CITATION: Swisscanto v. BlackBerry, 2015 ONSC 6434
COURT FILE NO.: CV-13-495413-CP
DATE: 20151117

SUPERIOR COURT OF JUSTICE – ONTARIO

RE: Swisscanto Fondsleitung AG, Plaintiff / Moving Party

AND:

BlackBerry Limited, Thorsten Heins and Brian Bidulka / Defendants / Responding Parties

BEFORE: Justice Edward P. Belobaba

COUNSEL: *Michael G. Robb, Paul J. Bates and S. Sajjad Nematollahi* for the Plaintiff

James C. Tory, Andrew Gray and James Gotowiec for the Defendants

HEARD: October 15 and 16, 2015

Proceedings under the Class Proceedings Act, 1992

DECISION ON LEAVE MOTION

Belobaba J.

[1] The launch of the "next generation" BlackBerry 10 smartphone was not a success. Sales were disappointing, to say the least. So when BlackBerry announced an almost $1 billion inventory charge for unsold product, a major reduction in its work force and a change in revenue recognition methods, its share price fell dramatically. And, as is almost always the case when there is a significant drop in a company's share price, class actions were commenced in the U.S. and Canada.

[2] This motion for leave under s. 138.8 of the Ontario *Securities Act*[1] ("OSA") turns on the misrepresentation and public correction requirements in s. 138.3. The latter sub-

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[1] *Securities Act*, R.S.O. 1990, c. S.5.

section makes clear that the statutory right of action for damages for secondary market misrepresentation requires both.

[3] The misrepresentation requirement – and whether the plaintiff can show a reasonable possibility of success at trial – is well-understood in Ontario class action law and has been the subject of considerable litigation.[2] However, the scope and content of the public correction requirement has not been judicially considered, at least not in a principled fashion.[3]

[4] The plaintiff says both requirements are satisfied and asks that leave to proceed with the statutory right of action be granted. The defendant argues that neither requirement has been satisfied, especially the public correction requirement, and asks that the motion be dismissed. The parties have agreed to defer the scheduling of the certification motion under the *Class Proceedings Act*[4] until the leave motion has been decided.[5]

Background

(1) The launch of the BB 10

[5] After a series of delays, BlackBerry launched its newest smartphone, the BlackBerry 10 ("BB 10") on January 30, 2013 on a rolling schedule – first in the U.K. and Canada, and then two months later in the U.S.[6]

[6] There is little doubt that the BB 10 was important to the life of the company. Some analysts believed that the "long overdue" BB 10 was BlackBerry's "last chance to become relevant again" and "the firm's last roll of the dice after dwindling success." CEO Thorsten Heins said "it would be an understatement to say that BB 10 represented

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[2] See, for example, *Green v. Canadian Imperial Bank of Commerce*, 2014 ONCA 90 and the case law discussed therein. At time of writing, the Supreme Court's decision in the *Green* appeal and its much-awaited interpretation of the "reasonable possibility" leave test is still pending.

[3] In *Ironworkers Ontario Pension Fund (Trustees of) v. Manulife Financial*, 2013 ONSC 4083, at para. 65, leave to appeal ref'd 2014 ONSC 1347 (Div. Ct), I dealt with public correction very briefly, referring to an American decision on corrective disclosure. In *Mask v. Silvercorp Metals Inc.*, 2015 ONSC 5348, at para. 30, I concluded that third party sources can provide public correction, including anonymous internet postings.

[4] *Class Proceedings Act, 1992*, S.O. 1992, c. 6.

[5] Counsel have since advised that the certification motion will proceed on January 22, 2016.

[6] The Q10 was the keyboard version and the Z10 the touchscreen version. Unless otherwise indicated, I will refer to both as the BB 10.

the reinvention of the company itself." Indeed, to coincide with the launch of the BB 10, the company changed its name from Research in Motion to Blackberry.

[7] Expectations were high because they had to be. The previous several years had been grim. One media report in early 2013 noted that a company that was once seen as "revolutionary" was now "clueless as to what customers wanted."

[8] In fiscal 2012, Blackberry had experienced significant difficulties selling the BlackBerry 7 smartphone and PlayBook, its tablet computing device, and took inventory charges on both of them in the hundreds of millions of dollars. As a result of the uncertainties created by the market conditions and, in its words, "continued pressure on revenue and earnings," BlackBerry discontinued its practice of providing quantitative future guidance regarding its business and operations.

[9] Needless to say, a great deal was riding on the BB 10.

(2) "Sell-in" and "sell-through" accounting

[10] BlackBerry's revenue recognition policy, like those of other companies in its sector, was to recognize sales to its customers made in a quarter as revenue in that quarter. That is, Blackberry booked the sale as soon as the product was sold into the distribution channel to its distributors (known as "sell-in" accounting) rather than waiting until the distributors sold the product to the end-users ("sell-through" accounting).

[11] The sell-in method of revenue recognition is perfectly acceptable provided that GAAP criteria for doing so are satisfied. GAAP allows sell-in revenue recognition if at the time of sale into the distribution channel, the sales price was "fixed or determinable"- "fixed" meaning that the sales price was not subject to any future adjustments and "determinable" meaning that any future adjustments could be reasonably estimated and then accrued as a reduction to revenue.

[12] Put simply, if Blackberry was able to make reasonable estimates of the actual amount of future adjustments that might be needed to help move the product from distributors to end-users, the company could legitimately book the sales revenue at the moment the product was shipped to the distributor. However, if Blackberry was unable to reasonably estimate the pricing adjustments at the time of shipment, then GAAP required that revenue recognition be deferred until the sell-through was completed and the product sold to the end-user.

[13] Blackberry decided to use the sell-in method of revenue recognition in the launch and sale of the BB 10 and continued to do so until the sales suggested otherwise.

(3) Sales of the BB 10

[14] It was soon apparent that the BB10 products were not selling as expected. Indeed, the sales of the BB 10 to end-users were nowhere near what had been shipped to distributors. During the four-month period from January 30, 2013 to June 1, 2013 – that is, from the last month of 4Q13 to the end of 1Q14 – only about a quarter to a half of the BB 10 smartphones shipped to distributors had been purchased by end-users.

[15] The "in channel" inventory accumulated rapidly. In 1Q14 BlackBerry tried to drive the sell-through of BB 10 products by offering sales incentives to its channel and carrier partners. In 2Q14, BlackBerry reduced the price on new shipments and continued to offer sales incentives to the distributors. However, the sell-through levels of BB 10 products decreased and the volume of BB 10 products in the channel increased.

(4) The news release of September 20, 2013

[16] On September 20, 2013, BlackBerry announced its results for 2Q14, the three-month period ending August 31, 2013. In the three-page news release, BlackBerry reported that it was writing off by way of inventory charge close to $1 billion in unsold BB Z10 smartphones; it was eliminating 40 per cent of its global work force as part of an effort to cut 50 per cent of its operating costs; it was limiting its focus to corporate and professional customers; and it was pursuing "strategic alternatives", corporate-speak for seeking a buyer. These measures were set out in bullet point highlights at the beginning of the news release and then discussed in more detail in the body of the release.

[17] At the bottom of the first page, just under the heading, "Preliminary Second Quarter Fiscal 2014 Results" the company said this:

> For the second quarter, the Company expects to recognize hardware revenue on approximately 3.7 million BlackBerry smartphones. Most of the units recognized are BlackBerry 7 devices, in part because *certain BlackBerry 10 devices that were shipped in the quarter will not be recognized until those devices are sold through to end customers.* (Emphasis added.)

[18] Most readers were probably more focused on the $1 billion inventory charge and the reduction in workforce than on the news that in the second quarter BlackBerry was changing its revenue recognition practice from sell-in to sell-through – that is, it was deferring revenue recognition on new shipments of BB 10 products until those products were sold through to end customers.

[19] In any event, the market price of BlackBerry's shares dropped by 15 per cent.

(5) The proposed class action

[20] The plaintiff, Swisscanto Fondsleitung AG (formerly Swisscanto Asset Management AG) is a European-based investment fund that purchased 1700 BlackBerry shares during the proposed class period and was still holding those shares at the end of the class period. The proposed class period is March 28, 2013 (when the MD&A for 4Q13 was released) and September 20, 2013 (the date of the news release that was just discussed.)

[21] The defendant BlackBerry is a well-known provider of wireless communications solutions and generates revenue primarily from sales of its hardware products through its carrier and distributor partners who, in turn, sell BlackBerry's products to end customers. Headquartered in Waterloo, Ontario, the company is a reporting issuer in Ontario and all other provinces and trades on the Toronto Stock Exchange as well as on other global exchanges.

[22] The defendant Thorsten Heins was President, CEO and a director of BlackBerry over the relevant time period and the defendant Brian Bidulka was the CFO. Both have since left the company.

(6) The issues

[23] There are two basic issues: was there a misrepresentation and was there a public correction? That is, was BlackBerry's revenue recognition on the sales of its BB 10 products in 4Q13 and 1Q14 and, ultimately, its financial statements for these two reporting periods, GAAP-compliant?[7] And if not, was the September 20 news release which noted that revenue on sales of BB10 units shipped in 2Q14 was being deferred until sell-through, a public correction of the earlier misrepresentation?

[24] Both an alleged misrepresentation and public correction are needed. If either is missing, there is no statutory "right of action for damages" under s. 138.3(1) of the OSA.

The leave test

[25] As I have already noted, s. 138.3(1) of the OSA creates a statutory right of action for damages for secondary market misrepresentation available to any person who acquires or disposes of an issuer's securities between the time that documents containing misrepresentations were publicly released and the time when the misrepresentations were publicly corrected.

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[7] There is no dispute that Blackberry represented that its financial statements complied with GAAP.

[26] An action for secondary market misrepresentation under s. 138.3 requires leave of the court under s. 138.8. Leave will be granted if the court is satisfied that the action is brought in good faith and "there is a reasonable possibility that the action will be resolved at trial in favour of the plaintiff."[8]

[27] There is no issue about good faith. The only question is whether the plaintiff can clear the "reasonable possibility" hurdle.

[28] In two recent decisions, *Goldsmith v. National Bank*[9] and *Coffin v. Atlantic Power*,[10] I set out my understanding of the "reasonable possibility" test. I noted that in *Theratechnologies*,[11] the Supreme Court made clear that the leave test was more than a "speed bump" and that judges should undertake "a reasoned consideration of the evidence to ensure that the action has some merit."[12] The "reasonable possibility" threshold, said the Court, requires that there be a "reasonable or realistic chance that the action will succeed."[13] The Court explained as follows:

> A case with a reasonable possibility of success requires the claimant to offer both a plausible analysis of the applicable legislative provisions, and some credible evidence in support of the claim. A full analysis of the evidence is unnecessary ... What *is* required is sufficient evidence to persuade the court that there is a reasonable possibility that the action will be resolved in the claimant's favour.[14]

[29] The Supreme Court reminded class action judges that the leave threshold is intended to provide "a robust deterrent screening mechanism" to ensure "that cases without merit are prevented from proceeding."[15] In the end, I adopted and applied the test from *Theratechnologies* which, in my view, was the same test in essence that was approved by the Court of Appeal in *Green*:

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[8] OSA, *supra*, note 1, s. 138.8.

[9] *Goldsmith v. National Bank of Canada*, 2015 ONSC 2746 at paras. 6-10.

[10] *Coffin v. Atlantic Power Corporation*, 2015 ONSC 3686 at paras. 16-21.

[11] *Theratechnologies Inc. v. 121851 Canada Inc.*, 2015 SCC 18.

[12] *Ibid.*, at para. 38.

[13] *Ibid.*, at para. 38.

[14] *Ibid.*, at para. 39. Emphasis in original.

[15] *Ibid.*, at para. 38.

> [W]hether, having considered all the evidence adduced by the parties and having regard to the limitations of the motions process, the plaintiffs' case is so weak or has been so successfully rebutted by the defendant, that it has no reasonable possibility of success.[16]

[30] I take the same approach here. Given the decisions in *Green* and *Theratechnologies*, the question for me, as I see it, is this: after considering all of the evidence presented by the parties, does any part of the plaintiffs' case have a reasonable or realistic chance of success at trial? Or is the plaintiffs' case so weak or has it been so successfully rebutted by the defendants that is has no reasonable possibility of success?

Decision

[31] For the reasons set out below, the motion for leave is granted. I am satisfied on the evidence before me that both the alleged misrepresentation and the public correction have been sufficiently established and that there is a reasonable possibility that the action will be resolved in the plaintiff's favour at trial.

Analysis

(1) Misrepresentation

[32] The parties have filed the expert opinions of two highly qualified accountants with impressive credentials, Mr. Regan for the plaintiff and Mr. Ellingsen for the defendants. In coming to their respective conclusions, both experts relied only on publicly available information.[17]

[33] The experts agree on several points. Both agree that BlackBerry could recognize revenue only if the selling price was fixed or determinable, and that the precondition to the use of sell-in accounting was that the company be able to reasonably estimate future adjustments, such as price and other concessions, based on information available at the

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[16] *Green v. Canadian Imperial Bank of Commerce,* 2014 ONCA 90 at para. 93 (affirming Strathy J.'s test in the court below).

[17] The plaintiff objects to the defendants' reliance on the record filed by the plaintiff. However, the case law is clear that the defendants are entitled to rely on the record put forward by the plaintiff: *Ainslie v. CV Technologies Inc.*, [2008] O.J. No. 4891 (S.C.J.) at para. 24; *Millwright Regional Council of Ontario Pension Trust Fund (Trustees of) v. Celestica Inc.*, 2014 ONSC 1057, at paras. 125-127. This is not a violation of the rule against hearsay. The defendants' use of the record filed by the plaintiff is not to establish the truth of the contents of the record but to show that the record does not substantiate what the plaintiff says it substantiates to the degree required on a leave motion.

time of shipment. Both of the experts agree that the decision as to whether to use sell-in or sell-through accounting is product and situation-specific and that GAAP required BlackBerry to determine that it was able to reasonably estimate price and other concessions on BB 10 products in the particular circumstances of those specific products. As Mr. Ellingsen explained, "I don't believe [GAAP] requires the use of either sell-in or sell-through … different companies do it differently based on the circumstances."

[34] Both experts also agree that the sell-in accounting decision involves two steps. First, the company has to determine under GAAP that it is able to make a reasonably reliable estimate of the costs required to sell products through to end users. If it determines that it can do so, the company then has to actually estimate the amount of future adjustments, which would accrue as a reduction to the revenue. The fact that the second step, the actual estimate, may prove to be inaccurate, does not invalidate the sell-in accounting decision. In any event, the plaintiff is not complaining about the accuracy of any actual estimate. The focus of the plaintiff's allegation is on the first step - whether BlackBerry was in a position to make reasonable estimates in the circumstances that existed at the time when the relevant revenue recognition determinations were made.

[35] Most importantly, both experts agree that a company is obliged to undertake the "first step" analysis (i.e. whether a reasonable estimate can be made) even if it believes that no future adjustments are likely and the appropriate actual estimate is "zero". Mr. Ellingsen made this clear when he was cross-examined by counsel for the plaintiff:

> *Mr. Robb*: All right. And we talked before about the fact that your estimate for accruals on revenue in the sell-in context might be zero?
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> *Mr. Ellingsen*: Yes.
>
> *Mr. Robb*: But the fact that you're estimating zero doesn't alleviate a company's obligation to meet the criteria that you can make a reasonably reliable estimate; is that fair?
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> *Mr. Ellingsen*: That's essentially fair. You have to -- if it's zero, you have to have some support that it's zero.

[36] To assist with the first-step of the analysis, GAAP sets out specific factors that every company, including BlackBerry, is obliged to consider in determining whether its ability to reasonably estimate future adjustments has been affected or impaired. These factors include the newness of the product, the company's dependence on the success of the product, the company's dependence on its distribution partners, the presence of other competitive products and any significant increases or decreases in levels of inventory which might make price concessions more likely.

[37] The two experts part company in their interpretation of these factors and in their ultimate opinion as to whether BlackBerry was able to reasonably estimate future adjustments in 4Q13 and 1Q14. Mr. Regan says it could not. Mr. Ellingsen says it could.

Mr. Regan's opinion

[38] Mr. Regan's opinion is based on the following. He says that because of the uncertainties that surrounded the launch of the BB 10 in 4Q13 and into 1Q14, BlackBerry was unable to make reasonable estimates. Its ability to do so was impaired by the following (GAAP identified) factors:

(i) The newness of the BB 10 product and the lack of reliable historical sales data coupled with recent negative experiences with the BB 7 and PlayBook products - unexpected future concessions could therefore be required to sell the BB 10 through to end customers;

(ii) BlackBerry's dependence on the success of the BB 10 products, resulting in a greater risk that BlackBerry may offer concessions to its distributor partners in order to drive sell-through of BB 10 products, as in fact was done beginning in 1Q14, shortly after BB 10's launch, and through 2Q14;

(iii) BlackBerry's dependence on its carrier and distributor partners, resulting in a greater risk that BlackBerry may offer concessions to them if they were unable to sell the products to end customers, even though BlackBerry may not be contractually obligated to do so, as in fact was done in 2Q14;

(iv) The presence of other competitive products with greater market acceptance in a highly competitive market which, in BlackBerry's words, "ma[de] it difficult to estimate units, revenue and levels of profitability"; and

(v) The significant increases in or excess levels of inventory which, in BlackBerry's words, "ma[de] it more likely that price concessions in the future would be required to reduce channel inventory levels".

[39] Accordingly, says Mr. Regan, GAAP did not permit BlackBerry to recognize revenue on BB 10 products based on sell-in accounting in Q413 and 1Q14 and BlackBerry should not have recognized those revenues. Mr. Regan estimates that BlackBerry recognized about $273 million in 4Q13 and $872 million in 1Q14 on BB 10 shipments into distribution channels when the selling price of those products was not fixed or determinable in accordance with GAAP. Given the publicly available information that 46 to 76 per cent of the BB 10 products shipped and recognized in 4Q13 and 1Q14 did not sell through to end users, it follows, says Mr. Regan, that if BlackBerry had complied with GAAP, the revenues would have been 46 to 76 per cent lower in these two periods.

[40] Mr. Regan concludes that BlackBerry's financial statements for 4Q13 and 1Q14 appear to have been materially misstated in violation of GAAP. The just over $1 billion in sell-in revenue that was recorded upon shipment was premature. The revenue should not have been recognized, says Mr. Regan, until the units were sold to end-users. BlackBerry changed its revenue recognition practice and adopted the sell-through method in 2Q14. This should have been done from the outset, concludes Mr. Regan, at the end of 4Q13 when the BB 10 was first launched.

Mr. Ellingsen's opinion

[41] Mr. Ellingsen's opinion is that Blackberry's use of sell-in accounting in 4Q13 and 1Q14 complied with GAAP. At the time of launch, the sales potential was promising. BlackBerry's management was experienced and was able to reliably estimate product returns and concessions through 1Q14. It was not until and as a result of events commencing in 2Q14 that the company concluded that the success of the BB 10 was uncertain. At that point, BlackBerry decided it could no longer reasonably estimate future concessions and accordingly switched to sell-through accounting. Mr. Ellingsen concludes that Mr. Regan's contrary opinion "cannot reasonably be supported" by the publicly available information.

[42] Mr. Ellingsen also criticizes Mr. Regan for his selective application of the so-called "impairment" factors and his disregard of the fact that the company's external auditor, Ernst & Young ("EY"), issued an unqualified audit opinion on BlackBerry's annual financial statements and that the SEC reviewed the sell-through 2Q14 financials and said nothing about the earlier sell-in decisions. Restatements were not requested and none have been made.

Mr. Regan's reply opinion

[43] In his reply affidavit, Mr. Regan responds in detail to the points made by Mr. Ellingsen. He shows that he considered all of the GAAP factors. He explains that neither the EY audit opinion nor the SEC staff review of the change to sell-through accounting is determinative.[18] And he repeats the point (acknowledged by EY in their accounting

[18] Mr. Regan notes as follows: "The accounting issues relevant to this matter pertain only to the fourth fiscal quarter of 2013 and the first fiscal quarter of 2014. While the accounting at issue is material to each of these quarters, Ernst & Young may have concluded that the accounting was immaterial to fiscal 2014. In any event, BlackBerry, not Ernst & Young, made the determination to recognize the BlackBerry 10 Products on a sell-in basis." As for the fact that the SEC did not require BlackBerry to restate its financial statements, Mr. Regan points out that "the SEC's July 31, 2014 letter to BlackBerry states that the SEC is not foreclosed from taking action against the Company and that BlackBerry could not assert SEC Staff comments as a defense. Accordingly, Mr. Ellingsen's conclusion is not supported by the documents he cites."

guide) that sales into a distribution channel are inherently riskier than direct sales to end-users because "if a distributor experiences difficulty selling the related product, there is increased risk that the manufacturer may provide a concession to the distributor that jeopardizes the amount of revenue the manufacturer has already recognized."

[44] Mr. Regan then goes on to explain why in his view "there was significant uncertainty" as to whether the fees were fixed or determinable at the end of January, 2013 when the BB 10 was being launched:

> Due to competition, there was significantly more uncertainty regarding the market demand for BlackBerry smartphone products in January 2013 as compared to when, for example, the BlackBerry 7 product was released in August 2011. Specifically, in the quarter preceding the BlackBerry 7 launch, BlackBerry reported hardware revenue of $3.8 billion and had global market share of approximately 12%. Less than two years later, in the quarter preceding the BlackBerry 10 Product launch, however, BlackBerry's hardware revenue and global market share had fallen by more than 50% from those levels …
>
> Based on the information available to me, or cited by Mr. Ellingsen, it appears that the same data, or substantially similar data, was available at the time of the product launch, but BlackBerry failed to adequately consider it as GAAP requires.

[45] In my view, the opinion evidence of Mr. Regan, as set out above, is cogent and compelling. It was not undermined on cross-examination. Mr. Regan has carefully explained his opinion, based on BlackBerry's own statements, that BlackBerry's revenue recognition during the class period was not in compliance with GAAP and materially overstated BlackBerry's revenues.

[46] Mr. Ellingsen tried his best to rebut this conclusion and presented a thoughtful counter-opinion. And the defendants supplemented their expert's report with additional submissions – for example, about the fact that "there was nothing to estimate", that none of the impugned revenues have been restated, and about the meaning of what was said in a July 11, 2014 letter to the SEC about possible changes to "previously recognized revenue".[19] However, without exception, each of these additional submissions was rebutted by the plaintiff with plausible evidence and argument.

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[19] This letter was much discussed by counsel on both sides. In response to the defendants' submission that there is no evidence that any of the impugned revenues were subsequently adjusted, the plaintiff disagreed and pointed to this letter to the SEC in which BlackBerry explained its switch to sell-through accounting. In this letter, BlackBerry noted that the use of non-pricing strategies such as marketing and promotional programs failed to increase the sell-through rate "making it more likely that price concessions in the future would be required to reduce channel

Conclusion on misrepresentation

[47] The defendants may well prevail at trial. But, to track the language in *Theratechnologies,*[20] the plaintiff has presented "sufficient evidence to persuade the court that there is a reasonable possibility that the action will be resolved in the claimant's favour."[21] This is obviously not a strike suit. The proposed action has some merit. Putting aside the issue of public correction which will be discussed below, it cannot be said that the plaintiff's case is so weak or has been so successfully rebutted by the defendant that it has no reasonable possibility of success.

[48] The most that can be said is that there is a conflict in the opinions of the two competing experts – but this is a conflict that cannot and should not be resolved at this stage of the proceeding. As Justice Strathy noted in *Green,*[22] "the conflict in the expert evidence is a matter that should be resolved at trial."[23] Indeed, the very fact that such a conflict exists strongly supports this court's conclusion that on the misrepresentation issue the plaintiff has established a reasonable possibility of success at trial.

[49] In short, I am satisfied that a "misrepresentation" has been sufficiently identified and that, public correction aside, the leave motion should be granted.

(2) Public correction

[50] Recall that s. 138.3 of the OSA creates a statutory right of action for damages for secondary market misrepresentation available to any person who acquires or disposes of an issuer's securities between the time that document containing a misrepresentation was publicly released and the time that the misrepresentation was publicly corrected.

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inventory levels." BlackBerry also added this in a footnote: "[P]roduct returned to channel partners does affect the Company's determination of whether the price is fixed or determinable as the related costs incurred by the channel partners impact the Company's ability to sell future product into the channel and *may prompt the Company to offer future sales incentives, resulting in concessions on previously recognized revenue.*" (Emphasis added.)

[20] *Theratechnologies, supra,* note 11.

[21] *Ibid.,* at para. 39.

[22] *Green v. Canadian Imperial Bank of Commerce,* 2012 ONSC 3637.

[23] *Ibid.,* at para 315.

The plaintiff's position

[51] The plaintiff pleads that the public correction is found in the September 20, 2013 news release, and in particular in the following disclosure:

> For the second quarter, the Company expects to recognize hardware revenue on approximately 3.7 million BlackBerry smartphones. Most of the units recognized are BlackBerry 7 devices, in part because *certain BlackBerry 10 devices that were shipped in the quarter will not be recognized until those devices are sold through to end customers.* (Emphasis added.)

[52] There can be little doubt that informed readers and analysts following the company understood that Blackberry changed its revenue recognition accounting in 2Q14 from sell-in to sell-through. The question is whether this disclosure satisfies the public correction requirement in s. 138.3 of the OSA.

The defendants' position

[53] The defendants say the information provided in the September 20 news release was not a correction of anything. Rather, it was the timely disclosure of new facts occurring in 2Q14 that were unrelated to revenue recognition in 4Q13 and 1Q14. The news release, say the defendants, was mainly about the $1 billion write-off of BB10 inventory, the massive restructuring of its operations, and the shift in its strategic focus. There was, to be sure, a passing reference to revenue recognition. But that reference was about the deferral of revenue recognition until sell-through on BB10 sales in 2Q14 based on events occurring in 2Q14.

[54] The defendants submit that a press release about a change in revenue recognition beginning in 2Q14 is not a "correction" of the revenue recognition in prior quarters. There is insufficient correlation between the alleged misrepresentation and the pleaded public correction. It follows, say the defendants, that the public correction requirement has not been satisfied and there is thus no statutory right of action under s. 138.3.

[55] I pause here to note that the defendants are not advancing the attribution defence under s. 138.5(3)[24] – the argument that the 15 per cent drop in share price is attributable to reasons other than the change in revenue recognition (namely, the $1 billion write-off

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[24] Section 138.5(3) provides that "[D]amages shall not include any amount that the defendant proves is attributable to a change in the market price of securities that is unrelated to the misrepresentation ..." The defendants were at liberty to present such evidence on this leave motion but chose not to do so. Indeed, counsel for the defendants made clear that his clients were not using or relying (at this point) on the attribution defence in s. 138.5(3).

and the news about global work-force reductions). This argument will no doubt be made at trial if the proposed class action is certified. Here, the defendants are making a more preliminary objection: that the public correction requirement has not been satisfied.

[56] In order to decide this question, one must begin with first principles.

First principles

[57] It is well understood that the objectives of Part XXIII.1 of the OSA are to deter misrepresentative disclosure and provide a remedy for injured investors, while at the same time preventing strike suits against issuers.[25] The wrong targeted by Part XXIII.1 is the misrepresentation.[26] In order to provide a fixed and identifiable time period for liability and the statutorily prescribed assessment of damages set out in s. 138.5(1) and (2), s. 138.3(1) provides a statutory right of action for damages sustained between two time-posts: the time that the document containing the alleged misrepresentation was publicly released and the time that the misrepresentation was publicly corrected.

[58] As a time-post for damages assessment, the public correction requirement in s. 138.3 performs a relatively modest role. Unlike in the U.S. where the plaintiff must prove that shareholder losses were caused by the misrepresentation and "corrective disclosure" is often used to establish "loss causation",[27] this is not the purpose of the public correction requirement in Part XXIII.1 of the OSA. Once the plaintiff meets the requirements of s. 138.3(1) by showing a misrepresentation and a public correction, causation is presumed and damages are implied. Under the "attribution defence" that is provided under s. 138.5(3), the onus is on the defendant to show that the decline in share price was not caused by the misrepresentation. In other words, for the statutory right of action provided in s. 138.3, causation is transformed into a defence under s. 138.5(3).[28]

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[25] See Committee on Corporate Disclosure, "Interim Report of TSE Committee on Corporate Disclosure" (1995), 19 O.S.C.B. 7 at para. 6.5; Canadian Securities Administrators, Notice 53-302, (2000) 23 O.S.C.B., at 7385-7387; *Drywall Acoustic Lathing and Insulation Local 675 Pension Fund v. SNC-Lavalin Group Inc.*, 2015 ONCA 718, at para. 49.

[26] *Mask, supra*, note 3, at para. 29. Also see the discussion in Larry P. Lowenstein and Mary Paterson, *Corporations, Claimants, and Cross-Border Attitudes: The Different Approaches in Ontario and the United States to Civil Liability for Misrepresentations in the Secondary Securities Markets*, (72nd Biennial Conference of the International Law Association, Toronto, June 7, 2006, unpublished), online: <http://www.ila2006.org/lowenstein.pdf.

[27] See, for example, *Meyer v. Green*, 710 F.3d. 1189 (11th Cir. 2013) at 1196: Loss causation can be established by identifying a corrective disclosure that "reveals to the market the pertinent truth that was previously concealed or obscured by the company's fraud." Also see CSA 2000, *supra*, note 25, at 7391, and Lowenstein and Patterson, *supra*, note 26, at 10.

[28] Lowenstein and Patterson, *supra*, note 26, at 10.

[59] Some judges have referred to the public correction requirement in s. 138.3 of the OSA as "corrective disclosure."[29] There is no harm in doing so, provided that both court and counsel understand that "corrective disclosure" as used in American case law carries additional (causation) baggage and for this reason this American usage should be handled with care.

The case law thus far

[60] The phrase "publicly corrected" is not defined and the case law interpreting or dealing with this requirement is sparse. In my brief discussion of the public correction requirement in *Mask*,[30] I noted that "it is obviously a matter of fairness to the defendant that both the start point (the misrepresentation) and the end point (the public correction) be identified with some precision."[31]

[61] I also agreed with the observations of Justice Perell in *SNC-Lavalin*[32] that the plaintiff is obliged to specifically "identify and articulate" the "falsity" in the initial representation, which the court can then use as a "benchmark to determine when and whether there was a corrective disclosure";[33] and that the plaintiff must "link" that misrepresentation to a "pleaded public correction", providing full particulars of "the necessary material facts with sufficient clarity and precision so as to give the other party fair notice of the case they are required to meet".[34]

[62] In the case law to date, one can find two further contributions to the discussion about the scope and content of the public correction requirement. First, that the correction need not be a "mirror-image" of the alleged misrepresentation or "a direct admission that a previous statement is untrue;"[35] and second, that the correction need not be issued by

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[29] See, for example, *Drywall Acoustic Lathing and Insulation Local 675 Pension Fund v. SNC-Lavalin Group Inc.*, [2015] O.J. No. 125 (S.C.J.) at paras. 28 and 44.

[30] *Mask, supra*, note 3.

[31] *Ibid.*, at para. 22.

[32] *SNC-Lavalin, supra*, note 29.

[33] *Ibid.*, at paras. 16, 28, and 44.

[34] *Drywall Acoustic Lathing and Insulation Local 675 Pension Fund v. SNC-Lavalin Group Inc.*, 2014 ONSC 660, at paras. 40-42 and 47-49.

[35] *Manulife, supra*, note 3 at paras. 64-71.

the company itself. The public correction can emanate from third parties, including media reports and even anonymous internet postings.[36]

[63] One can also add the following. The plain meaning of the word "corrected" means to "set right" or "mark the errors".[37] It follows from this that the public correction must be reasonably capable of revealing to the market the existence of an untrue statement of material fact or an omission to state a material fact – that is, the existence of a misrepresentation.

The criteria for a public correction

[64] In attempting a more principled articulation of the public correction requirement in s. 138.3, it is important to reiterate that the public correction requirement plays a relatively modest role in the statutory scheme. It provides a "time-post" prerequisite for the statutory right of action. The public correction requirement does not involve a causation analysis. Issues of causation are left to be resolved under the attribution defence in s. 138.5(3).[38]

[65] In my view, the public correction requirement in s. 138.3 of the OSA can be satisfied as follows:

(i) The public correction must be *pleaded with sufficient precision* to provide fair notice to the defendant. The plaintiff must point to specific words or figures that allegedly constitute the public correction of the alleged misrepresentation. Because the function of the public correction requirement under s. 138.3(1) is to establish the second "time-post" for fixing liability, the plaintiff must also identify the timing of the public correction.

(ii) The pleaded public correction need not be a "mirror-image" of the alleged misrepresentation or a direct admission that a previous statement is untrue. But there must be *some linkage or connection* between the pleaded public correction and the

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[36] *Mask, supra,* note 3, at para. 29.

[37] R. E. Allen, ed., *The Concise Oxford Dictionary,* 8th ed. (Oxford: Clarendon Press, 1990).

[38] If the defendant wants to lead evidence under s. 138.5(3) that the drop in share price was caused by something other than the pleaded public correction, it may do so either at trial or on the leave motion. If the defendant decides to lead causation evidence on the leave motion in an attempt to totally rebut damages – defeating the claim – it is obliged to do more than prove its assertion on a balance of probabilities (as would be the case at trial.) On a leave motion, the defendant must satisfy the leave test and foreclose the reasonable possibility that the attribution defence will not fully succeed at trial.

alleged misrepresentation – at the very least, the pleaded public correction must share the same subject matter as, and in some way relate back to, the misrepresentation. The fact that an alleged public correction is over or under-inclusive relative to the misrepresentation is not a bar to establishing that the words or figures constitute a public correction. Of course, the more tenuous the connection between the public correction and the misrepresentation, the more likely that the defendant will be able to show under s. 138.5(3) that shareholder losses were unrelated to the misrepresentation.

(iii) The public correction *must be reasonably capable of revealing to the market the existence of the alleged misrepresentation.* However, the public correction need not prove, or help prove, that the earlier statement or omission was in fact a misrepresentation as defined by s. 1(1) of the OSA. Moreover, the public correction need not be understood by the ordinary investor as revelatory of the existence of a misrepresentation. It may be the case that only market participants with specialized knowledge and expertise (e.g., analysts or traders) are able to understand that particular words or figures constituted the public correction of a misrepresentation. But that will be sufficient.

(iv) The public correction may take "any of a number of forms"[39] and *need not emanate from the defendant corporation*. The source of the public correction can be third parties, including media reports or internet postings.[40]

[66] These are the criteria that, in my view, define the scope and content of the public correction requirement.

The public correction requirement is satisfied

[67] In my view, the pleaded public correction herein – the excerpt in the press release of September 20, 2013 announcing that BlackBerry changed its revenue recognition method to sell-through as of 2Q14 and was incurring an inventory charge – satisfies the criteria set out above.

[68] The pleaded public correction is sufficiently specific - that revenue from certain BB10 devices "will not be recognized until those devices are sold through to end users" and that the company was taking an inventory charge of nearly $1 billion "primarily attributable" to BB Z10 devices.

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[39] See *Mask, supra,* note 3 at para. 30 (citing Matthew L. Fry, "Pleading and Proving Loss Causation in Fraud-on-the-Market-Based Securities Suits Post-Dura Pharmaceuticals" (2008) 36 Sec. Reg. L.J. 1 at 22-23).

[40] *Ibid.*

[69] The decision to adopt the sell-through method for the BB10 in 2Q14 shares the same subject matter and is obviously connected to the misrepresentation alleged – that recognizing revenue on BB10 products using the sell-in accounting method violated GAAP.

[70] The fact that Blackberry changed its accounting policy for 2Q14 is reasonably capable of revealing the alleged misrepresentation that using the sell-in accounting method in earlier periods was not GAAP-compliant.

[71] To similar effect, the announcement by Blackberry that it would be incurring a significant inventory charge in 2Q14 is also connected to, and reasonably revelatory of, the alleged misrepresentation. On the plaintiff's theory, the build-up in inventory led the company in 1Q14 to offer various incentives and price reductions to move the BB10 products through the distribution channel, which made the price unpredictable and should have prompted the company to adopt the sell-in method. At least part of the inventory charge, according to the plaintiff, is a consequence of inappropriate revenue recognition of BB10 products in 4Q13 and 1Q14 and an implicit recognition that they should not have been using the sell-through accounting method in those periods.

[72] And finally, just because the accounting change was a passing reference in the press release, as the defendant claims, is not determinative in deciding whether a public correction has been established. It may, however, assist the defendants should they assert a section 138.5(3) defence at trial.

[73] In sum, I agree with the plaintiff that the announcement about the switch to sell-through accounting in 2Q14 and the associated $1 billion inventory charge, when read in context, can fairly and reasonably be said to be a public correction of the sell-in method of revenue recognition that was used in the previous two quarters. I find that the public correction requirement in s. 138.3 is satisfied.[41]

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[41] I note that the plaintiff did not try to argue that the leave test in s. 138.8 should be applied to the public correction requirement and that the plaintiff simply had to show a reasonable possibility that its pleading of public correction would succeed at trial. The leave test does not figure in the analysis of the public correction requirement for at least two reasons. First, the leave test in s. 138.8 refers to the "action" as a whole and not to each of its constituent parts. Second, the cause of action in s. 138.3(1) arises from a misrepresentation ("where a responsible issuer...releases a document that contains a misrepresentation..."). The "publicly corrected" requirement is not a constituent element of the cause of action. It plays a necessary but modest role as a time-post to help determine the time period during which the cause of action arises (i.e. during which affected investors have a statutory right of action) and the associated damages. The public correction requirement is satisfied, in my view, if the criteria set out herein, are satisfied.

Conclusion

[74] Both the misrepresentation and the public correction requirements in s. 138.3 have been satisfied. I also find, for all the reasons stated, that there is a reasonable possibility that the action will be resolved in favour of the plaintiff.

Disposition

[75] The motion for leave under s. 138.8 of the OSA is granted as against all of the defendants.

[76] If the parties cannot agree on costs, I would be pleased to receive brief written submissions within 14 days from the plaintiff, and within 14 days thereafter from the defendants.

[77] I am obliged to counsel for their assistance.

Belobaba J.

Date: November 17, 2015