) Messrs. Nadal, Sabatino, and Doft were not permitted to waive any part of MDC's Code of Conduct (which was incorporated by reference into the Annual Report) unless disclosed and approved by the Board of Directors; *i.e.*, they were complying with the Code of Conduct; and (c) based upon Messrs. Nadal's and Sabatino's knowledge, the Annual Report, financial statement, and MD&A did not contain any untrue statement of a material fact or omit to state a material fact in order to make the statements made, in the light of the circumstances under which they were made, not misleading.

[30] Mr. Paniccia submits that the March 2, 2015 Statement contained misrepresentations because: (a) the Statement omitted to disclose the service of the SEC subpoena; (b) it omitted to disclose MDC's Special Committee about internal controls over accounting and compliance with

its Code of Conduct; (c) it omitted to disclose the true amount of Mr. Nadal's compensation; and (d) it misstated how MDC presented its segments of partner firms.

[31] On April 27, 2015, Mr. Paniccia purchased 245 shares of MDC on the TSX for $34.36 per share. That day MDC's common shares closed at $33.80 on the TSX and $27.98 on the NASDAQ.

[32] After the market closed on April 27, 2015, MDC released a Statement indicating that the SEC had served a subpoena in an investigation into MDC's disclosure practices relating to: (a) reimbursement of expenses incurred by Mr. Nadal; (b) accounting for goodwill; (c) certain other accounting practices; and (d) the trading in its securities by third parties. The Statement also indicated that MDC had formed a Special Committee of independent directors to investigate the matters raised by the SEC's subpoena and they were implementing new policies and procedures. The Statement stated:

> Since October 5, 2014, the Company has been actively cooperating with the production of documents for review by the Securities and Exchange Commission (the "SEC") pursuant to a Subpoena. In connection with this production of documents, the Company formed a Special Committee of independent directors to review certain matters relating to the reimbursement of expenses incurred by the CEO. The Special Committee is being advised by Bruch Hanna LLP, as special independent advisor, and by Simpson Thacher & Bartlett LLP, as legal counsel.
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> The Special Committee completed an extensive review of perquisites and payments made by the Company to or on behalf of Miles Nadal and Nadal Management Limited during the six-year period from 2009 through 2014. The review included a detailed analysis of the available back-up documentation supporting such payments, as well as consideration of the Management Services Agreement among Mr. Nadal, Nadal Management Limited and the Company and certain historical practices. These payments included, among other things, travel and commutation expenses, charitable donations, medical expenses, and certain expenses for which the information was incomplete.
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> Mr. Nadal cooperated fully with the review. Following the review, Mr. Nadal agreed to reimburse the Company for perquisites and payments for which the Company sought reimbursement, in the aggregate amount of $8.6 million. The Company does not expect there will be any impact to its previously issued financial statements as a result of the review.

[33] As a result of the internal investigation, the Company's Special Committee recommended, and MDC's Audit Committee adopted, a series of remediation procedures to strengthen MDC's ICFR related to travel, entertainment, and related expenses, including hiring two new senior executives; a Senior Vice President, Internal Controls and Compliance, and a Director, Compliance & Risk Management.

[34] Mr. Paniccia submits that the April 27, 2015 Statement was a partial corrective disclosure.

[35] On April 28, 2015, MDC's shares dropped in value to $24.20 on the TSX and to $20.20 on the NASDAQ, reflecting a price reduction of 28% on both exchanges.

[36] During the period between the first statement on October 29, 2014 through to April 27, 2015, Mr. Nadal donated 30,000 MDC shares to a charity. He did not otherwise dispose of shares during this period. During this period, Mr. Doft donated 3,000 shares to a charity. He did not otherwise dispose of his shares during this period.

[37] On July 20, 2015, Messrs. Nadal and Sabatino resigned. In resigning, Mr. Nadal repaid MDC $1.88 million (USD) in reimbursed expenses, $10.58 million (USD) in bonuses, and he

forfeited severance payments valued at $27.2 million (USD). Mr. Sabatino repaid $218,583 (USD) in bonuses, and he forfeited a severance payment.

[38] In July 2015, in the U.S., the North Collier Fire Control and Rescue District Firefighter Pension Plan ("Pension Plan") sued MDC, Mr. Nadal, Mr. Sabatino, and Mr. Doft for misrepresentation in the secondary market; *i.e.* on NASDAQ. Mr. Paniccia was a putative Class Member of this proposed U.S. class action.

[39] The Pension Plan relied on SEC Rule 10b-5 of the *Securities Exchange Act of 1934*,[4] which states:

> *Employment of Manipulative and Deceptive Tactics*
>
> 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 a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or
> >
> > (c)To engage in any act, practice, or course 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.

[40] Meanwhile in Canada, in Ontario, on August 7, 2015, Mr. Paniccia issued a Statement of Claim against MDC and Messrs. Nadal, Sabatino, and Doft. Mr. Paniccia's claim was subsequently amended three times, with the most recent amendment in April 2018.

[41] In August and September 2015, the SEC raised a new matter with MDC. The new matter was about how MDC grouped or segmented its partner firms into reporting units. The SEC's correspondence on this topic was publicly filed, and the discussions about segmenting continued for two years.

[42] (Pausing here to foreshadow the discussion below, it may be noted that Mr. Paniccia submits, as noted above, that the October 29, 2014, November 6, 2014 and March 2, 2015 Statements (the impugned Statements) omitted reference to the segments matter although it was not raised by the SEC until the summer of 2015.)

[43] In the U.S., on September 30, 2016, the U.S. action brought by the Pension Plan was dismissed before certification and with prejudice by Judge Richard J. Sullivan of the United States District Court – Southern District of New York.[5]

[44] Under U.S. law, Judge Sullivan had to decide whether the plaintiff, the Pension Plan, had pleaded facts that would allow the court to draw the reasonable inference that the defendant was liable for the misconduct alleged. The U.S. court was required to accept as true all factual allegations in the complaint and draw all reasonable inferences in favour of the plaintiff. The court could only dismiss the action on the grounds that the plaintiff had failed to plead material misrepresentations; *i.e.*, that the alleged misstatements or omissions were so obviously

[4] 15 U.S.C. 78aa.

[5] *North Collier Fire Control and Rescue District Firefighter Pension Plan v. MDC Partners, Inc., et al*., 5-cv-6034 (RJS) (S.D.N.Y.).

unimportant to a reasonable investor that reasonable minds could not differ on the question of their importance.

[45] Judge Sullivan concluded that: (a) there was no misrepresentation with respect to MDC's reporting of goodwill estimates, which were "not matters of objective fact"; (b) there was no material misrepresentation with respect to MDC's reporting of non-GAAP EBITDA, which is by definition a "non-standard" measure; (c) the characterization of $10.5 million in payments to Mr. Nadal as expense reimbursement rather than compensation was neither quantitatively nor qualitatively material; and (d) there was no material misrepresentation with respect to the adequacy of MDC's internal controls.

[46] Further, Judge Sullivan concluded that even if Mr. Nadal's expenses were an undisclosed form of compensation, this was not a material misstatement. The $10.48 million in expenses were reimbursed to Mr. Nadal over the period from 2009 to 2014, averaging approximately $2.1 million per year. Judge Sullivan held that these payments were not quantitatively material as against MDC's total expenses in any given year, for example, in 2013, the payment was 0.18% of MDC's $1.18 billion in expenses.

[47] The dismissal of the class action in the U.S., however, did not bring to an end proceedings against MDC. The SEC brought an enforcement action against MDC and some of its officers.

[48] In January, May, and November 2017, MDC and Messrs. Nadal and Sabatino entered into "no contest" settlements with the SEC. They did so without admitting or denying the findings, and with no proof by the SEC of the allegations of fact or of alleged breaches of securities laws.

[49] The SEC never took issue with the timing of MDC's disclosure of the subpoena and rather noted that MDC's formation of the Special Committee and its internal investigation were remedial acts that prompted the SEC to resolve the investigation. The civil penalty of $1.5 million eventually paid by MDC when the investigation was resolved in January 2017 through the MDC Settlement represented 0.1% of MDC's 2016 consolidated revenues of $1.386 billion. The SEC concluded its investigation without requiring any restatement in respect of the financial statements or in respect of ICFR.

[50] On February 22, 2017, the appeal from Judge Sullivan's decision was voluntarily dismissed.

[51] In Canada, in April and June 2017, the Defendants brought motions to limit the proposed class to purchasers of MDC's shares on the TSX. In response to the motion, Mr. Paniccia amended his Statement of Claim to bring his action on behalf of the following class of Canadian purchasers:

> All persons and other entities residing in Canada or formed or registered under the provincial or federal laws of Canada, other than Excluded Persons, who acquired MDC's Common Stock on any domestic or foreign stock exchange or through an over-the-counter transaction during the Class Period [October 28, 2013 to and including April 27, 2015] and who held some or all of those securities at the close of trading on April 27, 2015.

[52] In August 2017, as a result of its communications with the SEC about how to group or segment its partner firms into reporting units, MDC decided to recast its reportable segments from two into four reportable segments. MDC amended its annual report for the year ended

December 31, 2016 and its quarterly report for the period ended March 31, 2017. MDC disclosed that "the recasting of prior period segment information does not affect the Company's consolidated financial condition or results of operations, balance sheets, cash flows, or goodwill for any period."

[53] On April 23, 2018, Mr. Paniccia delivered a Second Fresh as Amended Statement of Claim. The amended claim shortens the proposed Class Period to October 29, 2014 to April 27, 2015. The amended claim makes new allegations of material errors and ineffective internal controls in relation to MDC's segment reporting — a different and distinct accounting issue from any of those previously alleged in this action or in the SEC investigation. The amended claim relies upon the SEC settlements entered into in 2017.

[54] In the Amended Notice of Motion delivered on May 8, 2018, Mr. Paniccia limits the alleged misrepresentations to three public disclosure documents released by MDC during this period; namely: (1) the Current Report on Form 8-K released on October 29, 2014, reporting MDC's financial results for the period ended September 30, 2014; (2) the Quarterly Report on Form 10-Q released on November 6, 2014, including MDC's unaudited interim financial statements for the period ended September 30, 2014; and (3) Annual Report on Form 10-K released on March 2, 2015, including MDC's audited financial statements.

C. The Mintzer Report

[55] To satisfy the statutory test under the Ontario *Securities Act* for leave to proceed with a statutory misrepresentation cause of action under s. 138.3 under the Act, Mr. Paniccia relies on: (a) common sense inferences; (b) the Settlement Agreements between the SEC and the Defendants; (c) post-Class Period correspondences between the SEC and MDC; and (d) the expert report of Andrew Mintzer.

[56] Mr. Mintzer of Santa Monica, California, is a Certified Public Accountant ("CPA") in the U.S. and is a Chartered Professional Accountant, Chartered Accountant, ("CPA, CA") in Canada. He has audited hundreds of companies as an auditor with Ernst & Young, LLP. He has been an expert witness on dozens of matters involving the determination of whether audits were performed in accordance with GAAP and/or Public Company Accounting Oversight Board ("PCAOB") Standards. He is also a Certified Fraud Examiner ("CFE"), a professional credential issued by the Association of Certified Fraud Examiners denoting proven expertise in fraud prevention, detection, and deterrence.

[57] It was Mr. Mintzer's opinion that MDC's publicly filed financial statements and earnings releases contained misrepresentations of material facts as defined in both Canadian and U.S. accounting rules; more specifically: (a) MDC's financial statements as of September 30, 2013, December 31, 2013, March 31, 2014, June 30, 2014, September 30, 2014, and December 31, 2014 failed to appropriately account for and disclose unauthorized disbursements to Mr. Nadal that directly resulted in Mr. Nadal resigning as CEO and returning over $21 million to MDC; (b) MDC's certifications that its disclosure controls and procedures were effective as of September 30, 2013, December 31, 2013, March 31, 2014, June 30, 2014, September 30, 2014, and December 31, 2014 were misleading given that the Company's internal controls failed to prevent and detect disbursements that "lacked appropriate substantiation" and that were "improperly paid" to Mr. Nadal; and, (c) MDC's earning releases issued on October 28, 2013, February 20, 2014 and April 20, 2014, failed to comply with Canadian and U.S. accounting related

requirements concerning the disclosure of a Non-GAAP measure called EBITDA.

[58] Mr. Mintzer opined that it was a material misrepresentation that MDC did not disclose the basis for its apparent decision to delay the disclosure of the subpoena and the SEC investigation, which investigation included an inquiry into the inappropriate reimbursement of Mr. Nadal's expenses, which, in turn, was a material matter concerning self-dealing or misappropriation by senior management that ought to have been disclosed. He concluded that the investigation of MDC's payment to Mr. Nadal to reimburse him for expenses ought to have been disclosed and the failure to do so was a misrepresentation of a material fact. He opined that MDC misrepresented that its ICFR was designed and operating effectively and that this was a material misrepresentation.

[59] In Mr. Mintzer's opinion, Mr. Nadal's ability to receive reimbursements for invalid, undisclosed, non-business-related expenses during the Class Period demonstrated that MDC's ICFR were ineffective. He opined that MDC's decision to introduce new measures to improve and strengthen its internal controls and procedures was evidence that its ICFR had been misrepresented as effective when it was not.

[60] Mr. Mintzer was cross-examined. During his cross-examination, he acknowledged that: (a) he is not qualified to give legal opinions about securities law; (b) when a company's auditors render an unqualified or clean audit opinion, they are certifying that the company's financial statements are free from misstatements that are material individually or in the aggregate, and therefore "fairly represent the picture of the company within materiality limits"; (c) in forming his opinion, he did not review BDO's work papers and he did not refer to the auditors' opinion in his report; (d) the SEC never required MDC to restate any of its public financial disclosure; (e) it is possible to have material misstatements despite effective ICFR; (f) auditors will not provide a clean report with respect to the effectiveness of ICFR if they identify any material weaknesses in a company's ICFR; and (g) EBITDA is a non-standard measure.

D. Law

1. The Statutory Cause of Action for Misrepresentations in the Secondary Market

[61] Securities statutes are remedial legislation and are to be given a broad interpretation.[6] Section 1.1 of the Ontario *Securities Act* specifies the purposes of the Act to be: (a) to provide protection to investors from unfair, improper or fraudulent practices; and (b) to foster fair and efficient capital markets and confidence in capital markets. The primary purpose of securities statutes is the protection of the investor with other goals including ensuring public confidence in the system and market efficiency.[7] To achieve these goals, securities statutes require companies whose shares are traded in the secondary market, among other things, to regularly disclose certain information to the regulator and to investors.

[62] There are two categories of continuous disclosure: (1) periodic disclosure of material facts in documents such as financial statements, proxy circulars, and insider trading reports; and (2) timely disclosure when there has been a material change in the company's affairs; *i.e.,* a

[6] *Kerr v. Danier Leather Inc*., [2007] 3 S.C.R. 331 at para. 32.
[7] *Pezim v. British Columbia (Superintendent of Brokers),* [1994] 2 S.C.R. 557; *Brosseau v. Alberta Securities Commission*, [1989] 1 S.C.R. 301 at p. 314.

matter that materially affects the company's business, operations, or capital must be disclosed at the time it occurs. The Act supplants the buyer beware orientation of the common law with compelled disclosure of relevant information, but in in compelling disclosure, the Act recognizes the burden it places on issuers and the legislation sets the limits on what is required to be disclosed; namely, material facts and material changes.[8]

[63] Securities statutes enforce the disclosure requirements imposed on companies with statutory causes of action. The major constituent elements of the statutory causes of action for misrepresentations in the secondary market are: (a) the making of a misrepresentation or the failure to disclose a material fact; (b) a public correction of the false information; and (c) the trading of a security between the time of the misrepresentation or the failure to disclose a material fact.

[64] To plead the statutory causes of action, the plaintiff should: (a) identify the inculpatory statement or omission and when it was made or ought to have been made; (b) specify the falseness of the inculpatory statement; and (c) identify the public correction and when it was made.[9]

[65] The specification of the public correction is important because it determines the class period for the purposes of determining class membership and it is a factor in the calculation of damages under Part XXIII.1 of the Ontario *Securities Act*.[10] The phrase "publicly corrected" is not defined in the Ontario *Securities Act*, and it is taken from economic theory about how to measure damages for misrepresentations that affect the value of securities trading in the primary or secondary market. A key identifier of a public correction is that it can be shown to have a statistically significant impact on market prices.[11]

[66] The public correction need not be made by the issuer of the security and can take any form of message, including statements by the issuer, credit rating agencies, market analysts, and short-sellers in newspaper articles and internet postings, even anonymous ones.[12] The public correction need not be a mirror-image of the alleged misrepresentation or a direct admission that a previous statement is untrue, but the correction must be reasonably capable of revealing to the market the existence of an untrue statement of material fact or an omission to state a material fact.[13]

[67] For the purpose of the leave requirement and for the purpose of determining whether the claim is timely and not statute-barred, each alleged misrepresentation or failure to disclose a material fact is a discrete misrepresentation claim.[14]

[68] For the statutory causes of action under the Ontario *Securities Act*, "misrepresentation," "material change," and "material fact," are defined in s. 1(1) of the Act as follows:

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[8] *Kerr v. Danier Leather Inc*., [2007] 3 S.C.R. 331 at para. 32.
[9] *Mask v. Silvercorp Metals Inc*., 2016 ONCA 641 at para. 15, aff'g 2015 ONSC 5348 at paras. 22-23.
[10] *Drywall Acoustic Lathing and Insulation Local 675 Pension Fund v. SNC-Lavalin Group Inc*., 2016 ONSC 5784.
[11] *Drywall Acoustic Lathing and Insulation Local 675 Pension Fund v. SNC-Lavalin Group Inc*., 2016 ONSC 5784.
[12] *Mask v. Silvercorp Metals Inc*., 2015 ONSC 5348 at paras. 29-30, aff'd 2016 ONCA 641.
[13] *Ironworkers Ontario Pension Fund (Trustees of) v. Manulife Financial*, 2013 ONSC 4083, at paras. 64-71, leave to appeal ref'd 2014 ONSC 1347 (Div. Ct); *Swisscanto Fondsleitung AG v. BlackBerry Ltd.*, 2015 ONSC 6434 at paras. 62 -65.
[14] *Drywall Acoustic Lathing and Insulation Local 675 Pension Fund (Trustees of)* v. *SNC-Lavalin Group Inc*., 2015 ONCA 718, var'g 2015 ONSC 256; *Millwright Regional Council of Ontario Pension Trust Fund (Trustees of) v. Celestica Inc*., 2014 ONSC 1057.

"misrepresentation" means,

(a) an untrue statement of material fact, or

(b) an omission to state a material fact that is required to be stated or that is necessary to make a statement not misleading in the light of the circumstances in which it was made;

"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 subclause (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 subclause (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;

[69] The definition of a misrepresentation of material fact in Canada is derived from American jurisprudence; namely, the U.S. Supreme Court's decision in *TSC Industries, Inc. v. Northway, Inc.*[15] Materiality is determined objectively from the perspective of what a reasonable investor would consider important in deciding to invest and at what price, and the business judgment rule does not apply to determine what is material.[16]

[70] A fact may be considered material if there is a substantial likelihood that a reasonable

[15] 426 US 438 (1976). *Sharbern Holding Inc v. Vancouver Airport Centre Ltd.*, 2011 SCC 23 at paras. 41-52; *Re Donnini* (2002), 25 OSCB 6225 at paras. 136-137, aff'd [2003] O.J. No. 3541 (S.C.J.), rev'd (with respect to sanctions only) (2005), 250 D.L.R. (4th) 195 (Ont. C.A.). The *TSC Industries* test was adopted in *Sparling v. Royal Trustco Ltd.* (1984), 6 D.L.R. (4th) 682 (Ont. C.A.), aff'd [1986] 2 S.C.R. 537; *Harris v. Universal Explorations Ltd.* (1982), 17 B.L.R. 135 (Alta. C.A.); *Inmet Mining Corp. v. Homestake Canada Inc*., 2003 BCCA 610.

[16] *Sharbern Holding Inc. v. Vancouver Airport Centre Ltd.*, 2011 SCC 23; *Wong v. Pretium Resources Inc*., 2017 ONSC 3361 at paras. 29-31.

investor would consider it important in deciding whether to invest and at what price.[17] A materiality standard is a legislated and regulatory balancing between too much and too little disclosure. In *TSC Industries, Inc. v. Northway, Inc.*, the U.S. Supreme Court stated:[18]

> ... if the standard of materiality is unnecessarily low, not only may the corporation and its management be subjected to liability for insignificant omissions or misstatements, but also management's fear of exposing itself to substantial liability may cause it simply to bury the shareholders in an avalanche of trivial information - a result that is hardly conducive to informed decision making.

[71] Materiality is a contextual and fact-specific inquiry, determined on a case-by-case basis from the perspective of the reasonable investor and involves the application of a legal standard to specific facts in light of all of the relevant circumstances and the total mix of information.[19] The court must therefore inquire into what the reasonable investor would consider as significantly altering the total mix of information made available to him or her in the particular circumstances; this is a fact-specific inquiry, and except in those cases where common sense inferences are sufficient, the party alleging materiality must provide evidence in support of that contention.[20]

[72] In *Sharbern Holding Inc. v. Vancouver Airport Centre Ltd.*,[21] Justice Rothstein summarized the test for materiality and the methodology for applying the test as follows:

> 61. In sum, the important aspects of the test for materiality are:
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> (i) Materiality is a question of mixed law and fact, determined objectively, from the perspective of a reasonable investor;
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> (ii) An omitted fact is material if there is a substantial likelihood that it would have been considered important by a reasonable investor in making his or her decision, rather than if the fact merely might have been considered important. In other words, an omitted fact is material if there is a substantial likelihood that its disclosure would have been viewed by the reasonable investor as having significantly altered the total mix of information made available;
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> (iii) The proof required is not that the material fact would have changed the decision, but that there was a substantial likelihood it would have assumed actual significance in a reasonable investor's deliberations;
>
> (iv) Materiality involves the application of a legal standard to particular facts. It is a fact-specific inquiry, to be determined on a case-by-case basis in light of all of the relevant considerations and from the surrounding circumstances forming the total mix of information made available to investors; and
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> (v) The materiality of a fact, statement or omission must be proven through evidence by the party alleging materiality, except in those cases where common sense inferences are sufficient. A court must first look at the disclosed information and the omitted information. A court may also consider contextual evidence which helps to explain, interpret, or place the omitted information in a broader factual setting, provided it is viewed in the context of the disclosed information. As well, evidence of concurrent or subsequent conduct or events that would shed light on potential or actual behaviour of persons in the same or similar situations is relevant to the materiality assessment.

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[17] *Sharbern Holding Inc. v. Vancouver Airport Centre Ltd*., 2011 SCC 23; *Wong v. Pretium Resources Inc*., 2017 ONSC 3361.

[18] 426 U.S. 438 (1976), at pp. 448-49; approved in *Sharbern Holding Inc. v. Vancouver Airport Centre Ltd.*, 2011 SCC 23 at para. 41.

[19] *Sharbern Holding Inc. v. Vancouver Airport Centre Ltd.*, 2011 SCC 23 at paras. 52-58.

[20] *Sharbern Holding Inc. v. Vancouver Airport Centre Ltd.*, 2011 SCC 23 at para. 58.

[21] 2011 SCC 23 at para. 61.

> However, the predominant focus must be on a contextual consideration of what information was disclosed, and what facts or information were omitted from the disclosure documents provided by the issuer.

[73] The definition of material fact is broader than that of material change because it encompasses any fact that reasonably would be expected to have a significant effect on the market price or value of the securities of an issuer and not only changes in the business, operations, assets or ownership of the issuer that would be expected to have such an effect.[22] The distinction between material change and material fact was a deliberate and policy-based legislative decision to relieve reporting issuers of the obligation to continually interpret external political, economic, and social developments as they affect the affairs of the issuer, unless the external change will result in a change in the business, operations or capital of the issuer, in which case, timely disclosure of the change must be made.[23]

[74] However, the requirement to make timely disclosure of a material change is not an obligation to provide running commentary on the company's progress or to comment on internal or external events that may impact on the company's performance.[24] A downward trend in the performance of a business caused by a significant disruption or interference in the ongoing business operations is a material change, but a downward trend without more is not a material change requiring disclosure.

[75] In the context of a motion for leave to pursue a statutory cause of action, a company's restatement of its financial statements is an acknowledgment by the company that it has made material misrepresentations in relation to its audited financial statements that justifies granting leave to bring a statutory cause of action.[25] In the context of a motion for leave to pursue a statutory cause of action, the absence of a restatement, an acknowledgement, a criminal or regulatory finding, or a qualified audit report, the Plaintiffs must adduce some evidence to show that they have a reasonable prospect of successfully demonstrating at trial that the Defendants misled the market by publishing an untrue statement of material fact or by failing to disclose a material change on a timely basis.[26]

[76] In *Pezim v. British Columbia (Superintendent of Brokers)*,[27] information contained in drilling results regarding a mining company's exploration site was held capable of being a material change. In the same case, the Supreme Court held that the failure to disclose the details of a private placement in which the issuer would increase its control of an associated corporation was a material change that ought to have been disclosed. The Court also held that depending on the circumstances, a contractual dispute with a trade debtor of the issuer could constitute a material change affecting the business, operations, ownership or affairs of a reporting issuer.

[77] In *Rex Diamond Mining Corp., Re*,[28] the Ontario Securities Commission found that a material change occurred in the diamond company's business when it was legally unable to

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[22] *Pezim v. British Columbia (Superintendent of Brokers)*, [1994] 2 S.C.R. 557 at paras. 79-82; *Kerr v. Danier Leather Inc*., [2007] 3 S.C.R. 331 at para. 35.
[23] *Kerr v. Danier Leather Inc*., [2007] 3 S.C.R. 331 at para. 38.
[24] *Green v. CIBC*, 2012 ONSC 3637 at para. 28, aff'd 2014 ONCA 90, aff'd 2015 SCC 60; *Mask v. Silvercorp Metals Inc*., 2015 ONSC 5348 at para. 56, aff'd 2016 ONCA 641.
[25] *Silver v. Imax Corp*. (2009), 66 BLR (4th) 222 at paras. 7, 208, and 351.
[26] *Millwright Regional Council of Ontario Pension Trust Fund (Trustees of) v. Celestica Inc.*, 2014 ONSC 1057.
[27] [1994] 2 S.C.R. 557.
[28] (2008), 31 O.S.C.B. 8337.

access its mining properties in order to extract diamonds.

[78] In *Coventree Inc., Re,*[29] the Ontario Securities Commission found that the inability of a capital markets company to continue to issue commercial paper through its conduits, which was a primary source of its revenue and a crucial aspect of its business, was a material change because the company was no longer able to carry on its principal business.

[79] In *Theratechnologies inc. v. 121851 Canada inc.*,[30] a pharmaceutical company's response to the questions of an Advisory Committee about the potential side effects of a drug pending regulatory approval was held not to be a material change. The potential side effects of the drug had already been disclosed to shareholders well before the regulator published its questions and there was no new information about the side effects of the drug that required timely disclosure.

[80] In *Kerr v. Danier Leather Inc.*,[31] intra-quarterly results indicating a possible failure to reach forecast sales because of unseasonable weather was held not to constitute a material change to the business, operations or capital of the company because the weather that triggered the drop in sales was external to the company and its business.

2. Disclosure of Regulatory Investigations

[81] Pursuant to statute, the investigation by a securities regulator is confidential.

[82] Under the Ontario *Securities Act*, no person or company may disclose the nature or content of an investigation order, the nature or content of any demands for production, or the fact that any document was produced to an investigator, at any time, except to counsel.[32] To disclose the existence of an investigation, including any request for and production of documents, the issuer must first obtain an order from the Commission authorizing the disclosure on the grounds that it is in the public interest. The Guidelines for Staff Disclosure of Investigations, set out in Staff Notice 15-703, indicate that the "general rule" is that there will be no public disclosure of information about an on-going or closed investigation.[33]

[83] Under U.S. federal securities law, there is no general obligation to disclose an ongoing SEC investigation to investors. The SEC's Form 8-K, which identifies matters that require immediate reporting, does not include reporting a regulatory subpoena.

[84] In *In re Lions Gate Entertainment Corp.*,[34] Judge Koeltl, of the U.S. District Court for the Southern District of New York, dismissed a proposed secondary market class action alleging that Lions Gate had failed to disclose a SEC investigation. Lions Gate had received notices informing it of a SEC enforcement proceeding. The court held that a government investigation, without more, does not trigger a generalized duty to disclose. The court held that an issuer has a duty to disclose potential litigation only if it is substantially certain to occur, and the commencement of an SEC investigation did not indicate that a SEC enforcement proceeding was substantially certain to occur.

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[29] (2011), 34 O.S.C.B. 10209.
[30] 2015 SCC 18.
[31] [2007] 3 S.C.R. 331.
[32] Ontario *Securities Act*, R.S.O. 1990, c. S.5, ss. 11, 13, 16, 17.
[33] OSC Staff Notice 15-703, s. 5, *Guidelines for Staff Disclosure of Investigations* (2004), 27 OSCB 8520. SEC Form 8-K Current Report.
[34] 2016 U.S. Dist. LEXIS 7721. See also *Markman v. Whole Foods Mkt. Inc.*, 2016 U.S. Dist. LEXIS 199933.

3. The Leave Requirement

[85] Under s. 138.8(1) of the Ontario *Securities Act*, leave of the court is required to proceed with a statutory misrepresentation cause of action under s. 138.3. Section 138.8(1) reads:

> 138.8(1) No action may be commenced under s. 138.3 without leave of the court granted upon motion with notice to each defendant. The court shall grant leave only 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.

[86] The statutory causes of action require leave, and the leave requirement was designed to have a gatekeeper function.[35] Leave is required for each discrete misrepresentation, such that leave for one allegation of misrepresentation does not mean that leave is granted for all other allegations of misrepresentation and, therefore, a plaintiff must lead sufficient evidence to satisfy the Court as to the leave requirement for each discrete allegation of misrepresentation.[36]

[87] In *Theratechnologies inc. v. 121851 Canada inc*.,[37] Justice Abella, writing for a unanimous Court, described the test for leave as a "robust deterrent screening mechanism," which is designed to prevent "costly strike suits and litigation with little chance of success. The reasonable possibility of success requirement of the leave test is a meaningful but low threshold, merits-based test that is more than a superficial examination of the merits of the plaintiff's statutory cause of action but a meaningful examination of the evidence to ensure that the action has some merit.[38] While relatively low, the test for leave is a different and more robust standard than the general threshold for the certification or authorization of a class action.[39]

[88] The leave test is meant to create a robust deterrent screening mechanism with a reasoned consideration of the evidence from both parties so that cases without merit are prevented from proceeding.[40]

[89] The motions judge should be cognizant of the fact that full production has not been made and that the defendant may have relevant documentation and evidence that is not before the court.[41] A full analysis of the evidence is unnecessary, and the plaintiff need only provide a plausible analysis of the applicable legislative provisions and some credible evidence in support of the claim sufficient to persuade the court that there is a reasonable possibility that the action

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[35] *Theratechnologies inc. v. 121851 Canada inc*., 2015 SCC 18 at para. 36; *Abdula v. Canadian Solar Inc.*, [2013] O.J. No. 3517; *Ainslie v. CV Technologies Inc.*, [2008] O.J. No. 4891 (S.C.J.), leave to appeal to Div. Ct. granted, 2009 CanLII 7165, appeal discontinued, at paras. 7-13.

[36] *Drywall Acoustic Lathing and Insulation Local 675 Pension Fund (Trustees of) v. SNC-Lavalin Group Inc*., 2015 ONSC 256 at para. 34, aff'd 2015 ONCA 718; *Musicians' Pension Fund of Canada (Trustees of) v. Kinross Gold Corporation*, 2014 ONCA 901 at paras. 83-87; *Trustees of the Millwright Regional Council of Ontario Pension Trust Fund v. Celestica Inc.*, 2014 ONSC 1057 at paras. 106 and 123-150.

[37] 2015 SCC 18 at para. 39.

[38] *Musicians' Pension Fund of Canada (Trustees of) v. Kinross Gold Corp*., 2014 ONCA 901, aff'g 2013 ONSC 6864; *Green v. CIBC*, 2014 ONCA 90, var'g 2012 ONSC 3637, aff'd 2015 SCC 60, leave to appeal refused [2011] O.J. 656 (Div. Ct.); *Bradley v. Eastern Platinum Ltd.*, 2016 ONSC 1903 at para. 51.

[39] *Theratechnologies inc. v. 121851 Canada inc*., 2015 SCC 18 at para. 35; *Goldsmith v. National Bank of Canada*, 2016 ONCA 22 at paras. 27-33, aff'g 2015 ONSC 2746.

[40] *Theratechnologies inc. v. 121851 Canada inc*., 2015 SCC 18 at para. 38; *Mask v. Silvercorp Metals Inc*., 2016 ONCA 641 at paras. 42-43, aff'g 2015 ONSC 5348.

[41] *Rahimi v. SouthGobi Resources Ltd.*, 2017 ONCA 719 at paras. 45-49.

will be resolved in the plaintiff's favour.[42] However, the court must do more than simply ascertain whether the plaintiff has presented evidence of a triable issue; using the record of affidavit evidence and cross-examinations, the court is entitled to weigh the evidence of both parties, but the court must take into account that the leave motion involves merely a paper record and that the statutory leave test sets a low evidentiary threshold.[43]

[90] In the leave test, "good faith" has been interpreted to mean that the plaintiff has brought his or her action in the honest belief that he or she has an arguable claim, for reasons that are consistent with the purpose behind the statutory remedy, not for an oblique or collateral purpose, and with the genuine intention and capacity to prosecute the claim if leave is granted.[44]

[91] On the second branch of the leave test, the test is that leave should not be granted if having considered all the evidence and having regard to the limitations of the motions process, the plaintiff's case is so weak or has been so successfully rebutted by the defendant, that it has no reasonable possibility of success.[45]

E. Discussion and Analysis

1. The Flaw in Mr. Paniccia's Statutory Cause of Action

[92] As noted above, each alleged misrepresentation or failure to disclose a material fact is a discrete misrepresentation claim for the purpose of the leave requirement under the Ontario *Securities Act*. In the case at bar, five misrepresentations can be identified; namely: (1) the SEC Subpoena Misrepresentation; (2) the Special Committee about Internal Controls Misrepresentation; (3) the EBITDA Misrepresentation; (4) Mr. Nadal's Compensation Misrepresentation; and (5) the Segments Misrepresentation.

[93] In the case at bar, there is no dispute that Mr. Paniccia satisfies the "good faith" branch of the leave test for each of the five misrepresentations. In the immediate case, the contest over leave is about whether having considered all the evidence and having regard to the limitations of the motions process, Mr. Paniccia's case is so weak or has been so successfully rebutted by the defendant, that it has no reasonable possibility of success.

[94] As explained below, there are discrete reasons for concluding that for each of the five misrepresentations, there is no reasonable possibility of success. There is also a fundamental weakness in Mr. Paniccia's statutory cause of action that applies to all of the alleged misrepresentations. The fundamental flaw is all the alleged misrepresentations want for materiality.

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[42] *Theratechnologies inc. v. 121851 Canada inc*., 2015 SCC 18 at paras. 38-39; *Green v. CIBC*, 2015 SCC 60 at paras. 122, 147, and 212, aff'g 2014 ONCA 90, var'g 2012 ONSC 3637; *Goldsmith v. National Bank of Canada*, 2016 ONCA 22 at para. 34, aff'g 2015 ONSC 2746.

[43] *Mask v. Silvercorp Metals Inc*., 2016 ONCA 641, aff'g 2015 ONSC 5348; *Musicians' Pension Fund of Canada (Trustees of) v. Kinross Gold Corp*., 2014 ONCA 901, aff'g 2013 ONSC 6864; *Green v. CIBC*, 2014 ONCA 90, var'g 2012 ONSC 3637, aff'd 2015 SCC 60.

[44] *Silver v. Imax Corp*., [2009] O.J. No. 5573 at para. 308, leave to appeal refused [2011] O.J. 656 (Div. Ct.).

[45] *Mask v. Silvercorp Metals Inc*., 2016 ONCA 641, aff'g 2015 ONSC 5348; *Swisscanto Fondsleitung AG v. BlackBerry Ltd.*, 2015 ONSC 6434; *Rahimi v. SouthGobi Resources Ltd*., 2015 ONSC 5948, var'd 2017 ONCA 719; *Coffin v. Atlantic Power Corp*., 2015 ONSC 3686; *Goldsmith v. National Bank of Canada*, 2015 ONSC 2746, aff'd 2016 ONCA 22.

[95] Determination of materiality of financial data is typically a matter for the auditor's professional judgment,[46] and the Defendants submit that in the immediate case, the want of materiality is demonstrated by the fact that BDO has not withdrawn their unqualified audit opinions nor required a restatement of MDC's financial statements for any of the years 2012 to 2016 and BDO has not withdrawn its ICFR reports for any of the years 2012 to 2016, and it is demonstrated by the fact that the SEC did not require any restatements. Further, the Defendants go further and submit that the absence of any restatements from BDO precludes Mr. Paniccia from arguing that the alleged misrepresentations by omission are misrepresentations of material facts.

[96] I agree with the Defendants that the absence of restatements has evidentiary value in the assessment of materiality, but I disagree that the absence of restatements precludes a finding that a material fact was misrepresented. As Justice Rothstein noted in *Sharbern Holding Inc. v. Vancouver Airport Centre Ltd., supra,* evidence of concurrent or subsequent conduct or events that would shed light on potential or actual behaviour of persons in the same or similar situations is relevant to the materiality assessment. However, he emphasized that the predominant focus must be on a contextual consideration of what information was disclosed, and what facts or information were omitted from the disclosure documents provided by the issuer.

[97] The Defendants are correct that in the absence of a restatement, an acknowledgement, a criminal or regulatory finding, or a qualified audit report, Mr. Paniccia must adduce some evidence to show that he has a reasonable prospect of successfully demonstrating at trial that there was a misrepresentation of a material fact, but that is not to say the absence of a restatement, an acknowledgement, a criminal or regulatory finding, or a qualified audit report precludes him proving in some other way that there was a misrepresentation of a material fact. In my opinion, in the immediate case, however, he has failed to do so. Such evidence as exists stands against material misrepresentations.

[98] There are no categorical elements to materiality because materiality is a contextual and fact-specific inquiry, determined on a case-by-case basis from the perspective of the reasonable investor. The inquiry involves the application of a legal standard to specific facts in light of all of the relevant circumstances and the total mix of information.[47] Applying that methodology to the circumstance of the immediate case it cannot be said that a reasonable investor would consider any of the alleged misrepresentations as being material to his or her investment decisions.

[99] Mr. Paniccia is not assisted by the evidence of Mr. Mintzer. Mr. Mintzer is qualified to opine from an accountant's or auditor's perspective what is a material fact or change from an accountant's perspective of preparing or auditing financial statements. However, it is for the court to determine what to an investor is a material fact or a material change under the *Securities Act*. This is a legal test.

[100] As described above, materiality involves the application of a legal standard (not simply an accounting or auditing standard) to specific facts, and while depending on the nature of the alleged misrepresentation, a court may be assisted by understanding what is material from an auditor's point of view and what is the appropriate accounting or auditing standard, just as it might be assisted by understanding what is material from a geologist's or economist's point of

[46] *Livent Inc. (Receiver of) v. Deloitte & Touche*, 2014 ONSC 2176 at para. 104, aff'd 2016 ONCA 11, var'd 2017 SCC 63.
[47] *Sharbern Holding Inc. v. Vancouver Airport Centre Ltd.*, 2011 SCC 23 at paras. 52-58.

view, ultimately, it is for the court to determine what is objectively important to a reasonable investor in making his or her investment decisions.

[101] While each case must be considered on its own merits, the case law is informative about the methodology of determining materiality for the purposes of a motion for leave to purse a statutory cause of action under securities statutes.

[102] In *Abdula v. Canadian Solar Inc.*,[48] Mr. Abdula alleged that Canadian Solar made three representations in core documents that artificially inflated the company's share price resulting in damages to shareholders after the truth was revealed. With respect to the first misrepresentation, which was that Canadian Solar misrepresented its financial results in reporting revenues, losses, allowances for advance payments, and loss reserves, based on Canadian Solar's concession, Justice Taylor granted leave to pursue the statutory cause of action with respect to the Q4 2009 financial statements. However, he did not grant leave in relation to the Q1, Q2 and Q3 2009 financial statements because there was no evidence that these financial statements were materially misstated; *i.e.*, leave was not granted because the materiality of the alleged misrepresentation was not established.

[103] With respect to the third alleged misrepresentation, which was that Canadian Solar had falsely misrepresented that its internal financial controls were effective, Justice Taylor granted leave. He concluded that Canadian Solar had identified the deficiencies in its controls but had not reported them until later and there was expert evidence that the deficiencies were material and should have been disclosed.

[104] With respect to the second alleged misrepresentation, which also concerned misrepresentations about the efficiency of the company's internal controls in relation to revenue recognition, Justice Taylor found that there was a misrepresentation, but he did not grant leave because there was no evidence as to the materiality of the defective revenue recognition controls. Justice Taylor stated at paragraphs 68 and 69 of his reasons:

> 68. …. I interpret from these statements that the weaknesses were identified at some point during the year in 2009 and were corrected over a period of time in 2010. On this point, I also think it to be significant that the SEC was investigating, or is investigating, Canadian Solar in relation to financial fraud focusing on revenue recognition issues for the period 2008 to 2010.
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> 69. I, therefore, would conclude that, in all likelihood the internal control in relation to revenue recognition existed at the time of the issuance of Canadian Solar's annual report and Audited Consolidated Financial Statements for the fiscal year 2008. However, there is no opinion from Professor Pritchard that the internal control in relation solely to the revenue recognition policy was a material deficiency. Because there is no evidence as to the materiality of the defective revenue recognition policy standing on its own, I am not satisfied that there is a reasonable possibility of the plaintiff being successful at trial in showing a misrepresentation contained in Canadian Solar's annual report and Audited Consolidated Financial Statements for the fiscal year 2008.

[105] In comparison to the case at bar, Mr. Abdula had a stronger argument than Mr. Paniccia. The SEC was investigating Canadian Solar about financial fraud focusing on revenue recognition and while Justice Taylor was prepared to conclude that Canadian Solar had identified the weakness in its financial controls before making its representation, he was not prepared to conclude that materiality had been established by the mere fact of there being an investigation. In the immediate case, the SEC was investigating MDC and the evidence from the outcome of that investigation does not support the inference of materiality. The want of materiality is

[48] 2014 ONSC 5167.

demonstrated by, among other things, the fact that the financial statements were not recalled or restated.

[106] As I shall explain below, in more detail, in my opinion, materiality was not established for any of the five alleged misrepresentations in the immediate case.

2. The SEC Subpoena Misrepresentation

[107] Mr. Paniccia submits that the receipt of this October 5, 2014 subpoena due to the seriousness of the topics being investigated by the SEC was a material fact that MDC was required to disclose in compliance with MDC's Code of Conduct and the requirements of Part XVIII of the Ontario *Securities Act.* Mr. Paniccia submits that by not disclosing the investigation earlier that MDC was representing that it was not under investigation and that not disclosing an investigation amounts to a misrepresentation.

[108] In my opinion, there was no misrepresentation and no withholding of a material fact between the time the subpoena was served on MDC and April 27, 2015 when MDC disclosed the service of the subpoena. The mere service of a subpoena does not trigger a duty to disclose, and as noted above, the law is that, generally speaking, the existence of an investigation is a confidential matter that ought not to be disclosed and that disclosure requires the approval of the regulator.

[109] I agree with the reasoning of Judge Koetl *In re Lions Gate Entertainment Corp*., *supra* that a regulator's investigation, without more, does not trigger a duty to disclose.

[110] I also agree with the Defendants' argument that the commencement of an investigation does not necessarily or even probably mean that there have been any misrepresentations or breaches of securities laws that may lead to enforcement proceedings. Premature disclosure of an investigation may be harmful and adversely affect share values because the investigation may determine that there was no misrepresentation by the company or no wrongdoing by the company or that any misrepresentation or wrongdoing was not a matter rising to the level of materiality.

[111] Mr. Paniccia relies on the authority of *Wong v. Pretium Resources Inc.*[49], a misrepresentation by omission case, in support of its argument that as an objective measure, a reasonable investor would have considered it material to know that MDC had been served with a subpoena.

[112] In the *Wong* case, Pretium Resources, a mining company, reported a consultant's mineral resource estimate for a mine project. Pretium planned to test the accuracy of the estimate by excavating and testing a 10,000-ton sample, but while that test was pending, Pretium retained another consultant. The second consultant, based on a smaller test sample, opined that Pretium ought to report that there was reason to doubt the first consultant's resource estimate. Pretium disagreed with that opinion, and the second consultant resigned. Pretium then disclosed to the market its disagreement with the second consultant and its reason for not disclosing the pessimistic opinion, which after an investigation Pretium felt was based on an unreliably small sample. The disclosure of the disagreement with the second consultant, however, led to a precipitous decline in the value of Pretium's shares. Mr. Wong brought a statutory action for

[49] 2017 ONSC 3361.

misrepresentation for Pretium's omission to disclose its disagreement with the second consultant. Mr. Wong sought leave to assert his statutory cause of action.

[113] In the *Wong* case, although by the time of the leave motion, it had been determined that the original resource estimate had indeed been accurate and that the mining project was on schedule, Justice Belobaba granted Mr. Wong leave to proceed with his statutory claim. Justice Belobaba concluded that Mr. Wong had met the test of showing a reasonable possibility of success of his statutory claim at trial. At paragraphs 36-37 of his Reasons for Decision, Justice Belobaba stated:

> 36. As already noted, the debate between [first consultant] on the one side and [second consultant] on the other was a debate that would eventually be won by Pretium when the bulk sample was fully milled and tested. However, during the time period in question, it cannot be said, in all the circumstances, that the unreliability of the sample tower date was so obvious and self-evident and [second consultant's] concerns so wrong-headed that [its] findings and views were not material and that no reasonable investor would want to know what [second consultant] was saying.
>
> 37. In my view, by any objective measure, reasonable investors would have considered it material that two respected mining consultancies retained by Pretium … fundamentally disagreed as to whether there were valid mineral resources in the VOK zone of the Brucejack mine, a question that went to the very heart of Pretium's entire business model.

[114] I do regard the *Wong v. Pretium Resources Inc.* case as helpful to Mr. Paniccia. SEC's service of a subpoena and commencement of an investigation is not comparable to a second consultant conducting an independent investigation and wishing to report his conclusions about a resource estimate. An investigation is not a conclusion about a fact. An investigation may be short or it may be long, but whether its conclusions amount to anything material is an unknown at the point of commencement.

[115] A reasonable investor would not expect a company to immediately report the service of subpoena. What a reasonable investor would expect is that the company would respond to the subpoena, cooperate with the investigator, and conduct an internal investigation and then determine whether there was a material fact to correct or a material change to report to its investors. This is precisely what occurred in the case at bar.

[116] In the case at bar, having considered all the evidence and having regard to the limitations of the motions process, Mr. Paniccia's case based on the subpoena misrepresentation is so weak, that it has no reasonable possibility of success.

3. The Special Committee about Internal Controls Misrepresentation

[117] For similar reasons, I conclude that the Defendants made no misrepresentation in not disclosing its internal investigation after MDC was served with the subpoena. It acted responsibly by cooperating with the SEC and forming its own Special Committee of independent directors to conduct an investigation of the matters raised by the SEC. The Special Committee investigated and then made recommendations to respond to the problems its investigation revealed.

[118] There was no misrepresentation about the effectiveness of MDC's internal controls. BDO has not withdrawn or restated its clean audit opinion. Neither Mr. Paniccia nor Mr. Mintzer identified any specific weakness with respect to MDC's ICFR or a material misstatement about the ICFR. Rather they infer a weakness by reasoning backwards from the Committee reporting

that MDC was taking steps to strengthen and improve its ICFR. That inference does not logically follow because it is possible to have material misstatements despite effective ICFR and in the case at the bar there were no material misstatements as evidenced by the fact that BDO has not withdrawn their unqualified audit opinions nor required a restatement of MDC's financial statements for any of the years 2012 to 2016, and BDO has not withdrawn its ICFR reports for any of the years 2012 to 2016.

[119] In the case at bar, having considered all the evidence and having regard to the limitations of the motions process, Mr. Paniccia's case based on the internal controls misrepresentation is so weak, that it has no reasonable possibility of success.

4. The EBITDA Misrepresentation

[120] EBITDA is a non-GAAP metric for which there is no standard formula and MDC reported accurately its formulation of EBITDA.

[121] There are four reasons why Mr. Paniccia's misrepresentation claim about EBITDA has no reasonable prospect of success.

[122] First, there is no basis to Mr. Paniccia's allegation that the Impugned Statements contained misrepresentations because they did not disclose that the SEC had demanded that MDC use the term "adjusted EBITDA" instead of EBITDA. The evidence is that MDC did disclose its exchange of correspondence with SEC, which correspondence was publicly filed on EDGAR at the time it was made and thus was publicly available before the commencement of the Statutory Leave Period.

[123] Second, MDC's EBITDA reporting was not false or misleading. It disclosed to investors how it calculated EBITDA. I agree with Judge Sullivan's analysis of this issue. He stated:

> The fact that a plaintiff may "take issue with the way a company chooses to calculate these metrics ... is of no moment," because "it is not fraudulent for a reporting entity to calculate metrics that," like EBITDA, "are not defined under GAAP," nor is it fraudulent for the company to "take (or not take) into account whatever factors the reporting entity thinks appropriate - as long as the public is told exactly what the company is doing." *Id.* Unless Plaintiffs can show that MDC somehow misled investors about how it actually calculated EBITDA, which they have not, there can be no claim for fraud. ...
>
> Plaintiffs' allegation that MDC "altered the components of its EBITDA metric to further inflate its financial performance" [...] is similarly deficient. The allegation is conclusory, and in any event, "there is nothing inherently improper ... about reporting a positive EBITDA while simultaneously reporting a GAAP net loss" because "the two are entirely different measures." Indeed, the fact that MDC included a reconciliation of adjusted EBITDA to GAAP metrics in each of its earnings releases, see, e.g., [...] (Form 8-K) (Feb. 23, 2015), belies Plaintiffs' conclusory assertion that MDC used adjusted EBITDA to mask GAAP losses.

[124] Third, the alleged EBITDA misrepresentation occurred before the Statutory Leave Period, and there is no evidence of any misrepresentation during the Statutory Leave Period as it relates to EBITDA. MDC changed its EBITDA reporting in April 2014, and has not changed it again since then.

[125] Fourth, there was no public correction with respect to EBITDA at the end of the Statutory Leave Period - in the April 27, 2015 Statement or otherwise. This element of the statutory cause

of action has not even been pled.

[126] In the case at bar, having considered all the evidence and having regard to the limitations of the motions process, Mr. Paniccia's case based on the EBITDA misrepresentation is so weak, that it has no reasonable possibility of success.

5. Mr. Nadal's Compensation Misrepresentation

[127] Turning to the allegations of misrepresentations with respect to Mr. Nadal's compensation, none of the Impugned Statements contained any false statements about Mr. Nadal's compensation nor any statements that are corrected by the alleged corrective disclosure. The $10.48 million in reimbursement expenses were at all times reflected in MDC's financial statements in the years in which they had been paid to Mr. Nadal. The issue raised by the SEC was their characterization as proper expenses for which Mr. Nadal could claim reimbursement. Mr. Nadel's extraordinarily remunerative salary was not misrepresented. The amount of his expense claims was not misrepresented. What was learned as a result of the internal investigation was that some of his expense claims were not properly expensed to the company. Mr. Nadal repaid those expenses.

[128] The October 29, 2014 Statement does not address executive compensation, except insofar as it reported MDC's total stock-based compensation, which report would not have been affected by the alleged misrepresentation. The November 6, 2014 Quarterly Report did not address executive compensation, and the March 2, 2015 Annual Report addressed compensation expenses only insofar as it included the Company's audited annual financial statements for fiscal year 2014, which statements have never been withdrawn or restated.

[129] Further, the expenses for which Mr. Nadal was reimbursed were not material. MDC indicated in the April 27, 2015 Statement that the Company did not expect there would be any impact to its previously issued financial statements as a result of its conclusion that certain amounts had been inappropriately reimbursed to Mr. Nadal and no restatement of the financial statements has ever been made. The SEC did not require a restatement when it concluded its investigation into Mr. Nadal's perquisites and expense reimbursements and when it entered into a settlement with MDC.

[130] In the case at bar, having considered all the evidence and having regard to the limitations of the motions process, Mr. Paniccia's case based on misrepresentations with respect to Mr. Nadal's compensation is so weak, that it has no reasonable possibility of success.

6. The Segments Misrepresentation

[131] The allegations relating to segment reporting can be addressed quickly. These issue of the segments did not form part of the SEC investigation and was raised by the SEC for the first time after the end of the Statutory Leave Period. The alleged segment misrepresentation issue arose after MDC's April 27, 2015 Statement, which Mr. Paniccia regards as a partial corrective disclosure, and Mr. Paniccia has not pleaded any public correction with respect to the alleged segments misrepresentation.

[132] Assuming that the segments misrepresentation could be the subject of a statutory claim, it wants for materiality.

[133] In the case at bar, having considered all the evidence and having regard to the limitations of the motions process, Mr. Paniccia's case based on the segments misrepresentations is so weak, that it has no reasonable possibility of success.

F. Conclusion

[134] For the above reasons, Mr. Paniccia's motion is dismissed. If the parties cannot agree about the matter of costs, they may make submissions in writing, beginning with the Defendants' submissions within 20 days of the release of these Reasons for Decision followed by Mr. Paniccia's submissions within a further 20 days.

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Perell, J.

Released: June 4, 2018

CITATION: Paniccia v. MDC Partners Inc., 2018 ONSC 3470
COURT FILE NO.: 16-CV-564034-00CP
DATE: 20180604

ONTARIO
SUPERIOR COURT OF JUSTICE

BETWEEN:

ROBERTO PANICCIA

Plaintiff

– and –

MDC PARTNERS INC., MILES S. NADAL, MICHAEL C. SABATINO, DAVID DOFT

Defendants

REASONS FOR DECISION

PERELL J.

Released: June 4, 2018