

## Prospectus Liability and Investor Protection in Quebec Law

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Résumé de l'article

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Pour assurer le succès d'une telle sollicitation financière, les promoteurs ont parfois exagéré la situation réelle de la compagnie et n'ont pas hésité à faire de fausses représentations sur la santé économique de leurs entreprises. L'incidence de la fraude et de la négligence à ce stade du financement public a donc donné lieu à une jurisprudence abondante dans la Province et à des législations spéciales.

Cet article étudie, à la lumière de notre droit provincial, cet aspect bien particulier du droit corporatif tout en examinant de façon incidente l'approche de nos tribunaux et du Législateur au problème de préserver dans leur intégrité les règles du droit civil québécois face à l'assaut séculaire de la *common law*.

# Prospectus Liability and Investor Protection in Quebec Law.

Robert DEMERS\*

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« ...l'on voit qu'il y a ici un écart entre la conception anglo-canadienne et franco-québécoise... »

M. Giguère, *Les devoirs des dirigeants de sociétés par actions*, P.U.L., Québec, 1967, at p. 173.

One area of company law in which very little research has been carried out in Canada is prospectus liability. Of late, many of the problems dealing with the more technical aspects of issuing a prospectus have been examined in great detail in common and civil law jurisdictions<sup>1</sup> but no important contribution has appeared on the legal implications of fraud and negligence in the preparation of such documents. In Quebec, this problem takes on a peculiar dimension: not only must the courts deal with various statutory enactments essentially inspired from the common law tradition but they must also understand such mechanisms in function of civil law principles. The result is a curious mixture of both common and civil law and a considerable confusion<sup>2</sup> in deciding which jurisdiction

1. For common law provinces: R. C. Meech, "Prospectus and registration requirements", [1968] L.S.U.C. 211. For Quebec: Y. Renaud et J. Smith, *Droit québécois des corporations commerciales*, vol. 2, Judico Inc., Montreal, 1974, at pp. 1186 and following. An interesting discussion of prospectus liability from the underwriter's point of view can be found in P. P. Côté, "The underwriters civil liability and investor protection", (1975) 10 R.J.T. 137.
2. Professor Gower himself points to the rather confusing nature of this problem in English law: *The principles of modern company law*, 3<sup>rd</sup> ed., Stevens & Sons, London, 1969, at p. 295.

to follow. The problems of prospectus liability in Quebec to this day remain a mystery: the decisions of the courts on this aspect of the law have never been properly analysed, the statutes contain surprising elements of non-conformity to standard national models and the authors, in general, avoid touching upon the issue. It is hoped that this article will fill in this important gap in Quebec company law whilst studying at the same time the reactions of both the courts and the provincial Legislator to this intriguing problem.

## PART I

### Civil law remedies for mis-statements in the preparation of a prospectus in Quebec company law.

The main purpose of a prospectus is "to call the attention of the public"<sup>3</sup> to the company in order that they be interested in investing in the capital of that body<sup>4</sup>. Obviously, when one tries to convince a third party to participate in any joint-venture, one tries to publicize the more interesting aspects of that particular enterprise, minimizing the negative points in favour of the convincing sides of the affair. In the case of public finance, this raises great difficulties because promoters and directors will sometimes try to obtain capital at all costs. It was the particular incidence of fraud and negligence at this stage of company organization that caused the enactment of the many statutory amendments now lumbering most modern *Companies Acts* and as will be seen later on, Quebec is no exception to the rule.

In the interpretation of such statutes and of simple cases of fraud and negligence, it thus becomes exceedingly important in Quebec to decide whether common or civil law principles should apply. This is a crucial point in the discussion of this problem for the determination of the applicable rules will have important consequences on the rights of all parties involved.

As far as statutes are concerned, the rule of interpretation is a clear one: all statutes in Quebec are governed by the general principles of the Civil Code, and the Court of Appeal has indicated that the corporate laws are no exception to this principle<sup>5</sup>. As for ordinary cases of fraud and negli-

3. *French Gas Saving Co. v. The Desbarats Advertising Agency Ltd.*, [1912] 1 D.L.R. 136 (Q.B.) at p. 145 per Archer, J., in the Superior Court.

4. *Cox & Paton v. The Queen*, (1963) 40 C.R. 52 (S.C.C.) at p. 74.

5. *Darveau v. D'Amours*, (1933) 54 Que. K.B. 481 at pp. 493-494 per Létourneau, J., diss. on another issue. Unless of course the particular statute is excepted from its application. A good example is the *Special corporate powers Act*, R.S.Q. 1964, c. 275, articles 22 and following.

gence, it seems quite evident that the rules of civil law should apply: Quebec courts have readily admitted that contracts to take up shares in a company fall under the general rules of the Civil Code and that they are subjected to the same regulation as other contracts. As pointed out by Rivard, J., in *La Cie rurale de lumière électrique v. Cauchon*<sup>6</sup>:

“Les règles ordinaires du droit civil doivent s’appliquer chez nous, à ces sortes de contrats. . .”.

Thus, questions of fraud and negligence are essentially to be dealt with by the rules of civil law and the courts, consistent with their own views, have admitted French law as authority on this question<sup>8</sup>.

The influence of English law, however, was to be felt even in this sphere of company law: some courts took the unusual view that English rules should prevail over those of civil law in questions relating to fraudulent statements in connection with the issue of shares<sup>9</sup> and much confusion results from this approach in Quebec law today<sup>10</sup>.

As a general rule, the most common form of relief suggested by the cases and commentators for mis-statements in a prospectus is an action in damages against the persons making the statements and in some cases,

6. (1924) 35 Que. K.B. 532.

7. *Ibid.*, at p. 536. See also Allard, J., diss., at p. 539 agreeing on this point. Also: *Boulet v. Hudon*, (1917) 51 Que. S.C. 29 (C.R.), at p. 32; *Arless v. The Belmont Manufacturing Co.*, (1885) 1 M.L.R. 340 (Q.B.) at p. 344; *La Banque d’Hochelaga v. Garth*, (1886) 2 M.L.R. 201 (S.C.) at p. 210.

8. *Cloutier v. Dion*, [1954] Que. Q.B. 595 at p. 603 where Pratte, J., refers to the following case: S. 1882.1.311; see also *Bergeron v. La Cie. de meubles de Jonquière*, (1913) 22 Que. K.B. 341 at pp. 351-352. The tendency of accepting French authorities has always been indicative in this field of commercial law of the basically civilian nature of many of the problems involved. In *Young v. McNider*, (1895) 25 S.C.R. 272, Taschereau, J., dealt with this issue at pp. 282-284.

9. *Robert v. The Montreal Trust Co.*, (1917) 56 S.C.R. 342 per Anglin, J., at pp. 363-364 where the judge argued that the rules of civil law concerning prescription of rights resulting from a fraudulent act should be governed by the principles of common law in the field of corporate frauds for the sake of creating harmony on this question in Canada. See also *ibid.*, at pp. 362-363. In fact, what the judge is saying is that whatever civil law decides in such cases should give way to common law, a view that has not been without serious critics even of late. See: J. L. Baudouin, « L’interprétation du Code civil québécois par la Cour suprême du Canada », (1975) 53 C.B.R. 715 and more precisely at p. 722 n. 23. Also: *Rhodes v. Starnes*, (1878) 22 L.C.J. 113 (S.C.) at pp. 116-118, 120-121 where Johnson, J., refers to various authorities of English law.

10. *Renaud et Smith, op. cit.*, vol.II at p. 1135. It is not surprising to see how deeply felt was to be the influence of English law in this sphere when one considers that it even had an impact on French law: J. Hémard, F. Terré et P. Mabilat, *Sociétés commerciales*, vol. 1, Librairie Dalloz, Paris, 1972, at p. 587, n. 638.

the nullity of the subscription contract. Damages can be asked for in cases where there has been a fraudulent or a negligent statement and even where there has been a promise that has been inexecuted. These various points will be studied separately in order to underline more clearly the rules of civil law applicable to each case and the inconsistencies of importing rules of common law on such questions.

#### A. FRAUDULENT STATEMENTS IN A PROSPECTUS

##### 1. *Fraud in a civil law context: definition*

It is not easy to give a general definition of fraud that will cover every possible case<sup>11</sup> but a fraudulent act or statement, in Quebec, could be described as follows:

“. . . le fait de provoquer volontairement une erreur dans l'esprit d'autrui pour le pousser à contracter. . .”<sup>12</sup>.

In a prospectus, fraudulent statements usually fall into two categories : omissions and false representations.

Omissions, at common law, do not give rise to liability, unless they amount to a *suggestio falsi*<sup>13</sup>. This is the rule in England and in the common law provinces of Canada<sup>14</sup>. In Quebec, a similar position is adopted. A simple omission is not constitutive of fraud at civil law<sup>15</sup>: there are two important exceptions to this principle, one of them being that partial disclosure of facts can amount to fraud<sup>16</sup> and contracts where *uberrima fides* is involved<sup>16</sup>. A good illustration of the first exception in Quebec is *Chrétien v. Crowley*<sup>17</sup>. In that case, an agent sold shares in a

11. G. Trudel, *Traité de droit civil du Québec*, vol. 7, Wilson et Lafleur, Montréal, 1946, at p. 180.

12. J. L. Baudouin, *Les Obligations*, P.U.M., Montréal, 1970, at p. 77, n. 125.

13. Some of the older authorities suggest that there was a wider duty of disclosure at common law: A. Stiebel, *Company law and precedents*, vol. 1, 3<sup>rd</sup>. ed., Sweet & Maxwell Ltd., London, 1929, at p. 145, n. (t); F. W. Wegenast, *The law of Canadian companies*, Burroughs & Co., Toronto, 1931 at p. 717; but the rule came to be settled that only omissions amounting to fraud would be valid: Stiebel, *ibid.*, at p. 145; Wegenast, *ibid.*, at pp. 717-718. See, generally, A. Stiebel, "Inferences from a prospectus", (1932) 48 L.Q.R. 43.

14. Wegenast, *op. cit.*, at pp. 717-718.

15. BAUDOUIN, *op. cit.*, at pp. 78-79, par. 127; *Dupaul v. Varyland Investments Co.*, (1923) 35 Que. K.B. 328 at p. 332; *Rhodes v. Starnes*, (1878) 22 L.C.J. 113 (S.C.) at pp. 119-120.

16. Baudouin, *ibid.*

17. (1882) 2 Dorion C.A. 385 (Q.B.).

unincorporated company<sup>18</sup>. The shares were quoted on the Stock Exchange but their quotation had been fraudulently altered by illegal dealings<sup>19</sup>. Defendant agreed to take up shares in the company but plaintiff omitted to tell him that the company had no charter and that the true value of the shares had been changed by artificial dealings on the Exchange: the Court of Appeal held that these omissions were sufficient to avoid the contract<sup>20</sup> remarking that defendant "would not have contracted as he did"<sup>21</sup> if he had known all of the facts.

The other exception to the rule of civil law is contracts *uberrimae fidei*<sup>22</sup>. One wonders if contracts to take up shares in a company do not actually fall under such a category: the extensive regulation by the *Securities Act*<sup>23</sup> of the information that must be set out in a prospectus covers material omissions<sup>24</sup> and it would appear that this statutory regulation has altered the nature of such agreements. A plaintiff could argue that a simple omission in a prospectus now amounts to fraud because of the very peculiar nature of his contract.

False statements, in this context, are more common. A false statement is the affirmation of an untrue fact in order to induce a third party to contract<sup>25</sup>. In Quebec, false statements in prospectus cover all types of information. The most common examples to be found in the jurisprudence are that certain persons have agreed to become shareholders or

18. *The Silver Plume Mining Co.*

19. *Supra* n. 17 at pp. 388-389, 392-397.

20. *Ibid.*, at pp. 389, 391 and 396-397.

21. *Ibid.*, at p. 392 *per* Ramsay, J. See also *Rhodes v. Starnes*, *supra* n. 15, at p. 115; Trudel, *op. cit.*, at p. 183. *Dorchester Electric Co. v. Thompson*, (1915) 48 Que. S.C. 471; 48 R. de J. 27 (S.C.) at pp. 29-31 for another case possibly explained by this approach; *Hardy v. Dallaire*, (1923) 63 Que. S.C. 83. See also Côté, *loc. cit.*, n. 1, at pp. 144-145.

22. *Supra* n. 16. Note that at common law, contracts for shares were not considered as such: Stiebel, *op. cit.*, vol. I at p. 145; Wegenast, *op. cit.*, at pp. 717-718. Such contracts were not *uberrimae fidei* but rather the maxim *caveat emptor* was more applicable to such cases: A. Stiebel, in (1932) 48 L.Q.R. 43 at p. 43.

23. R.S.Q. 1964, c. 274. (Hereinafter referred to as the *Securities Act*.)

24. See G. C. Cheshire and C. H. S. Fifoot, *The law of contract*, Butterworths, London, 1972 at p. 277.

25. Baudouin, *op. cit.*, at p. 79 n. 128. Note however that where the statement becomes false by the fault of a third party, the company cannot be liable in fraud. Thus, where a company represents that a city council has offered a considerable bonus and the city then refuses to honor its promise, the company cannot be liable for the consequence because it honestly believed the statement to be true: *La Cie. des cercueils en verre v. Doyon*, (1923) 29 R.L. n.s. 288 (S.C.) at pp. 289-290.

directors of the company when this in fact is not true<sup>26</sup> or that the company is organised<sup>27</sup>, that the capital is paid-up to a certain amount<sup>28</sup> or that a charter has been applied for<sup>29</sup>. It is of course the falsity of the statement that causes it to become fraudulent and this entails an important consequence. Simple exaggerations of fact do not constitute, in civil law, a fraudulent statement: what the civil law generally describes as *dolus bonus* has never been sufficient, in this context, to avoid a contract to take up shares<sup>30</sup>.

But the falsity of a statement, and the same rule is found in English law<sup>31</sup>, is not sufficient to qualify as a fraud if the party who claims to have been victim of the statement has not in fact relied thereon. A false statement in a prospectus will give rise to liability in damages only where in fact it has induced the plaintiff to contract: as pointed out by Curran, J., in *Bonhomme v. Bickerdike*<sup>32</sup>, the *locus classicus* of Quebec law on this subject,

“. . . plaintiff has established that he did not see the prospectus complained of in this cause until after he and his brother had secured their interview. . . and that

26. *Leroy v. J. A. Davis and Co. Ltd.*, (1919) 55 Que. S.C. 497 (C.R.) at pp. 499-500; *Bergeron v. La Cie de meubles de Jonquière*, *supra* note 8 at pp. 347-348 where Cross, J., distinguishes between the case where there is a clear representation and a mere possibility; *Duquenne v. La Cie. générale des boissons canadiennes*, (1907) 31 Que. S.C. 409 (C.R.) at pp. 415-416; *Bonhomme v. Bickerdike*, (1899) 17 Que. S.C. 28 (C.R.) at pp. 46-47. Note that where a person is falsely represented as a shareholder in a petition for incorporation, he can obtain the nullity of the charter by *scire facias*: *La Banque d'Hochelaga v. Murray*, (1890) 15 A.C. 414 (P.C.) at pp. 427-428. For the position of English law: J. Gross, *Company promoters*, Tel-Aviv University Press, Tel-Aviv, 1972, at pp. 49-51; representations as to patronage by "eminent or opulent persons" have always been prohibited by statute in England. See *Joint-Stock Companies Act* (1844) 7-8 Vict. c. 110, s. 65 and more recently, *Companies Act, 1948*, s. 43 (4). In French law, see: Giguère, *op. cit.*, at p. 166.

27. *Bonhomme v. Bickerdike*, *ibid.*, at pp. 47-48.

28. *Rhodes v. Starnes*, *supra* n. 15 at p. 114.

29. *Bonhomme v. Bickerdike*, *supra*, n. 26 at p. 33.

30. *Dupaul v. Varyland Investment Co.*, *supra* n. 15 at p. 329 and authorities cited on what is also known as *gratis dicta*; *Caverhill v. Burland*, (1888) 4 M.L.R. 169 (S.C.) at pp. 173-174: ". . . A purchaser is expected to be on his guard against what in the United States courts, has acquired the half contemptuous term of 'dealers' talk'. . ." Generally, *vide* Beaudoin, *op. cit.*, p. 80 n. 130. The same rule prevails in French company law: Hémond, Terré et al., *op. cit.*, vol. I at p. 601 n. 665; J. Escarra, E. Escarra et J. Rault, *Traité théorique et pratique de droit commercial*, vol. 2, Recueil Sirey, Paris, 1951, at p. 110 n. 601.

31. Gower, *op. cit.*, at p. 321.

32. *Supra* n. 26.



in so far as plaintiff is concerned the said prospectus did not and could not have in any way misled him. . .<sup>33</sup>.

A fraudulent statement in a prospectus is governed, in Quebec, by the general principles applicable to fraud in civil law: the fact that civil and common law seem to coincide in the formulation of those special rules is no argument in favour of the application of common law authorities to what is a simple case of fraud in a corporate context.

## 2. Remedies at civil law for fraudulent statements in a prospectus.

Fraud, in civil law, gives rise to two remedies: nullity of contract and damages<sup>34</sup>. As pointed out by Cross, J., in *Bergeron v. La Cie. de meubles de Jonquière*<sup>35</sup>, “. . . fraud vitiates everything”<sup>36</sup> and this is a rule applicable even more so to misrepresentations in a prospectus. The two remedies will be examined separately.

### a. Damages

In civil law, a fraudulent act or statement is a delict falling under the general principles of article 1053 C.c. Beaudoin tells us that:

“. . . le dol, étant un délit, donne ouverture à une action en dommages basée sur l'article 1053 C.c. . . .”<sup>37</sup>.

Consequently, any fraud committed in a prospectus will give rise to delictual liability under the general principles of the Code. The jurisprudence, as we shall see, has followed the rules of civil law in the majority of

33. *Ibid.*, at p. 38. Also at pp. 33, 49 and 57-58. Note that the judgment of the Court of Review was affirmed in appeal on the 24 April 1900 (unreported). See also: *Rhodes y Starnes*, *supra* n. 15 at pp. 114-115, 121, 122; *Carverhill v. Burland*, *supra* n. 30 at pp. 174-175; *Préfontaine v. Grenier*, (1906) 15 Que. K.B. 563 (P.C.) at pp. 568-569; *Robert v. The Montreal Trust Co.*, *supra* n. 9 at pp. 354-355; *La Cie. des cercueils en verre v. Doyon*, *supra* n. 25 at p. 289. Note in this last case, Rinfret, J's opinion that where a party has agreed in writing that only the representations in the prospectus have induced him to contract, he cannot rely on any other fraudulent statement to obtain relief: *ibid.*, at p. 290; *Yuksel Atillasoy v. Crown Trust Co.*, [1974] C.A. 442, at p. 444; Giguère, *op. cit.*, at pp. 171-172; Côté, *loc. cit.*, n. (1), at pp. 143-144. On the general rules of civil law applicable in Quebec, see Baudouin, *op. cit.*, at p. 80 n.131. In French company law, one finds the same position: Escarra et Rault, *op. cit.*, vol. II at p. 11, n. 601; Hémard, Terré et al., *op. cit.*, vol. I at p. 601, n. 665.

34. Baudouin, *op. cit.*, at p. 82 n. 134, and generally, at pp. 82-83 where the author examines the traditional authorities of French and Quebec law on this point.

35. *Supra* n. 8.

36. *Ibid.*, at p. 346, an evident paraphrase of the Latin maxim *fraus omnia corrumpit*.

37. Beaudoin, *op. cit.*, at p. 83 n. 136; Trudel, *op. cit.*, at p. 184; *Pinkus Construction Inc. v. McRobert*, [1968] Que. Q.B. 516.

cases. However, certain exceptions appear here and there, invoking principles derived from English law: some amount of criticism will be devoted to showing the incompatibility of such cases with the economy of civil law responsibility. In an action for damages, the two main questions of importance are to know who is liable and who can be plaintiff.

i. *Who is liable?*

Article 1053 C.c. reads as follows:

"Every person capable of discerning right from wrong is responsible for the damage caused by his fault to another, whether by positive act, imprudence, neglect or want of skill."

If one applies this rule to a prospectus situation, one could say that any person who has participated in any degree to a fraud committed in a prospectus is liable for the resulting damages. The jurisprudence agrees with the above proposition. In *Bonhomme v. Bickerdike*<sup>38</sup>, the first case to deal with prospectus liability under Quebec law with any degree of attention, the Court gave an authoritative judgment on this point. The facts of the case were quite simple: defendant was a promoter of the company and had read, corrected and consented to the issuance of a misleading prospectus to the public<sup>39</sup>. The Court held that where a person knowingly participates in the publication of such a false document and allows it to circulate in the public, that person is liable for any resulting damages:

"A prospectus was drawn up and submitted to defendant, who, having made some slight alterations in its wording, approved of it and consented to its being issued in the form above recited. Beyond doubt defendant was responsible for the issuing of the prospectus and for the truth or falsity of its contents. . ."<sup>40</sup>.

As a rule, a fraudulent statement always brings about the personal liability of the person making it: in contracts for the sale of shares, where a director falsely represents to a purchaser any particular fact, he is liable in damages to that person<sup>41</sup> and cannot invoke the rules of mandate to

38. *Supra* n. 26.

39. The prospectus contained many false assertions: that there was a provisional organization, that certain persons has agreed to become shareholders, *ibid.*, at pp. 46-48; that a charter had been applied for, p. 33. Defendant was well aware that those representations were false: *per* Cimon, J., at p. 49 of the judgment.

40. *Ibid.*, at pp. 32-33, *per* Curran, J. Also, see pp. 49, 57-58.

41. *Cafo Ltd. v. Harper*, [1968] Que. S.C. 236, at pp. 239-240, recently affirmed by the Court of Appeal in the *Yuksel Atillasoy* case, *supra* n. 33 at p. 448; *Cloutier v. Dion*, *supra* n. 8 at pp. 602-603 *per* Gagné, J., and at p. 603 *per* Pratte, J., where the learned judge refers to French law on this point: S. 1882.1.311. *Lefebvre v. Prouty*,

avoid this responsibility<sup>42</sup> or a statutory liability that would somehow relieve him from the ordinary rules of civil law<sup>43</sup>—this last point now being well settled that statutory liability never excludes the ordinary civil law rules unless clearly intended as such<sup>44</sup>.

In Quebec, a rather simple rule thus evolves from this straightforward jurisprudence: every person, whether he be a promoter, an accountant or a company director, is liable for a false statement knowingly made in a prospectus under the general delictual principle of article 1053 C.c.<sup>45</sup>, unless of course he has not made such statement, the onus of proof being on the plaintiff to establish *mala fides*<sup>46</sup>.

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(1918) 54 Que. S.C. 490 at pp. 497-498; *Rhodes v. Starnes*, *supra* n. 15 at pp. 113-114 where Johnson, J., remarked that: “. . . as a general proposition, and under certain circumstances, it may be at once admitted that an action against directors might lie for an injury done to an individual by inducing him by false representations to purchase stock. There are numerous and well known decisions to that effect. . . Then we have. . . our Civil Code establishing a general principle of liability”; *Préfontaine v. Grenier*, (1905) 27 Que. S.C. 307 (C.R.) at p. 320 although this case was to be reversed by the Privy Council on different grounds: (1906) 15 Que. K.B. 563 (P.C.)

42. *Cafo Ltd. v. Harper*, [1968] Que. S.C. 236, at pp. 239-240. This view has been recently confirmed by the Court of Appeal in the unreported judgment of: *Nadeau et Viau v. Restaurant Pierre et Paul Inc. et al.*, C.A., Montréal, n. 14402, 11 February 1975.

43. *Ibid.* This now overrules the position taken in *Rhodes v. Starnes*, *supra* n. 15 at pp. 118-119, 120-121. In French company law, the same position is accepted: a statutory liability does not avoid the common law liability. See Escarra et Rault, *op. cit.*, vol. II, at p. 110.

44. The most important consequence in this respect is that if a person is liable under special statutory provisions like the *Securities Act*, he cannot invoke this liability to escape from the application of the general principle of article 1053 C.c.: *Yuksel Atillasoy* case, *supra* n. 33, at pp. 447-448.

45. Giguère, *op. cit.*, at p. 170:

“Civilement, les cadres généraux de la responsabilité peuvent. . . se refuser à toute restriction. On ne saurait par exemple, en droit français et québécois, établir *exhaustivement* le nombre de ceux qui y sont sujets sur la seule indication de preuves documentaires. . .”

See also: Smith et Renaud, *op. cit.*, vol. 3, at pp. 1428-1437.

46. Thus, in *Cloutier v. Dion*, *supra* n. 8, the secretary of the company was not liable for a fraudulent statement because there was no proof that he actually made it. *Ibid.*, at pp. 605-606. See also *Lefebvre v. Prouty*, *supra* n. 41. On the question of proving fraud in civil law, oral evidence is admissible: *Bergeron v. La Cie. de meubles de Jonquière*, *supra* n. 8 at p. 352; *La Cie. de meubles de Robertsonville v. Bilodeau*, (1914) 46 Que. S.C. 5 (C.R.) at p. 7. Fraud must be corroborated by some evidence: *Faubert v. Poirier*, [1959] S.C.R. 459, approved in *Giguère v. Bourque*, [1973] Que. C.A. 663 at p. 666; *Baudouin*, *op. cit.*, at p. 73 n. 115. The courts will look to all the circumstances to decide this point: *Amyot v. The Dominion Cotton Mills Ltd.*, (1909) 36 Que. S.C. 35 at p. 52.

If the prospectus was issued by a group of persons and where plaintiff can establish that each person knew of the falsity of the contents, there results a joint and several liability on the part of the directors or promoters: this rule is not particular to fraud in prospectuses, although applicable to such cases<sup>47</sup> for it is based on the general principle stated at article 1106 C.c.<sup>48</sup>.

In Quebec, every person who participates in a fraud in a prospectus is thus liable in damages under the principle established by article 1053 C.c.; in English law, every person who makes a fraudulent statement is liable for damages in an action for deceit<sup>49</sup> but although there is some similarity between the basis of the right to damages in both jurisdictions<sup>50</sup>, it becomes obvious that common law principles cannot apply to what is in fact a pure question of civil law.

A rather more interesting and complicated question is the one of knowing whether the company can also be liable for false statements made in a prospectus. In such cases, the first condition for such a liability to arise is an obvious one: the company cannot answer for documents that it did not issue<sup>51</sup>. This introduces an important distinction: if a prospectus purports to be issued by the company, one has to decide to what extent the representatives of a company can actually bind it for their faulty act.

#### Directors and other mandataries:

In Quebec company law, a director is the mandatary of the company<sup>52</sup>. As a consequence, the rules of mandate set out in the Civil Code

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47. *Nadeau et Viau v. Restaurant Pierre et Paul Inc. et al.*, *supra* n. 42. See also: *Lefebvre v. Prouty*, *supra* n. 41 at pp. 497-498.

48. J. L. Baudouin, *La responsabilité civile délictuelle*, P.U.M., Montréal 1973, at pp. 161-162, par. 230-231.

49. *Wegenast*, *op. cit.*, at p. 725; C. M. Schmitthoff, *Palmer's Company Law*, vol. I, 22<sup>nd</sup> ed., Stevens & Sons, London, 1976, at p. 197; W. K. Fraser and J. L. Stewart, *Company law of Canada*, 5<sup>th</sup> ed., Carswell, Toronto, 1962, at p. 498.

50. *Giguère*, *op. cit.*, at p. 171.

51. *Forget v. The Cement Products of Canada*, (1915) 24 Que. K.B. 445, at p. 447.

52. See: *Upton v. Hutchison*, (1898) 8 Que. Q.B. 505; *Beckow v. Panich*, (1940) 69 Que. K.B. 389, at pp. 404-405. This question has been the object of considerable debate between legal commentators in Quebec. However, it seems to be settled in favour of mandate rules since recent authoritative work in this field: J. Smith, *Duties and powers of corporate executives and promoters in Quebec with particular reference to the interaction of civil law and common law*, thesis, University of London, London, 1972. See also: J. Smith, "Le statut juridique de l'administrateur et de l'officier au Québec", (1973) 75 R. du N. 530 and 609. Recently, the Superior Court has also favoured Professor Smith's views: *Crevier v. Paquin*, [1975] Que. S.C. 260, at p. 263.

in the title of *Mandate*<sup>53</sup> govern the relationship between the company and its directors or other representatives<sup>54</sup> and in certain cases, between the company and third parties<sup>55</sup>.

As a rule, the mandatory is liable in civil law for the delictual acts of his mandatory: this is the rule of article 1731 C.c., which is a mere variation in the context of this particular relationship of the more general principle of liability set out in article 1054 C.c. which reads as follows:

"1054. He is responsible not only for the damage caused by his own fault, but also for that caused by the fault of persons under his control. . . Masters and employers are responsible for the damage caused by their servants and workmen in the performance of the work for which they are employed"<sup>56</sup>.

This rule is applicable to all delicts: where a director or other mandatory of a company commits a fraudulent statement in a prospectus, the logical conclusion should be that he is liable for this delict under the general principle of article 1053 C.c. and that the company is also liable under article 1731 C.c.

There is no case dealing with this question in a prospectus context in Quebec law: however, a few decisions of the courts have readily admitted that a fraudulent representation made by the legal mandatory of a company binds the company under the rules of civil law. Thus, for example, in *Ward v. The Montreal Cold Storage and Freezing Co.*<sup>57</sup>, directors of a company had issued false warehouse receipts and the company in that case was held liable for the fraud of its agents in pursuance of the general

53. Articles 1701-1761 C.c.

54. Articles 1720-1726 C.c.

55. Articles 1727-1731 C.c.; J. Smith, "The protection of third parties contracting with companies in Quebec", (1974) 52 C.B.R. 1 at pp. 2-9.

56. Although article 1731 C.c. extended the application of the principle of article 1054 C.c. to mandate, it innovated in this respect. Such a rule is unknown in French law: Baudouin, *La responsabilité civile délictuelle*, at p. 231, par. 346; *British American Oil Co. Ltd. v. Roberge*, [1964] Que. Q.B. 18 at p. 28. This judgment was confirmed by the Supreme Court of Canada on 9 July 1964. Actually, the rule comes not from civil law but strangely enough from common law authorities. Smith tells us that the rule was drafted according to English authorities and that the Commissioners preferred to follow such opinions as opposed to Pothier's more restrictive views: *ibid.*, at p. 8 n. 37. The rule in English law is of course the same one. A company is liable for the fraud of its agents: R. R. Pennington, *Company law*, 3<sup>rd</sup> ed., Butterworths, London, 1973, at p. 242; Gower, *op. cit.*, at pp. 317-318. Thus, it is not surprising to find a remarkable similarity in this respect between English and Quebec law, both jurisdictions having applied the same rule. However, although the rule of common law was adopted in the Civil Code, it should be that body of laws that is now applicable to the question and not English authorities.

57. (1904) 26 Que. S.C. 310 (C.R.). For a comment on that case: (1901) 7 R.L. n.s. 537.

principles examined above<sup>58</sup>. As a rule, the majority of cases have declared the company liable by following authorities of civil law<sup>59</sup> although the same result was obtained in one case where common law principles were applied<sup>60</sup>. A prospectus issued by a company containing false statements thus imposes upon the company a responsibility for the truth of such statements<sup>61</sup>: the rule in this respect is the same in England and Quebec<sup>62</sup>. It is, however, important to stress the fact that where in England the vicarious liability of the principal is established according to the general rules of agency, in Quebec the rules of mandate govern the issue. The fact that article 1731 C.c. was partly inspired from English authorities is not a sufficient argument to set aside the rules of civil law, which should prevail, as established previously, in the Province<sup>63</sup>.

Promoters and unauthorized representatives.

If the company is to be bound by the act of its mandataries, it cannot be liable for the illegalities committed by third parties: in this context, fraudulent misrepresentations on the part of promoters are probably the best illustration of the rule.

A fraudulent representation by a promoter will not bind the company: he has no authority to represent it and the only person answerable for his fraud is himself. This point was established clearly in the Court of Appeal decision of *Bergeron v. La Cie des meubles de Jonquière*<sup>64</sup>,

58. *Ibid.*, at pp. 338-340, where the Court applied articles 1731 and 1054 C.c. For an interesting discussion of the vicarious liability of a company under article 1731 C.c., see Smith et Renaud, *op. cit.*, vol. I at pp. 384-387 and the cases therein examined.

59. *Banque provinciale du Canada v. Banque canadienne nationale*, [1969] Que. S.C. 476; *Sévigny v. Provincial Improvement Corporation Ltd.*, (1934) 72 Que. S.C. 5; *Lamarche v. Beaver Stove Machinery Co.*, (1916) 23 R.L. n.s. 104 (C.R.) at pp. 107-108, 110; *Compagnie de meubles de Robertsonville v. Bilodeau*, (1914) 46 Que. S.C. 5 (C.R.) at p. 7; Renaud et Smith, *op. cit.*, vol. II, at pp. 665-666; Baudouin, *La responsabilité civile délictuelle*, at pp. 35, par. 40 and 41 and p. 231, par. 346; Trudel, *op. cit.*, at p. 184.

60. *Rhodes v. Starnes*, *supra* n. 15, at pp. 116-117.

61. But there are limits to this responsibility: if the mandatary of the company makes a fraudulent representation contrary to the clear terms of the prospectus, then the plaintiff cannot invoke such a statement against the company. The representative's authority was clearly set out in the prospectus and he has no authority, as a rule, implicit or apparent, to alter it: *Forget v. Cement Products Company of Canada*, (1916) 28 D.L.R. 717 (P.C.) at p. 721.

62. *Supra*, n. 56.

63. *Supra*, n. 7.

64. *Supra*, n. 8. For an older case on the same principle: *Connecticut and Passumpsic Rivers RR. Co. v. Comstock*, (1870) 20 R.J.R.Q. 392 (Q.B.) at p. 406.

where Cross, J., made copious references to English law on this question<sup>65</sup>.

However, the rule admits of certain exceptions. Firstly, in *Duquenne v. La Cie. générale des boissons canadienne*<sup>66</sup>, St-Pierre, J., pointed out, in an *obiter dictum*, that where one acts as a pre-incorporation trustee for a company to be formed, then the representations of such a trustee might bind the company *in futurum*:

“Il ne faut pas oublier qu'en donnant aux souscripteurs l'assurance que plus tard il deviendrait le directeur-gérant de la compagnie, Duquenne agissait comme le fidéicommissaire de la compagnie en voie de formation et que c'était au nom de cette compagnie, qu'il faisait au public la représentation que je trouve consignée dans le “Projet de Constitution”. Or, cette représentation, faite ainsi au nom de la future compagnie, dont Duquenne s'était constitué le fidéicommissaire, faisait bien naître un droit en faveur des souscripteurs. . .”<sup>67</sup>.

The pre-incorporation trustee can validly bind the company to third parties by contracts entered into in pursuance of a pre-incorporation trust created under section 29 of the *Companies Act*<sup>68</sup>. If he has this power of representation, it is submitted that he also has the power to bind the company by his illegal conduct and more precisely, by misrepresentations in a prospectus<sup>69</sup>.

65. *Ibid.*, at pp. 349-351. The judge referred to, *inter alia*, Buckley, *On Companies*, 9th ed. at pp. 49, 90; Palmer, *Company Law*, 9th ed. at p. 102; Hamilton and Parker (Can. ed.) at p. 141 and various decisions of the English courts and our own provincial tribunals. The company is not liable but as pointed out by Cross, J., in the same case, referring to *Derry v. Peek*, (1889) 14 A.C. 337, the plaintiff's recourse in such a case is against the promoters personally: *Bergeron case*, *ibid.*, at pp. 350-351. See also, Gross, *op. cit.*, at p. 157. The Courts have consistently held that the fraudulent representation of a promoter gives no right against the company: *Dupaul v. Varyland Investment Co.*, (1923) 35 Que. K.B. 328 at p. 331 *per* Archibald, J., in the Court of Review; note that the decision of the Court of Appeal confirmed the Court of Review's judgment without expressly passing on this issue. *Skelton v. Frigon*, (1923) 35 Que. K.B. 11 is also a good illustration of the promoter's personal liability on the contract when a fraudulent statement is made. See also, generally, Renaud et Smith, *op. cit.*, vol. II, at pp. 666-668.

66. (1907) 31 Que. S.C. 409 (C.R.).

67. *Ibid.*, at pp. 415-416. The right referred to by his Lordship is that of the subscribers to ask for the nullity of their subscription and reimbursement of their advances: *ibid.*, at p. 415. A reference is made to *In re Scottish Petroleum Co.—Anderson's Case*, (1881) 17 Ch.D. 373. In the *Duquenne* case, the trustee had represented that he would be managing director of the future company but this proved to be false. This type of representation was held sufficient in the *Anderson Case* to nullify the contract. Renaud et Smith, *op. cit.*, vol. II, at p. 667 n. 49; Gross, *op. cit.*, at p. 194.

68. R. Demers, “From the *Bubble Act* to the pre-incorporation trust: investor protection in Quebec law”, (1977) 18 C. de D. 335, at pp. 366 and following.

69. Renaud et Smith, *op. cit.*, vol. II, at p. 667 n. 49; Wegenast, *op. cit.* at p. 262.

Another exception to the rule stated above is that the company can be liable to a certain extent where it actually has knowledge that a fraudulent representation has been made by a third party: this is usually described as the rule in *Karberg's Case*<sup>70</sup>. It was held in that case that the misrepresentations of a promoter contained in a prospectus will allow the subscriber to ask for the nullity of his contract on the basis that the contract was concluded on the terms of the prospectus and that "the acceptance of the application by the allotment of the shares is the acceptance of the offer on those terms, . . ."<sup>71</sup>.

Whatever is the precise basis of the company's liability under common law, the Quebec Civil Code offers an original solution to this difficult question. Article 993 C.c. reads as follows:

"Fraud is a cause of nullity when the artifices practised by one *or with his knowledge* are such that the other party would not have contracted without them. . ."

In French law, the fraud of a third party is not a valid cause of nullity<sup>72</sup>; in the context of preincorporation contracts, French courts have even held that this was insufficient to justify the nullity of the contract<sup>73</sup> although recent views have criticised this approach<sup>74</sup>. In Quebec, the position is different: our Code clearly admits the possibility of a fraud committed by a third party as a nullifying cause<sup>75</sup> and it is submitted that this should also apply to circumstances where a promoter has made a

70. *Metropolitan Coal Consumers' Association-Karberg's Case*, [1892] 3 Ch. 1 (C.A.); ". . . by no means an easy case to understand. . .": *Note*, (1938) 82 Sol. J. 923-924, 942-943 at p. 942; Gower, *op. cit.*, at pp. 322-323.

71. *Karberg's Case*, *ibid.*, at p. 13 *per* Lindley, J. See also Gower, *op. cit.*, at p. 323 n. 59.

72. R. Demogue, *Traité des obligations en général*, vol. I, Rousseau, Paris, 1923, at pp. 577-578-79. For a criticism of this rule in French law, see: *Encyclopédie Dalloz, Droit civil*, vol. 2, p. 247 par. 34 (1952 and *Suppl.*, 1973).

73. Lyon, 6.3.1912, *Gaz. Trib.* 1912 2<sup>e</sup> sem., 2.225, S. 1913.2.129 with a note by M. Wahl. See also Demogue, *op. cit.*, vol. I at p. 577.

74. Escarra et Rault, *op. cit.*, vol. II at p. 112 n. 601 and also at p. 110 n. 601. Hémard, Terré et al, *op. cit.*, vol. I at pp. 601-602 n. 665.

75. Article 993 C.c.; Baudouin, *Les Obligations* at p. 82 n. 132. Trudel, *op. cit.*, suggests an explanation for this rule: "il nous faut trouver le concept de faute dans le seul profit qu'une personne tire de la connaissance d'un acte dolosif commis par un étranger. . .": *ibid.*, at p. 194. Would the rule of article 993 C.c. be a simple application of the principle that "nul ne doit s'enrichir aux dépens d'autrui"? See *Rhodes v. Starnes*, *supra* n. 15 at pp. 116 and 118 where Johnson, J., suggests this explanation. On unjust enrichment generally, *vide*: Baudouin, *Les Obligations*, at pp. 215-228, and more precisely at pp. 215-216, where the author points to the relationship between unjust enrichment and fraud: *ibid.*, par. 411.



fraudulent statement to the knowledge of the company<sup>76</sup>. However, an important distinction must be made. Where in the case of a mandatory the company is liable for damages under the principle of article 1731 C.c., this would not apply to a case under article 993 C.c. In such a case, the only recourse against the company is an action in nullity of contract<sup>77</sup>: it cannot be liable for damages because in fact, it did not make the fraudulent statement. Only the person who actually is responsible for the falsity of the prospectus will be liable in damages, whereas the company will be liable to an action in nullity of the subscription<sup>78</sup>.

ii. Who can sue?

The rule in English law is that a person is entitled to sue in an action for deceit if he can prove that the prospectus was intended to be distributed to him or at least that he should see it in order to influence his decision to buy: thus, if he simply buys from an existing shareholder or on the open market, he cannot claim damages<sup>79</sup> unless he proves that the prospectus "was intended to induce market dealings. . ."<sup>80</sup>. In Quebec, jurisprudence has followed closely the rulings of English courts on this

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76. *Ibid.* There is, however, no case on this point: perhaps the *Duquenne* case, *supra* n. 66 at pp. 415-416 can be explained on the basis of article 993 C.c.
77. Trudel, *op. cit.*, at pp. 184-185. Baudouin, *Les Obligations*, at p. 81 note 132. The same rule is applicable in English law. *Vide Karberg's Case, supra* n. 70 *per* Lindley, L. J., at p. 13: "The company, not having made the representation by itself or by its agents, is not liable in damages; but as regards rescission of contract, the company is in the same position as if it had made the representation itself. . ."
78. As a rule, an agreement between a promoter and a shareholder will not bind the company because the promoter has no power of representation: *Connecticut and Passumpsic Rivers RR. Co. v. Comstock*, (1870) 20 R.J.R.Q. 392 (Q.B.) at p. 406 where the Court distinguished between the fraudulent act of a promoter and of the company as a cause of nullity of a contract. See also: *Leroy v. J. A. Davis Co. Ltd.* (1919) 55 Que. S.C. 497 (C.R.) at pp. 499-500; *National Insurance Co. v. Hatton*, (1880) 24 L.C.J. 26 (Q.B.) at p. 26. Thus a fraud on the part of the promoter will not bind the company in principle. However, if the company profits thereby, it will be bound. On the application of unjust enrichment to the field of pre-incorporation contracts in Quebec law, see J. Smith, "Duties and powers of promoters", (1973-74) 76 R. du N. 207 at pp. 232-235. It is the same principle that governs the case under examination: a fraud in a prospectus will not bind the company where it has been carried out by the promoters, unless the company profits thereby. The rule of article 993 C.c. is a statutory application of the principles of unjust enrichment in this field. See also *supra* n. 75.
79. Gower, *op. cit.*, at pp. 320-321 commenting with severity on *Peek v. Gurney*, (1873) L.R. 6 H.L. 377, the House of Lords decision that established the principle. See also Côté, *loc. cit.*, n. (1), at p. 149.
80. Gower, *ibid.*, at p. 320; *Andrews v. Mockford*, [1896] 1 Q.B. 372 (C.A.).

matter and have refused to admit that a prospectus might create rights in the case of the unsolicited investor. Thus, in *Rhodes v. Starnes*<sup>81</sup>, which was not a case dealing with a prospectus but with annual statements<sup>82</sup>, Johnson, J., followed the authority of *Peek v. Gurney*<sup>83</sup> and thought that the liability of directors for fraudulent statements could not last *ad infinitum*<sup>84</sup> and for that reason, preferred to adopt English authorities on this question<sup>85</sup>.

The learned judge's view is open to serious criticism. At the time, it was probably difficult for a Quebec court to refuse to follow the ruling of the House of Lords in such "a case of recent date"<sup>86</sup> and high authority: however, there are two reasons why Johnson, J.'s view should not prevail. In civil law, it is well established that where one commits a delict, one is liable for the damages caused to any person adversely affected by one's fault: this is the rule in Quebec law<sup>87</sup> and was stated as such by the Supreme Court of the country<sup>88</sup>. Thus as a matter of principle, where a

81. *Supra* n. 15.

82. *Ibid.*, at p. 114. In a sense, this limits the impact of the case although as a rule a fraudulent misrepresentation, whether in a prospectus, in an annual statement or any other document should be governed by the same principles of law.

83. *Supra* n. 79, Johnson J., referred to the case at pp. 120 and following of his judgment.

84. *Ibid.*, at p. 123. ". . . Therefore as to the duration of existing responsibility, that case and this one are on the same footing; and it was as to the injustice of the duration of this responsibility, if it existed, at all, that Lord Cairns was speaking. . ."

85. In the *Rhodes* case, Johnson, J., was well aware that the issue could have been discussed by following principles of civil law. Note at p. 114 his reference to article 1053 C.c. as establishing ". . . a general principle of liability, of which I will not stop now to discuss the limitations. . ." See also at p. 119.

It is of interest to note that the judge also made the distinction that where reports of the company are "industriously circulated" then the liability of the directors might extend to any member of the general public because it was meant to be an inducement to such persons: *ibid.*, at pp. 117-118 where he refers to *New Brunswick and Canada Railway and Land Co. v. Conybeare*, (1862) 31 L.J. 297 (H.L.). In that case, Lord Westbury made the distinction that *Andrews v. Mockford*, *supra* n. 80 was to consecrate more than twenty years later.

86. *Ibid.*, at p. 120 of Johnson, J.'s opinion, "it is a leading case. . .": *ibid.*

87. J. L. Baudouin, *La responsabilité civile délictuelle*, at pp. 80-85 where the author reviews the jurisprudence and doctrine of the Province on this issue. In civil law, the rule is clear that all persons who suffer a damage resulting from the commission of a delict are entitled to compensation. Thus, Baudouin, *op. cit.*, at p. 82 n. 104 tells us: ". . . Du moment qu'un acte fautif lèse le droit d'autrui, il y a lieu en principe à compensation. Il apparaît à cet égard contraire à la logique même des principes généraux de la responsabilité civile de restreindre à la seule victime directe le droit à la compensation. . ."

88. *Congrégation des Petits Frères Maristes v. Regent Taxi*, [1929] S.C.R. 650. For an analysis of this important case, *vide* Baudouin, *op. cit.*, at p. 81 n. 102 and following.

fraudulent prospectus is issued, the person responsible for the fraud should be answerable to every subscriber and purchaser of shares, if they can establish an appreciable damage<sup>89</sup>. This is the rule of French law<sup>90</sup> and one finds it extremely difficult to see why a different principle should be applied in Quebec simply because the delict is committed in the context of the *Companies Act*. The argument that the directors' liability cannot last *ad infinitum*<sup>91</sup> is an interesting and somewhat valid point: however, one must stress the fact that it does not last perpetually, for liability arising out of delicts, in civil law, is extinguished after a period of two years<sup>92</sup> and this rule is applicable to fraudulent statements of every kind<sup>93</sup>. It is true that prescription starts to run only when the damage actually occurs and not from the moment of the commission of the fraud<sup>94</sup>: this rule, however, does not expose the directors to a permanent liability for the false prospectus. The true question, as pointed out by Baudouin<sup>95</sup>, always remains in such cases of establishing a direct link between the delict and the damages: a plaintiff who suffers a loss years after the office of the prospectus is over<sup>96</sup> has the burden of establishing clearly that his damage is a direct consequence of the delict and simply not a remote one<sup>97</sup>. In the particular case of a prospectus, this burden will of itself limit the number of actions that can be taken against directors without straining unduly the rules governing civil liability in order to adapt them to such circumstances.

89. The test is in fact whether the plaintiff can establish a causal link between the delict and the damage. Thus, in the case of a prospectus, a purchaser on the open market must establish a clear connection between the false statements of the prospectus and the damages he suffered. On this point, *vide* Baudouin, *op. cit.*, at pp. 82-83 n. 104

90. R. R. Pennington, *The investor and the law*, MacGibbon & Kee, London, 1968, at p. 196. For an analysis of English law, *ibid.*, at pp. 194-195.

91. *Rhodes v. Starnes*, *supra* n. 15 at p. 123, referring to Lord Cairns "admirable judgment" in *Peek v. Gurney*.

92. Article 2261 (2) C.c.; Baudouin, *La responsabilité civile délictuelle*, at p. 464, n. 722.

93. A false statement on the part of a director gives rise to a liability that is extinguished after two years: *Préfontaine v. Grenier*, (1906) 27 Que. S.C. 307 (C.R.) at pp. 321-324 *per* Robidoux, J., in the Superior Court; Lavergne, J., *diss.*, at pp. 329-330 and Curran, J., at pp. 349-351; Loranger, J., at pp. 353-354, all three judges in the Court of Review agreeing on the matter of principle. Note that this issue was not discussed in the higher courts: (1906) 15 Que. K.B. 143; 15 Que. K.B. 563 (P.C.).

94. *Préfontaine v. Grenier*, *ibid.*; Baudouin, *op. cit.*, at pp. 468-469, pars. 731-732.

95. Baudouin, *op. cit.*, at pp. 82-83, par. 104.

96. *Rhodes v. Starnes*, *supra* n. 15 at p. 123; Côté, *loc. cit.*, n. (1), at p. 175.

97. Baudouin, *op. cit.*, at pp. 80 and following. For a similar view in English law: Gower, *op. cit.*, at p. 320.

One last note on the *Rhodes* cases: when one examines the basis of the Court's reasoning in such cases as *Peek v. Gurney*<sup>98</sup> and its Quebec counterpart, one actually finds that the judges of the period were usually biased in favour of the directorate and the interest of commerce often justified exemptions from the traditional rules applicable to the common mortal<sup>99</sup>. This preferential treatment has of course subsided in recent years and directors and other company officials are now bound to act according to very high and strict standards: this change of attitude would undoubtedly alter the outcome of such cases if they were to be decided today by our provincial courts.

In Quebec, the rule of civil law is that a person who suffers a damage from a fraudulent statement is entitled to relief: in the field of liability arising from a false prospectus, this would mean that every person incurring a loss due to such a document would have a recourse against the person making the false statement, whether he be a subscriber or a purchaser on the open market.

b. *The action in nullity*

The main consequence, as far as a contract to take up shares is concerned, is that the defrauded party can ask for the nullity of his subscription. As pointed out by Beaudry, J., in *The Glen Brick Co. v. Shackwell*<sup>100</sup>,

“. . . des souscriptions à un fonds social ou stock, obtenues par surprise, fraude, et par de faux états des affaires de la compagnie faits par ses officiers et ses directeurs, sont nulles et ne produisent aucune obligation. Les actionnaires ainsi

98. *Supra* n. 79.

99. In Quebec, the tendency in the nineteenth century was to avoid imposing a liability on the directors unless they were guilty of gross negligence or fraud. See, e.g., *Thérien v. Brodie*, (1893) 4 Que. S.C. 23; *Connolly v. The Montreal Park and Island RR. Co.* (1902) 22 Que. S.C. 322 (C.R.) at pp. 359-361 where Mathieu, J., suggested that where directors are in a position of conflict of interest they cannot be made accountable at law if they act *bona fide*. Other good examples of this judicial clemency towards the directorate: *Rhodes v. Starnes*, *supra* n. 15 at p. 122; *Préfontaine v. Grenier*, (1906) 27 Que. S.C. 307 (C.R.); (1906) Que. K.B. 143, 563 (P.C.). This attitude has been severely criticized: J. Smith, "The duties of care and skill of corporate executives in the company law of the Province of Quebec", (1974) 34 R. du B. 464 where the author demonstrates how the Courts and the Legislature progressively adopted a more critical attitude towards those officers: directors came to be judged according to more universal standards and the interests of commerce were to give way to the protection of the investor.

100. (1870) 2 R.L. 625 (S.C.).

trompés peuvent même recouvrer ce qu'ils ont payé en acompte de leurs parts. . .<sup>101</sup>.

Thus, the subscriber has a right of asking for the nullity of the subscription if he can prove that the company has fraudulently represented a fact in the prospectus: this means that the representations must have been made by an authorised agent of the company<sup>102</sup> or by the board of directors<sup>103</sup>. Consequently, misrepresentations on the part of a promoter will give no right to the subscriber, unless of course the company has knowledge of such illegality<sup>104</sup>.

The nullity resulting from a fraud is a relative one<sup>105</sup>. It is established in favour of the contracting party: he can renounce thereto by ratification of the fraudulent act or he can lose the right to rescind by prescription or by a supervening event like the winding-up of the company.

#### i. Ratification

In civil law, the nullity resulting from a fraudulent misrepresentation being a relative one is always open to ratification<sup>106</sup> or confirmation<sup>107</sup> as opposed to absolute nullities that can never be covered<sup>108</sup>. In cases of contracts to take up shares, the subscriber can ratify the nullity either expressly or impliedly<sup>109</sup>. In cases of express ratification, there is of

101. *Ibid.*, at p. 625; *Johnston v. The Ewart Co. Ltd.*, (1908) 14 R. de J. 332 (S.C.) at p. 335; *Dorchester Electric Co. v. Thompson*, (1915) 48 Que. S.C. 471; 48 R. de J. 27 (S.C.) at pp. 29-31. Plaintiff is also entitled to be reimbursed the calls or monies he has advanced: *Leroy v. J.A. Davis and Co. Ltd.*, (1919) 55 Que. S.C. 497 (C.R.) at p. 500. The general rule of contracts is of course the same one: Baudouin, *Les Obligations* at p. 82, par. 135. For a recent but unreported case on the matter: *Commercial Trust Company Ltd. v. Littler*, S.C.M., n. 757 251, 21 November 1974.

An important distinction has to be made in such cases: if plaintiff is in fact one of the original petitioners for the company's charter, he is not entitled to ask for the nullity of his contract, even for reason of fraud: the only way he can be relieved of his duties is by asking for the nullity of the charter. *Bergeron v. La Cie. de meubles de Jonquière*, (1913) 22 Que. K.B. 341 at p. 346 and even that possibility seems to be restricted because of the fact that plaintiff's name in the letters-patent might have acted as an inducement to third parties who thereafter became members of the company: *ibid.*, at p. 351. See also *Giguère v. Colas*, (1915) 48 Que. S.C. 198 at p. 203 for a similar reasoning in cases where there is absence of consideration.

102. *Vide, supra*, n. 62.

103. *Ibid.* See also Gower, *op. cit.*, at pp. 322-323.

104. *Supra*, n. 76.

105. Baudouin, *op. cit.*, at p. 82, n. 135. See also article 1000 C.c.

106. Baudouin, *op. cit.*, at p. 148, n. 260.

107. *Ibid.*, article 1214 C.c.

108. Baudouin, *op. cit.*, at p. 147, par. 259.

109. *Ibid.*, at p. 148, par. 260.

course no problem: the shareholder affirms the contract voluntarily, knowing that a fraud has been committed but to which he is ready to assent<sup>110</sup>. It is where the ratification is implied that problems arise in Quebec law. Most authorities agree on the proposition that a shareholder who has a right to repudiate his contract for any reason might be debarred from doing so if he has acted in such a way as is consistent only with his desire to affirm the contract: the authorities in this instance have generally followed English precedents to state the rule without making any allowances for civil law distinctions<sup>111</sup>. Active participation in the affairs of the company implies a willingness on the part of the shareholder to accept his quality of member of the corporation, notwithstanding the fact that he has a right to ask to be relieved of his obligations<sup>112</sup>.

Ratification resulting from acts is thus one way of covering the nullity; but what about the case where one does nothing at all, although one knows of a cause of nullity entitling one to the rescission of one's contract? The rule of the Civil Code governing the matter is expressed at article 2258 C.c.

“2258. The action[s]. . . in rescission of contracts for error, fraud, violence or fear, are prescribed by ten years. This time runs. . . in the case of error or fraud from the day it was discovered. . .”

110. Note that if the express ratification is in writing, it has to respect the conditions of article 1214 C.c.; Baudouin, *op. cit.*, at p. 148 par. 260 although this is only necessary as an evidentiary requirement. The shareholder only validly ratifies an obligation when he has full knowledge of the facts that he is willing to confirm: *Prévost v. Allaire*, (1861) 11 L.C.R. 293 (Q.B.) at p. 320.
111. *Robert v. The Montreal Trust Co.*, (1917) 56 S.C.R. 342, at pp. 354-358, 361-364 for an extensive review of English authorities. *Rhodes v. Starnes*, *supra* n. 15 at p. 122. For other cases establishing the principle, *vide*: *Pineau v. La Cie. Neigette*, (1916) 22 R.L. n.s. 154 (K.B.) at pp. 156-157; *Caverhill v. Burland*, (1888) 4 M.L.R. 169 (S.C.) at pp. 175-176; *Stadacona Insurance Co. v. Côté*, (1879) 5 Q.L.R. 133 (S.C.) at pp. 136-137; (1880) 6 Q.L.R. 147 (Q.B.) at p. 155; *The Windsor Hotel Co. v. Lewis*, (1881) 26 L.C.J. 29 (Q.B.) at p. 34. Ratification by conduct is admitted by civil law: Baudouin, *op. cit.*, at p. 148 par. 260.
112. Acting as a shareholder when there is no valid contract or where such contract is open to an action in nullity will entitle the Court to presume that a valid contract is in existence: in *In re Drummond Cotton and Bleaching Co. Ltd.*, (1906) 13 R. de J. 232 (S.C.) at pp. 234-236, Lynch, J., made an extensive review of the Quebec jurisprudence on the question of the theory of the *de facto* shareholder. See also: *Arless v. The Belmont Manufacturing Co.*, (1885) 1 M.L.R. 340 (Q.B.) at pp. 345-346; *MacDougall v. The Union Navigation Co.*, (1877) 21 L.C.J. 63 (Q.B.); Renaud et Smith, *op. cit.*, vol. II at pp. 603-605. However, one can seriously question the application of such a doctrine to Quebec law. The doctrine is predicated on the principle of estoppel: Renaud et Smith, *ibid.*, at p. 694 and estoppel is unknown to Quebec law: Mignault, J., in *Grace and Co. v. Ferras*, (1921) 62 S.C.R. 166 at p. 172; J.-G. Castel, *Le juge Mignault défenseur de l'intégrité du droit civil québécois*, (1975) 53 C.B.R. 544 at p. 549.

What the article seems to suggest is that where one has a right to ask for the nullity of a contract on the ground of fraud, one can actually wait ten years before bringing the action. The Courts have examined the problem in the context of fraudulent representations to induce a party to take up shares but even today, as a matter of principle, the state of the jurisprudence on this point is generally confused<sup>113</sup>.

In one interesting case, *Robert v. The Montreal Trust Co.*<sup>114</sup>, the Supreme Court of Canada expressed the view that on this question Quebec law should follow common law authorities and apply the rule that a considerable delay in asking for a nullity should be tantamount to acquiescence, notwithstanding the formulation of article 2258 C.c. Anglin, J., a judge of considerable note and common law training, rendered the following opinion in the course of his judgment:

"It would, I think, be most unsatisfactory if the right of a subscriber in Quebec for shares in a Dominion company to disaffirm his obligation to take or pay for them should endure for ten years after he had fully learned the facts which render that obligation voidable, whereas the like right of a subscriber in British Columbia or Ontario for shares in the same company would be unavailable to him should he fail to repudiate his obligation with the utmost promptitude reasonably possible after discovering its voidability. While I should deprecate any attempt to modify or affect any doctrine of the civil law of Quebec or an established construction of any legislation of that province by an introduction of English law or by adopting English views or practice merely for the sake of securing conformity, I incline to think that in regard to subscriptions for shares in companies, 'in the absence of any legislation in force in Quebec inconsistent with the law as acted upon in England' and other provinces of Canada, and in the absence of any jurisprudence or established practice to the contrary, the courts of Quebec might well accept and apply the English rule imposing prompt repudiation as a condition of maintaining a plea of misrepresentation or granting the relief of rescission on that ground. . ."<sup>115</sup>.

113. Even in the general law of contract, the rule is not clear: Baudouin, *op. cit.*, at p. 148 par. 260, n. 431. Baudouin discusses the view that suggests that delay in asking for the nullity of the contract is tantamount to acquiescence but as he points out: "Ceci a pour effet en pratique de réduire considérablement, sinon d'annihiler les effets de la prescription de 10 ans. . .": *ibid.* The problem is still not settled in civil law: see, e.g., *Renzi v. Azeman*, [1959] Que. S.C. 170 at p. 176 where Collins, J., remarked that a plaintiff in such cases has a ten-year delay to act and that". . . his failure to do so within such time would not constitute a ratification or confirmation by itself alone. . ."

114. *Supra* n. 111.

115. *Ibid.*, at pp. 363-364, quoting from *Préfontaine v. Grenier* [1907] A.C. 101 (P.C.) at p. 110. The rule is predicated on the basis that by remaining a shareholder, the member induces others to take up shares in a company: *ibid.*, at p. 356. Also: *National Insurance Co. v. Hatton*, (1879) 24 L.C.J. 26 (Q.B.) at p. 27; *Johnston v. The Ewart Co.*, *supra* n. 101 at p. 336. Some cases have based the rule on the doctrine of estoppel: *Montreal Trust Co. v. Robert*, (1917) 52 Que. S.C. 73 (C.R.) at pp. 79-80; *National Insurance Co. v. Hatton*, *ibid.*, at pp. 27-28. However, estoppel is unknown to civil

The view is an interesting one but is open to serious criticism. The learned judge suggests the adoption of English law on this issue, arguing that there is no law or authority in Quebec "inconsistent" with the English position. This is not true. As for the "inconsistent" law, article 2258 C.c. clearly states a rule different from the one prevailing in England. As for authorities, the learned judge would have been surprised to learn that the Supreme Court had already given, more than thirty years before, a contrary ruling. In *Côté v. Stadacona Insurance Co.*<sup>116</sup>, Fournier, J., decided that where a party to a subscription contract had a right to ask for the nullity of the contract on the ground of error or fraud<sup>117</sup>, his right to do so lasted for ten years<sup>118</sup> and during that period, he was under no obligation to act. The learned judge said, *inter alia*,

"Le deuxième motif du jugement attaqué, consistant à dire que l'appelant ne peut plus opposer les vices dont on admet que son contrat est entaché, parce qu'il a laissé un délai de près de deux ans, sans prendre aucune mesure judiciaire pour faire rescinder sa souscription, ne me paraît pas fondé en loi. Pour lui opposer ce moyen avec succès, il faudrait établir par quelque texte de droit qu'il était *obligé d'agir* dans le délai de deux ans. . . Il aurait pu. . . prendre l'initiative, mais ce n'est qu'une faculté qu'il était libre d'exercer ou non, à son gré. . . Dans le cas où l'on considérerait qu'il y a eu contrat, mais que le consentement à ce contrat a été vicié par le dol ou l'erreur, le contrat étant annulable

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law: *supra* n. 112 and consequently, the authority of such cases in greatly diminished. The Supreme Court of Canada's earlier tendency of sacrificing the rules of civil law to the more general rules of common law has often been decried: for a recent critical appraisal of this approach, see J. L. Baudouin, "L'interprétation du Code civil québécois par la Cour Suprême du Canada", (1975) 53 S.C.R. 715. In the field of company law, it was not the first attempt to overthrow the application of civil law principles in favour of common law rules: *vide* the judgment of the same court in *The Exchange Bank of Canada v. Fletcher*, (1890) 19 S.C.R. 278 at pp. 288-289. Whether the main preoccupation of the tribunal in such cases was to ensure uniformity of commercial rules is not always apparent but this method of interpretation could not be a valid one: where the Civil Code in Quebec gives a clear rule to be applied, one finds it extremely difficult to understand the approach of those earlier cases suggesting that common law rules should prevail over the logic of civil law. The paramount duty of the courts is to apply the law as it is stated and not to create absurdities for the sake of convenience: on this point, *Abbott v. Fraser*, (1874) 20 L.C.J. 197 (Q.B.) at p. 201. Whether the rule of civil law is desirable or not should not be a factor influencing a court in deciding which law or rule to apply.

116. (1881) 6 S.C.R. 193. For the lower courts: (1880) 6 Q.L.R. 147 (Q.B.); (1879) 5 Q.L.R. 133 (S.C.).
117. The rule is the same for error and fraud under article 2258 C.c. Note that the case also discussed the nullity resulting from absence of consent. In such a case, it is an absolute nullity and the Court was of opinion that a thirty-year delay would be allowed to plaintiff. *Vide, ibid.*, at pp. 215-217. Renaud et Smith, *op. cit.*, vol. II, at pp. 690-691.
118. Article 2258 C.c.



seulement, l'appelant avait encore en vertu de l'article 2258 C.c. de Québec, dix ans pour prendre son action en nullité. . ."<sup>119</sup>.

Thus, the learned judge was of the opinion that there was no positive duty incumbent at law upon plaintiff to act before the ten-year delay was over and that he was entitled to wait that period before asking for the nullity of his contract. Anglin, J.'s views in the *Robert* case<sup>120</sup> seem doubtful in light of the previous Supreme Court of Canada decision: it is of interest to note that whereas the *Robert* case was decided by a judge of common law training, the *Côté* case was settled by a civil law jurist.

In Quebec, the rule should be as expressed by Fournier, J.: a plaintiff, in an action in nullity, should be entitled to the ten-year delay specifically given by the Code, unless proof that he has ratified the contract can be adduced. Mere omission to act should not constitute a cause for implying on plaintiff's part an intention to ratify the contract. The rule of English law is predicated on the desire of protecting innocent third parties: if a subscriber remains a shareholder for a number of years without prompt repudiation, this acts as an inducement to third parties to join the company. Consequently, he is estopped from asking for the nullity of his contract on this ground<sup>121</sup>. In civil law, the same problem can be settled differently: if one respects the delays of article 2258 C.c., one should be entitled to rescission if nothing has been done to imply a ratification. However, third parties who have joined the company might have a recourse against the plaintiff under the general rule of article 1053 C.c.: he might be answerable in damages for his omission to act, knowing very well that creditors and new members rely to a certain extent on his participation to the capital of the company.

This particular aspect of the law of misrepresentation in Quebec presents considerable difficulties that have yet to be settled by the authorities: it also highlights the conflict between civil and common law in Canadian company law, where courts are torn between a justifiable desire

119. *Supra* n. 116 at pp. 215-216 where the learned judge referred to: F. Laurent, *Principes de droit civil français*, vol. 15, A. Durand, Paris, 1869-78, at p. 536 n. 465. *Vide* also in the same case, Henry, J., at p. 223; *Brownlee v. Hyde*, (1906) 15 Que. K.B. 221 at p. 229; *Côté*, *loc. cit.*, n. (1), at pp. 171 and following for possible legislative amendments to such a rule.

120. *Supra* n. 111.

121. Gower, *op. cit.*, at p. 337 n. 34, where the author suggests that the rule is based on estoppel. Even in the common law provinces of Canada, there is some uncertainty as to whether the English rule should prevail: Wegenast makes an extensive review of all the authorities and concludes that English rulings on this point should be received with caution in Canada: *op. cit.*, at pp. 305-307, 734 and 737-738. In Quebec, the rule cannot be applicable for estoppel is unknown to civil law. *Supra* n. 112.

to harmonise the rules concerning share capital throughout the country and an invincible will on the part of Quebec judges to preserve at all costs the purity of their civil law heritage.

ii. Loss of the right to rescind: the winding-up of the company.

In English law, it is generally accepted that the right to rescind a contract for fraud will not be exercisable once the winding-up of the company has started<sup>122</sup>; if the plaintiff has commenced his action before the winding-up proceedings, his right will be preserved<sup>123</sup> but lost if he should try to exercise it after that moment.

It is not easy to determine the exact rationale of this rule and authorities differ on the basis of the principle. One view<sup>124</sup> argues that “. . . the member having subscribed to the share capital has allowed the company to obtain credit on the strength of it. . .”<sup>125</sup>; for that reason, once the creditors’ rights become involved in the winding-up of the company, they are entitled to look to this “guarantee fund”<sup>126</sup> for the satisfaction of their rights and the shareholder cannot at that moment repudiate his obligations.

This explanation has been criticised, however, and an alternative has been suggested to this approach. Professor Hornby concludes, after an examination of various sections of the *Companies Act, 1948*<sup>127</sup>:

“The true basis of the rule would appear to be that by these provisions, on the commencement of winding up the company’s assets become subject to the rights

122. Gower, *op. cit.*, at p. 327. This is the rule established by *Oakes v. Turquand*, (1867) L.R. 2 H.L. 325.

123. *Ibid.*

124. Gower, *op. cit.*, at pp. 326-327. Also at pp. 104-105.

125. *Ibid.*, at p. 327.

126. Hornby, in (1955) 71 L.Q.R. 415 at p. 416. Professor Hornby was then reviewing the first edition of Gower’s *Principles of modern company law* (1954).

In America, jurisprudence on this question is in a state of complete confusion: 18 C.J.S. 842 n. 326 (Suppl. 1975). However, one line of cases adopts this “guarantee fund” approach: *ibid.*, at pp. 842-843. In the American jurisdictions, this has given rise to the peculiar “trust fund” doctrine: J. J. Norton, “Relationship of shareholders to corporate creditors upon dissolution: nature and implications of the “trust fund” doctrine of corporate assets”, (1974-75) 30 Bus. L. 1061, [note at pp. 1077-1078 the discussion of such a doctrine in a civil law context (Louisiana)]; E. S. Hunt, “The trust fund theory and some substitutes for it”, (1902-1903) 12 Yale L.J. 63.

In Canada, the “trust fund” doctrine is generally considered inapplicable: Wegenast, *op. cit.*, at pp. 338, 517; Martel, *op. cit.*, vol. I at pp. 141, 148-151 and 307 n. 1.

127. *Ibid.*, at p. 417 where the author refers to ss. 13, 26, 212 and 213 of the Act.

of the creditors and contributories in liquidation, so that *restitutio in integrum*, and therefore rescission, are impossible. . . .<sup>128</sup>.

It is because the rights of the creditors attach to the property of the company that the latter is incapable of giving back to the subscriber the monies paid in and consequently, the parties to the contract cannot be reinstated to their original positions: this explains the rule and as Hornby suggests, is one of general application in the field of winding-up as far as contracts involving the company are concerned<sup>129</sup>.

The cases in Quebec on this point present a rather conflicting aspect. Most courts tend to apply the rule of English law without attempting to understand or explain it<sup>130</sup>. There is, however, one case of distinction where the learned judge tried to elucidate the reason of the ruling and applied in doing so English authorities, and surprisingly enough, French case law: that case was the Court of Appeal decision in *Brownlee v. Hyde*<sup>131</sup>. Champagne, J., speaking for the Court, adopted a position similar to the guarantee fund theory<sup>132</sup> as a basis for refusing to allow an action in nullity of the contract, once the winding-up has begun. The learned judge said:

“. . . C'est sur la foi de sa signature. . . que les tiers ont contracté avec la compagnie, et ils ne sauraient être privés du recours qu'ils étaient en droit d'espérer contre lui. . . .”<sup>133</sup>.

128. *Ibid.*, at p. 417. For a similar but earlier view, see A. Stiebel, *op. cit.*, vol. I at p. 175. For an interesting criticism of this approach: Wegenast, *op. cit.*, at pp. 731-735 where the author comes to the conclusion that this approach, in Canada at least, cannot be accepted: “. . . any argument as to the necessity of *restitutio in integrum* must be abandoned. . . .” *Ibid.*, at p. 735.

129. *Supra* n. 126 at p. 417 where the author extends the application of the rule to the whole field of contracts involving the company, illustrating his point with special reference to promoters' contracts in cases of secret profit.

130. Most cases have followed the *Turquand* rule, *supra* n. 122, without making any distinctions: the *locus classicus* in this respect is the decision of Archibald, J., in the two judgments rendered in *Johnston v. The Ewart Co.*, (1907) 31 Que. S.C. 336 at pp. 337-338; (1908) 14 R. de J. 332 (S.C.) at p. 335. See also: *Compagnie d'Hôtel St-Roch v. Barbeau*, (1915) 48 Que. S.C. 94 at p. 96; *Boulet v. Hudon*, (1917) 51 Que. S.C. 29 (C.R.) at p. 31; *Note*, in 10 R.L. at pp. 65-66; Renaud et Smith, *op. cit.*, vol. II at pp. 676-678.

131. (1906) 15 Que. K.B. 221.

132. See the discussion, *supra* n. 126.

133. *Supra* n. 131 at p. 227, quoting from Sir A. Lacoste's decision in *McArthur v. Common*, (1899) 8 Que. Q.B. 128 at p. 133. This last case was affirmed by the Supreme Court of Canada in (1898-99) 29 S.C.R. 239.

As authorities for this proposition, the learned judge referred to the standard English cases<sup>134</sup> but he also adopted the reasoning of the French courts in this instance<sup>135</sup>. It is interesting to note that the same rule applies in French law as in English law and that the nullity of the subscription contract cannot be opposed to the company in liquidation or bankruptcy<sup>136</sup>. In French law also, commentators are not unanimous in establishing the *motif* of such a principle. One school adopts a "guarantee fund" approach as a justification. Lescot, for example, remarks<sup>137</sup>:

"... Le motif, communément donné à l'appui de cette solution, est tiré du fait que, le capital social, tel qu'il a été fixé dans les statuts, étant porté à la connaissance des tiers par les moyens légaux de publicité, ceux-ci doivent pouvoir, en tout état de cause, compter sur lui pour être désintéressés, alors surtout que, dans les sociétés anonymes du moins, il constitue l'unique gage qui leur soit offert et que le plus souvent ils n'auront traité avec la société qu'en considération de son montant. . ."<sup>138</sup>.

Another explanation suggested by the commentators of French law is that the fraud of the company cannot be opposed to an innocent third party and the creditors in the winding-up fall in that category<sup>139</sup>.

134. *Ibid.*, at p. 228 of the same judgment, the learned judge referred to *Oakes v. Turquand*, *supra* n. 122; *Tennent v. The City of Glasgow Bank*, (1879) 4 A.C. 615; *Thompson on Corporations*, vol. II, art. 1438 and note also at p. 227 of the case report, the reference to W. J. White, *A treatise on Canadian company law*, C. Théoret ed., Montréal, 1901, at p. 146.

135. Champagne, J., referred to the classic French case on this point: the decision of the Court de Cassation in 10.2. 1868. Sirey 1868.1.149. This case remains to this day the most important one in French law on the issue: see Hémard, Terré et al., *op. cit.*, vol. I at p. 602 n. 4. The Cour de Cassation held in that particular instance that the fraud of the company could not be opposed to the creditors under the general rule of civil law that the fraud of a third party will not affect an innocent person. Thus, in fact, the *Brownlee* case can be described as adopting a double position to explain the rule: the traditional guarantee fund doctrine and the rule of civil law concerning the effect of the fraud of a third party.

136. Hémard, Terré et al., *op. cit.*, vol. I at p. 602 par. 666. Escarra et Rault, *op. cit.*, vol. II at pp. 248-249 par. 757. See also the following cases: 25 mai 1886, D.P., 1887.1.379; Paris, 19 juin 1934, S., 1935.2.25 and the note on this case by Lescot.

137. Paris, 19 juin 1934, S., 1935.2.25.

138. *Ibid.*, at p. 25. Lescot elaborates on the guarantee fund theory and suggests that the basis of the theory is a unilateral obligation on the shareholder's part whereby he undertakes to be liable towards the future creditors of the company for the amount of his share. *Ibid.*, at p. 25 "... la solution de la loi française qui, soucieuse de procurer aux tiers une *garantie* efficace, encore que limitée à un capital déterminé. . ." *ibid.* The author also argues that such an obligation is implicit in the contract of the shareholder: *ibid.*, at pp. 25-26. Professor Gower's views on the subject, *supra*, n. 125, thus have a striking counterpart in French company law.

139. *Supra*, n. 135. Escarra et Rault, *op. cit.*, vol. II at pp. 248-249 par. 757: "... La raison en est que la loi ne prend en considération que le dol émanant du cocontractant ou de

In Quebec, the rule that thus seems to prevail is that there is no right to ask for the nullity of a subscription contract for fraudulent misrepresentation, where this right is invoked after the winding-up of the company has commenced, the rule being predicated in some instances on a theory familiar to English and French law and known as the "guarantee fund" doctrine.

This would be all rather clear if it were not for the decision of the Quebec Superior Court in *In re McDonald Lumber Co. et al.*<sup>140</sup> where Panneton, J., held that the bankruptcy of a company had no effect whatsoever on a subscriber's right to obtain the nullity of his contract for fraud and that such a defence was valid, even as against the trustee in bankruptcy<sup>141</sup>. The learned judge did not really discuss the issue and one would be tempted to dismiss his opinion as erroneous and expressing a minority view as far as Quebec law is concerned. However, this is not the case and surprisingly enough it is possible that Panneton, J.'s approach is the better one. There is no distinction to be drawn in this respect between winding-up and bankruptcy: the same rule should prevail in both cases<sup>142</sup>. How then, does one reconcile the authorities?

Wegenast, in his admirable treatise on *Canadian Companies*<sup>143</sup>, examined the problem in some detail and found, as a conclusion, that to assume generally that winding-up precludes rescission is erroneous, for many cases have settled the contrary point<sup>144</sup>. The question, according to the author, is one of knowing in each case whether the plaintiff has not in fact acquiesced to the nullifying cause: if one waits until the winding-up of a company to ask for the rescission of one's contract, this might be—but is not necessarily—an indication that the contract was indeed affirmed by plaintiff.

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ses complices. Or, le syndic représente non seulement la société mais la masse des créanciers. Il ne peut donc se voir opposer les manœuvres dolosives commises soit par les fondateurs, soit . . . par la société elle-même. . . ." See however, Hémard, Terré et al., *op. cit.*, vol. I at p. 602 par. 666 for a serious criticism of this approach and a suggestion that it should be abandoned.

140. (1923) 3 C.B.R. 765 (S.C.); [1923] 4 D.L.R. 44 (S.C.).

141. *Ibid.*, at pp. 765-766 and see at p. 766 n. a the authorities cited by the Court.

142. Wegenast, *op. cit.*, at p. 736 and more particularly at n. 5. There is also no difference in this respect in French law: see Hémard, Terré et al., *op. cit.*, vol. I at p. 602 par. 666.

143. "Canada's most valued commentator on the law of Canadian Companies. . ." per O'Connor, J., in *Gattuso Investments Corporation v. Gattuso Corporation Ltd.*, (1971) 14 C.B.R. (n.s.) 161 (S.C.) at p. 164.

144. *Ibid.*, at p. 735: ". . . the cases in which relief has been granted notwithstanding the commencement of winding-up are so numerous as to preclude any doubt. . ." and see the cases at n. 16 of p. 757, the last one mentioned being the Quebec case under examination.

“Nor can reliance be placed on the theory that any action for relief from a contract to take shares must be taken before a winding-up or bankruptcy has intervened. . . the authority of the cases on this point has been challenged. The view to the contrary was expressed by Mr. Holmsted, Registrar in Bankruptcy for Ontario, as follows: ‘. . . In all such cases the question really turns on whether or not in the circumstances of each case the shareholder has by delay or otherwise debarred himself from getting the equitable relief he claims. The fact that the company has ceased to be a going concern before he takes effective steps to have his name removed from the register or list of shareholders is a most important fact. . . and it is this question of the state of the company at the time the relief is sought which may or may not, according to circumstances, preclude the shareholder from getting relief. . .’”<sup>145</sup>.

The test suggested by Wegenast is an *ad hoc* one: the circumstances of each case will indicate whether or not plaintiff has waited too long to ask for rescission and the fact that the company is now being wound-up will undoubtedly create a strong presumption that he has, although one can imagine situations where in fact the fraud and the winding-up are so closely linked together in time that plaintiff could not have asked for relief any sooner<sup>146</sup>.

The rule in Quebec, it is submitted, should be modelled on Wegenast’s views: although the majority of our cases do not seem to make finer distinctions on this complicated issue, it appears logical to explain all the cases by the acquiescence principle and to admit of rescission, even after winding-up has commenced, where there is a clear indication that plaintiff could not have acted in any other manner. Panneton, J.’s views in the *McDonald Lumber Co.* case<sup>147</sup> follow the authorities referred to by Wegenast and should be the prevailing rule in Quebec<sup>148</sup>.

Thus, the position in Quebec is ambivalent. There is some authority that admits as a basis for the rule the “guarantee fund” approach while

145. Wegenast, *ibid.*, at pp. 734-735, quoting extensively from: *In re National Stadium Ltd, ex parte Williams and Poyntz*, (1922) 2 C.B.R. 195; 21 O.W.N. 346.

146. “It is possible to conceive that the fraud and the winding-up order may be so closely connected in point of time, that the defrauded person has had no opportunity before the making of the winding-up order of prosecuting his claim to be relieved. In such a case, I do not think any case has been referred to which would preclude the defrauded person from relief. . .”: Wegenast, *ibid.*, at p. 735, still quoting from the same case.

147. *Supra* n. 140.

148. Panneton, J., *ibid.*, at p. 766 n. a of his judgment refers to the *In re National Stadium* case, *supra* n. 146 that forms the basis of Wegenast’s argumentation and also to *In re Western Canada Fire Ins. Co.: Cowper’s Case*, (1915) 8 Alta. L.R. 348. See for another example of what seems to have been a case decided on the same principle: *Boulet v. Hudon*, (1917) 51 Que. S.C. 29 (C.R.) at p. 31. This approach would also explain the uneasiness of French law where the commentators of late have started to doubt of the traditional rule: Hémard, Terré et al., *op. cit.*, vol. I at p. 602 par. 666.

others suggest that a shareholder could have the right to rescind his contract at all times. This basic conflict of views will only be solved by future jurisprudence taking into account all the ramifications of this complex question.

iii. The rescission of the contract: a requirement indispensable before an action in damages against the company?

In English law, the right to sue the company for damages cannot be exercised if the subscriber elects to remain a member of the company and keeps his shares: this rule was stated by the House of Lords in *Houldsworth v. The City of Glasgow Bank*<sup>149</sup>. The basis of the rule has given rise to some conflict in the authorities<sup>150</sup>, one school suggesting that this rule is also predicated on the guarantee fund theory<sup>151</sup> where another adopts a more literal interpretation of the case and suggests that an implied term of a shareholder's contract with his fellow members is that his funds will be used to meet the liabilities of the company, amongst which are not to be included damages resulting from an action for fraud on the shareholder's part<sup>152</sup>.

In Canada, the rule and its applications have been severely criticised. Wegenast has argued that basic differences between our *Companies Acts* and the English statute should preclude the application of the rule to our jurisdictions<sup>153</sup>. The author also indicated that the ordinary rules of con-

149. (1880) 5 A.C. 317 (H.L.); Pennington, *op. cit.*, at p. 242; Gower, *op. cit.*, at p. 319. In American jurisdictions, one can find a similar approach but the majority view now is that one can retain one's contract and also sue for damages: 28 C.J.S. 832-833 n. 326.

150. See the interesting debate between Professors Gower and Hornby in: (1956) 19 M.L.R. 54, 61 and 185.

151. Gower, *ibid.*, at p. 62. See also, in his third edition of *The principles of modern company law*, where the author at p. 319 comments that "the reasons for this anomalous rule are not altogether clear. . ." Also, at pp. 262, 276, 324, 329 and 330.

152. Hornby, *supra* n. 150 at p. 57 and following. See also Lord Cairns' judgment at pp. 324-325, *supra* n. 149; Lord Selborne, at p. 329. For another discussion of the case: P. F.P. Higgins, "Rescission of contracts to take company shares", (1963) i. Tasmania U.L.R. 826 at pp. 838-841; J. Gross, "Civil liability for the contents of the prospectus in the light of the new Israeli Securities Law", (1973) 36 M.L.R. 600 at p. 605, for a statutory exception to the traditional rule.

The minority view in American law has taken a similar approach to that of Professor Hornby. See: *Virginia-Carolina Rubber Co. Inc. v. Flanagan*, 142 S.E. 376, 150 Va. 276 (1928), referring at p. 377 to the *Houldsworth* case, *supra* n. 149.

153. Wegenast, *op. cit.*, at pp. 733-734, where the learned author comments: "It is to be observed that the judgments in *Houldsworth v. City of Glasgow Bank* and its associated cases are all based on the analogy between a company and a partnership. . . The analogy of a partnership fails when applied to our letters patent companies,

tract allow the possibility of retaining the contract and suing for damages and that it was difficult to justify the exclusion of this rule in contracts to take up shares<sup>154</sup>. Finally, the author argues that the facts of the case do not really justify the wide formulation of the rule and that the House of Lords itself tried to avoid stating a general principle<sup>155</sup>.

In Quebec, cases have not followed nor criticised the *Houldsworth* rule and the authorities do not discuss the point at all<sup>156</sup>. However, if the courts were to be called upon to decide the issue, they should refuse to follow the ruling. In English law, the justification of the decision is still controverted and in common law provinces, as seen above, its application is seriously doubted<sup>157</sup>. In Quebec, the civil law allows a person the right to retain his contract and simply sue for damages in cases of fraud<sup>158</sup>.

Consequently, it is submitted that the *Houldsworth* case should not be accepted in Quebec as an authoritative judgment: provincial courts have no real justification today for imposing a special regimen to the relationship of a shareholder to his company and for this reason, an action in damages should be possible even if the member wishes to retain his contract.

#### B. NEGLIGENT STATEMENTS IN A PROSPECTUS: REMEDIES AT CIVIL LAW AND STATUTORY RELIEF.

In English law, the traditional view was that a negligent statement on the part of a director, whether made generally or in a prospectus, did not impose on the person making it any liability at common law: it is only where plaintiff could establish that the statement was made fraudulently that the directors incurred liability in damages. This was the rule established by the classic case of *Derry v. Peek*<sup>159</sup> where Lord Herschell said:

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founded, as they are, on executive decree rather than partnership contract. And it would seem that whatever disability a shareholder of a chartered company may be under in claiming damages against the company would have to depend on the statute. . . ."

154. *Ibid.*, at p. 733: ". . . to approbate and at the same time reprobate is precisely what he is entitled to do. . . ."

155. *Ibid.*, at pp. 735-736.

156. Renaud et Smith, *op. cit.*, vol. II at p. 679 where the authors do not discuss the question when dealing with the recourses of a subscriber in damages for false representations.

157. Wegenast, *op. cit.*, at pp. 733-734.

158. Baudouin, *Les Obligations*, p. 83 par. 136.

159. (1889) 14 A.C. 337 (H.L.).



“ . . . I think those who put before the public a prospectus to induce them to embark their money in a commercial enterprise ought to be vigilant to see that it contains such representations only as are in strict accordance with fact, and I should be very unwilling to give any countenance to the contrary idea. I think there is much to be said for the view that this *moral* duty ought to some extent to be converted into a legal obligation, and that the want of reasonable care to see that statements, made under such circumstances, are true, should be made an actionable wrong. . . If it is to be done the legislature must intervene and expressly give the right of action in respect of such a departure from duty. . . ”<sup>160</sup>.

The judicial suggestion was followed up and the next year, the *Directors Liability Act*<sup>161</sup> was enacted in order to cover cases of negligent misrepresentations in a prospectus. The statute was merged into the *Companies Act*<sup>162</sup> and to this day, the Act makes it an actionable wrong to negligently state something in a prospectus which is not true<sup>163</sup>. Negligent statements thus became a statutory tort<sup>164</sup> where the common law had refused to admit them under general principles of tort liability.

However, the position in England is not so clear now since the House of Lords decision in *Hedley Byrne & Co. Ltd. v. Heller & Partners Ltd.*<sup>165</sup> where the Law Lords held that in certain circumstances there might be a duty imposed upon one making a statement to see that a certain amount of care is taken to ensure that the statement is true<sup>166</sup>. Most authors agree that the decision would most probably apply in the context of mis-statements in a prospectus<sup>167</sup> although there is some dispute as to

160. *Ibid.*, at p. 376; Gower, *op. cit.*, at pp. 315-316; Pennington, *op. cit.*, at p. 240.

161. (1900) 53-54 Vict. c. 64 (U.K.).

162. Wegenast, *op. cit.*, at p. 691.

163. For a discussion of what eventually became s. 43 of the *Companies Act, 1948*, see Gower, *op. cit.*, at pp. 331-333.

164. Pennington, *op. cit.*, at p. 245: “The *Companies Act, 1948*, by sanctioning the statutory claim, no doubt creates a statutory tort. . .”

165. [1964] A.C. 465 (H.L.).

166. To impose the duty, there must be a special relationship between the parties and the person giving advice must know that it will be relied upon: Pennington, *ibid.*, at p. 243.

167. Gower, *op. cit.*, at pp. 316-317; R. C. A. White, “Towards a policy basis for the regulation of insider dealing”, (1974) 90 L.Q.R. 494 at pp. 498-499; Pennington, *The investor and the law*, at p. 120-121 and note also at p. 185 where the author suggests that the only difference between the statutory tort of s. 43 and the *Hedley Byrne* principle would be one of evidence; also the same author, *Company Law*, at pp. 243-244. A recent Canadian case dealing with the question of negligent statements in the purchase of shares is *Culling v. Sansai Securities Ltd.*, (1974) 45 D.L.R. (3<sup>rd</sup>) 456, at p. 462 where Anderson, J., followed the House of Lords’ decision. This was a case of special relationship: it involved a broker-customer transaction. In civil law, there is no room for such an approach. For example, the relationship between a broker and a customer is one of mandate: article 1735 C.c. expressly admits this and see the discussion of this principle in Renaud et Smith, *op. cit.*, vol. II at pp. 555-556. If the

the persons who can actually claim damages under such a duty<sup>168</sup>. If the *Hedley Byrne* principle is applicable to company prospectuses, this would result in a very peculiar situation: the statutory relief now afforded by section 43 of the *Companies Act* would in a sense become useless because it would cover by statute a tort recognized by common law and apart from the evidentiary advantage<sup>169</sup>, the legislation would be merely duplicative of the common law on this point.

This brings us to a discussion of the problem in Quebec law. A striking feature of the provincial *Companies Act* is that it contains no reference to prospectus liability. Quebec, unlike most provinces at the beginning of the century<sup>170</sup> did not follow suit and copy the *Directors Liability Act*<sup>171</sup> which was to become a model for many *Companies Acts* in the common law provinces. As a matter of fact, there is no equivalent in our array of corporate legislations to a s. 43 of the *Companies Act*,

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broker is a mandatary, he is then bound to take all reasonable care in whatever he does for his client. This obligation is imposed by article 1710 C.c.:

"The mandatary is bound to exercise, in the execution of the mandate, reasonable skill and all the care of a prudent administrator. Nevertheless, if the mandate be gratuitous, the court may moderate the rigor of the liability arising from his negligence or fault, according to the circumstances."

This is applicable to brokers: Renaud et Smith, *op. cit.*, vol. II at pp. 560-561. See: *Mount v. Regem*, (1931) 51 Que. K.B. 482, at p. 485 where Bernier, J., remarked:

"... dans l'exécution de ses engagements, il doit apporter la plus stricte rigueur..."

Thus, a broker in Quebec making a negligent statement will be liable in damages under article 1710 C.c. whereas in the common law provinces he will be liable under the principle of the *Hedley Byrne* case, as applied by the *Culling* case.

168. Gower, *op. cit.*, at p. 317 expressed the view that subscribers and purchasers on the market could sue under the principle where Pennington would restrict this right to existing shareholders: *Company Law*, at p. 243 and wonders whether the rule has not been restricted even further by the recent decision in *Mutual Life and Citizens' Assurance Co. Ltd v. Evatt*, [1971] 1 All E.R. 150; [1971] A.C. 793: *ibid.*, at pp. 243-244.
169. Pennington, *The investor and the law*, at p. 185.
170. Wegenast, *op. cit.*, at pp. 691-692, 700 and 711 for an interesting historical review of this question. The Federal *Companies Act* only adopted a similar section in 1917: *ibid.*, at p. 700. It was to remain on the statute books until the new Act, passed in 1975: *The Canada business corporations Act* S.C. 1974-75-76, c. 33, assented to on the 15 December 1975. This Act does not contain a prospectus liability section: the reason for this important change is that the provincial *Securities Acts* deal extensively with this question now and it was thought unnecessary to duplicate the legislation. See the *Commentary* following the 1975 edition of the statute edited by CCH Canadian Ltd, at p. 111. This also sets to rest the difficult question of knowing whether the federal legislature could regulate fraud, this being normally within the jurisdiction of the provinces. See Wegenast, *op. cit.*, at pp. 699-700; Côté, *loc. cit.*, n. (1) at p. 139 n. 11.
171. *Supra* n. 161.

1948. What is the reason for this important omission? Is it explained by the fact that our legislation in this field has always been rather slow to adapt to newer ideas<sup>172</sup> or is there a more fundamental explanation for the refusal of the provincial Legislature to copy the English model?

The answer to this question lies in the peculiar nature of civil law responsibility. In Quebec law, a person who is negligent in any manner is liable in damages to the person who suffers from his act: this rule is of general application<sup>173</sup>, and consequently, a director who makes a negligent declaration in a prospectus will be liable under the general principle of article 1053 C.c.

The *Directors Liability Act*<sup>174</sup> was enacted because a negligent statement was not an actionable tort at common law whereas, if the same case had arisen in Quebec, it would have been dealt with under the general principle of liability set out in article 1053 C.c. This is the reason why there is no similar legislation in the *Companies Act*: what the civil law could deal with adequately was not to be regulated by the importation of unnecessary legislation.

Before examining the provincial case law on this point, a comparison with French law, where the same problems are settled under the general liability section of the French Civil Code<sup>175</sup>, will help to stress the original position of Quebec law. In French law, the making of a negligent statement will give rise to civil liability<sup>176</sup> and the rule is applicable in the context of contracts to take up shares. As Professor Pennington points out:

“... under the general provisions of the Civil Code, subscribers or purchasers of securities may recover damages from persons responsible for issuing an invitation to invest if it contained false or misleading statements of fact made fraudu-

172. Professor Caron, in his preface to the second volume of M. & P. Martel's *Aspects juridiques de la compagnie au Québec*, 2<sup>nd</sup> ed., Publications Les Affaires, Montréal, 1972, describes the provincial law as “victorienne”: p. xix.

173. Baudouin, *La responsabilité civile délictuelle*, at p. 70 par. 89.

174. *Supra* n. 161.

175. The French equivalent to article 1053 C.c. is to be found in articles 1382-1383 C.N.

176. H. et L. Mazeaud et A. Tunc, *Traité théorique et pratique de la responsabilité civile*, vol. I, 5<sup>th</sup> ed., Ed. Montchrétien, Paris, 1957, at p. 555, par. 501, where the authors remark: “... celui qui donne des renseignements inexacts ou incomplets engage sa responsabilité quasi-délictuelle envers la personne visée par ces renseignements, lorsqu'il s'est informé à la légère, sans effectuer les vérifications désirables. . .” The authors also make an extensive review of the jurisprudence in French law on the question: *ibid.*, at pp. 555-556 n. 2 and 3.

In civil law, the distinction between delict and quasi-delict is mostly historical: Baudouin, *op. cit.*, at p. 3 n. 2, although it has some significance from the point of view of the consequences of an act: *ibid.*, at p. 4-5.

lently or *negligently*, and in the case of bankers and stockbrokers soliciting subscriptions from their customers or clients, liability is imposed if they are *guilty of imprudence or slight negligence* in not ensuring that the invitation is accurate. . . .<sup>177</sup>.

In this context, there are no restrictions similar to the ones set out by the House of Lords in the *Hedley Byrne* case<sup>178</sup>: in French law, the duty to exercise due care before giving information is a general one<sup>179</sup> and it is not surprising to find that the French courts, when faced with a situation identical to that of the *Hedley Byrne* case, decided the issue according to the general civil liability section of the Civil Code<sup>180</sup>.

The position in Quebec is similar to that of French law. Where a person purports to inform a third party and in doing so is negligent, he is liable under the general principle of article 1053 C.c.<sup>181</sup>. Thus, in *Cossette v. Dun*<sup>182</sup>, a credit information agency was held liable in damages for negligent statements made concerning a third party: this case was decided according to article 1053 C.c.<sup>183</sup> and after indicating that French law should prevail on such question<sup>184</sup>, Fournier, J., in the Supreme Court of Canada, went on to differentiate between civil and common law and stressed that on the issue involved, civil law offered wider relief:

“. . . Il est inutile d'aller chercher soit dans le droit anglais soit dans le droit américain la solution de cette question. Les principes de ces législations n'étendent pas la responsabilité aussi loin que les art. 1053, 1054 du Code civil de la province de Québec. Ces articles ne font pas de la malice un des éléments de la responsabilité, ni de la bonne foi une exemption de cette responsabilité. Pour qu'il y ait responsabilité, il suffit qu'il y ait faute, imprudence, négligence ou inhabilité (sic).”<sup>185</sup>

177. *The investor and the law*, at p. 192 referring to the decision of the Court of Appeal of Paris: *Escafe v. Banque de Paris et des Pays-Bas*, reported at D.P., 1896.2.481. The author also refers to article 1382 C.N. In French law, slight negligence is sufficient: *ibid.*, at p. 196. See also pp. 190 and 213 n. 54 for similar liabilities in German civil law. The author also expresses the view that there is no case directly dealing with prospectuses in French law on this point: *ibid.*, at p. 197. Since the writing of the book, the French courts have not examined the question in this precise context.

178. *Supra* n. 165.

179. *Supra* n. 176.

180. *Banque populaire industrielle et commerciale de la Région de Paris et Chambre Syndicale des banques c. Saint-Cizi-Castan* 21 juin 1937, D.P. 1.28 with a note by P. Mimin at pp. 28-31 is a remarkably similar situation to that of the *Hedley Byrne* case.

181. J. J. Beauchamp, *Répertoire général de jurisprudence canadienne* vol. 3, Wilson & Lafleur, Montréal, 1914-15, at pp. 2036-2038. A. Nadeau, *Traité pratique de la responsabilité civile délictuelle*, Wilson & Lafleur, Montréal, 1971, at p. 264 par. 248.

182. (1890) 18 S.C.R. 222; (1889) 5 M.L.R. 42 (Q.B.).

183. *Ibid.*, at p. 241 *per* Ritchie, C. J.

184. *Ibid.*, at p. 247.

185. *Ibid.*, at p. 251, referring to Laurent, *op. cit.*, vol. 20, at p. 512.

Other cases had already admitted the principle consecrated by the Supreme Court: a negligent statement in civil law will give rise to liability under the general principles of the Code<sup>186</sup>. In the context of contracts to take up shares, a similar position has been accepted by the provincial Court of Appeal in the case of *Cloutier v. Dion*<sup>187</sup>. The Court held that in questions of liability arising from statements made to purchasers of shares, French law was to provide the guidelines and referred as authority for its decision in that case to French jurisprudence<sup>188</sup>. In the French case referred to by the Court of Appeal, it was held that:

“... l'imprudente légèreté d'affirmations aussi précises, aussi formelles, suffirait à engager sa responsabilité envers les souscripteurs. . .”<sup>189</sup>.

As a conclusion, in Quebec, there is a long line of authorities agreeing with the principle that negligent statements give rise to liability under article 1053 C.c. This approach indicates the exceptional position of Quebec law: in matters of contract and tort, the authorities of English law should be received with great caution<sup>190</sup> for they are based on a system of law so foreign to the economy of civil law that their reception cannot be admitted in the Province.

If there is a liability resulting from negligent statements in Quebec under article 1053 C.c., this entails interesting consequences. If the statement is made by a representative of the company, the company is also liable under the principles of mandate and vicarious liability: a company can be sued for the negligent act of its agents in Quebec law and there is no reason to refuse to admit this rule in the context of a prospectus<sup>191</sup>. The same reasoning applies under this heading as in the case of fraudulent statements: every person who suffers a damage resulting from

186. *Carsley v. The Bradstreet Co.*, (1886) 2 M.L.R. 33 (S.C.) where Loranger, J., at p. 39 said: “. . . it has been properly said that the French law must apply. . .” Also: *ibid.*, at pp. 46 and 50. This was affirmed in appeal: (1887) 3 M.L.R. 83 (Q.B.).

187. [1954] Que. Q.B. 595.

188. *Ibid.*, at p. 603 per Pratte, J., referring to: S. 1882.1.311.

189. *Ibid.*, at p. 311. See also: Giguère, *op. cit.*, at pp. 172-174 where the author points to the basically different nature of civil and common law liability in the field of prospectus statements. Commenting on the English legislation, Professor Giguère remarks:

“On ne trouve, ni en droit français ni en droit québécois, l'organisation d'une semblable responsabilité qui. . . paraît avoir été manifestement édictée par suite d'une insuffisance de la “common law”. . . (*ibid.*, at p. 174).

190. Nadeau, *op. cit.*, at p. 12 par. 19; *Desrosiers v. The King*, (1920) 60 S.C.R. 105 at p. 126 where the Supreme Court itself warns against such an influence.

191. This was the reasoning applied in the case of fraudulent statements. Fraud and negligence being both delicts fall under the same rules. In Quebec, a company can be liable for the negligent act of its representatives: *Ward v. The Montreal Cold Storage and Freezing Co.*, (1904) 26 Que. S.C. 310 (C.R.) at pp. 338-340; Smith et Renaud, *op. cit.*, vol. I at pp. 384-387.

the statement has a right of action<sup>192</sup> but he has the burden of establishing the causal link between fault and damage<sup>193</sup>.

In Quebec law, the only recourse given at law for a negligent statement will be damages: the shareholder cannot obtain rescission of his contract. As pointed out by Cross, J., in *Bergeron v. La Compagnie de meubles de Jonquière*<sup>194</sup>,

“... misrepresentation, not amounting to fraud, has not been made a ground of rescission here, as it has been in England. . .”<sup>195</sup>.

This last rule, however, must now be stated with some qualifications. The provincial *Securities Act* does give a right of rescission where a person commits the following offence:

“... upon the occasion of a dangerously hazardous speculative transaction respecting securities, to abuse the credulity, ignorance, weakness or manifest inexperience in business of a person incapable of estimating the risk involved in the transaction, and so to cause him serious prejudice. . .”<sup>196</sup>.

If a prospectus is issued and contains a negligent statement, it could be argued, in favour of the purchaser, that this constitutes an infringement of the *Securities Act* and entitles the party to rescission of his contract<sup>197</sup>.

In fact, the *Securities Act* seems to impose an even greater standard of care than article 1053 C.c.: from the formulation of s. 35 g of the Act, it would appear that not only a negligent representation gives right to relief but that all types of statements creating confusion in the purchaser's mind are also prohibited by the Act. Thus, where at civil law, mere *gratis dicta* have never given a party to a contract any rights against the person making them<sup>198</sup>, it would appear, under the *Securities Act*, that even this

192. *Supra* n. 87.

193. *Supra* n. 97.

194. (1913) 22 Que. K.B. 341.

195. *Ibid.*, at p. 348; *Wegenast, op. cit.*, at p. 732 n. 4.

196. R.S.Q. 1964, c. 274, s. 35 g.

197. The right of rescission is given by article 60 of the Act but certain conditions are set out in article 60 for the exercise of the right of rescission: there must be serious prejudice and the action must be brought within *one* year of the date of the transaction. This limits considerably the right of the aggrieved party but when one considers that at civil law he would have no recourse at all, this is probably a reasonable delay. For an interesting case dealing with s. 35 g of the Act, see: *Mines v. Calumet Investments Ltd.*, [1959] Que. S.C. 455.

198. As established previously, *dolus bonus* is not a cause of nullity in civil law and does not even give rise to damages. Thus, as Baudouin remarks: “Il est impossible en effet, pour la nécessité des affaires de commerce, d’aller jusqu’à protéger la crédulité naïve des acheteurs. . .”, in *Les Obligations*, at p. 80 n. 130. Contrast this with s. 35 g which makes it an offence “to abuse the credulity. . .” of an investor who is inexperienced.

type of statement is now prohibited. This question will be examined in greater detail later on.

### C. STATEMENTS IN A PROSPECTUS NOT AMOUNTING TO FRAUD OR NEGLIGENCE: REMEDIES IN THE LAW OF CONTRACT.

A prospectus might contain references to future facts or statements of intention made by the company or its representatives. Such promises do not amount to fraud<sup>199</sup> unless of course the plaintiff can establish that they are made without any belief in their veracity<sup>200</sup>. A plaintiff in Quebec law has no recourse in nullity for such representations: he might however have a recourse in damages. In English law, some authority admits the possibility that a subscriber might sue in damages for promises that are not executed<sup>201</sup>. In Quebec, there is very little authority on this point but various *dicta* suggest the possibility of an action in damages in cases where representations of future conduct, promises and other assurances have not been executed<sup>202</sup>. In such cases, the rule of article 1065 C.c. governing contractual relief will be applicable<sup>203</sup>.

The remedies available to the investor at civil law for mis-statements in a prospectus are thus numerous. The most striking feature of Quebec law in this context is that the principles of civil responsibility offer a wide range of relief when contrasted with English law. This partially explains

199. *Bergeron v. La Cie des meubles de Jonquière*, *supra* n. 194 at pp. 342-343, 348 and 351-352. Note that proof that such promises were made might help to establish fraud: *ibid.*, at p. 345.

200. Baudouin, *op. cit.*, at p. 80 n. 185 where the author argues that future promises might be fraudulent if made without any belief in their truth. They might also amount to negligence if the person making such references does so negligently. See also: Pennington, *The investor and the law*, at p. 181; Stiebel, *op. cit.*, vol. I at pp. 146 and 168.

201. Gower, *op. cit.*, at p. 329. The author however points out that rescission might be necessary in view of the principle set out in the *Houldsworth* case, *supra* n. 149.

202. A possibility admitted clearly by Cross, J., in the *Bergeron* case, *supra* n. 194 at p. 343: ". . . he nonetheless becomes a shareholder, and must be taken to rely upon the good faith or the legal obligation of those in control to see that these conditions are observed or fulfilled. . . ." Such legal obligation gives rise to damages if not respected: *T.W. Hand Fireworks v. Baikie*, (1913) 43 Que. S.C. 325 (C.R.) at p. 329 where a recourse in damages is stated as the relief afforded in cases of promises that are not executed. In Quebec law, rescission is not possible for such promises: *supra* n. 195, unless one sues for the nullity of contract under failure of consideration. This last case will be exceptional for one rarely sees a prospectus where a representation of future promises can actually have been the main consideration of a contract to take up shares. See Gower, *op. cit.*, at p. 329.

203. For an exposition of the ramifications of this rule, see Baudouin, *op. cit.*, at p. 279 and following.

the absence in the corporate legislations of any special enactment regulating declarations in prospectuses and points to interesting differences that must be taken into account when one is called upon to analyse, in Quebec law, the relationships between the company and investors on the open market.

Although the protection of civil law is considerable in this context, it was not sufficient in many cases to deal with the ingenuity of company promoters whose experience of the share markets was often a precious tool in evading the standards set by the traditional rules of the Civil Code. In this last section, a brief study of the various statutes dealing with prospectuses in Quebec will illustrate the particular care taken by the provincial courts and the Legislature in ensuring that the average investor in the Province is guarded against all forms of promotional abuse.

## PART II

### Protecting the investor in Quebec law: judicial surveillance and statutory relief.

#### A. THE ROLE OF THE COURTS: PROTECTOR OF INVESTORS' RIGHTS

Before examining in some detail the various provincial statutes that have given supplementary relief to the investor in cases where the civil law offered no remedies, it is of interest to study the position of the courts in Quebec. Prospectus liability is a good illustration of the general problem of investor protection: the attitude of the provincial Courts to the plight of the investor in the nineteenth century and in a contemporary context reveals a constant willingness to protect the innocent purchaser against the artifices of speculators.

In the nineteenth century, the Courts of the Province took a surprisingly protective attitude towards the investing public: although the interests of commerce were a major preoccupation of the times<sup>204</sup>, Quebec courts often stressed the fact that they would do all in their power to favour the much abused investor. As pointed out by Aylwin, J., in *Prévost v. Allaire*<sup>205</sup>,

"... it is fitting that the public should know that there is a tribunal which can control individuals in their management of such a concern. . ."<sup>206</sup>.

204. *McDougall v. Demers*, (1886) 2 M.L.R. 170 (Q.B.) at p. 183. See also *Belleau v. Lagueux*, (1904) 25 Que. S.C. 91 at p. 93 where Routhier, J., pointed to the inherent difficulty of reconciling the interests of commerce with the protection of investors.

205. (1861) 11 L.C.R. 293 (Q.B.).

206. *Ibid.*, at p. 321.



Thus, the provincial courts of the period often mentioned that it was their duty to protect the naïve public from abuse<sup>207</sup>. However, in doing so, they had to respect the limitations of civil law: where the law imposed no liability for a particular course of conduct, it was not the office of the Courts to correct what they considered an abuse by an exceptional construction of the Code<sup>208</sup> and courts soon felt that they were powerless to deal with many of the problems involving speculation and share flotations<sup>209</sup>. It thus became apparent that the only solution to the problem of investment protection had to be legislative. As pointed out by Hall, J., in his admirable dissent in the *Forget v. Ostigny* case<sup>210</sup>:

“ . . . speculation. . . almost always results. . . in serious ultimate loss to the novice who attempts it. We couple such transactions most naturally with the purchase and sale of stocks, because of the daily public quotations of their value and the facility of transferring the certificates by which they are represented. It is possible that by reason of the greater temptation in connection with this class of security, special legislation should be enacted in the interest of those who have not judgment and prudence for their own protection, to impose special conditions upon civil contracts for the sale of stocks, instead of leaving them, as the legislature has thus far done, to be determined by those general principles under which ordinary commercial contracts are governed. . . .”<sup>211</sup>.

The solution to most problems dealing with the protection of investors thus had to be statutory: this general statement of Hall, J., was not the first time<sup>212</sup> nor the last<sup>213</sup> that courts of the Province suggested

207. *Côté v. The Stadacona Insurance Co.*, (1880) 6 Q.L.R. 147 (Q.B.) at p. 151; *Syme v. Heward*, (1856) 5 R.J.R.Q. 373 (S.C.) at p. 391.

208. The duty of the court is to apply the law as it is and not as it should be: *Abbott v. Fraser*, (1874) 20 L.C.J. 197 (P.C.) in the Court of Appeal at p. 201.

209. *Forget v. Ostigny*, (1895) 4 Que. Q.B. 118 at pp. 160-161, and more precisely at p. 161: “ . . . the courts should hesitate to undertake a task in which those have signally failed to whom it legitimately belongs. There is great danger that the laudable effort to reach special cases may intimidate the use of capital and check the spirit of enterprise upon which the progress and prosperity of the country depend.” (*per* Hall, J., diss.). See also: *McDougall v. Demers*, *supra* n. 204, at p. 175.

210. *Supra* note 209. This case went to the Privy Council on appeal: [1895] A.C. 318 and became the *locus classicus* on the legitimacy of speculation. On the historical evolution in Quebec of this question: see Renaud et Smith, *op. cit.*, vol. II at pp. 527-543.

211. *Ibid.*, at p. 155. See also at pp. 160-161, where the learned judge discussed the usefulness of making “men prudent by statute” (at p. 161).

212. See *McDougall v. Demers*, *supra* n. 204 at p. 175 for an earlier example.

213. The Courts have probably been the best Company Law Reform body in the Province. There are numerous examples where the courts have pointed to certain shortcomings of the provincial legislation in this field and have suggested appropriate amendments. See, for example: *Société des arts du Canada v. Prévost*, (1911) 20 Que. K.B. 227, at pp. 235-236 where the Court suggested that *fontines* should be regulated by statute.

adequate legislation in this field of commerce, pointing to the inadequacies of civil law to cope with modern problems of issuing techniques, company promotions and share flotations.

Of late, the Courts have not abandoned their function of corporate "ombudsman": in a recent case, for example, the tribunal stated that its primary consideration in questions of share dealings was always the protection of the public, even if this was to be detrimental to commercial interests<sup>214</sup>.

In a sense, the Courts in Quebec were instrumental in bringing about important reforms in the laws governing share dealings: our modern statutes are due to their sincere preoccupation in seeking some form of relief for the much oppressed investor of the last one hundred and fifty years. As regards the question of prospectus liability, two statutes have some bearing on the present discussion. They are the *Companies Information Act*<sup>215</sup> and the *Securities Act*<sup>216</sup>. These will be discussed separately.

## B. STATUTORY RELIEF FOR THE AGGRIEVED INVESTOR

### 1. *The Companies Information Act*

The first legislative attempt in Quebec to control the qualitative contents of a prospectus was to be the *Companies Information Act*, enacted in 1930 and modelled on an Ontario statute of 1928<sup>217</sup>. The Act was amended from time to time<sup>218</sup> but in essence, it has not changed much over the years. The Act imposes an obligation on company promoters and directors to deposit with the Minister of Consumer Affairs a prospec-

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For the regulation of such agreements in French law, see: C. Houpin et H. Bosvieux, *Traité général théorique et pratique des sociétés civiles et commerciales*, vol. 2, 7<sup>th</sup> ed., Administration du Journal des notaires et des avocats, Paris, 1935, at pp. 1122 and following; *Black v. Carson*, (1913) 22 Que. K.B. 217 p. at p. 219 where provisions regarding compulsory take-over bids were suggested and enacted *fifty years* later: S.Q. 1963, c. 54, s. 1. A more recent example is *Mines v. Calumet Investments Ltd*, *supra* n. 197 at pp. 459-460 suggesting the controlling of over-the-counter sales of speculative shares by appropriate legislation: this was partly carried out by the *Revised Policy Statement n. 5* prepared by the Securities Commission of the province in March 1974.

214. *Mines v. Calumet Investments Ltd*, *supra* n. 197 at p. 463.

215. R.S.Q. 1964, c.273. [Hereinafter, referred to as the *Companies Information Act*.]

216. R.S.Q. 1964, c. 274. [Hereinafter, referred to as the *Securities Act*.]

217. The statute was enacted by (1930) 20 Geo. V, c. 87. It was modelled on the Ontario Act: (1928) 18 Geo. V, c. 33. See Wegenast, *op. cit.*, at pp. 696-693 for the historical outline of these Acts.

218. The most recent amendments being: S.Q. 1974, c. 66; S.Q. 1975, c. 74.

tus whenever a company is about to establish an office in the Province, commence business or sell any of its shares therein<sup>219</sup>. There is a statutory liability imposed for failing to do what the statute prescribes<sup>220</sup> but although the Act clearly sets out the information that the prospectus must contain, it imposes no liability for false or negligent statements made in the document<sup>221</sup>. Thus, the Quebec legislature attempts to control the issue of shares in the province by requiring a prospectus to be delivered to the provincial authorities but it leaves to the general principles of civil law the control of illegalities committed in the preparation of such a document.

## 2. The Securities Act

Legislative control of the securities industry in Quebec was attempted at various stages during the decade preceding 1930<sup>222</sup> but it was only with the passing of an *Act for the prevention of fraud in connection with securities*<sup>223</sup> that proper regulation of investment contracts appeared in the Province. The statute was modelled on what is commonly known as the *Martin Act* of the State of New York<sup>224</sup> and contained basically the same provisions. It is beyond the scope of this article to examine in full detail the structure of our modern *Securities Act*<sup>225</sup> but as it has some relevance to the question of prospectus liability, an examination of certain parts of the law is necessary.

219. *Supra* n. 215, s. 2. Note s. 2(c) requiring a new prospectus to be filed whenever there have been material changes in the fact set out in a previously deposited prospectus. The same obligation is imposed by the *Regulations* made under the *Securities Act*: O.C. 2745-73, Que. Reg. 73-417, as amended by O.C. 3963-73, Que. Reg. 73-550; O.C. 1260-74, Que. Reg. 74-172, in section 7 of said *Regulations* [hereinafter referred to as *Regulations*].

220. *Ibid.*, at s. 3.

221. Strangely enough, the Act imposes such liability for a false statement in an annual return: *ibid.*, s. 4(3) and (3a) but the case of a prospectus is not covered. See also: J. P. Williamson, *Securities regulation in Canada*, University of Toronto Press, Toronto, 1960, at pp. 39, 83-84 (*Suppl.* 1966).

222. Various statutes were enacted to control the sale of securities in the Province. See: *An Act respecting the issue and sale of shares, bonds and other securities*, (1924) 14 Geo. V, c. 64. Control of brokers was also attempted: *An Act to amend the Quebec License Act*, (1928) 18 Geo. V, c. 14. For the historical context of those statutes: Williamson, *op. cit.*, at pp. 11-14 and more particularly at p. 13.

223. (1930) 20 Geo. V, c. 88.

224. Wegenast, *op. cit.*, at p. 693 n. 19 and p. 699. The New York Act was passed in 1921: L. Loss and E. M. Cowett, *Blue Sky Law*, Little, Brown, Boston, 1958, at p. 22. For a discussion of the statute, see L. Loss, *Securities regulation*, vol. 1, 2<sup>nd</sup> ed., Little, Brown, Boston, 1961, (*Suppl.* 1969), at pp. 35-43.

225. For a good analysis of the statute: Renaud et Smith, *op. cit.*, vol. II at pp. 1123-1253.

Like other statutes of the province dealing with securities, the Act contains no express liability section for false or misleading statements in a prospectus<sup>226</sup>. Curiously enough, the provincial legislature seems to constantly avoid having to deal with this issue, although recent amendments in other fields of company legislation reveal a greater willingness to cope with the problem<sup>227</sup>. The Act, however, does contain rather curious features that are not wholly foreign to the present discussion.

a. *A statutory definition of fraud*

In a long and detailed section, the *Securities Act* declares that certain representations and forms of conduct are fraudulent acts "within the meaning of this Act"<sup>228</sup>. A question of interpretation immediately arises concerning this section: was it the Legislator's intention to extend the definition of civil law fraud to cover cases not admitted by the ordinary principles of law? If this were so, the remedies examined above would in every case contemplated by s. 35 be available to the purchaser<sup>229</sup>. Or is the section simply a statutory definition of conduct that was to be considered undesirable in transactions involving share dealings and subject to either the sanctions of the Act itself or the pressures of administrative action?

Since the enactment of the statute, commentators have wondered whether the section does indeed give rise to the ordinary rules of civil

226. Although it does deal extensively with the information that must be set out in a prospectus: s. 5 of the *Regulations* and *Annex "A"*; Renaud et Smith, *ibid.*, at pp. 1202-1222.

227. In the case of false or misleading statements in documents required in take-over bid and insider trading legislation, it is now an offence under the Act to make such statements: see the recent amendments to the *Securities Act* enacted in 1973 by S.Q. 1973, c. 67 adding ss. 137, 138 and ss. 160, 161. The sections create a presumption of knowledge on the part of the person making the statement that it was false or misleading unless he can establish that he had reasonable cause to believe it. This is the first appearance in the statute books of a legislation of the type of the *Directors Liability Act* passed in England after the *Derry v. Peek* case: see *supra* note 161 and following. Is this necessary? As pointed out above, negligent statements in civil law give rise to liability under the general principles of civil law responsibility. The only advantage of such legislation is the presumption created by statute: this, however, is possibly created in civil law by simple judiciary discretion. *Vide* Trudel, *op. cit.*, at p. 187; *Chrétien v. Crowley*, (1882) 2 D.C.A. 385 (Q.B.), at p. 389 and articles 1238 and 1242 C.c. Consequently, in civil law, legislation of the type created by the 1973 amendments appears to be duplicative of the common law of the Province.

228. *Securities Act*, s. 35.

229. If this interpretation were to prevail, a right of rescission and an action in damages would be available for every case of "fraud" contemplated by section 35.

law<sup>230</sup>. One can most probably conclude that the legislative intent in this instance was not to extend the remedies of civil law to cases enumerated in the section but to simply proscribe certain conduct and leave it to the persons charged with administering the statute to see that offenders be dealt with. Reasons for this conclusion are numerous. First of all, in the New York statute from which the provincial Act was copied<sup>231</sup>, there is a similar section: commentators of American law suggest that such a section was merely intended as a basis for investigation and proper administrative action rather than common law liability<sup>232</sup>. The administrative nature of the Quebec section was very clearly set out in the original 1930 Act: wide powers of investigation were given to the Attorney General to determine whether a fraudulent act had been committed<sup>233</sup> and if it had, the consequence was that the person involved in the commission of the act was to be restrained from dealing in securities in the Province<sup>234</sup>.

230. Wegenast, *op. cit.*, at p. 697. More recently: Y. Caron, "Aspects du droit des valeurs mobilières", (1971) 17 McGill L. J. 234 at p. 287, where the author notes the complete absence of jurisprudence on this point, a view that is however erroneous. See *infra* note 238.

231. *Supra* note 224.

232. *Ibid.* Vide Loss, *supra* note 224, vol. I at p. 40. See also: Williamson, *op. cit.*, at pp. 357-358.

American law is not very useful in the interpretation of the Quebec *Securities Act*. The basic liability sections in the *Securities Act* of 1933 [48 Stat. 74 (1933), 15 U.S.C.A. 77] were modelled very closely on English law: Loss, *op. cit.*, vol. 3, at p. 1683; R.R. Pennington, *The investor and the law*, at p. 194.

Most cases of liability for false statements are taken under sections 11 and 12 of the *Securities Act*, 1933. The classic case is now *Escott v. Bar Chris Construction Corporation*, 283 F. Supp. 643 (S.D.N.Y. 1968) but that was a case mainly brought under s. 11 of the Act, and there is no equivalent in Quebec to such a section. See also: E. R. Latty, "Prospectus Liability—The Bar Chris Case", [1970] J.B.L. 65.

Some American authorities also suggest implied liability under Rule 10b-5 [17 C.F.R. 240.10b-5 (1970)] for misstatements in a prospectus. Generally: "Prospectus Liability and Rule 10b-5: A Sequel to Bar Chris", [1971] Duke L.J. 559 (Note). However, under the Quebec Act, there is also no equivalent rule or regulation of the Securities Commission. Consequently, the rather complicated decisions of American courts in this respect cannot serve in the interpretation of our *Securities Act*. On American law, see also *Expanding responsibilities under the securities laws* (S. C. Goldberg, ed.), Law Journal Press, New York, 1971.

233. In the 1930 Act, *supra* note 223, the fraud definition was set out in s. 2, which was the interpretation section: s. 2(3). The investigation section was s. 10 which read as follows: "The Attorney-General. . . may hold an investigation and examine any person, company or thing whatsoever at any time in order to ascertain *whether any fraudulent act. . . has been, or is about to be committed. . .*"

234. The consequences of a finding that a fraudulent act had been committed were that the Attorney-General could prevent a person from dealing in securities for a period of ten days or ask the Superior Court for a permanent injunction and give public notice of the

The purpose of securities legislation of this type thus becomes clear: by controlling securities dealers in the province, it is much easier to control the share market and ensure standards acceptable to all<sup>235</sup>. The modern *Securities Act* is slightly altered in that it does not expressly set out the consequence of committing a fraudulent act within the meaning of s. 35<sup>236</sup>. However, the Securities Commission still has complete discretion in deciding whether a registration will be granted to a dealer or an issuer and if the latter should have fallen within the application of the section, he most probably would be subject to the exercise of this discretion: thus, registration as an issuer or dealer could either be refused or revoked where the Commission is satisfied after investigation that a fraudulent act has been committed<sup>237</sup>.

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suspension. See the 1930 statute, *supra* note 223, ss. 11, 12. Thus, the finding of a fraudulent act simply resulted in administrative sanctions of great consequence but no civil liability seems to have been intended. Wegenast, *op. cit.*, at p. 696; Williamson, *op. cit.*, at p. 22: "There was no attempt to create civil liabilities based on these "fraudulent" acts; they constituted offences and were punishable by fine or imprisonment and they could be the basis for an injunction. . ." See also: *ibid.*, at p. 23.

235. *Gregory and Co. v. La Commission des valeurs mobilières du Québec*, [1961] S.C.R. 584 at p. 590. See also: Williamson, *op. cit.*, at p. 21. Note that the Quebec Act now deals with the question not only at the level of controlling securities dealers as it originally did in 1930 but also controls the issue of shares. See Renaud et Smith, *op. cit.*, vol. II at pp. 1186-1187.
236. Note that until the amendments of S.Q. 1959-60, s. 51, the Quebec Securities Commission had the duty to cancel the registration of a dealer or an issuer if a fraudulent act should be found to have been committed by an investigation. This was originally brought into the statute by: S.Q. 1954-55, c. 11 s. 43. *Vide*: Williamson, *op. cit.*, at pp. 229 and 235. Now, the Commission has complete discretion in the matter: R.S.Q. 1964, c. 274, ss. 24 and 25a of the Act.
237. *Ibid.* See also: Williamson, *op. cit.*, at pp. 22, 23, 175 and 224. Note the author's comment at p. 175: "Like the other securities acts, the Quebec Act lists activities which are 'deemed fraudulent'. Probably no civil liability attaches to these activities in the absence of an express provision: they are offences punishable by fine or imprisonment, but there do not appear to have been any recoveries in civil actions based on them. . ." One wonders if the statute itself imposes any sanctions apart from administrative displeasure that results in suspension and cancellation of the registration. S. 35 does not declare at any point that a violation or commission of any act therein described constitutes an offence. Consequently, serious doubts arise in deciding whether such an act constitutes an offence under the statute. See: *Canadian Securities Law Reporter*, vol. I, CCH Canadian Ltd., Don Mills, 1973, at p. 616 par 627. Note however that a conspiracy and complicity in committing such acts are offences: *Securities Act*, ss. 88, 89. The reason for this rather surprising omission is either an oversight on the part of the draftsman or is more legalistic. The imposition of a fine or imprisonment for the commission of a fraudulent act would be the consequence of making such act an offence. This would present a difficult problem of constitutional law: criminal legislation is the exclusive field of the federal parliament and the provincial regulation on this question could be viewed as infringing upon the federal jurisdiction, *Vide*

There is almost no reported jurisprudence on this type of legislation: however, in one Ontario case, *Re Attorney General for Ontario and Hutesson*<sup>238</sup>, the Court was dealing with a similar section<sup>239</sup> and came to the conclusion that the purpose of this legislation was to ensure that those dealing on the share market should not make use of abusive tactics<sup>240</sup> and that the method of ensuring the application of the Act was to control the registration of such individuals<sup>241</sup>. In that case, the Attorney General sought a permanent injunction against the defendant, which the court granted willingly.

No mention is made in the course of that judgment of the possibility of common law recourses against those committing a fraudulent act within the meaning of the statute. This is a reasonable position, for surely, if the Legislature had intended such recourses, it would have been more specific. This was to be the case in Quebec.

Thus, the statute itself gives some form of relief but only in the case contemplated by section 35 g which reads as follows:

“ . . . upon the occasion of a dangerously hazardous speculative transaction respecting securities, to abuse the credulity, ignorance, weakness or manifest inexperience of a person incapable of estimating the risk involved in the transaction, and so to cause him serious prejudice; . . . ”

Where such an act has been committed, the purchaser has a right of rescission<sup>242</sup>. The case contemplated in s. 35 g is never admissible in civil

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Williamson, *op. cit.*, at pp. 186-188. This probably explains the curious formulation of s. 84 of the Act which declares that “every person convicted of . . . any fraudulent act not punishable under the Criminal Code of Canada. . .” shall be liable to certain fines and/or imprisonment. But even then, how can one be convicted of a fraudulent act under s. 35 if such act is not an offence? *Nullum crimen sine lege*. Consequently, the Act should be amended to state clearly that a fraudulent act not punishable under the criminal law should be an offence and subjected to the penalties of s. 84. On the constitutional issue, see Williamson, *op. cit.*, at pp. 182-184 for supplementary material.

238. (1930-31) 66 O.L.R. 387.

239. *The Ontario Securities Fraud Prevention Act* (1930) 18 Geo. V, c. 39, s. 12.

240. *Supra* note 238 at pp. 390-391, *per* Kelly, J.

241. *Ibid.* See however the unreported case of *Johnston v. Windsor, K.B.*, Montreal, n. 1888, 29 May 1942, where there is some suggestion that the statutory fraud might indeed have extended the ambit of civil law remedies.

242. The right is given by s. 60 of the Act. The party must be “seriously prejudiced” and note that the section reserves the recourse of civil law. The right to rescission is lost after a year’s delay.

law as a cause of rescission: lesion between majors<sup>243</sup> and *dolus bonus*<sup>244</sup> have never been valid causes of rescission under our laws. If the Legislator thought it necessary to give relief in such a clear case where the civil law offered no recourse, is not the logical conclusion that he must have considered civil law recourses inapplicable to the other cases set out in s. 35 of the Act<sup>245</sup>?

Thus, a fraudulent or negligent misrepresentation in a prospectus will certainly fall under the application of the section but it will offer little added relief to the investor. The sole purpose of this enactment would seem to be purely supervisory and to ensure that persons involved in the provincial securities market take all due care to act with reasonable honesty in their dealings with innocent purchasers. If they should fail to do so, they will be prevented from trading in securities in the Province by administrative action.

b. *The statutory declaration*

Every prospectus must contain a signed declaration on the part of the promoters and directors of the issuing company in the following words:

“The foregoing constitutes, under the *Securities Act*, full, true and plain disclosure of all material facts in respect of the offering of the securities referred to

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243. S. 35(g) gives a right of rescission for any form of abusive conduct in share dealings. In civil law, there is no relief for mere abuse on the part of a contracting party: this is the rule of article 1001 and 1012 C.c. Only in cases of minors is abusive conduct a valid cause of nullity: 1002 C.c. The minor's right of action is lost after ten years: 2258 C.c. Thus, the right given by s. 60 is a statutory exception to the rule of article 1012 C.c.: Baudouin, *Les Obligations*, at p. 95 note 157. An interesting case where a minor sued under s. 35(g) of the Act is: *Mines v. Calumet Investments Ltd.*, [1959] Que. S.C. 455. Note that in the case of a minor, the section offers less protection than the civil law relief: *ibid.*, at pp. 461-462. Under s. 35(g), the minor must fall within the one year delay given by s. 60, where under the Civil Code, he has ten years to sue: 2258 C.c.; *Mines case, ibid.*, at p. 465. Thus, curiously enough, what is considered as a fraud under statutory law (*ibid.*, at pp. 462-463) is equivalent to lesion under civil law, when the case involves a minor. See also: N. R. Burns, “Infants as shareholders”, (1955) 28 Aust. L.J. 407.
244. As seen above, mere exaggerations do not constitute fraud in civil law but under the Act, such conduct will give rise to a right of rescission: Baudouin, *op. cit.*, at p. 80 note 130. A right of rescission will exist if plaintiff can convince the court that the defendant's conduct falls within the purview of s. 35(g). This offers good possibilities to the investor but no case seems to have dealt with the section since the *Mines case, supra*.
245. Unless of course the cases of s. 35 are already covered by the general principles of civil law applicable to fraud or negligence. See, for example, ss. 35(a), 35(b), 35(f), 35(h).



above, and there is no further material information applicable other than in the financial statements or reports required or exigible."<sup>246</sup>

The brokers, underwriters and optionees must also sign a similar declaration<sup>247</sup>. What is the effect of such a declaration? Some authorities consider it as a purely formal condition without any liability attached thereto<sup>248</sup>. This position cannot be accepted. Where such a declaration is made, it constitutes a representation to third parties that the statement is true: if it should prove false, this would incur the liability of the persons making it where they have acted negligently or fraudulently. As pointed out by Martel<sup>249</sup>:

"Il semble qu'une personne lésée pourra se baser sur cette déclaration des administrateurs pour les poursuivre civilement en dommages si elle a subi une perte par suite d'une fausse déclaration ou d'une déclaration erronée contenue dans le prospectus. . ."<sup>250</sup>.

246. This obligation is imposed by s. 5(2) of the *Regulations*. Note that where the regulation prescribes that a certain thing has to be done, it constitutes an offence under the Act not to follow this direction: see s. 83 of the *Securities Act*, *in fine*. Thus, if the directors do not sign the declaration, they will be liable to the penalties of s. 84 of the Act. They might also be liable in delict under article 1053 C.c. In civil law, the breach of statutory duties gives rise to civil law liability: Baudouin, *La responsabilité civile délictuelle*, at p. 50 note 59; H. Newman, "Breach of statute as a basis of responsibility in civil law", (1949) 27 C.B.R. 782; Williamson, *op. cit.*, at p. 162 where the author states that this is "the usual rule in Quebec. . ." (*ibid.*); *Lagueux v. Phœnix Assurance Co. Ltd.*, (1932) 53 Que. K.B. 398 at p. 407. This question is not settled in English law: see the discussion in Gower, *op. cit.*, at pp. 334, 338; Williamson, *op. cit.*, at p. 162. The duty is imposed by a regulation under the Act: however, see s. 83 *in fine*: ". . . These regulations and amendments to them shall have force of law while not repealed as if they are part of this act. . ." Thus, where the regulations state that a prospectus has to contain certain information, this imposes a duty on those responsible for the preparation of such a document to see that that information is set out in the prospectus. If it is not, then they will be liable in damages under article 1053 C.c. for breach of duty. Note however that the normal rules of civil liability are applicable to such cases also: Baudouin, *op. cit.*, at p. 51 note 59.

247. *Regulations*, s. 5(2) (b). On underwriter's liability, see P. P. Côté, *loc. cit.*, note (1), generally.

248. Williamson, *op. cit.*, at pp. 156-157. But the author concludes this because of the general liability sections in the statutes discussed: Quebec has no such section. Consequently, his conclusion could not apply to our provincial Act.

249. *Supra* note 172.

250. *Ibid.*, at p. 356. See also: Gower, *op. cit.*, at pp. 292, 317 and 320.

The Quebec Court of Appeal has recently adopted a similar position in *Yuksel Atilasoy v. Crown Trust Co.*, [1974] Que. C.A. 442. This is the first reported case in Quebec to deal with investment contracts, as defined by the *Securities Act*: see the definition section in the Act, s. 1 (1)(a) and Renaud et Smith, *op. cit.*, vol. II at pp. 1139-1142. In the case cited, a prospectus was prepared in order to inform investors as to the financial status of an investment trust that was formed to acquire a shopping centre. Part of the purchase price of the property was to be obtained by way

The statutory declaration also offers an element of solution to the question of determining what constitutes a material fact relevant to the issue of shares.

As pointed out above, simple omissions in civil law do not amount to fraud<sup>251</sup>. Although certain exceptions do qualify the generality of this statement<sup>252</sup>, they are not important enough to justify the regulation of this question by civil law principles exclusively.

The *Securities Act* of the Province deals extensively with the question of omissions. Firstly, an omission is a fraudulent act under the statute<sup>253</sup>: this exposes the person making an omission to the sanctions of

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of a hypothecary loan that was to be repaid over a period of twenty years and the trustee was empowered to lease out the property by way of "net lease".

The prospectus contained representations to this effect, which, however, were false. The loan was not for a period of twenty years but was repayable after five years only and the property was leased not by "net lease" but by way of emphyteusis. The directors of the promoting company had signed the statutory declaration required under the *Securities Act*. Dubé, J., in the Court of Appeal, commented on their liability. The learned judge pointed out, firstly, that the directors could not invoke the fact that they were simple representatives of the company in order to avoid the civil liability attaching to their fraudulent statements and referred to the case of *Café Ltd v. Harper*, [1968] Que. S.C. 235: pp. 447-448 of the judgment.

The learned judge then came to the conclusion that defendant directors knew that the prospectus was false: *ibid.*, at p. 447 and consequently ". . . les six directeurs de Realty Equities Company of Canada Ltd doivent être tenus personnellement responsables. . ." The directors not only committed a fault in such a case but also a fraud: *ibid.*, at p. 448. The Court also cited as authority for this conclusion the decision of the Supreme Court of Canada in *Nesbitt, Thomson & Co. Ltd v. Joseph M. Pigott*, [1941] S.C.R. 520 at p. 530. Thus, the Court of Appeal found defendants liable for damages under the general principles of civil law and common law: *ibid.*, at p. 448. See also at p. 449.

The case presents other interesting features. The Court clearly indicated that the investment contract, although in the form of a trust, was to be analysed according to the principles of the Civil Code: *ibid.*, at p. 449, where Dubé, J., remarked:

"Quand au surplus de la fiducie en question qui constitue réellement une entreprise commerciale à but lucratif, je serais plutôt d'opinion qu'il s'agit là d'un contrat innommé qui doit être régi par les règles générales du Code Civil concernant les obligations et les contrats. . ."

See also Bélanger, J., at p. 450, taking the same position. The Court of Appeal also indicated that the duties of a trustee under such an agreement were to be governed by the rules of trust as set out in the Civil Code: *ibid.*, at pp. 449 and 451, where the Court refers to articles 981u and 981k C.c. The *Atillasoy* case is thus an excellent example of the tendency of the Quebec judiciary to try to assimilate the influence of common law to the economy of the Civil Code.

251. *Supra* note 15.

252. *Supra* note 16.

253. Ss. 35(a) and (j) of the Act.

administrative action examined above<sup>254</sup>. The *Regulations* under the Act<sup>255</sup> describe in considerable detail the information that is required to be set out in any prospectus issued in the Province: there is the precise duty to declare all material contracts<sup>256</sup> and all material facts<sup>257</sup> that are relevant to the issue of shares.

What sanctions attach to a failure to respect these statutory directives?

i) An action in damages under article 1053 C.c. for breach of a statutory duty could be available to any person who suffers damages resulting from this omission<sup>258</sup>.

ii) An action in damages under article 1053 C.c. for fraud and/or negligence: the statutory declaration<sup>259</sup> contains a representation that all material facts are contained in the prospectus. Where this is false, the normal rules concerning misrepresentations in civil law come into play.

iii) An action in nullity of the contract:

This appears to be possible under common law<sup>260</sup>. In civil law, prohibitive laws import nullity, even where this is not specified in the statute<sup>261</sup>. It seems that in Quebec, where the Legislature has indicated that certain information must be given to a contracting party, the fact that

254. *Supra* note 237.

255. *Regulations*, s. 5(1)(a) and Annex "A".

256. *Ibid.*, s. 27 of Annex "A". See Wegenast, *op. cit.*, at pp. 705-706. The only case in Quebec dealing with material contracts is *Lefebvre v. Prouty*, (1918) 54 Que. S.C. 490 but it is of limited interest. It dealt with the interpretation of s. 43 of the *Dominion Companies Act*, R.S.C. 1906, c. 79. For an analysis of that type of legislation, see: Stiebel, *op. cit.*, vol. I at pp. 146-147. Compare with a modern equivalent: Wegenast, *op. cit.*, at pp. 705-706; Renaud et Smith, *op. cit.*, vol. II at pp. 1202 and 1216. The "materiality" concept is not an easy one to apply for "... what is material to one man may be immaterial to another. . .": Stiebel, *ibid.*, at p. 147 note k. See also *Yuksel Atillasoy v. Crown Trust Company*, *supra* note 250 at p. 447 where Dubé, J., quotes from the Superior Court judgment rendered by Nolan, J.,

"There can be no doubt that if Defendants had been considering purchasing this property with their own money at risk, the terms of the hypothec would have been a serious factor in any decision they reached. . ."

See also Côté, *loc. cit.*, note (1), at pp. 157-158, and 165 and following.

257. *Ibid.*, s. 33.

258. *Supra*, note 246. See also: Wegenast, *op. cit.*, at p. 719. Gower, *op. cit.*, at pp. 334-335. Generally: G. Williams, "The effect of penal legislation in the law of tort", (1960) 23 M.L.R. 233; L. Loss, "The fiduciary concept as applied to trading by corporate insiders in the United States", (1970) 33 M.L.R. 34, at p. 43.

259. *Supra* note 246.

260. Wegenast, *op. cit.*, at p. 719.

261. Article 14 C.c. See also, *infra*, note 264.

this was not done might give that party a right to ask for the nullity of the contract: this nullity would be merely relative and not absolute<sup>262</sup>.

Thus, the *Securities Act* offers considerable possibilities to the investor in cases of omissions, taking over where the civil law generally failed because of its restrictions.

The *Securities Act* of the Province deals extensively with the question of the contents of a prospectus and sets out the numerous details that must be given to the purchaser of shares<sup>263</sup>: this complex regulation however does not deal with civil liabilities arising out of false or negligent statements made by promoters and directors in the preparation of such documents. Although the *Securities Act* sometimes offers relief where the civil law would be without protection for the abused investor<sup>264</sup>, as a general rule the Legislature of the Province seems to have considered that the rules of civil law were sufficiently adequate to afford enough remedies for most cases involving deceptive practices in corporate financing, without having to deal with this question statutorily.

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262. Is the contract to take up shares in a company now a contract *uberrimae fidei*? See *supra* note 22.

263. The *Securities Act*, s. 53, declares that a prospectus must give "a full disclosure of relevant facts. . ."

264. As in the case of lesion which is not normally a cause of nullity in civil law: *supra*, note 243. The Act also imposes the duty of preparing a prospectus each time an issue of shares is contemplated: s. 53. The prospectus is examined by the Commission and then permission is granted to distribute it generally: *ibid*. A copy of every prospectus must be given to each purchaser of shares: *ibid*. But *quaere*, what if a prospectus is not given to a purchaser? The Act states that this constitutes an offence: s. 53. It also could give rise to a civil law liability under article 1053 C.c. for non-compliance: *supra* note 246. Could the purchaser sue for the nullity of his contract? This is a question that is "not free from doubt": Fraser and Stewart, *op. cit.*, at p. 482. Common law provinces in Canada seem to be divided on the issue: see Williamson, *op. cit.*, at pp. 163-167 for an extensive review of the authorities and a conclusion that most probably the contract is voidable in favour of the purchaser. However, recent cases seem to suggest that the contract subsists and that only the penalties imposed by the statute are to be applied in cases of non-compliance: S. Beck in (1974) 52 C.B.R. 589 where the author criticizes the view adopted in *Ames et al. v. Investo-Plan Ltd & al.*, (1973) 35 D.L.R. (3d.) 613 (B.C.C.A.) and suggests that the contract should also be voidable at the purchaser's option: *ibid.*, at p. 597. In Quebec, the rule is simpler: a contract that does not respect statutory conditions is made voidable at the option of the person for whom the legislative safeguards were intended. Thus, the jurisprudence of the Court of Appeal has always considered that a relative nullity exists in the case where a prospectus is not given to the purchaser: Renaud et Smith, *op. cit.*, vol. II at pp. 1189-1190 for a review of the cases on the subject. See also: article 14 C.c.; s. 93 of the *Securities Act*.

## CONCLUSION

Prospectus liability in Quebec law presents highly interesting features. As a general rule, one might conclude that most cases of fraud and negligence in this context are dealt with by reference to the rules of civil law. However, the great similarity between common and civil law on such questions was to have important consequences in Quebec: the courts did not hesitate to refer in many instances to precedents of common law to decide technical questions of civil law liability. English law was also resorted to in cases where more equitable results were sought<sup>265</sup> or where the courts wished to create harmony in the rules of company law throughout Canada<sup>266</sup>.

The discussion on negligent statements in a prospectus indicated however the limits of the English influence: although statutory relief for such statements has existed in common law jurisdictions since 1900, no equivalent is to be found in the provincial statutes dealing with investor protection. As we have seen, the rules of civil law in this context were much wider than those of common law and this would appear to be the only rational explanation for the absence of similar legislation in the statute books. Thus, even if modern securities legislation in Quebec was copied from Anglo-American models, it remains subject to the more general rules of civil law where questions of delictual liability arise.

In the field of capital investments, one can thus detect the persistent influence of English law in the numerous references to common law precedents and the enactment of statutes inspired from the Anglo-American tradition. However, the reception of English law had clear limits and one finds that, as a rule, the Legislator and the jurisprudence have indicated that the civil law was to ultimately govern the application of such statutes by refusing to import into the Province principles incompatible with the economy of the Civil Code.

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265. In *Rhodes v. Starnes*, *supra* note 15, English law was invoked in order to avoid imposing upon directors a liability *ad infinitum* for their false or negligent statements.

266. *Supra* note 9.