Ontario

Ontario Securities Commission | Commission des valeurs mobilières de l'Ontario

P.O. Box 55, 19th Floor
20 Queen Street West
Toronto ON M5H 3S8

CP 55, 19e étage
20, rue queen ouest
Toronto ON M5H 3S8

IN THE MATTER OF THE *SECURITIES ACT*,
R.S.O. 1990, c. S.5, AS AMENDED

- AND -

IN THE MATTER OF
COVENTREE INC.,
GEOFFREY CORNISH and DEAN TAI

REASONS FOR DECISION

Hearing:	May 12-14, 17, 19-21, 26-28 and 31, 2010 June 1-4, 14, 15, 28 and 29, 2010 September 15-17, 20, 21 and 24, 2010 October 4, 6-8, 13-15, 18, 19, 25, and 27-29, 2010 November 1-3, 2010 December 1, 3, 8 and 9, 2010	
Decision:	September 28, 2011	
Panel:	James E. A. Turner	- Vice-Chair and Chair of the Panel
	Mary G. Condon	- Commissioner
	Paulette L. Kennedy	- Commissioner
Appearances:	Jane Waechter Michelle Vaillancourt Donna Campbell Shauna Flynn Christie Johnson Daniel Waldman	- For Staff of the Commission
	Robert W. Staley Shara Roy Jason Woycheshyn Kent E. Thomson Sean Campbell Derek Ricci	- For Coventree Inc.
	J. Thomas Curry Monique Jilesen Nadia Campion	- For Geoffrey Cornish
	Paul Le Vay Johanna Braden Paul Saguil	- For Dean Tai

TABLE OF CONTENTS

REASONS FOR DECISION

I. INTRODUCTION

[1] On December 7, 2009, the Ontario Securities Commission (the "**Commission**") issued a notice of hearing in this matter pursuant to sections 127 and 127.1 of the *Securities Act*, R.S.O. 1990, c. S.5, as amended (the "**Act**") in connection with a statement of allegations issued by Staff of the Commission ("**Staff**") on the same day (the "**Statement of Allegations**").

[2] This proceeding relates to whether Coventree Inc. ("**Coventree**") complied with its obligations (i) to disclose material facts related to its credit arbitrage business in its final prospectus dated November 15, 2006 offering its common shares for sale to the public (the "**Prospectus**"), and (ii) to disclose material changes that Staff alleges occurred on January 19, 2007 and August 1, 2007, or thereafter and prior to the market disruption in the asset-backed commercial paper ("**ABCP**") market that occurred on August 13, 2007. Staff alleges that Geoffrey Cornish ("**Cornish**") and Dean Tai ("**Tai**"), both senior officers and directors of Coventree, authorized, permitted or acquiesced in Coventree's non-compliance with the Act and are therefore deemed also to have not complied with the Act. Staff also alleges that Coventree breached the Act in April, 2007 by making a misleading statement as to the total U.S. subprime mortgage assets held by Coventree sponsored conduits. Coventree, Cornish and Tai are referred to collectively in these reasons as the "**Respondents**" and individually as a "**Respondent**".

[3] The hearing of this matter took place over 45 hearings days from May 12, 2010 to December 9, 2010.

[4] These are our reasons and decision in this matter.

[5] We have provided a glossary of many of the terms used and defined in these reasons as Schedule A. We have included in Schedule A a list of many of the individuals referred to in these reasons. A chronology of significant events is contained in Schedule E.

II. THE PARTIES

Coventree Inc.

[6] Coventree was incorporated under the *Business Corporations Act*, R.S.O. 1990, c. B.16 in 1998 as Coventree Capital Group Inc. and changed its name to Coventree Inc. effective October 6, 2006. Its registered office is in Toronto, Ontario.

[7] Coventree became a reporting issuer following an initial public offering of its common shares (the "**IPO**") pursuant to the Prospectus. The Prospectus qualifying the common shares for distribution to the public was filed with the Commission on November 16, 2006. Coventree's common shares (the "**shares**") traded on the Toronto Stock Exchange under the symbol "COF".

[8] Coventree described itself in the Prospectus as "a niche investment bank specializing in structured finance using securitization-based technology". Coventree was the largest third-party

(non-bank) sponsor of ABCP in Canada. It appears that Coventree was the only third-party sponsor of ABCP in Canada that was a reporting issuer within the meaning of the Act.

[9] Coventree Capital Inc., a subsidiary of Coventree that was referred to as the Capital Markets Group, was registered with the Commission as a limited market dealer from October 6, 2006 to December 31, 2008.

[10] Nereus Inc. ("**Nereus**") was a wholly-owned subsidiary of Coventree. Nereus commenced business in 2004 and, at that time, Coventree owned 75.5% of the Nereus shares. The balance of the Nereus shares was acquired by Coventree on May 10, 2007. Nereus focused its business principally on credit arbitrage transactions.

Geoffrey Cornish

[11] Mr. Cornish was one of the three founders of Coventree (the others were Tai and David Ellins). Cornish was the President and a director of Coventree during 2006 and 2007. Cornish was also head of Coventree's Capital Markets Group until David Allan took over that position on January 22, 2007. Cornish's primary duties involved transaction structuring and client identification. Cornish was a member of Coventree's strategic council and of its disclosure committee. By the end of September 2006, Cornish resided in Denver, Colorado.

[12] Cornish is a control person of Coventree within the meaning of the Act. After the IPO, Cornish (and entities or persons related to Cornish) owned 4,508,919 Coventree shares or approximately 27% of the outstanding shares.

[13] Cornish was a lawyer at Davies Ward & Beck from 1985 to 1998. He practiced primarily securities and competition law.

Dean Tai

[14] Mr. Tai was the Chief Executive Officer ("**CEO**") and a director of Coventree during 2006 and 2007. Tai was one of the founders of Coventree and was a member of Coventree's strategic council and of its disclosure committee. Tai was primarily responsible for the administration, management and finance side of Coventree's business. Tai divided his time between working at the Coventree Toronto office and working from his home office in Boston, Massachusetts.

[15] Tai is a control person of Coventree within the meaning of the Act. After the IPO, Tai (and entities or persons related to Tai) owned 4,508,919 Coventree shares or approximately 27% of the outstanding shares.

[16] Prior to forming Coventree, Tai was Chairman and Chief Operating Officer of Align Service Delivery Corporation, a company jointly owned by Bell Canada and IBM Canada, that provided client server and network computing services. Tai was previously Treasurer of IBM Canada's leasing division.

III. STAFF ALLEGATIONS

[17] Staff alleges that Coventree breached section 56 (disclosure of material facts in a prospectus), subsection 75(1) (disclosure of material changes), subsection 75(2) (report of material changes) and subsection 126.2(1) (materially misleading or untrue statements).

[18] Staff made the following primary allegations against Coventree in the Statement of Allegations:

(a) Coventree failed to make full, true and plain disclosure in the Prospectus by failing to disclose the fact that Dominion Bond Rating Service Limited ("**DBRS**") had adopted more restrictive credit rating criteria for ABCP in November 2006 (contrary to section 56 of the Act);

(b) Coventree failed to comply with its continuous disclosure obligations by failing to issue and file a news release, and file a material change report, disclosing that DBRS's decision in January 2007 to change its credit rating methodology resulted in a material change in Coventree's business or operations (contrary to subsections 75(1) and 75(2) of the Act);

(c) Coventree made a misleading statement on April 25 and 26, 2007 by telling the market that the total U.S. subprime mortgage exposure ("**subprime exposure**") of its sponsored conduits was 7.4% (the "**subprime statement**"), and by failing to provide investors with a breakdown of that exposure by conduit and ABCP note series (contrary to subsection 126.2(1) of the Act); and

(d) Coventree failed to comply with its continuous disclosure obligations by failing to issue and file a news release, and file a material change report, disclosing liquidity and liquidity-related events and the risk of a market disruption in the days leading up to the disruption in the ABCP market that occurred on August 13, 2007 (contrary to subsections 75(1) and 75(2) of the Act).

[19] Staff alleges that Cornish and Tai, as senior officers and directors of Coventree, authorized, permitted or acquiesced in the breaches of Ontario securities law by Coventree referred to in sub-paragraphs (a), (b) and (d) of paragraph 18 of these reasons and are deemed to also have not complied with Ontario securities law in accordance with section 129.2 of the Act.

[20] Staff's detailed allegations from the Statement of Allegations are set out in Schedule B.

[21] In considering Staff's allegations and in determining materiality for purposes of this proceeding, the principal question we must address is what effect certain facts, events or developments would reasonably be expected to have had on the market price or value of Coventree shares. With the exception noted in paragraph 22 of these reasons, it is not a question of whether any of those facts, events or developments were material to purchasers of ABCP or would reasonably be expected to have had a significant effect on the market price or value of Coventree sponsored ABCP. The latter questions are not the subject of this proceeding.

[22] In addressing Staff's allegation with respect to the subprime statement (referred to in paragraph 18(c) of these reasons), we must determine whether that statement was misleading to the market and contravened subsection 126.2(1) of the Act.

[23] The issues we must determine in this matter are set out in paragraph 112 of these reasons.

IV. WITNESSES AT THE HEARING

[24] We heard testimony from fifteen witnesses.

[25] Mr. Huston Loke ("**Loke**") was a Group Managing Director and Head of Global Structured Finance at DBRS in 2006 and 2007. He testified that in that capacity he managed a team of analysts across Canada, the United States and Europe involved in rating structured finance transactions and was a member of DBRS's rating committee and executive committee. Loke testified regarding the Canadian ABCP market generally, DBRS's role in issuing credit ratings of ABCP, issues related to the DBRS November Letter and the DBRS January Release and DBRS's dealings with Coventree. At the time of the hearing, Loke was Co-President of DBRS. Loke testified for approximately five days.

[26] Mr. Michael Jones ("**Jones**") was the President of Xceed Mortgage Corporation ("**Xceed**"), an asset originator that funded Canadian residential mortgages and sold mortgage portfolios almost exclusively to Coventree sponsored conduits from 2002 to 2007. Tai was a member of Xceed's board of directors and at the time of Coventree's IPO, Coventree owned shares in Xceed representing less than 10% of the shares outstanding.

[27] We heard testimony from three witnesses who were involved in the purchase of Coventree sponsored ABCP:

(a) Mr. Per Homer ("**Homer**") was a Vice-President and Senior Trader at Citibank Canada ("**Citibank**") who worked on its Canada risk treasury desk during 2006 and 2007. During that time, he was primarily responsible for running Citibank's credit portfolio and would have typically been the person carrying out credit or non-sovereign trades. He testified that he invested in Coventree sponsored ABCP on behalf of Citibank.

(b) Mr. Patrick Miller ("**Miller**") was a junior money market trader at Bell Investment Management Corporation ("**BIMCOR**"), the corporation that manages Bell Canada's pension fund. From mid-2006 to 2008, Miller was responsible for trading, among other securities, money market securities. He testified that he invested in Coventree sponsored ABCP on behalf of BIMCOR.

(c) Mr. Craig Allardyce ("**Allardyce**") was an Associate Portfolio Manager at Mavrix Fund Management Inc. ("**Mavrix**"), a mutual fund management company. Allardyce testified that Mavrix invested in Coventree sponsored ABCP.

No witness testified on behalf of Caisse de dépôt et placement du Québec (the "**Caisse**"), the holder of approximately one-third to one-half of Coventree sponsored ABCP outstanding during the relevant period.

[28] Mr. Peter Dymott ("**Dymott**") was head of the Canadian fixed income and currency business at RBC Dominion Securities Inc. ("**RBC**") during 2006 and 2007. He was the only representative of Coventree's dealer syndicate involved in the sale of Coventree sponsored ABCP who testified. He supervised the RBC money market group that sold ABCP. RBC resigned as a member of the dealer syndicate on July 27, 2007 (see the discussion commencing at paragraph 541 of these reasons).

[29] Mr. Michael McCloskey ("**McCloskey**") was a Partner and Director, Investment Banking at Sprott Securities Inc. ("**Sprott**") (Sprott is now Cormark Securities Inc.). McCloskey described Sprott as a small and mid-cap equity specialist. Sprott and RBC were co-lead underwriters of Coventree's IPO. McCloskey was Coventree's lead contact at Sprott during the IPO process.

[30] We heard testimony from four former Coventree employees:

(a) Mr. Doug Paul ("**Paul**") was a member of Coventree's funding group in 2006 and 2007. He was in daily telephone contact with members of Coventree's dealer syndicate regarding sales of Coventree sponsored ABCP. Paul reported to Judi Dalton.

(b) Ms. Judi Dalton ("**Dalton**") was group leader of Coventree's funding group. Initially, she reported to Cornish and then to David Allan when he joined Coventree. In 2006 and 2007, Coventree's funding group consisted of Dalton, Paul and Adrian Leung.

(c) Ms. Bridget Child ("**Child**") is a Chartered Accountant and was Coventree's Chief Financial Officer ("**CFO**") during 2006 and 2007. Child was a member of Coventree's credit committee, of its strategic council and of its disclosure committee. Child signed Coventree's Prospectus as CFO.

(d) Mr. David Allan ("**Allan**") joined Coventree on January 22, 2007 as head of the Capital Markets Group. Prior to joining Coventree, he was head of Global Securitization and Credit Structuring at CIBC World Markets Inc. ("**CIBC**"). Allan was regarded by Coventree as a particular expert in traditional securitizations. Subsequent to January 22, 2007, Allan was the most senior officer located in Coventree's Toronto office. From 1987 to 1995, Allan practiced corporate law with two different major Canadian law firms. The majority of his practice related to securitization transactions. He also advised companies with respect to their disclosure obligations. Allan testified over a period of approximately six days.

[31] Ms. Clara Jane Mowat ("**Mowat**") also testified. She was a Coventree Board member and was Chair of Coventree's Audit Committee. She signed the Prospectus on behalf of the Board.

[32] Two Staff witnesses testified: Ms. Christine George ("**George**") and Mr. Marcel Tillie ("**Tillie**"), both of whom are Senior Forensic Accountants in the Enforcement Branch of the Commission. George gave evidence regarding Staff's investigation. Tillie testified primarily about the significance to Coventree of its credit arbitrage business and about disclosure in the Prospectus.

[33] Cornish testified at the hearing over a period of approximately 10 days. Tai did not testify.

V. THE CANADIAN ABCP MARKET

[34] As a preliminary matter and as background to the issues we must address, we will describe the ABCP market in Canada as it existed in 2006 and 2007.

1. Asset-Backed Commercial Paper

[35] ABCP is short-term commercial paper that was initially offered for sale by banks in Canadian credit markets. It was sold through investment dealers' money market desks and generally had a term to maturity of under one year, with typical maturities of 30 to 90 days. Coventree was one of the first non-bank entities to sponsor ABCP in Canada. By late 2006, there were a number of bank and non-bank sponsors of ABCP that was sold in the Canadian market.

[36] ABCP is backed by a pool of underlying assets. ABCP offered a yield slightly higher than the yield on short-term government issued debt instruments. Traditional ABCP is securitized by repackaging cash flows from long-term financial assets (such as residential or commercial mortgages, equipment leases, auto loans or leases and credit card receivables) into pools backing ABCP securities. ABCP issued in credit arbitrage transactions reflects a broad array of transaction structures and underlying asset classes. The underlying collateral could be investment-grade corporate securities or other fixed income assets such as corporate bonds, commercial and residential mortgage backed securities and emerging market debt. The underlying assets may be purchased directly or exposure to the assets may be created synthetically by entering into credit default swaps with respect to the referenced assets or portfolio.

[37] An investor in ABCP receives interest on the ABCP based on a spread above the Canadian Deposit Offering Rate ("**CDOR**"), which is the daily average of the interest rates for Canadian bankers' acceptances ("**BAs**"). This spread is measured in basis points; each basis point is one one-hundredth of one percent. Spreads would vary based on the type of note series (i.e., A notes or E notes; see paragraphs 68 to 74 of these reasons) and the length to maturity of the ABCP. Spreads would also vary depending on whether the sponsor of the ABCP was a bank or non-bank sponsor. ABCP issued by bank sponsors generally had a lower interest rate spread (approximately two to three basis points lower) than ABCP issued by third-party sponsors.

[38] ABCP distributed in Canada is exempt from the prospectus requirements of the Act under the short-term debt exemption in section 2.35 of National Instrument 45-106 – *Prospectus and Registration Exemptions* ("**NI 45-106**"). No prospectus is required for the distribution of ABCP that has an "approved credit rating" from an "approved credit rating organization" and has a term to maturity of not more than one year from the date of issue.

[39] DBRS was the only approved credit rating organization that rated ABCP in Canada that had Canadian style liquidity (see paragraphs 70 and 71 of these reasons). DBRS's credit ratings were R-1(high), R-1(mid), R-1(low), R-2 and R-3. Under NI 45-106, an approved credit rating must be at or above an R-1(low) rating.

[40] In 2006 and 2007, Canadian ABCP was either sponsored by a bank or other large financial institutions or by a non-bank or "**third-party sponsor**". Bank sponsored ABCP was issued by special purpose vehicles, usually in the form of a trust (referred to as a "**conduit**"), that was sponsored by a bank. Third-party sponsored ABCP was issued by a conduit sponsored by a non-bank or third-party entity, such as Coventree. A sponsor has no legal obligation to repay or make any other payment in respect of ABCP issued by a sponsored conduit.

[41] Coventree sponsored conduits participated in two general types of securitizations: traditional securitization transactions and credit arbitrage transactions. Nereus sponsored conduits focused principally on credit arbitrage transactions.

2. ABCP Transactions: Traditional Securitization Transactions

[42] Initially, Canadian ABCP was issued in connection with traditional securitization transactions. Traditional securitization transactions were used to fund cash-flow-producing asset classes such as credit cards, auto loans or leases, residential or commercial mortgages and personal lines of credit. In traditional securitizations, "**asset originators**" sell a pool of financial assets to the conduits and the conduits fund the purchase of those assets by issuing ABCP to investors.

[43] As a result of the sale of the pool of assets from the asset originator to the conduit, the conduit owns the underlying assets that "back" the ABCP issued to fund their purchase.

[44] For traditional securitizations, asset originators would normally service and manage the underlying assets. When the assets are sold to the conduit, a portion of the purchase price is typically held back, creating a kind of equity or residual interest in the assets on the part of the asset originator.

3. ABCP Transactions: Credit Arbitrage Transactions or SFA Transactions

[45] Eventually, ABCP was also used to fund structured finance transactions referred to as credit arbitrage transactions. Unlike the securitization of traditional asset classes, which is a form of financing for the asset originator, these transactions transfer risk from one financial institution to another. Credit arbitrage transactions involve "arbitraging" the difference between the possible return on the underlying assets acquired by a conduit and the cost of funds of the ABCP issued by the conduit to fund that purchase.

[46] In credit arbitrage transactions, the conduit issues ABCP to fund the purchase of securities, rather than the cash-flow producing assets purchased in a traditional securitization. In some cases, rather than purchase securities directly, the underlying assets can be created synthetically through credit default swaps with respect to the referenced assets or portfolio.

[47] "**Structured Financial Asset Transactions**" or "**SFA transactions**" is a term used by DBRS and others for credit arbitrage transactions. Cornish testified that SFA transactions would include all credit arbitrage transactions, but not all SFA transactions are credit arbitrage transactions.

[48] Credit arbitrage transactions can be broken down into two categories: CDO related credit arbitrage and non-CDO related credit arbitrage.

(a) CDO Related Credit Arbitrage Transactions

[49] Collateralized debt obligations ("**CDOs**") are securitization structures that acquire bonds, loans or other debt and allocate returns and losses in connection with those obligations to investors.

[50] In CDO transactions, a type of special purpose vehicle (the "**CDO Trust**") purchases bonds or other reference securities that are repackaged for sale to a conduit. The securities issued by the CDO Trust are broken down into different series, each with a different credit rating ranging from unrated to the highest rating (these series are referred to as "**tranches**"). Investors' exposure to losses in the portfolio depends on which tranche of securities they purchase; the higher-rated securities experience losses only after the lower-rated securities, so that investors in the highest rated securities suffer losses last. As a result, the higher a security is rated, the lower the interest rate on that security, reflecting its reduced exposure to credit risk.

[51] The point at which an investor in a CDO structure would have exposure to losses is referred to as the "**Attachment Point**". If the Attachment Point of a tranche of securities is 15%, that would mean losses on the reference portfolio would have to be greater than 15% before they are allocated to investors that purchased securities in that tranche. The other investors who invested in securities in lower-rated tranches would bear the entire burden of the first 15% of losses.

(b) CDO Related Credit Arbitrage: Cash and Synthetic CDOs

[52] CDOs took the form of either "**cash CDOs**" or "**synthetic CDOs**".

[53] With cash CDOs, the CDO Trust purchases the pool of underlying securities directly.

[54] With synthetic CDOs, the CDO Trust does not directly purchase the securities (the "**reference portfolio**") but creates an exposure to the reference portfolio through the acquisition of credit default swaps. With a synthetic CDO, the reference portfolio may consist of a specified tranche of underlying securities, for instance, the highest rated tranche.

[55] In a synthetic CDO, the conduit takes the cash from the issue of ABCP and invests that cash in collateral that is generally highly liquid assets such as treasury bills or BAs. The collateral is pledged to a financial institution (the "**protection buyer**") against a decline in the value of the reference portfolio. The protection buyer pays a fee to the conduit for the protection. The collateral can be liquidated to repay ABCP investors at maturity. In connection with these transactions, the conduit is the "**protection seller**".

[56] In addition to the initial pledge of collateral, the conduit may be required to make additional payments to the protection buyer, referred to as "**protection payments**". If losses reach the threshold of the Attachment Point (using the example above, if losses reached 15%), protection payments would be triggered. To make protection payments, conduits would liquidate

some of the collateral purchased with the proceeds of the issue of ABCP, leaving less collateral available to repay ABCP investors.

(c) CDO Related Credit Arbitrage: LSS Transactions

[57] A further subset of synthetic CDOs is a CDO for which the highest rated tranche of securities issued by the CDO Trust is subdivided into three levels: junior, mezzanine and super senior. Within this structure, conduits can obtain an interest in an even higher-ranked subset of the CDO Trust securities by purchasing exposure to the super senior securities. Super senior securities would have the highest Attachment Points, so losses in the reference portfolio would have to be at the highest level in order for those losses to be allocated to the holders of super senior securities.

[58] Super senior tranches were the most secure and accordingly provided the CDO Trust with the lowest interest rate return. In order to increase returns on investments in the super senior tranches of CDOs, conduits would purchase exposure to those tranches on a leveraged basis. These CDO transactions are referred to as leveraged super senior transactions ("**LSS transactions**").

[59] In an LSS transaction with ten times leverage, the "**notional portfolio**" to which the conduit has exposure is ten times the size of the reference portfolio.

[60] Since the Attachment Points are higher for LSS transactions than for CDO transactions with exposures to the highest rated tranches of securities, the likelihood of having to make a protection payment or of incurring losses is much lower. However, if a protection payment is triggered for an LSS transaction, it would be ten times the protection payment payable for an unleveraged transaction with the same reference portfolio.

[61] Because of the potentially higher protection payments, conduits holding LSS assets can be required to post additional collateral at certain thresholds (a "**collateral call**"). These thresholds, referred to as "**triggers**", are set by the parties to the original transaction structuring the assets. The risk associated with the additional funds that might have to be posted in the event of a collateral call is referred to as "**contingent funding risk**".

(d) Non-CDO Related Credit Arbitrage Transactions

[62] A non-CDO related credit arbitrage transaction is a credit arbitrage transaction where the securities purchased by the conduit are not CDOs. An example of a non-CDO related transaction is the purchase by a conduit of bonds issued in connection with the term securitization of a pool of residential mortgages. The expectation is that the securities will yield an income stream that exceeds the conduit's cost of funding that security.

4. Distribution of ABCP in Canada

[63] ABCP in Canada is traded in the over-the-counter market. Dealers sell ABCP by telephone directly to investors on behalf of the conduits that issue the ABCP. On a typical day, ABCP trading is completed by 9:00 a.m.

[64] When a portion of ABCP matures, the dealer will either try to resell ABCP to the same investor, for another term and at current interest rate spreads, or find another investor to purchase the paper. When a buyer cannot be found for maturing ABCP, dealers may purchase the paper through their "**market-making lines**" and hold it in inventory, to be resold at a future date. When maturing ABCP is purchased by the original investor for another term, or is purchased by another investor or dealer, it is said to have "**rolled**".

[65] ABCP investors can sell their ABCP prior to maturity by asking for "**bids**" to purchase the ABCP from dealers in the secondary market. Generally, dealers will provide bids for ABCP placed by them. Given the short-term maturity of ABCP, it is unusual for ABCP investors to sell ABCP before maturity.

[66] The over-the-counter market for ABCP was a very opaque securities market. There was no public reporting of the prices at which transactions in ABCP were effected, there were no securities law filings required in connection with the sale or trading of ABCP and there was no disclosure legally required with respect to the attributes of, or assets backing, ABCP. As a result, investors relied heavily on the credit rating of the ABCP and had very limited ability to carry out their own due diligence with respect to the ABCP and the assets backing it. The distribution and rolling of ABCP was carried out by dealers through sales to their clients. Coventree did not know who all of those clients were or how much Coventree sponsored ABCP was held by a particular client or dealer. Coventree had limited contact with purchasers of its ABCP. Accordingly, Coventree had to rely heavily on the dealers to provide market information with respect to the sale of its sponsored ABCP.

[67] DBRS had a very significant role in establishing standards in the ABCP market through the conditions it imposed as a requirement for issuing its ratings of ABCP.

5. Different Note Series

[68] There were three series of commercial paper that were issued by Coventree and Nereus sponsored conduits: A notes, E notes and floating rate notes ("**FRNs**").

(a) A Notes or Liquidity-Backed Notes

[69] "**A notes**" were ABCP that was supported by liquidity arrangements that required payments from liquidity providers in the event the conduit could not roll the maturing ABCP, if certain conditions were met. Because the terms to maturity of the assets underlying ABCP were longer than the terms of the ABCP backed by those assets, conduits had to sell new notes to investors (including rolling the paper with existing investors) in order to have the funds to meet its obligations to repay maturing ABCP. Due to this "**rollover risk**", conduits entered into liquidity agreements with financial institutions to provide cash that could be used to pay investors holding maturing A notes if the conduit could not sell new ABCP.

[70] There were two main types of liquidity facilities that could theoretically back ABCP transactions: general market disruption liquidity and global style liquidity. General market disruption liquidity would be provided to a conduit only if two conditions were met: (i) there was a general market disruption of the ABCP market, and, (ii) the rating agency re-confirmed its rating of the assets underlying the ABCP. In contrast, a global style liquidity facility provided

liquidity if the ABCP covered by the facility failed to roll for essentially any reason. Accordingly, global style liquidity facilities contained conditions to draw that did not require a general market disruption and were not dependent on confirmation of the ratings of the affected ABCP.

[71] All A notes in Canada were supported by general market disruption liquidity facilities, which were also referred to as "Canadian-style" liquidity facilities. There was no generally accepted definition of a "general market disruption" for purposes of Canadian style liquidity facilities; what constituted a general market disruption could differ from one liquidity agreement to another. Generally, however, there had to be a market disruption that affected the ABCP issued by more than one conduit or sponsor.

[72] Generally, the interest rate spread on all Coventree sponsored A notes was the same for each daily offering of such notes.

(b) E Notes or Extendible Commercial Paper

[73] "**E notes**" were ABCP that were not supported by any liquidity facility. In the event that E notes did not roll on maturity, the conduit sponsor had the option of extending the maturity of the E notes for a period of up to 364 days at a substantially higher spread. For E notes rated R-1 (high), the interest rate spread upon an extension was 110 bps over CDOR. As a result of this "**extension risk**", E notes were offered at higher interest rate spreads than A notes, generally approximately 10 basis points higher than the spread for A notes.

[74] Generally, the interest rate spread on all Coventree sponsored E notes was the same for each daily offering of such notes.

(c) FRNs or Floating Rate Notes

[75] FRNs were also issued by conduits. FRNs are generally notes with terms that exceed one year and which are not backed by liquidity arrangements.

VI. COVENTREE'S BUSINESS

[76] Coventree had three primary lines of business: (i) it acted as a securitization agent for Coventree sponsored conduits, (ii) it administered conduits sponsored by third parties, and (iii) it made investments in other issuers, such as Nereus and Xceed.

1. Role as Securitization Agent

[77] In its role as a securitization agent, Coventree arranged traditional securitization transactions and credit arbitrage transactions. For the three months ended December 31, 2006, March 31, 2007 and June 30, 2007, approximately 80% of Coventree's revenues were derived from credit arbitrage transactions (see paragraph 222 of these reasons). As securitization agent for the Coventree sponsored conduits, Coventree would establish and administer the conduits and carry out securitization transactions through those conduits. Its role included selecting and arranging the purchase of assets by the conduits or entering into credit default swaps, arranging for liquidity and other agreements necessary to carry out securitization transactions, submitting

transactions to DBRS for its rating, arranging the issue by the conduits of ABCP and contracting with dealers for the sale of ABCP.

(a) Traditional Securitization Transactions

[78] As discussed above, a traditional securitization transaction provides capital markets-based financing to an asset originator. A pool of receivables from an asset originator is sold to a conduit at a price that is generally less than the face value of the receivables. The conduit finances the purchase by issuing ABCP. Upon completion of the securitization transaction, the conduit owns the underlying assets that ultimately "back" the ABCP issued to fund their purchase.

[79] In its capacity as securitization agent, Coventree earned a "program fee" in connection with each traditional securitization transaction. The fee would be negotiated with the asset originator and was typically calculated as a percentage of the ABCP issued in connection with the particular transaction. Coventree's program fees were paid on a monthly or quarterly basis and continued to be paid throughout the life of a transaction, or for as long as the conduit retained the assets.

(b) Credit Arbitrage Transactions

[80] Coventree pioneered the structuring of credit arbitrage transactions by ABCP conduits in the Canadian market. As discussed above, credit arbitrage transactions include both CDO related transactions (consisting of cash CDOs or synthetic CDOs, including LSS transactions), and non–CDO related transactions. For credit arbitrage transactions, Coventree earned the spread between the return on the reference assets or portfolio and the conduit's cost of funds. Coventree would be paid all amounts remaining after payment was made to all other participants in a credit arbitrage transaction, including swap counterparties, the trustee, the rating agency, ABCP dealers and other service providers.

(c) Revenue Backlog

[81] The program fees from traditional securitizations, and estimated revenues from credit arbitrage transactions, that Coventree would receive in the future from transactions that had been completed represented Coventree's "**revenue backlog**". The revenue backlog was the present value of Coventree's total estimated revenues in future years derived from completed transactions using a 15% discount rate. Coventree submits that its calculation of revenue backlog was very conservative. See the discussion of Coventree's revenue backlog commencing at paragraph 355 of these reasons.

(d) LSS Transactions

[82] In the two-year period leading up to the IPO, LSS transactions were the largest contributor to Coventree's growth. In 2005, 50% of Coventree's revenue backlog came from three LSS transactions. The super senior asset portfolios of the conduits were highly leveraged. Allan testified that he discovered on his first day at Coventree that Coventree sponsored conduits were even more highly leveraged than he had anticipated. The Roadshow Presentation described one of Coventree's weaknesses as "extreme leverage" (see paragraph 260 of these reasons).

(e) Coventree Sponsored Conduits

[83] Coventree sponsored ABCP was issued by separate legal entities known as conduits. Coventree structured each of its conduits as a flow-through trust. Coventree carried out and managed the business functions of the conduits through agreements with the conduit trustees, the dealers selling the conduits' ABCP and others.

[84] Coventree sponsored eight conduits: Apollo Trust, Aurora Trust, Comet Trust, Gemini Trust, Planet Trust, Rocket Trust, Slate Trust and Venus Trust (the "**Coventree sponsored conduits**"). Nereus, Coventree's wholly owned subsidiary as of May 10, 2007, sponsored two conduits: Structured Investment Trust III (SIT III) and Structured Asset Trust (SAT) ("**Nereus sponsored conduits**"). Nereus focused principally on credit arbitrage transactions.

[85] The Coventree sponsored conduits were traditional securitization conduits, credit arbitrage conduits, or hybrid conduits. Hybrid conduits contained both traditional assets and structured finance assets. Coventree managed the conduits in this way to accommodate ABCP investor preferences for investment in ABCP backed by certain types of assets. In addition to having preferences relating to asset composition, investors also had preferences with respect to the types of notes they would purchase from a conduit (such as A notes or E notes).

[86] Coventree arranged for the conduits to acquire traditional assets from asset originators and to enter into the arrangements necessary to complete credit arbitrage transactions. In a traditional securitization, the asset originator would typically service and manage the underlying assets. Financial assets could be added or removed from the conduits from time to time. New conduits could be established so that ABCP investors could purchase more Coventree sponsored ABCP without exceeding any of their internal investment limits with respect to the amount of ABCP issued by a single conduit or backed by particular assets that they could hold.

(f) Dealer Syndicate

[87] Coventree sponsored conduits sold ABCP through a syndicate of investment dealers that included National Bank Financial ("**NBF**"), Scotia Capital Inc. ("**Scotia**"), CIBC, RBC, Deutsche Bank Securities Limited ("**Deutsche Bank**"), HSBC Bank Canada ("**HSBC**"), Laurentian Bank Securities Inc. ("**Laurentian Bank**") and BNP Paribas (Canada) ("**BNP**") (collectively, the "**dealer syndicate**" or the "**syndicate**").

[88] NBF was the lead dealer of the syndicate and Scotia was lead dealer for Nereus sponsored conduits. The lead dealers would allocate the ABCP to dealer syndicate members for sale by them and would set the interest rate or yield on the ABCP in consultation with the sponsor and other dealers.

[89] Pursuant to the dealer agreements between the conduits and the dealers, the dealers would act as agents to solicit and receive offers from investors to purchase ABCP. Coventree was a party to the dealer agreements in its role as securitization agent. The dealers would be paid commissions by the conduit for distributing Coventree sponsored ABCP to investors. The larger dealers also maintained market-making lines which allowed the dealers to purchase and hold unsold ABCP in inventory for short periods of time. Typically, the ABCP would be held overnight and sold to investors the following day. The dealers had no obligation to purchase

Coventree sponsored ABCP pursuant to their market-making lines. Coventree had limited information as to the amounts of the dealer market-making lines available at any particular time.

[90] Coventree sponsored ABCP was first issued in 2000 by the Rocket Trust. Coventree sponsored ABCP was issued in various note series, the most common being A notes and E notes. E notes were pioneered by Coventree and Coventree became the largest issuer of E notes in the market. As noted above, if a market disruption occurred, the maturity date of E notes could be extended for up to 364 days from the original date of issue at a higher interest rate spread. As a result of this extension risk, the E notes had higher interest rates than the A notes.

[91] When an investor purchased ABCP, they would typically request a specific maturity date of up to 364 days. Cornish testified that the average maturity for Coventree sponsored ABCP was 30 days.

[92] In typical market conditions and for 30 day maturities, Coventree's A notes were issued at CDOR plus two to four basis points and its E notes were issued at CDOR plus 11 to 13 basis points.

[93] The purchasers of Coventree sponsored ABCP were typically sophisticated institutional investors such as pension funds, insurance companies, financial institutions and mutual funds. ABCP could, however, also be purchased by retail investors. ABCP was issued on a prospectus exempt basis (see paragraph 38 of these reasons).

(g) Coventree's Relationship with the Caisse

[94] Coventree knew through its dealer syndicate that a relatively high percentage of ABCP issued by Coventree sponsored conduits was purchased by a relatively small number of investors. Coventree was aware that the Caisse held a substantial portion of ABCP issued by Coventree sponsored conduits.

[95] The Caisse owned a substantial equity investment in Coventree when Coventree was a private company. At the time, the Caisse held a put option that, if exercised, required Coventree to buy back all of the Caisse's shares in Coventree. The put was terminated if Coventree became a public company. In a memorandum to the Coventree board of directors (the "**Board**") dated February 13, 2006, Tai confirmed that the Caisse intended to exercise its put option in 2008. Coventree considered the exercise of the put as potentially a "firm threatening" event. As a result, after considering other alternatives and after unsuccessful negotiations with the Caisse, Tai recommended to the Board that Coventree become a public company. Accordingly, the put option was the principal reason why Coventree became a public company in November 2006.

(h) Coventree's Initial Public Offering

[96] Coventree retained Sprott as co-lead underwriter, with RBC, for Coventree's IPO. At the request of the Caisse, RBC prepared a valuation of Coventree. The offering was ultimately completed at a price within the range of the RBC valuation and of a separate high level valuation prepared by Sprott. NBF and Scotia were also members of the underwriting group for the IPO.

[97] The preliminary due diligence session with respect to the IPO took place on October 11, 2006 and the preliminary prospectus was filed with the Commission on October 18, 2006. Marketing road shows took place in Toronto and Montreal between November 3 and November 15, 2006 (see the discussion of the roadshow presentation commencing at paragraph 259 of these reasons). The final bring-down due diligence session took place on November 15, 2006 and the final Prospectus was filed on SEDAR on November 16, 2006. The Prospectus was signed by Cornish, Tai, Child and Mowat, on behalf of Coventree and its Board, and by representatives of Sprott, RBC, NBF and Scotia. McCloskey signed the Prospectus on behalf of Sprott.

[98] The IPO involved a secondary offering of approximately 23% of the then outstanding shares held by certain Coventree shareholders. The selling shareholders included the Caisse and entities and persons related to Tai and Cornish. The Caisse sold 3,155,402 shares under the Prospectus; after giving effect to that sale, the Caisse held approximately 10% of Coventree's outstanding shares. Cornish testified that the Caisse required Cornish and Tai (or entities and persons related to them) to sell some portion of their shares. As a result, entities and persons related to each of Cornish and Tai sold 150,000 shares (an aggregate of 300,000 shares) under the Prospectus. After giving effect to the IPO, Cornish (or entities and persons related to Cornish) held approximately 27% of Coventree's outstanding shares and Tai (or entities and persons related to Tai) held approximately 27% of such shares.

[99] Accordingly, following the IPO, Cornish and Tai (including entities and persons related to them) together retained a controlling interest in Coventree, holding an aggregate of more than 50% of the outstanding shares.

(i) Coventree's Disclosure Committee

[100] Following the IPO, Coventree formed a disclosure committee comprised of Cornish, Tai and Child. The disclosure committee was responsible for communications with Coventree's shareholders, ensuring that all securities regulatory disclosure requirements were met and overseeing the company's disclosure practices. Coventree's disclosure policy required the committee to meet as conditions dictated (and at least quarterly) and to keep minutes of its meetings. We heard testimony that the disclosure committee often met on an informal basis and notes of meetings were not always prepared.

(j) Coventree's Relationship with DBRS

[101] DBRS is a privately-owned, Canadian domiciled, independent credit rating organization and was Coventree's sole supplier of credit rating services. For practical purposes, Coventree sponsored ABCP could not be issued on a prospectus exempt basis unless the ABCP had a designated high quality rating from DBRS. When Coventree formed a conduit and/or wished a conduit to issue ABCP, Coventree would request a rating of the ABCP from DBRS, and DBRS would produce an initial ratings report. When the transaction proceeded, DBRS would provide a letter confirming DBRS's rating of the ABCP. Assets could not be transferred between Coventree sponsored conduits unless DBRS confirmed its ratings with respect to the affected ABCP after giving effect to the transfer.

(k) Investments in Other Companies

[102] During the period relevant to these reasons, Coventree held equity interests in Nereus and Xceed.

(i) Nereus

[103] Nereus commenced business in 2004 and focused principally on credit arbitrage transactions. Coventree owned 75.5% of the shares of Nereus at incorporation and, on May 10, 2007, Coventree purchased the remaining shares and Nereus became a wholly-owned subsidiary of Coventree. Coventree financial statements consolidated Nereus' financial results from its inception.

(ii) Xceed

[104] In April 2002, Coventree invested in Xceed, a non-prime residential mortgage lender that was previously owned by the Bank of Montreal. Xceed sold mortgage assets almost exclusively to Coventree sponsored conduits. By the time of the IPO, Coventree owned less than 10% of Xceed.

2. Chapter One Business and Chapter Two Initiatives

(a) Chapter One Business

[105] At the time of the IPO, Coventree's business was as described in these reasons commencing at paragraph 76. That business focused on arranging traditional securitization transactions and credit arbitrage transactions for its sponsored conduits, administering conduits sponsored by third parties and investing in other issuers. Coventree referred to its existing business as of the date of the IPO as "Chapter One".

(b) Chapter Two Initiatives

[106] By the time of the IPO, Coventree was changing its strategic objective to becoming a financial services company "focused on niches" (see paragraph 253 of these reasons for the description in the Prospectus of this expanded focus). There were three principal growth experiments that Coventree planned to pursue to achieve this corporate objective: (i) establishing a U.S. conduit, (ii) establishing a Canadian retail bank, and (iii) establishing an asset management business. Coventree referred to these new initiatives as "Chapter Two". Coventree hired Allan to head Coventree's Capital Markets Group, which was to be more focused on traditional securitizations rather than credit arbitrage transactions. Allan joined Coventree on January 22, 2007. As a result, Cornish was able to focus on advancing Coventree's U.S. expansion. Cornish moved to Denver, Colorado for that purpose.

U.S. Conduit

[107] In 2006, Coventree approached DBRS regarding the possibility of Coventree establishing a U.S. based conduit, with Deutsche Bank acting as asset originator. Towards the end of 2006, DBRS decided that it would not rate ABCP issued by the proposed conduit.

[108] As a result, Coventree made a proposal to Bank of America in May 2007 to establish a securities arbitrage conduit to issue E notes in the U.S. Coventree was also working on creating a conduit to fund traditional assets that would be rated by a U.S. rating agency.

[109] No U.S. conduit was established by Coventree prior to the market disruption that occurred on August 13, 2007.

Retail Bank

[110] Coventree filed an application with the Office of the Superintendent of Financial Institutions in October 2006 to establish a retail bank. That application was never approved and the process did not come to a conclusion prior to the market disruption that occurred on August 13, 2007.

Asset Management Business

[111] In May 2007, Coventree authorized the formation of Coventree U.S. Securities Inc. to carry on an asset management business and to be registered as a broker/dealer with the United States National Association of Securities Dealers. On July 27, 2007, Coventree also submitted an application to the Commission for registration in the category of investment counsel and portfolio manager. At the time of the hearing, Coventree had not obtained any of those registrations.

VII. ISSUES

[112] The issues we must determine in this matter are:

(a) Was the November 10, 2006 DBRS letter set out in Schedule C to these reasons (the "**DBRS November Letter**") a material fact that was required to be disclosed in Coventree's Prospectus in accordance with section 56 of the Act?

(b) Was the January 19, 2007 DBRS press release set out in Schedule D to these reasons (the "**DBRS January Release**") a material change with respect to Coventree that was required to be disclosed by Coventree in accordance with section 75 of the Act? If so, when did that material change occur?

(c) Did Coventree make a misleading statement when it stated at its April 25 and 26, 2007 presentations to ABCP investors (the "**April Investor Presentations**") that Coventree sponsored conduits had overall exposure to U.S. subprime mortgages of 7.4% (referred to in these reasons as the "subprime statement")? If so, did that statement contravene subsection 126.2(1) of the Act?

(d) Did a material change occur with respect to Coventree on August 1, 2007 or thereafter, and prior to the August 13, 2007 market disruption, that was required to be disclosed by Coventree in accordance with section 75 of the Act? If so, when did that material change occur?

(e) Did Cornish or Tai authorize, permit or acquiesce in the alleged non-compliance by Coventree with its disclosure obligations referred to in sub-paragraphs (a), (b) and/or (d) above? If so, are Cornish or Tai deemed also to have not complied with the Act in accordance with section 129.2 of the Act?

(f) In the circumstances, was the conduct of Coventree, Cornish or Tai contrary to the public interest?

(g) Does the release of "ABCP Market Claims" contained in the plan of arrangement under the *Companies' Creditors Arrangement Act*, R.S.C. 1985, c. C-36 (the "**CCAA**") related to the ABCP market, prevent Staff from bringing this proceeding and the Commission from making any sanction order against Coventree, Cornish or Tai?

VIII. PRELIMINARY MATTERS

1. Mandate of the Commission

[113] The mandate of the Commission is: (i) to provide protection to investors from unfair, improper or fraudulent practices, and (ii) to foster fair and efficient capital markets and confidence in the capital markets (Act, *supra*, section 1.1).

[114] The Commission is guided by certain fundamental principles expressly reflected in the Act in fulfilling its mandate. One of these principles is that the primary means for achieving the purposes of the Act are: (i) requirements for timely, accurate and efficient disclosure of information; (ii) restrictions on fraudulent and unfair market practices and procedures; and (iii) requirements for the maintenance of high standards of fitness and business conduct to ensure honest and responsible conduct by market participants (Act, *supra*, section 2.1).

2. Standard of Proof

[115] The civil standard of proof and the nature of the evidence that is required to meet that standard are integral to the duty of an administrative tribunal to provide a fair hearing. It is well established that the standard of proof that must be met in an administrative proceeding such as this is the civil standard of the balance of probabilities (*Re ATI Technologies* (2005), 28 OSCB 8558 at paras. 13-14 ("***Re ATI***"); *Re Sunwide Finance Inc.* (2009), 32 OSCB 4671 at paras. 26-28; *Re Al-Tar Energy Corp.* (2010), 33 OSCB 5535 at paras. 32-34; *Re White* (2010), 33 OSCB 1569 at paras. 22-25; and *Re Biovail Corporation* (2010), 33 OSCB 8914 at paras. 58-62 ("***Re Biovail***")).

[116] The Supreme Court of Canada has considered the nature of the civil standard of proof. The Court has confirmed that there is only one civil standard of proof, which is proof on a balance of probabilities:

> Like the House of Lords, I think it is time to say, once and for all in Canada, that there is only one civil standard of proof at common law and that is proof on a balance of probabilities. Of course, context is all important and a judge should not be unmindful, where appropriate, of inherent probabilities or improbabilities

> or the seriousness of the allegations or consequences. However, these considerations do not change the standard of proof.
>
> (*F.H. v. McDougall*, [2008] 3 S.C.R. 41, at para. 40 ("***McDougall***"))

[117] The Court noted in *McDougall* that the "evidence must always be sufficiently clear, convincing and cogent to satisfy the balance of probabilities test". However, this requirement for clear, convincing and cogent evidence does not elevate the civil standard of proof above a balance of probabilities (*McDougall*, *supra,* at para. 46).

[118] The balance of probabilities standard requires a trier of fact to decide "whether it is more likely than not that the event occurred" (*McDougall*, *supra,* at para. 44).

[119] We will apply this standard of proof in addressing the matters before us.

3. Evidence

(a) General Comment on the Evidence

[120] We heard testimony in this matter from a number of witnesses and received and reviewed a large number of e-mails, presentation materials, handwritten notes, transcripts of audio tapes of telephone conversations among representatives of Coventree and its dealers and other documents.

[121] Generally, we consider Cornish's testimony, and that of the other employees or former employees of Coventree, to be honest and credible. However, where the testimony of, or characterization of events by, a witness was inconsistent with contemporaneous documents tendered in evidence, we placed more reliance on that documentary evidence.

[122] We have based our findings on the preponderance of evidence before us and have concluded that, overall, the evidence is clear, convincing and cogent. This is not a matter in which there were what we considered to be inconsistencies in the testimony of witnesses that affected our decisions.

[123] In considering the evidence, we have attributed to Coventree the knowledge of, and information known by, any of Cornish, Tai, Allan or Child. We have done so on the basis that each of those individuals was a senior officer of Coventree at the relevant time.

(b) Audio Tapes and Call Transcripts as Evidence

[124] We heard a number of audio tapes of telephone conversations among representatives of Coventree and its dealers and reviewed a number of transcripts of those conversations. We are entitled to determine the weight that should be accorded to those audio tapes and transcripts (*R. v. Nikolovski,* [1996] 3 S.C.R. 1197 at para. 16) ("***Nikolovski***").

[125] Audio tapes are considered "real evidence" and have many of the characteristics of testimonial evidence. "Real evidence" is defined in *The Law of Evidence in Canada* as follows:

> The term is used in a number of different ways, but in its widest meaning includes any evidence where the court acts as a witness, using its own senses to make observations and draw conclusions rather than relying on the testimony of a witness.
>
> (Alan W. Bryant, Sidney N. Lederman & Michelle K. Fuerst, *Sopinka, Lederman & Bryant, The Law of Evidence in Canada*, 3rd ed., (Markham: LexisNexis, 2009) at 43-44, §2.13)

[126] Audio tapes can be valuable evidence in that they accurately convey the content of the recorded conversations as well as the actual sound and tone of the speakers' voices and the emphasis given to particular words and phrases. It has been noted that:

> … A tape, particularly if it is not challenged as to its accuracy or continuity, can provide the most cogent evidence not only of the actual words used but in the manner in which they were spoken. A tape will very often have a better and more accurate recollection of the words used and the manner in which they were spoken than a witness who was a party to the conversation or overheard the words.
>
> (*Nikolovski*, *supra*, at para. 16. See also *R. v. Pleich*, [1980] 55 C.C.C. (2d) 13 (Ont. C.A.) at para. 57 and *R. v. Rowbotham*, [1988] 41 C.C.C. (3d) 1 (Ont. C.A.) at 30)

[127] Staff and the Respondents agreed that the audio tapes that we heard are authentic and are evidence that the relevant conversations took place and of the words used, but not necessarily of the truth of the statements made.

[128] Staff submits that the audio tapes are strong evidence of market and other information that Coventree was aware of during late July and early August 2007. We do not, however, have a full record of all of the conversations and discussions that took place between Coventree and market participants during that period. Only certain of the phone lines of the dealers were taped.

[129] We have been sensitive to the limitations imposed by a less than full record of all of the telephone calls between Coventree and other market participants that occurred during the relevant period.

(c) Hearsay Evidence

[130] The Commission is entitled to receive as evidence and rely on relevant hearsay evidence. Subsection 15(1) of the *Statutory Powers Procedure Act*, R.S.O. 1990, c. s.22 ("**SPPA**") provides as follows:

> 15. (1) Subject to subsections (2) and (3), a tribunal may admit as evidence at a hearing, whether or not given or proven under oath or affirmation or admissible as evidence in a court,
>
> (a) any oral testimony; and

(b) any document or other thing,

relevant to the subject-matter of the proceeding and may act on such evidence, but the tribunal may exclude anything unduly repetitious.

[131] The Ontario Divisional Court has held that "the Commission is expressly entitled by statute to consider hearsay evidence" and that "hearsay evidence is not, in law, necessarily less reliable than direct evidence" (*Rex Diamond Mining Corp. v. Ontario Securities Commission*, 2010 ONSC 3926 (Div. Ct.) at para. 4 ("***Rex Diamond (Div. Ct.)***").

[132] As noted above, a large number of e-mails and other documents were submitted as evidence in this hearing. Many of those e-mails and documents were corroborated by the testimony of those who sent or received the e-mails or documents. Because Tai did not testify, we did not hear testimony from him with respect to the many e-mails he sent. Those e-mails constituted hearsay evidence. That being said, pursuant to section 15 of the SPPA, we are entitled to accept the e-mails, and other documents that constituted hearsay, as evidence and we have used our discretion as to the weight to be accorded to them. We have placed significant weight on contemporaneous e-mails and other documentary evidence.

(d) Respondents' Submissions

[133] We have not summarised in these reasons all of the submissions made by each of the Respondents. Those submissions necessarily overlapped and none of them was inconsistent with the submissions made by any other Respondent. Generally, where a submission was made by Coventree, we have not repeated that submission as a specific submission made by Cornish or Tai. We have taken the same approach to the submissions of Cornish and Tai.

4. The Law as to Material Fact and Material Change

(a) "Material Fact" and "Material Change"

[134] One of Staff's allegations is that the DBRS November Letter constituted a "material fact" that was required to be disclosed in the Prospectus in accordance with section 56 of the Act.

[135] The Act defines "material fact" in subsection 1(1) as follows:

> "material fact", when used in relation to securities issued or proposed to be issued, means a fact that would reasonably be expected to have a significant effect on the market price or value of the securities.

[136] Accordingly, for purposes of this proceeding, to be a "material fact", the DBRS November Letter by its terms must be a fact that would reasonably be expected to have a significant effect on the market price or value of Coventree shares. That is an objective test for materiality and is generally referred to as the market impact test.

[137] Staff also alleges that Coventree failed to publicly disclose the terms of the DBRS January Release as required under section 75 of the Act. That allegation turns on the question whether the DBRS January Release constituted a "material change" with respect to Coventree

within the meaning of the Act. Staff also alleges that Coventree failed to publicly disclose a material change on August 1, 2007, or thereafter, in the days leading up to the market disruption that occurred on August 13, 2007.

[138] The Act defines "material change" in subsection 1(1), which, as relevant for purposes of this proceeding, provides as follows:

> "material change",
>
> (a) when used in relation to an issuer other than an investment fund, means,
>
> > (i) a change in the business, operations or capital of the issuer that would reasonably be expected to have a significant effect on the market price or value of any of the securities of the issuer, or
> >
> > …

[139] Accordingly, in order for a "material change" to have occurred, there must be "a change in the business, operations or capital" of the issuer and that change must reasonably be expected to have a significant effect on the market price or value of the relevant securities. The latter element of that definition is the same objective test for materiality contained in the definition of "material fact".

[140] In *Kerr v. Danier Leather Inc.,* [2007] 3 S.C.R. 331 ("***Danier***"), the Supreme Court of Canada held that a change only in an issuer's intra-quarterly results of operations did not, by itself, constitute a change in its business, operations or capital for purposes of the definition of "material change" in the Act. In coming to that conclusion, the Court stated that:

> It almost goes without saying that poor intra-quarterly results may *reflect* a material change in business operations. A company that has, for example, restructured its operations may experience poor intra-quarterly results because of this restructuring, but it is the restructuring and not the results themselves that would amount to a material change and thus trigger the disclosure obligation. Additionally, poor intra-quarterly results may motivate a company to implement a change in its business, operations or capital in an effort to improve performance. Again, though, the disclosure obligation would be triggered by the change in the business, operations or capital, and not by the results themselves.
>
> In the present case, there is no evidence that Danier made a change in its business, operations or capital during the period of distribution. It is not disputed that the revenue shortfall as of May 16 was caused by the unusually hot weather, a factor external to the issuer. Consequently, Danier experienced no material change that required disclosure and did not breach s. 57(1).
>
> (*Danier*, *supra*, at paras. 47 and 48)

See the further comment on *Danier* in paragraph 588 of these reasons.

[141] If there is no change in an issuer's business, operations or capital, no "material change" has occurred, even if an event or development would reasonably be expected to have a significant effect on the market price or value of an issuer's securities. In contrast, a "material fact" requires only that a fact reasonably be expected to have a significant effect on the market price or value of an issuer's securities.

[142] Subsection 75(1) of the Act states that "where a material change occurs in the affairs of a reporting issuer, it shall forthwith issue and file a news release authorized by a senior officer disclosing the nature and substance of the change". Subsection 75(2) of the Act requires a reporting issuer to file a report of a material change "as soon as practicable and in any event within ten days of the date on which the change occurs".

[143] Subsection 75(1) of the Act requires that disclosure of a material change be made "forthwith". Accordingly, the obligation to publicly disclose a material change arises at the time the change occurs.

[144] The Commission recognized in *Re YBM Magnex International Inc.* (2003), 26 OSCB 5285 ("***Re YBM Magnex***") that timely disclosure of material changes enhances the fairness and efficiency of capital markets. Other decisions that have accepted that principle include *Pezim v. British Columbia (Superintendent of Brokers)* [1994] 2 S.C.R. 557 ("***Re Pezim***"), *Re Philip Services Corp*. (2006), 29 OSCB 3971 ("***Philip Services Corp.***"), *Re AiT Advanced Information Technologies Corp*. (2008), 31 OSCB 712 ("***Re AiT***"), and *Re Rex Diamond Corp.* (2008), 31 OSCB 8337 (OSC) ("***Re Rex Diamond***").

[145] Determining whether a material change has occurred involves an exercise of judgement in assessing the particular circumstances facing the reporting issuer.

[146] We do not believe that one should take a supercritical or technical approach to the interpretation of the term "material change". The Commission stated in *Re YBM Magnex* that:

> In our opinion, a supercritical interpretation of the meaning of material change does not support the goal of promoting disclosure or protecting the investing public …
>
> (*Re YBM Magnex, supra,* at para. 518)

(b) The Distinction between "Material Fact" and "Material Change"

[147] As noted above, the Act differentiates between "material facts" and "material changes" and the legal consequences of their occurrence.

[148] The definition of "material fact" is broader than that of "material change". Not all material facts will arise from a "change in the business, operations or capital of the issuer". This distinction is fundamental to the application of section 75 of the Act, which applies only to material changes, and is a key consideration in this proceeding.

(c) Materiality

[149] The standard of materiality for both a material fact and material change is the same. A fact or change is considered to be material if it "would reasonably be expected to have a significant effect on the market price or value" of an issuer's securities. When we refer to "**materiality**" in these reasons, we are referring to the application of that test. Clearly, such a fact or change would be important to a reasonable investor in making an investment decision with respect to the relevant securities.

[150] The interpretation of the disclosure provisions of the Act are also informed by National Policy 51-201 – *Disclosure Standards* (2002), 25 OSCB 4492 ("**NP 51-201**"), which provides guidance on best disclosure practices.

[151] In general, the concept of materiality in the Act is a broad one that varies with the characteristics of the reporting issuer and the particular circumstances involved. NP 51-201 states that:

> In making materiality judgements, it is necessary to take into account a number of factors that cannot be captured in a simple bright-line standard or test. These include the nature of the information itself, the volatility of the company's securities and prevailing market conditions. The materiality of a particular event or piece of information may vary between companies according to their size, the nature of their operations and many other factors.

[152] Section 4.4 of NP 51-201 also provides as follows:

> Companies are not generally required to interpret the impact of external political, economic and social developments on their affairs. However, *if an external development will have or has had a direct effect on the business and affairs of a company that is both material and uncharacteristic of the effect generally experienced by other companies engaged in the same business or industry, the company is urged to explain, where practical, the particular impact on them.* For example, a change in government policy that affects most companies in a particular industry does not require an announcement, but if it affects only one or a few companies in a material way, such companies should make an announcement. [emphasis added]

[153] The Commission concluded in *Re YBM Magnex* that:

> Materiality is a question of mixed law and fact, i.e. do the facts satisfy the legal test? Some facts are material on their own. When one or more facts do not appear to be material on their own, materiality must also be considered in light of all the facts available to the persons responsible for the assessment.
>
> (*Re YBM Magnex, supra,* at para. 94)

[154] In *Re Rex Diamond*, the Commission found, among other things, that a final notice from the Government of Sierra Leone that it would terminate key mining leases held by Rex Diamond

Mining Corporation ("**Rex Diamond**"), if Rex Diamond did not bring those leases into compliance by commencing mining operations, constituted a material change in Rex Diamond's business. The Commission concluded that the loss of the leases "affected Rex's operations because it would no longer have legal entitlement to access the land and extract diamonds" (*Re Rex Diamond, supra,* para. 218) (see also the discussion of *Re Rex Diamond* beginning at paragraph 612 of these reasons).

[155] On appeal of *Re Rex Diamond*, the Ontario Divisional Court confirmed that the test for materiality is objective in nature and is not affected by the subjective assessment or optimistic views of company executives that a different outcome could be negotiated (see paragraphs 368 and 369 of these reasons) (*Rex Diamond (Div. Ct.), supra,* at para. 6).

[156] Accordingly, the assessment of the materiality of an event or development is a question of mixed fact and law that requires a contextual determination that takes into account all of the relevant circumstances, including the size and nature of the issuer and its business, the nature of the event or development and the consequences to the issuer's business, operations or capital. That assessment requires the application of judgement and common sense. In assessing whether a fact is a "material fact" or whether a "material change" has occurred, one must take into account both quantitative and qualitative considerations or factors.

(d) The Commission is a Specialized Tribunal

[157] The materiality standard applicable in this case is an objective test based on reasonable expectation. Determining questions such as whether a fact is a material fact, whether a material change has occurred, the effect of events or developments on the market price or value of securities and the adequacy of disclosure made, are matters squarely within our expertise as a specialized tribunal. While the evidence of experts, shareholders or investors may be relevant or useful, we do not need such evidence in order to make these decisions (see *Re Donnini* (2002), 25 OSCB 6225 at para. 123, *Rex Diamond (Div. Ct.), supra,* at para. 3 and *Re Biovail, supra,* at para. 80). No evidence of experts or of Coventree public shareholders was introduced. We did hear evidence from a number of individuals involved in the purchase of ABCP by investors.

[158] In *Rex Diamond (Div. Ct.)* (*supra,* at para. 3), the Court recognized the Commission's expertise when it stated that "whether a material change occurred is a matter that is central to the expertise of the Commission". The same principle applies to the Commission's determination of whether a fact constitutes a "material fact".

(e) Hindsight

[159] The Commission has made clear that assessments of materiality are not to be made with the benefit of hindsight. The Commission stated in *Re AiT* that:

> Instead, we must objectively assess the facts that were available to the AiT Board during the Relevant Period, to determine in all the circumstances whether the three events constituted a material change in the business, operations or capital of AiT that triggered its disclosure obligation under section 75. It is important therefore, to recognize the dangers of hindsight in

> coming to this conclusion and to be careful not to look at the situation based on what subsequently happened.
>
> (*Re AiT*, *supra,* at para. 228)

[160] Further, in *Re YBM Magnex* (*supra,* at para. 90), the Commission stated that "[a]ssessments of materiality are not to be judged against the standard of perfection or with the benefit of hindsight. It is not a science and involves the exercise of judgement and common sense".

[161] Coventree should not be held to a standard of perfection and must not be judged with the benefit of hindsight. In particular, we must not judge the Respondents with the benefit of the hindsight that a market disruption in the ABCP market occurred on August 13, 2007. In our view, we have not so judged the Respondents.

(f) The Business Judgement Rule

[162] The Supreme Court of Canada held in *Danier* that the business judgement rule does not apply to decisions regarding disclosure under the Act. The Supreme Court stated that:

> … while forecasting is a matter of business judgment, disclosure is a matter of legal obligation. The Business Judgment Rule is a concept well-developed in the context of *business* decisions but should not be used to qualify or undermine the duty of disclosure.
>
> (*Danier*, *supra,* at para. 54)

This principle was adopted by the Commission in both *Re AiT* and *Re Rex Diamond* (see *Re Rex Diamond, supra,* at para. 238 and *Re AiT, supra,* at para. 228).

[163] Accordingly, the business judgement rule does not apply to the determination of whether the Prospectus failed to disclose a "material fact" or whether a "material change" occurred within the meaning of section 75 of the Act. Disclosure decisions under the Act are not sheltered by the business judgement rule.

IX. DISCLOSURE IN COVENTREE'S PROSPECTUS

1. Background

(a) Staff Allegation

[164] Staff alleges that Coventree failed to make full, true and plain disclosure of all material facts in its Prospectus by failing to disclose that DBRS had adopted more restrictive credit rating criteria for new credit arbitrage transactions in November 2006. In particular, Staff alleges that Coventree failed to disclose the DBRS November Letter. The key provisions of the DBRS November Letter are summarized below and the full DBRS November Letter is set out in Schedule C to these reasons.

(b) Coventree Submissions

[165] Coventree submits that Staff's allegation concerning the failure to refer to the DBRS November Letter in the Prospectus is without merit for at least three reasons. First, although the Prospectus did not refer specifically to the DBRS November Letter, or to each of the other policy initiatives DBRS had undertaken in 2005 and 2006, the Prospectus disclosed fairly and accurately the more restrictive approach that DBRS had taken at the time and might take in the future.

[166] Second, Coventree submits that the DBRS November Letter was not material to Coventree for a host of reasons. These include the fact that the letter was largely confirmatory of the more restrictive approach DBRS had already taken in considering credit arbitrage transactions and contained no specifics whatsoever concerning any new or different criteria DBRS might apply to credit arbitrage transactions in the future. Coventree submits that DBRS had a history of announcing changes and then significantly modifying those changes as a result of comments from market participants. Moreover, Coventree submits that well before the DBRS November Letter, Coventree had concluded that credit arbitrage transactions would not constitute a significant source of future growth or revenue for Coventree.

[167] Finally, Coventree submits that this case is unlike any other enforcement case the Commission has brought in the past concerning allegedly misleading disclosure in a prospectus. Coventree submits that there have been only two such cases of any significance in the past ten years, namely *Re YBM Magnex* and a very recent settlement involving BMO Nesbitt Burns arising out of an initial public offering of FMF Capital Group Ltd. (see *Re BMO Nesbitt Burns Inc.* (2010), 33 OSCB 10715). In both cases, the non-disclosure in question was egregious and went to the heart of the existence of the companies in question. Indeed, the undisclosed matters caused both companies to collapse shortly after the offerings in question were completed. By contrast, in this case, Coventree submits that it is obvious that the alleged non-disclosure in the Prospectus is trivial by any reasonable measure and mattered to no one.

(c) Cornish Submissions

[168] Cornish submits that, at the time the Prospectus was being prepared, he believed that Coventree's reliance on credit arbitrage transactions as a primary source of revenue would decrease for a number of reasons including that: (i) market conditions were making such transactions funded with ABCP less profitable, and (ii) the rapid growth of the ABCP market was curtailing the ability of the market to absorb future ABCP.

[169] Cornish submits that he therefore made a point of ensuring that the Prospectus reflected Coventree's view of the risks associated with the growth in the ABCP market and the fact that Coventree would pursue only a limited number of one-off credit arbitrage transactions in the future, with the result that these types of transactions would not be a significant source of future growth for Coventree. Cornish submits that the Prospectus clearly discloses this as well as the risk that Coventree's revenues could be negatively affected by a number of factors, including narrowing spreads in its credit arbitrage business.

[170] Cornish submits that he specifically turned his mind to including language in the Prospectus disclosing that DBRS had been pursuing more restrictive measures in the period leading up to the IPO. Indeed, the Prospectus expressly states that:

> With the increase in competition, DBRS has undertaken a number of new initiatives relating to the Canadian ABCP markets that are intended to protect or enhance the stability of that market. While Coventree supports those initiatives, many of them will also have the effect of reducing the profitability of future transactions.
>
> (Prospectus, at p. 32)

[171] Cornish submits that he and Tai both concluded that DBRS's more restrictive approach had already been disclosed and discussed at length in the Prospectus, such that no change to the Prospectus was required as a result of the DBRS November Letter.

[172] Cornish also adopts Coventree's and Tai's submissions with respect to this issue.

(d) Tai Submissions

[173] Tai submits that Coventree did not include reference to the DBRS November Letter in the Prospectus because the general spirit and intent of the DBRS November Letter had already been addressed in the Prospectus. Further, a reader of the Prospectus would know that Coventree was heavily dependent on DBRS as its sole provider of rating services and that DBRS had recently adopted a more stringent approach to various matters affecting the ABCP market.

[174] Tai submits that while he and Cornish may have had somewhat different interpretations of the meaning and impact of the DBRS November Letter, they both reached the same conclusion that it was not a material fact that was required to be disclosed in the Prospectus.

[175] Tai specifically objects to and denies Staff's suggestion that Coventree had a "preference for non-disclosure" or that he was attempting to keep secret his view that the credit arbitrage business was dying. To the contrary, Tai submits that very extensive risk factor disclosure was made in the Prospectus.

[176] Tai also adopts Coventree's and Cornish's submissions with respect to this issue.

(e) Summary of the DBRS November Letter

[177] The DBRS November Letter (attached as Schedule C to these reasons) set out DBRS's observations and conclusions about recent trends in the ABCP market including (i) the "extraordinary growth (in excess of 50%)" in the ABCP market over the previous two years, largely attributed to the growth of SFA transactions; (ii) that LSS transactions had been the most popular type of Canadian ABCP transaction; and (iii) that the structured credit market was providing less attractive returns for credit protection sellers (that is to say, ABCP conduits).

[178] After "considerable contemplation" and "a detailed review of existing SFA transactions", DBRS concluded in the DBRS November Letter that:

1. the quality of assets in SFA transactions was very high and future performance of those assets would be strong;

2. should growth rates in SFA-backed transactions continue at the pace previously experienced, DBRS believed that certain concerns would arise with respect to:

   (a) the "continued and near exclusive use of LSS technology resulting in contingent funding obligations embedded in an increasingly larger portion of the market"; and

   (b) SFA transactions potentially incorporating economic and risk characteristics that were quite different from previously structured transactions.

[179] These concerns prompted DBRS to advise market participants (through the DBRS November Letter) that DBRS would be taking a "measured approach" to "managing the future growth of SFA-backed transactions funded in the Canadian ABCP market", that "market participants should only expect transactions that clear the minimum rating requirements by an ample margin to be approved by DBRS" and that "consistent with DBRS's new approach to SFA transactions, market participants should also expect that the types of SFA transactions that will be approved going forward will be more restrictive than those approved in the past."

[180] The DBRS November Letter indicated that it was effective immediately and that it was DBRS's expectation that no existing Canadian ABCP ratings would be affected. Transactions then under review by DBRS would be "reviewed on a case by case basis" to determine whether they could be approved.

[181] It is not disputed that Coventree received the DBRS November Letter prior to filing the final Prospectus and that no express reference was made to it in the Prospectus.

(f) Relevant Considerations

[182] The Prospectus contains a discussion of a risk factor under the heading "Dependent Supplier Risk" related to the fact that "[t]he one key supplier that the Company is heavily dependent on as a sole provider of services is DBRS". It was also stated that:

> Further, DBRS has recently adopted a more stringent approach to various matters affecting the ABCP marketplace, such as new minimum requirements (including minimum equity) for new conduit sponsors, new market-disruption liquidity definitions and new disclosure requirements. While the Company supports these new changes as being positive developments for the industry, *there is no assurance that DBRS will not adopt additional requirements in the future that may adversely affect the Company's ability to carry on business or to execute transactions through its conduits on the same basis as in the past*. [emphasis added]
>
> (Prospectus, at p. 64)

[183] While he responded "good note" to DBRS in an e-mail regarding the DBRS November Letter, Tai stated in his examination by Staff that he interpreted the DBRS November Letter as "a very harsh letter" that meant that DBRS was "not going to do these [SFA transactions] anymore". On November 17, 2006, Tai sent an e-mail to the Nereus board of directors that included the statement that "[g]iven DBRS [*sic*] more recent letter regarding leverage [*sic*] super senior transactions, and CDO [*sic*] more generally, we are very uncertain about the long-term prospects of Nereus as a going concern." On December 23, 2006, Tai further communicated to the Nereus board that:

> Given that DBRS has now explicitly declared that they will be restricting these types of transactions [LSS transactions] to the point where they may be uneconomical, we would like to know why the Board has NOT insisted on Nereus diversifying away from these transactions or this business model in an aggressive fashion, despite warning at the inception and repeated warning by Coventree that this would occur.

[184] Cornish testified, however, that he did not agree with Tai's assessment of the DBRS November Letter. Cornish testified that it was difficult to determine exactly what DBRS intended by the DBRS November Letter, but that it appeared to be a continuation of DBRS's existing approach. He testified that DBRS had a history of making such announcements and then changing or modifying its approach based on feedback from market participants. In this respect, Loke testified that DBRS had not established the criteria it intended to apply in connection with rating transactions that were subject to the DBRS November Letter. Loke testified that the letter was simply trying to communicate that DBRS was concerned with the overall quality of transactions.

[185] Ken Toten ("**Toten**"), a Coventree employee, sent an e-mail to Cornish on November 16, 2006 in which he commented on the effect of the DBRS November Letter. He stated that:

> So, it is my belief that we will not be able to achieve our funding goals for FY07 based upon the user-unfriendly posture adopted by our primary rating agency. As such, I believe that the financial goals set in good faith 6 months ago will only serve to demotivate staff …

[186] Cornish testified that he felt Toten was attempting to use the DBRS November Letter as an excuse for renegotiating personal and employee objectives. Accordingly, Cornish discounted the significance of the concerns expressed by Toten. Notwithstanding, Cornish responded to Tai in respect of the e-mail from Toten that "we are going to have to get another rating agency in Canada or a US conduit or both".

[187] Cornish testified, however, that he did not consider the DBRS November Letter to constitute a material fact with respect to Coventree.

[188] Loke told McCloskey about the DBRS November Letter in a telephone call a few days prior to the filing of the final Prospectus. Loke was aware of the IPO and McCloskey referred him to the risk factors described in the Prospectus. Loke apparently confirmed the accuracy of references in the Prospectus to DBRS and that the risk factors were accurate.

[189] McCloskey obtained a copy of the DBRS November Letter before the final Prospectus was filed although he testified that he did not have a clear recollection of reading the letter. No express reference was made to the DBRS November Letter in the questions prepared for the final due diligence meeting held to finalise the Prospectus on November 15, 2006.

[190] In reviewing the DBRS November Letter in connection with this proceeding, McCloskey testified that it did not appear to him to be particularly important and, in any event, seemed to be a continuation of DBRS's approach referred to in the Prospectus.

Coventree Transactions Completed After the DBRS November Letter

[191] Based on Cornish's testimony, there was one Coventree sponsored securitization transaction for approximately $68 million completed on November 14, 2006 to which the DBRS November Letter did not apply. Cornish also testified that there were three Coventree or Nereus sponsored LSS transactions that Cornish believed were grandfathered under the DBRS November Letter that were closed in November and December 2006. Those transactions were in an aggregate principal amount of approximately $665 million. The only other credit arbitrage transactions that were completed by Coventree after the DBRS November Letter were four relatively small non-CDO related transactions completed in March and April 2007 in an aggregate amount of $169 million.

2. Law related to Prospectus Disclosure

[192] In order for capital markets to function fairly and efficiently, public companies must provide accurate and truthful disclosure to investors about their business and affairs. The importance of public disclosure cannot be underestimated. The Commission has emphasized the importance of disclosure to investors and capital markets in a number of decisions. In *Philip Services Corp.*, the Commission stated that:

> Disclosure is the cornerstone principle of securities regulation. All persons investing in securities should have equal access to information that may affect their investment decisions.
>
> (*Philip Services Corp., supra,* at para. 7)

[193] Information that is publicly disclosed must be accurate and not misleading or untrue in order to accomplish the goals of Ontario's securities regulatory regime to protect investors from unfair or improper practices and to foster fair and efficient capital markets and confidence in those markets (*Re Rex Diamond, supra,* at para. 205).

[194] A prospectus is an important means for ensuring that investors receive the information that permits them to make an informed decision when investing in the securities offered.

Full, True and Plain Disclosure

[195] The Act requires that a preliminary prospectus and a final prospectus be filed, and receipts be obtained, where a distribution of securities is made (Act, *supra,* subsection 53(1)).

[196] The Act provides that a prospectus shall contain full, true and plain disclosure of all material facts relating to the securities issued or proposed to be distributed and shall comply with the requirements of Ontario securities law (Act, *supra,* subsection 56(1)).

[197] The Act requires that where a prospectus is filed, the issuer's chief executive officer, chief financial officer and any two of its directors, on behalf of the board of directors, must certify that the prospectus contains full, true and plain disclosure of all material facts relating to the securities offered (Act, *supra*, subsection 58(1) and section 37.2 of Form 41-101F1 – *Information Required in a Prospectus* (the "**Prospectus Form**")). Underwriters in a prospectus distribution are required to certify that, to the best of their knowledge, information and belief, the prospectus constitutes full, true and plain disclosure of all material facts relating to the securities offered (Act, *supra*, subsection 59(1) and section 37.3 of the Prospectus Form).

[198] "Full" disclosure is achieved when disclosure is made of facts sufficient to permit investors to make an informed investment decision. "True" disclosure is achieved if the disclosure is accurate and not misleading and does not omit a fact that is either material itself or is necessary to understand the facts that have been disclosed. "Plain" disclosure must be understandable to investors and in plain language.

[199] Disclosure in the Prospectus is governed by National Instrument 41-101 – *General Prospectus Requirements* (2002), 23 OSCB 761. The Prospectus Form provides detailed instructions for the preparation of a prospectus and sets out 37 separate matters or "items" that must be disclosed. Item 29 requires issuers to disclose any other material fact not covered by any of the other items that is "necessary in order for the prospectus to contain full, true and plain disclosure of all material facts". Section 4.1 of Companion Policy 41-101CP provides that "[i]ssuers should apply plain language principles" when preparing a prospectus.

3. Analysis

[200] In considering the allegations of misleading or inadequate disclosure in the Prospectus, we have read the entire Prospectus with some care. We recognise that statements in the Prospectus can be taken out of context. While we quote selectively from the Prospectus in these reasons, we are mindful of that caution.

[201] It is clear that the DBRS November Letter contained information that was important to Coventree and its business. On its face, DBRS was proposing in the DBRS November Letter to take a more measured or restrictive approach to approving SFA transactions, a form of transaction that generated a substantial portion of Coventree's revenues. The DBRS November Letter was raising concerns about the large number of LSS transactions being carried out in the market and the contingent funding risks being created as a result. These issues were of much more importance to Coventree than a number of the earlier initiatives undertaken by DBRS and referred to in the Prospectus. Coventree was very active in the SFA market and its business could have been significantly and adversely affected by the DBRS November Letter. Both Tai and Toten appear to have viewed the DBRS November Letter as having a material and adverse effect on Coventree's credit arbitrage business (see paragraphs 183 and 185 of these reasons).

[202] Accordingly, we are surprised that specific reference to the DBRS November Letter was not included in the Prospectus. For the same reason, it is also surprising to us that McCloskey did not recall reviewing the DBRS November Letter at the time and that no express reference to it was included in the due diligence questions for the final Prospectus due diligence session. We would expect the underwriters to have had concerns or questions with respect to the DBRS November Letter, given that it was issued only a few days prior to the filing of the final Prospectus and related to a very important portion of Coventree's business.

[203] We note that Cornish did not immediately follow up with Loke at the time the DBRS November Letter was issued. It appears that he did not ultimately discuss it with Loke until approximately the end of November 2006.

[204] We would add that, in our view, disclosure of the DBRS November Letter and the concerns raised by DBRS would not have resulted in extensive or complex disclosure in the Prospectus that would have been unhelpful to investors. To the contrary, the nature of the concerns raised by DBRS could have been disclosed quite easily by the addition of one or two sentences to the disclosure referred to in paragraph 182 of these reasons. DBRS was worried about the large number of LSS transactions being carried out in the market and the contingent funding risks to which those transactions were giving rise. Expressing those concerns in the Prospectus would not have been difficult and that information would have been clearly relevant to a purchaser of shares under the Prospectus.

DBRS November Letter Not a Material Fact

[205] On balance, however, we have concluded that the DBRS November Letter did not constitute a material fact with respect to Coventree at the date of the Prospectus. We come to that conclusion for three reasons.

[206] First, it appears that the DBRS November Letter was primarily focused on "managing the future growth of SFA-backed transactions" and ensuring that only high quality transactions were approved.

[207] It is at best unclear exactly what DBRS was saying in the DBRS November Letter and what criteria it would apply in reviewing future SFA transactions. Loke agreed with that assessment in his testimony. He testified that DBRS had not established the criteria it would apply pursuant to the DBRS November Letter. Coventree submits that the only way to determine what the DBRS November Letter really meant was to submit proposed transactions to DBRS to see how DBRS responded. In an e-mail to Toten dated November 30, 2006, Cornish stated "… my vote is that we should submit [to DBRS] every deal that we want to do as per usual in CDOs … it is only once we get into this new process that we will find out how it will really apply to us and others".

[208] Based on Loke's testimony, it appears that other market participants also had concerns as to exactly what the DBRS November Letter meant.

[209] With that uncertainty as to its meaning and application, it was difficult to assess, at the time the Prospectus was filed, the likely impact of the DBRS November Letter on Coventree and its business. To the extent that DBRS was simply saying that it would in the future approve only

higher quality SFA transactions, Coventree may well have concluded that the letter was not addressed to the transactions it typically carried out, and that it would have a limited adverse effect on its business.

[210] Secondly, the DBRS November Letter does appear to be a continuation of DBRS's existing "measured approach" to approving SFA transactions. A measured approach is quite different than saying that no future LSS transactions would be approved. Further, the DBRS November Letter seems to be captured by the statement in the Prospectus that "there is no assurance that DBRS will not adopt additional requirements in the future that may adversely affect the Company's ability to carry on business or to execute transactions through its conduits on the same basis as in the past" (Prospectus, at p. 64; see paragraph 182 of these reasons). That disclosure does not relieve Coventree of its legal obligation to disclose material facts in the Prospectus *as they existed on the date of the Prospectus*, but it does alert a reader to the possibility that DBRS could take future action that would adversely affect Coventree's ability to complete future securitization transactions.

[211] Finally, the DBRS November Letter did not affect outstanding transactions or transactions that were then being reviewed by DBRS, although the letter indicates that the latter transactions would be reviewed on a case by case basis.

[212] We note that Loke testified that DBRS did not approve any new CDO related SFA transactions after the DBRS November Letter, other than grandfathered transactions and transactions that had the benefit of global style liquidity. It also appears that Coventree did not propose any new CDO related transactions to DBRS after the DBRS November Letter. However, if those were consequences of the DBRS November Letter (rather than the DBRS January Release), they were apparent only with the benefit of hindsight. We do not believe that those consequences of the DBRS November Letter were reasonably apparent to Coventree at the date of the Prospectus.

[213] We would add that we do not view the fact that no change was made to the disclosure in the Prospectus in response to the DBRS November Letter as a relevant factor in our analysis of this issue.

4. Conclusions

[214] One way of asking whether the DBRS November Letter was a material fact is to ask whether, if disclosure of the DBRS November Letter had been made in the Prospectus, that disclosure would have significantly affected the price investors would have paid to purchase Coventree shares under the Prospectus. We consider that unlikely.

[215] Based on the foregoing, we have concluded, on balance, that the DBRS November Letter would not reasonably be expected to have had a significant effect on the market price or value of Coventree shares. Accordingly, the DBRS November Letter did not constitute a "material fact" at the date of the Prospectus within the meaning of the Act. We therefore find that Coventree did not contravene section 56 of the Act by failing to disclose the DBRS November Letter in the Prospectus.

5. Other Prospectus Disclosure Issues

[216] The allegation referred to in paragraph 164 of these reasons is Staff's only allegation that Coventree contravened section 56 of the Act. There are, however, two other issues with respect to the disclosure in the Prospectus that are relevant to other allegations we must address in these reasons.

(a) Importance of Credit Arbitrage to Coventree's Business

Staff Allegation

[217] Staff alleges that the Prospectus did not disclose that approximately 80% of Coventree's revenues were derived from credit arbitrage transactions. Staff has conceded, however, that the failure to make that disclosure did not contravene section 56 of the Act. Staff submits that allegation is relevant only in considering whether the DBRS January Release gave rise to a material change in Coventree's business. We discuss that issue later in these reasons.

Coventree Submissions

[218] Coventree submits that Staff's allegation in this respect is completely without merit for at least two reasons.

[219] First, Coventree submits that the Prospectus made it abundantly clear that a significant portion of Coventree's business was attributable to credit arbitrage transactions, including CDO related credit arbitrage transactions.

[220] Second, Coventree submits that the precise percentage of Coventree's future business or revenues attributable to credit arbitrage transactions was irrelevant. Coventree had no expectation that credit arbitrage transactions would continue to be a significant source of future growth or new revenues and this fact was disclosed in the Prospectus.

[221] Coventree also submits that information as to its separate revenues derived from traditional securitizations and from credit arbitrage transactions was commercially sensitive and that it did not track its revenues from transactions, and did not manage its business, on that basis (see the concluding sentence of the quotation set out in paragraph 222 of these reasons). Coventree says that the portion of its revenues derived from credit arbitrage transactions was not a financial number generated by its accounting control systems.

[222] With respect to the proportion of Coventree's revenues derived from or attributable to credit arbitrage transactions, Coventree acknowledged in its letter to Staff dated September 14, 2007, that:

> The Company's estimated revenue attributable to the Conduits' credit arbitrage transactions for the three-month periods ending December 31, 2006, March 31, 2007 and June 30, 2007 is set out below:

Three-Month Periods Ending	Total Credit Arbitrage Transactions Approx. Revenue (in millions)	Company Total Revenue Excluding VIEs (in millions)	Total Credit Arbitrage Transactions as % of Total Revenue Excluding VIEs
December 31, 2006	$17.3	$21.8	80%
March 31, 2007	$16.4	$20.7	79%
June 30, 2007	$15.2	$18.8	81%

The amounts in the second column are estimates of revenue attributable to the Conduits' credit arbitrage transactions as the Company's reporting systems do not capture revenue attributable to the Conduits' credit arbitrage transactions separately from revenue attributable to the Conduits' traditional securitization programs.

[223] Coventree does not dispute that approximately 80% of its revenues were derived from credit arbitrage transactions as of the date of the Prospectus. Coventree also acknowledges that no express statement as to the proportion of its revenues derived from credit arbitrage transactions was made in the Prospectus.

[224] Coventree submits, however, that the Prospectus is clear that a significant portion of Coventree's business was attributable to credit arbitrage transactions including CDO related credit arbitrage transactions. Coventree comes to that conclusion based on the following analysis of the disclosure in the Prospectus.

[225] Coventree refers to the list of asset classes that are included in the description of traditional securitizations and credit arbitrage securitizations set out on page 12 of the Prospectus. The list of asset classes in the description of credit arbitrage transactions includes "corporate bonds, middle market loans, small business loans and asset-backed securities". The table on page 22 of the Prospectus indicates that "Asset-Backed Securities" and "Corporate Loans & Bonds" comprise an aggregate of approximately 44% of the assets held by Coventree sponsored conduits. Although the table on page 22 of the Prospectus includes other asset classes, Coventree submits that a reader would conclude from the table that credit arbitrage transactions constituted a significant portion of the assets held by Coventree sponsored conduits.

[226] In addition, Coventree submits that note 13(a) to the financial statements contained in the Prospectus discloses that the conduits' investments include approximately $8.0 billion of collateralized debt obligations and credit linked notes ("**CLNs**"). Coventree submits that CDOs and CLNs are forms of investments related to credit arbitrage transactions. Note 13(a) also states that the total principal amount of the investments held by Coventree and Nereus sponsored conduits was about $14.9 billion, which means that CDOs and CLNs alone represented about 54% of those investments. Coventree also notes that CDOs and CLNs do not constitute all of the investments related to credit arbitrage transactions held by the conduits. Accordingly, Coventree submits that a reader of the Prospectus would conclude from this information that credit arbitrage transactions constituted a significant portion of the investments of Coventree and Nereus sponsored conduits.

[227] Further, on page 26 of the Prospectus, it is stated that Nereus is focused "principally on structured credit arbitrage". Nereus' financial results are included in the "Coventree Investments" business segment. Nereus' recurring revenue from credit arbitrage transactions is $10.1 million (shown on page F-9 of the Prospectus, note 3, in the "Revenue" line item under "Coventree Investments"). In addition, $4.9 million of revenue (line item for "Sale/termination of transaction fees") also relates to Nereus' credit arbitrage business. In other words, Nereus' credit arbitrage revenue alone accounted for approximately $15 million of Coventree's total revenue (excluding CICA Accounting Guideline 15, Consolidation of Variable Interest Entities ("**AcG-15**")) of about $60.7 million, representing approximately 25% of Coventree's total revenues.

[228] The Prospectus also states on page 26 under "Nereus Financial Inc. ("*Nereus*")" that Nereus had close to $3 billion in fundings outstanding. If that $3 billion is deducted from the $8 billion figure set out in note 13(a) referred to above, that means that Coventree sponsored conduits held about $5 billion in CDOs and CLNs. Coventree submits that if one assumes that Coventree earned proportionally the same amount of revenue from CDOs and CLNs held by the Coventree sponsored conduits as Nereus did from the CDOs and CLNs held by Nereus sponsored conduits, that would mean that Coventree earned about $25 million in revenue from those transactions. Coventree submits that would mean that the total revenue earned by both Coventree and Nereus from CDOs and CLNs was about $40 million, or about 2/3 of Coventree's total revenues (excluding AcG-15).

[229] Based on the analyses set out above, Coventree submits that it was clear in the Prospectus that a significant portion of its revenues were derived from credit arbitrage transactions.

Cornish and Tai Submissions

[230] Cornish and Tai adopt Coventree's submissions with respect to the disclosure in the Prospectus of the importance of credit arbitrage to Coventree's business.

Discussion

[231] Coventree does not dispute that, at the time of the Prospectus, approximately 80% of its revenues were derived from credit arbitrage transactions. That conclusion is consistent with the statements in the letter to Staff referred to in paragraph 222 of these reasons (although those statements relate to periods ending subsequent to the date of the Prospectus).

[232] The Prospectus does not disclose the proportion of Coventree's revenues derived from credit arbitrage transactions. Coventree knew that the underwriters involved in the IPO considered that information to be relevant to investors. Two of the underwriters involved in the IPO requested Coventree to disclose that information in the Prospectus, but Tai successfully resisted disclosure on the basis that the information was confidential and proprietary. In an e-mail to Tai dated August 21, 2006, McCloskey stated: "[a]lso surprised that you won't disclose in the prospectus the breakdown of revenue and profit that come from your programs vs. "Proprietary/arb trading". The latter will command a lower valuation multiple. I would think that a proposed investor would want to know. Too sensitive from a business perspective?"

McCloskey testified that he discussed this disclosure question with his legal counsel and they ultimately concluded that additional disclosure was not required.

[233] We have difficulty seeing how the proportion of Coventree's revenues or business derived from credit arbitrage transactions was commercially sensitive. Child appeared to agree with that in her testimony. It is also clear to us on the evidence that Coventree tracked transactions on a deal by deal basis and characterized those transactions as either funding transactions (traditional securitizations) or investment transactions (credit arbitrage). It does not appear to us that it would have been difficult for Coventree to determine its revenue derived from credit arbitrage transactions and there is nothing preventing the disclosure of that information in the Prospectus. It also appears to us to be information that an investor reading the Prospectus would want to know.

[234] Accordingly, we do not accept the submissions set out in paragraph 221 of these reasons as valid grounds for not making clear in the Prospectus the importance of credit arbitrage transactions to Coventree's business.

Disclosure in the Prospectus

[235] Having said that, it is clear from the Prospectus that Coventree was engaged through its sponsored conduits in both traditional securitization transactions and credit arbitrage transactions. We accept that a reader of the Prospectus could determine, based on a careful reading, that credit arbitrage assets represented approximately 44% of the assets held by Coventree sponsored conduits (see paragraph 225 of these reasons) and that credit arbitrage transactions represented approximately 54% of Coventree's total investments (see paragraph 226 of these reasons).

[236] We also note that the Prospectus discloses that Nereus, Coventree's 75.5% owned subsidiary at the time, "focuses principally on structured credit arbitrage" and that "Nereus has close to $3 billion in fundings outstanding" (Prospectus, at p. 26). The total combined fundings of Coventree and Nereus conduits were $14.9 billion at the time. Accordingly, a reader would know from the Prospectus that Nereus focused principally on credit arbitrage and that it had fundings outstanding of close to $3 billion, representing approximately 20% of Coventree's total fundings.

[237] At the same time, the Prospectus gives much less emphasis to Coventree's direct involvement in the credit arbitrage business. For instance, the Prospectus states that:

> Coventree establishes multi-seller, multi-asset securitization conduits which are funded principally with ABCP, including ECP [extendible commercial paper]. Currently, the fundings outstanding in Coventree sponsored conduits are approximately $12 billion. Coventree engages in similar activities through its credit arbitrage securitization and asset management activities.
>
> (Prospectus, at p. 18)

That statement could be read as suggesting that credit arbitrage transactions were not included in the $12 billion of outstanding fundings, but the statement at least suggests that credit arbitrage is a secondary activity.

[238] Coventree also states in the section of the Prospectus describing Nereus that:

> Currently, Nereus focuses principally on structured credit arbitrage. Coventree's business is more diversified in nature, but some similarities exist between the business of Coventree and Nereus.
>
> (Prospectus, at p. 26)

That statement seems misleading when one realizes that approximately 80% of Coventree's revenues at the time were derived from credit arbitrage transactions.

[239] It is not up to investors reading the Prospectus to have to follow the somewhat convoluted and less than clear trail through the disclosure in the Prospectus, and through the disclosure in Coventree's financial statements contained in the Prospectus, to determine what proportion of Coventree's revenues or conduit assets were derived from credit arbitrage transactions. That information was important to investors given the competitive and other pressures that the credit arbitrage business was under (as described in the Prospectus). We also note in this respect that, in connection with the IPO, the underwriters applied different earnings multiples in valuing the credit arbitrage business and the traditional securitization business.

[240] *The Prospectus does not disclose that 80% of Coventree's revenues, or any other proportion of its revenues or conduit assets, were derived from credit arbitrage transactions as of the date of the Prospectus.*

[241] Accordingly, in our view, based on a fair reading of the Prospectus, the disclosure in the Prospectus on this subject was less than full, true and plain disclosure. We believe that a reader of the Prospectus would have been rightly surprised to be told that approximately 80% of Coventree's revenues were derived from credit arbitrage transactions.

[242] Mowat does not appear to have been aware until late June 2007 of the importance of credit arbitrage to Coventree's business. She sent an e-mail on June 27, 2007 to another Board member that stated, in part:

> … the Board meeting was awesome. Now the light bulb is going on for me and I wish we could get that into our disclosure …. I had no idea that over half the profit is from CDOs as opposed to traditional securitization and that the traditional business from an origination side had "dried up so much". David Allan's presence is timely. …

Mowat was Chair of the Coventree Audit Committee and signed the Prospectus on behalf of the Board.

[243] That statement is relevant because it suggests that investors would not have known how important credit arbitrage was to Coventree's business based on a review of the Prospectus. We

do not accept Mowat's testimony that her statement related only to her understanding of the nature or structure of CDO transactions.

Conclusion

[244] We have concluded that the disclosure in the Prospectus relating to the proportion of Coventree's business derived from credit arbitrage was less than full, true and plain disclosure. There was less than full disclosure of the proportion of Coventree's revenues or conduit assets that were derived from credit arbitrage transactions and the information on that topic was not plain to a reader of the Prospectus. However, we have concluded that one would fairly conclude based on a careful reading of the Prospectus that a significant portion of Coventree's business, measured by revenues or conduit assets, was derived from credit arbitrage transactions. One would not know that the proportion of Coventree's revenues derived from credit arbitrage transactions was approximately 80%, but one would know the proportion was substantial.

[245] We have not concluded that the Prospectus failed for this reason to provide full, true and plain disclosure of all *material facts*. Staff did not make that allegation and we have not addressed it.

(b) The Credit Arbitrage Business Was Dying

Coventree Submissions

[246] Coventree also submits that it was disclosed in the Prospectus that the credit arbitrage business was "dead or dying" and that Coventree expected in the future to do only the occasional, one-off credit arbitrage transaction. Coventree submits, based in part on the disclosure in the Prospectus referred to in paragraphs 247 to 249 of these reasons, that an investor would expect that Coventree's future growth would come from its investment in new businesses such as its efforts as part of the Chapter Two initiatives to establish a U.S. conduit, a Canadian retail bank, and an asset management business. Coventree also submits that an investor would expect that, while Coventree built these new businesses over the ensuing years, its net income could be flat or declining. Coventree submits that is the result of combining the expectation that revenues from the credit arbitrage business were not likely to grow significantly in the future with the expectation that Coventree would be incurring significant costs associated with its planned diversification.

Relevant Disclosure in the Prospectus

[247] The Prospectus discloses that:

> Past accomplishments don't guarantee future successes. At least part of these achievements are derived from fortuitous timing, and many of the more recent years' results are derived from anomalous, one-time events. One-time events include unique up-front structuring fees, sale/termination of transactions fees and the gain on the sale of shares from certain investments.
>
> (Prospectus, at p. 32)

[248] The Prospectus discloses that there was increasing competition and a narrowing of spreads in Coventree's credit arbitrage business. The Prospectus states that the expectation of Coventree's leaders is that "potential returns on credit arbitrage [will] become further compressed due in part to competition in that market …" (page 28 of the Prospectus) and that new entrants into the market puts "additional pressures on margins in the credit arbitrage business where spreads have narrowed dramatically …" (page 32 of the Prospectus). The Prospectus states that:

> There has also been a decline in spreads in the credit arbitrage business. If this trend continues or if credit spreads remain tight, the average spread on the credit arbitrage assets will decrease in the future resulting in lower revenue.
>
> (Prospectus, at p. 38)

[249] Coventree concludes in the Overview section of Management's Discussion and Analysis of Financial Condition and Results of Operations in the Prospectus that:

> As a result of all the above, the leaders of the Company believe that *net income growth* excluding AcG-15 could be flat if not declining for the next few years and expect volatility in short term quarterly results. [emphasis added]
>
> (Prospectus, at p. 33)

[250] Accordingly, the Prospectus alerts investors to the narrowing spreads and increased competition in the credit arbitrage business and the possibility that Coventree would have flat or declining "net income growth" in the future and volatility in short term financial results.

[251] Despite the increased competition in the credit arbitrage business and the fact that credit arbitrage transactions had become less profitable, Coventree continued to enter into credit arbitrage transactions in the two month period leading up to the filing of the Prospectus, generating total revenue backlog of approximately $37 million from four transactions. In addition, Coventree's business plan, developed in May 2006, and updated in September 2006, contemplated new credit arbitrage fundings of over $4 billion. That is approximately 50% of Coventree's projected total fundings for its 2007 financial year of $9.5 billion (excluding Nereus).

Discussion

[252] In our view, while a reader of the Prospectus would conclude that there were significant challenges to the credit arbitrage business going forward, they would also conclude that credit arbitrage would continue to be a substantial portion of Coventree's business. There is no express statement in the Prospectus that Coventree even intends to shift its strategic focus from credit arbitrage to traditional securitization transactions (perhaps because of the failure to clearly disclose the importance of Coventree's credit arbitrage business in the Prospectus).

[253] We would add that the Prospectus indicates that Coventree's:

> … expanded corporate objective is to become a financial services company focused on niches. Targeted niches include structured financing using securitization technology, conduit administration outsourcing services for third parties, asset management and private equity investments in synergistic enterprises, as well as eventual entry into certain retail banking activities.
>
> (Prospectus, at p. 18)

Establishing a U.S. conduit, a Canadian retail bank and an asset management business were Coventree's so-called "Chapter Two" initiatives (see paragraphs 106 to 111 of these reasons). The Prospectus discloses that "[m]any of these initiatives are in the initial or early planning stages, and there is no assurance that all, or any, of Coventree's current growth experiments will be successful" (Prospectus, at p. 18).

[254] None of the Chapter Two initiatives had been established by the time of the Prospectus and none of them had contributed any revenue to Coventree prior to the occurrence of the market disruption on August 13, 2007. To the contrary, the Chapter Two initiatives were expected to give rise to substantial costs before they were fully implemented.

[255] Coventree submits that one of the reasons why changes in its securitization business were not material to investors is because Coventree had changed its strategic focus and was moving forward with the Chapter Two initiatives. We do not accept that submission. In our view, based on the disclosure in the Prospectus, investors in Coventree would have been focused on its successful securitization business which had generated the substantial financial results described in the Prospectus. That is confirmed by the Roadshow Presentation that highlighted, among other factors, Coventree's "solid financial performance" and "strong core business to fund growth" (see paragraph 259 of these reasons). The Chapter Two initiatives were acknowledged by Coventree to be "experiments" and, in our view, had not been sufficiently advanced to form a significant reason why investors would purchase shares under the Prospectus.

[256] Coventree was in the securitization business. Its financial results at the time of the Prospectus were primarily derived from the credit arbitrage business, although its focus going forward was shifting to the traditional securitization business, to providing third-party conduit administration and to the Chapter Two initiatives. Allan joined Coventree on January 22, 2007, in part, because of the expected shift in focus to the traditional securitization business. There is no doubt, however, that Coventree's financial success to the date of the Prospectus was based on its securitization business and, in particular, credit arbitrage.

[257] *In our view, a reader of the Prospectus would not have fully understood the significance of credit arbitrage to Coventree's business and financial success and would not have known that Coventree considered that business to be dead or dying or that Coventree expected in the future to carry out only occasional, one-off credit arbitrage transactions. The Prospectus does not say that.*

[258] Further, if that expectation was true, it would mean that Coventree was for all intents and purposes out of the credit arbitrage business. That itself raises a question whether appropriate disclosure was made in the Prospectus.

The Roadshow Presentation

[259] Coventree prepared a roadshow presentation (the "**Roadshow Presentation**") in connection with the marketing of the shares offered under the Prospectus. The Roadshow Presentation highlighted, among other factors, Coventree's "solid financial performance" and "strong core business to fund growth". The Roadshow Presentation also notes as "strengths" that Coventree has a "proven track record in growing businesses", a "stable annuity income stream from program fees" and "income from highly rated assets sold to conduits".

[260] Among the weaknesses identified in Coventree's business are "historical performance not necessarily indicator of future performance", "assets beginning to come to end of term", "maturing markets, new entrants – margin pressures", "investments in growth experiments" and "extreme leverage".

[261] New fundings are shown as $5.9 billion to June 2006 (i.e., for the three financial quarters ended on that date) compared to full 2005 prior year fundings of $5.8 billion.

[262] There is a page forming part of the Roadshow Presentation entitled "Profitability Growth". That page contains a graph showing Coventree profitability for the previous seven financial years and for the three quarters ended June 2006. Profitability shows very large increases from 2002 to 2005. Profitability for the three quarters ended June 2006 equals profitability for all of 2005. Past that date, the profitability line becomes dotted and shows a dip in profitability, characterized as "Short-Term Flat or Declining", followed by an increasing dotted line characterized as "Theoretical Chapter Two Curve". The dip falls to $15 million (which is above normalized net income for 2005 and for the period ended June 2006) before trending up. The graph is intended to represent the shift in Coventree's profitability as a result of the Chapter Two initiatives.

[263] There is no direct reference in the Roadshow Presentation to credit arbitrage transactions, although inferentially one might conclude that the dip in profitability going forward is as a result of challenges and competition in credit arbitrage. There is, however, no express distinction made between credit arbitrage transactions and traditional securitizations in the Roadshow Presentation. Further, no direct reference is made to revenue backlog, except for the comments referred to above with respect to a "stable annuity income stream from program fees" and "income from highly rated assets sold to conduits". There are no numbers associated with these statements.

[264] The overall message from the profitability graph is that there will likely be a dip in Coventree's profitability as it moves to the Chapter Two initiatives, but growth in profitability is expected thereafter.

[265] In our view, however, an investor would not have understood from the Roadshow Presentation (based only on the written material submitted in evidence) the full significance of the credit arbitrage business to Coventree's financial success and would not have known that Coventree considered that business to be dead or dying or that Coventree expected in the future to do only occasional, one-off credit arbitrage transactions.

[266] We would add that the Roadshow Presentation was not part of the Prospectus and the information in that presentation was not generally disseminated to investors. We have referred to the Roadshow Presentation simply because it represents information that was provided by Coventree to some investors as part of the distribution of shares under the Prospectus. It is evidence of what Coventree was saying to investors at the time of the Prospectus.

Risk Factor Disclosure

[267] There is no question that the Prospectus contains extensive risk factor disclosure that addresses many of the events that ultimately occurred and are relevant to this proceeding. In particular, the Prospectus discloses the following risks affecting Coventree and Coventree sponsored conduits that are relevant for our purposes:

(a) "liquidity risk (inability to sell financial instruments or other assets in the market in the ordinary course)" (Prospectus, at p. 58);

(b) "market disruption risk (the risk that difficulties affecting one or more other financial institutions causes systemic repercussions to the financial system including the inability to roll funding)" (Prospectus, at p. 58);

(c) the risk that "[i]f the supply of available ABCP exceeds the demand for such securities from investors in Canada, this market will no longer provide a reliable funding source for Coventree sponsored conduits" (Prospectus at p. 58) and the risk that "[w]ith less investor demand, the Company would have no assurances that the conduits the Company sponsors could raise funds in a timely or economical manner and would be forced to limit their ABCP issuance accordingly" (Prospectus, at p. 59);

(d) the risk of a market disruption that "would not only prevent conduits sponsored by Coventree from issuing new paper necessary to acquire new deals but also could prevent the conduits from rolling their outstanding ABCP" (Prospectus, at p. 59);

(e) the risk that "[a]lthough Coventree has no legal obligation to fund the conduits to buy back ABCP from investors in the event of a disruption, Coventree's reputation in the industry and on going ability to access the capital markets could be severely adversely impacted if it did not or could not do so" (Prospectus, at p. 59);

(f) "[t]he potentially limited size of the ECP [extendible commercial paper] market in Canada", and the fact that the issue of extendible commercial paper "has been a major driver of Coventree's growth to date" (Prospectus, at p. 59);

(g) the risk that "a relatively high percentage of the outstanding ABCP issued by its conduits has been purchased by a small number of ABCP investors", including the fact that, "at certain times, a substantial minority percentage of the securities issued by its conduits has been purchased by one investor, the Caisse" (Prospectus, at p. 60);

(h) the risk that "[i]f the spread between CDOR and the interest rates payable on the ABCP issued by the Company's conduits widens, the Company's revenues can be materially decreased" (Prospectus, at p. 60);

(i) the risk that securitization transactions executed in Coventree sponsored conduits "often involve buying long-term assets that typically pay a fixed interest rate and funding these assets with short-term floating rate ABCP" (Prospectus, at p. 62);

(j) the risk of increased reliance by investors on Coventree because the ABCP market and the assets funded by the conduits are generally opaque to investors (Prospectus, at p. 63); and

(k) the risk of reliance on DBRS as sole provider of rating services to Coventree (Prospectus, at p. 64).

[268] Clearly, the risk factor disclosure in the Prospectus is extensive and comprehensive. As a result, investors in Coventree shares offered under the Prospectus cannot validly take the position that they were unaware of the material risks to which Coventree's business was subject. At the same time, however, disclosure of a risk to which a business is subject is quite different than the actual occurrence of an event reflected in the risk factor. When an event that is material to the business actually occurs and gives rise to a material change, an issuer will have a disclosure obligation regardless of whether the risk giving rise to the material change had been previously identified and disclosed. The previous disclosure of risk factors does not affect or qualify an issuer's obligation to disclose material changes, when they occur, in accordance with section 75 of the Act.

(c) Conclusion

[269] The disclosure deficiencies discussed under "Other Prospectus Disclosure Issues" (commencing at paragraph 216 of these reasons) made it much more difficult for public shareholders and potential investors to fully understand and assess the significance to Coventree's business of the subsequent events and developments discussed in these reasons.

X. DID A MATERIAL CHANGE OCCUR AS A RESULT OF THE DBRS JANUARY RELEASE?

1. Background

(a) Staff Allegation

[270] On January 19, 2007, DBRS issued the DBRS January Release announcing changes to its rating criteria for CDO related SFA transactions entered into by commercial paper issuers. A copy of the DBRS January Release is set out in Schedule D.

[271] Staff alleges that the DBRS January Release constituted a material change with respect to Coventree that was required to be disclosed in accordance with section 75 of the Act.

(b) Coventree Submissions

[272] Coventree submits that the DBRS January Release did not change Coventree's business or operations in any way, let alone materially. Coventree reiterates its submissions with respect to the credit arbitrage business referred to in paragraph 246 of these reasons. In particular, Coventree submits that the DBRS January Release was not material because Coventree did not expect credit arbitrage to be a significant source of future growth or revenues and the release did not affect a single transaction that Coventree was then proposing.

[273] Coventree also submits that it is clear that the DBRS January Release was not material because there was no significant change in Coventree's share price after disclosure of the effect of that release on Coventree's business. Coventree submits that it made that disclosure on May 14, 2007 when it publicly filed its second quarter Management's Discussion and Analysis ("**MD&A**") for the period ending March 31, 2007 ("**Q2 MD&A**") (see paragraph 327 of these reasons).

[274] Coventree submits that because of its substantial revenue backlog at the time, the DBRS January Release was expected to have little impact on Coventree's revenues over the ensuing three years. Coventree submits that its revenue backlog gave it a "three year runway" of revenues to advance the Chapter Two initiatives.

[275] Coventree submits that the DBRS January Release applied only to CDO related SFA transactions and that Staff has failed to prove what portion of its business related to those types of transactions. Coventree submits that failure is fatal to Staff's case on this issue.

[276] Finally, Coventree submits that any changes to its business or operations as a result of the DBRS January Release were changes resulting from external events and developments in credit markets that were widely reported in the media. As a result, Coventree did not have a disclosure obligation with respect to those events or developments. In this respect, Coventree relies on the principle underlying section 4.4 of NP 51-201 (see paragraph 152 of these reasons).

(c) Cornish Submissions

[277] Cornish submits that the meaning and effect of the DBRS January Release was not clear when it was issued on January 19, 2007. Cornish questioned at the time whether DBRS intended to introduce a requirement for global style liquidity and whether the new criteria would apply to existing transactions. He therefore discussed the DBRS January Release internally at Coventree and a Coventree employee contacted DBRS to attempt to determine the meaning of the DBRS January Release with respect to those matters.

[278] Cornish submits that he viewed the DBRS January Release as a further example of DBRS's restrictive approach to the ABCP market and its attempt to address its concerns about the growth of CDO related SFA transactions and LSS transactions in particular. Among other things, the DBRS January Release reiterated DBRS's concerns about the growth of the ABCP market and the increasing number of SFA transactions, as previously expressed in the DBRS November Letter and in the year leading up to the issue of the DBRS November Letter. Cornish submits that the DBRS January Release also reconfirmed DBRS's confidence in the quality of assets backing ABCP generally.

[279] Cornish submits that Coventree's public filings already disclosed the fact that credit arbitrage transactions would not be a significant source of future growth or revenues for Coventree, particularly given the Chapter Two initiatives being pursued and limitations on the capacity of the ABCP market for future growth. As a result, Coventree public shareholders or investors could not reasonably have concluded that credit arbitrage transactions would continue to generate significant revenues for Coventree in the longer term.

[280] Further, Cornish says that he discussed the DBRS January Release with Tai and concluded that the terms of the DBRS January Release would not have an immediate impact on Coventree from a financial perspective. Given the grandfathering of existing transactions, Cornish concluded that Coventree's credit arbitrage revenue would be largely unaffected. Further, Coventree already had a substantial revenue backlog derived from credit arbitrage transactions that was unaffected.

[281] Cornish submits that Coventree approached DBRS to discuss the new global style liquidity requirement and potential consequences to the ABCP market. Based on the reports he received from Allan, Cornish submits that he reasonably formed the impression that DBRS might modify the new criteria to address Coventree's concerns with respect to the global style liquidity requirement. Cornish reiterates that DBRS had a history of announcing new restrictive criteria and then reversing or changing its position.

[282] Cornish submits that it was not until the middle of February 2007, that Coventree came to understand that DBRS would not be adopting alternative suggestions or proposals made by Allan to DBRS.

[283] Cornish submits that in preparing the Q2 MD&A, he wanted to convey to Coventree public shareholders and investors the fact that the DBRS criteria would have an impact on Coventree's credit arbitrage business. However, Cornish submits that it was difficult to determine the extent of the impact on Coventree's profitability and whether the new criteria would bring Coventree's credit arbitrage business to a halt. In any event, it would not have a material impact on Coventree because credit arbitrage transactions were not a part of Coventree's Chapter Two initiatives.

[284] Cornish submits that he discussed the DBRS January Release with Tai and others, and together they concluded that the DBRS January Release was not a material change and that no disclosure was required, other than in Coventree's quarterly MD&A filings.

[285] Cornish also adopts Coventree's and Tai's submissions on this issue.

(d) Tai Submissions

[286] Tai submits that he and Cornish discussed the materiality of the DBRS January Release. They considered whether it would affect the way shareholders viewed Coventree and concluded that it would not and was therefore not a material change with respect to Coventree.

[287] Tai also submits that the import of the DBRS January Release was not immediately apparent. Cornish and Allan both viewed it as an invitation to further discussions with DBRS.

Tai submits that this was an entirely reasonable perception, given that DBRS had been open to feedback from market participants in the past.

[288] Tai also submits that Staff presented no evidence of the market impact of the DBRS January Release. Coventree's public disclosures in February and May 2007 caused little if any market reaction. Tai submits that Staff have not alleged that those disclosures were deficient or misleading in any respect. Accordingly, if the market did not react significantly to those disclosures (and it did not), it should be presumed that the market would not have reacted significantly to the news release that Staff now says Coventree should have issued.

[289] Tai also adopts Coventree's and Cornish's submissions on this issue.

(e) Summary of the DBRS January Release

[290] The DBRS January Release is attached as Schedule D to these reasons. The following is a summary of the relevant provisions of that release for our purposes.

[291] The DBRS January Release indicated that the securitization market had grown rapidly over the preceding two years with growth largely due to SFA transactions. The most common type of SFA transaction involved collateralized debt obligations that referenced corporate obligations. DBRS said that, recently, LSS transactions had been the most prevalent type of CDO transaction. SFA transactions represented approximately 30% of the ABCP market and LSS transactions represented approximately 22% of the market.

[292] DBRS also stated in the DBRS January Release that it had recently declined to approve many SFA transactions proposed by commercial paper issuers and that DBRS believed it appropriate to outline the basis upon which it would find new SFA transactions acceptable. DBRS stated that it would "*welcome the opportunity to consider*" CDO related SFA transactions that met four enumerated criteria that included resilient credit characteristics, limited exposure to one industry or non-investment grade entities and a superior level of information disclosure to ABCP investors. The key criterion for our purposes was a requirement that such transactions be:

> … supported by liquidity facilities from DBRS-approved liquidity providers that contain conditions to draw that are not limited to market disruption and are not dependent on a confirmation of the then-current ratings …

In effect, that is a statement that Canadian style liquidity would no longer be acceptable.

[293] DBRS also advised market participants in the DBRS January Release that the changes to its methodology were effective immediately and applied to all SFA transactions. The DBRS January Release stated that for non-CDO related SFA transactions that involved publicly traded instruments that were "deemed to have robust credit and liquidity characteristics, alternative mechanisms may be available to mitigate the risks" described in the release. Accordingly, DBRS would review non-CDO related SFA transactions on a case by case basis to determine whether they mitigated the risks described in the release.

[294] DBRS also stated its expectation that no existing Canadian ABCP ratings would be affected by the DBRS January Release and advised that the term "ABCP" used in the release

applied to "all forms of notes issued by a CP Issuer including extendible commercial paper, fixed or floating rate notes and medium term notes".

2. Analysis

(a) DBRS's Requirement for Global Style Liquidity

[295] We find that the DBRS January Release, at the time it was issued on January 19, 2007, imposed a requirement for global style liquidity arrangements for CDO related SFA transactions. Until that time, DBRS had been prepared to rate ABCP issued in CDO related SFA transactions that had the benefit of Canadian style liquidity. As discussed in paragraphs 70 and 71 of these reasons, Canadian style liquidity imposed two conditions on the obligation of a liquidity provider to provide liquidity in support of ABCP. The first requirement was that a general disruption of the ABCP market had occurred. That meant that the disruption had to relate to the overall ABCP market and not just to certain issuers or note series (although the specific terms of the relevant provisions contained in liquidity agreements varied). The second requirement was that DBRS had confirmed the credit rating of the relevant ABCP. That meant that there could be no material degradation in the credit quality of the assets supporting the ABCP. DBRS was the only credit rating agency that would rate ABCP with the benefit of Canadian style liquidity. DBRS stated that it did so on the basis of the credit quality of the underlying assets.

[296] *The DBRS January Release represented a continuation of DBRS's concerns with respect to developments in the credit arbitrage market expressed in the DBRS November Letter (less than three months before) and represented an escalation of DBRS's response to those concerns.* The importance of the DBRS January Release should be assessed in that context. We note, in this respect, that Tai had, in the first instance, viewed the DBRS November Letter as very negative to Coventree's business (see paragraph 183 of these reasons).

[297] Allan testified that prior to the DBRS January Release, DBRS had tried unsuccessfully to slow the credit arbitrage market but each time, to use a bicycle example, the bicycle kept on rolling. Then, in January, in Allan's words, DBRS said "… okay. Here comes the steel pipe through [the spokes]. You've got to have global style liquidity in order to do these transactions. And that stopped the bike dead in its tracks". That conclusion was represented by an image in the April Investor Presentations showing a bicycle with a pole through the spokes. In his testimony, Allan attempted to qualify the significance of that image in a manner that we did not find persuasive. The conclusion reflected in the April Investor Presentations was:

> Structured Finance assets require:
>
> - Liquidity to support extension risk (no ECP)
> - Liquidity must be "global-style"

[298] *DBRS knew the importance of Canadian style liquidity to the Canadian ABCP market and would not have required global style liquidity pursuant to the DBRS January Release without knowing the significant market impact of doing so.*

[299] Loke testified that the DBRS January Release was intended to be clearer than the DBRS November Letter, although he acknowledged in cross-examination that the DBRS January Release did not, by the language used, expressly state that global style liquidity was being required. He also acknowledged that a number of other market participants contacted DBRS for clarification on that and other issues raised by the DBRS January Release.

[300] For instance, on January 22, 2007, Terrence McCarthy (of Citibank) sent an e-mail to James Feehely (of DBRS) that stated:

> Based on our discussions with Mike B [of DBRS], it sounds like there is going to be a follow on criteria letter that may be published before the end of the month, which will expand Friday's criteria memo.

On January 23, 2007, David Reese (of Securitus Capital Corp.) sent an e-mail to Jireh Wong (of DBRS) that stated that "[a]gain, the DBRS announcement seems to have left many more questions unanswered than it answered".

[301] Because of the somewhat ambiguous language of the DBRS January Release referred to in paragraph 292 of these reasons, Coventree sought clarification from DBRS on January 22, 2007, the next business day after the issue of the DBRS January Release, with respect to whether global style liquidity was being required. DBRS confirmed that the release meant that global style liquidity was being required for all CDO related SFA transactions. We do not accept that, subsequent to that conversation, Coventree had any uncertainty that the DBRS January Release was requiring global style liquidity for CDO related SFA transactions. Market participants may have had other questions with respect to the application of the DBRS January Release, but, in our view, Coventree should have been clear that it required global style liquidity.

[302] Loke stated in his testimony that there were no new CDO related SFA transactions (other than grandfathered transactions) approved by DBRS after November 10, 2006 that did not have global style liquidity. Cornish testified that there were four relatively small Coventree or Nereus sponsored *non-CDO related SFA transactions* that were completed in March and April 2007 in an aggregate principal amount of $169 million. Those transactions were presumably approved by DBRS on a case by case basis pursuant to the terms of the DBRS November Letter and the DBRS January Release. We understand that those four transactions were all of the Coventree sponsored securitization transactions that were completed in 2007 prior to the market disruption on August 13, 2007. DBRS subsequently approved two bank-sponsored CDO related transactions, both of which were supported by global style liquidity.

[303] Cornish stated during his examination by Staff in April 2009 that he knew that the "window" for CDOs was closing but the window closed faster than he thought it would.

[304] In an e-mail to his fellow Nereus board members dated February 1, 2007, Tai stated:

> As you can imagine, given the recent DBRS letter, the entire industry is in an extremely tenuous and fragile situation with regard to the credit arbitrage business.

[305] On February 9, 2007, DBRS held a conference for investors which addressed the rating approval changes introduced by the DBRS January Release. The presentations reiterated that DBRS was requiring global style liquidity facilities for future CDO related SFA transactions and that existing ratings for SFA transactions would not be affected by the change (i.e., existing transactions would be "grandfathered" and would continue to have the benefit of general market disruption style liquidity arrangements). DBRS also confirmed that ratings for traditional securitization transactions would not be affected. Conduit sponsors were not invited to attend this presentation but Coventree was later provided with a copy of the presentation slides.

[306] Homer confirmed in his testimony that he knew, after the February 9, 2007 DBRS investor conference, that DBRS was requiring global style liquidity for "new transactions".

[307] The Coventree disclosure committee did not meet to discuss the materiality of the DBRS January Release. Cornish testified that he and Tai discussed the issue and concluded that the DBRS January Release did not constitute a material change with respect to Coventree.

(b) Change in Coventree's Business

[308] The DBRS January Release stated, in effect, that future CDO related SFA transactions would not be rated by DBRS unless they had the benefit of global style liquidity. Coventree knew that it could not obtain global style liquidity for Coventree or Nereus sponsored conduits. Tai confirmed that global style liquidity was not available to Coventree in a sworn affidavit dated March 1, 2007 filed on behalf of Coventree in its litigation with Nereus. Tai stated that:

> I know of no liquidity providers that are prepared to offer liquidity for credit arbitrage transactions on the terms required by DBRS. As a result, I believe that Nereus' current business model is no longer viable.

[309] That also means that as of March 1, 2007, Coventree knew that the CDO related credit arbitrage portion of its own business was "no longer viable" given the requirement for global style liquidity. Further, Nereus was a 75.5% subsidiary of Coventree at that time.

[310] Allan confirmed in his testimony that it was highly unlikely that Coventree could obtain global style liquidity. Loke testified that Allan told him on January 29, 2007 that global style liquidity was not available to Coventree. We accept Loke's testimony on this issue. We acknowledge that Allan testified that he did not recall that portion of their conversation.

[311] Ultimately, DBRS applied the DBRS January Release and its requirement for global style liquidity to all credit arbitrage transactions. In an e-mail to Tai and Child on May 4, 2007, Cornish stated that:

> One thing that I think we should include, maybe even highlight, in our MD&A for Q2 is the fact that, in Q2, DBRS has changed the rules for CDOs that will make it very unlikely, if not impossible, to do more CDOs in our conduits. In addition, we are discovering that DBRS is taking the view that this new policy extends to other "structured" investments too that are not CDOs. We should go back and see what we have said on this in the past but we need to be very clear on this now – although we have said something about this in the past and the

> potential for this to happen, it has now happened. *It is important for people to understand – it will bring that part of our business to a halt at least for a while, if not forever, within Canada*. [emphasis added]

Cornish testified that it was this conclusion as to the wider application of the DBRS January Release (never formally confirmed by DBRS) that led to the disclosure in its Q2 MD&A (referred to in paragraph 327 of these reasons) that DBRS's new criteria would "have the effect of reducing the profitability of the Company by substantially curtailing its ability to grow, if not halt in the short-term, its credit arbitrage business" (see our conclusion as to the significance of that statement in paragraph 328 of these reasons).

[312] We would add that the DBRS January Release was also applied by DBRS to extendible ABCP, or E notes, issued in SFA transactions, thereby requiring global style liquidity for that category of E notes. Coventree stated in the April Investor Presentations that "[t]his action [DBRS's revised CDO criteria] rules out the use of ECP [extendible commercial paper] to fund SFA transactions". The April Investor Presentations noted that "[i]n 2006, 77% of the $7.3 billion in new ECP [issued in the overall market] was backed by SFA". Coventree sponsored conduits had approximately $8.5 billion of E notes outstanding, representing 57% of the extendible ABCP outstanding in the overall ABCP market (see paragraph 460 of these reasons). However, only a portion of those E notes related to SFA transactions.

[313] A very substantial portion of Coventree's business was structuring and managing conduits that carried out CDO related SFA transactions. Coventree did not have access to global style liquidity arrangements. As a result of the DBRS January Release, Coventree could not carry out any new CDO related SFA transactions through its conduits, including the Nereus sponsored conduits. Non-CDO related SFA transactions were subject to case by case review by DBRS as contemplated in the DBRS January Release. *Accordingly, in our view, it is clear that the DBRS January Release resulted in a direct change to Coventree's business within the meaning of the term "material change" in the Act*. Coventree knew that on January 22, 2007.

[314] The question remains, however, whether the DBRS January Release and its effect on Coventree's business was material. If the DBRS January Release would reasonably be expected to have had a significant effect on the market price or value of Coventree shares, then it was a "material change" with respect to Coventree within the meaning of the Act.

(c) Effect of the Change on Market Price or Value

[315] In considering the materiality of the DBRS January Release, we have considered the following matters and disclosures made by Coventree.

2006 Annual Report and Letter to Owners

[316] Coventree's 2006 Annual Report was filed on SEDAR and made available to the public on February 14, 2007. The Annual Report contained a Letter to Owners (the "**Letter to Owners**") that stated, in part, as follows:

> Also, the size of the Canadian ABCP market has expanded rapidly over the past two years, with growth largely being attributed to the contemporaneous

> proliferation of credit-arbitrage-type transactions. As a result, Dominion Bond Rating Service Ltd. ("DBRS"), the current sole provider of rating-agency services for asset-backed commercial paper conduits, is changing their ratings methodology to become more rigid and less accommodating. *This could have a negative impact on Coventree's business, but likely will have a more serious effect on our majority-owned subsidiary Nereus, given that it is less diversified than Coventree.* The change in ratings methodology will not affect any existing transactions and thus will not alter our immediate financial results, but it will likely influence future growth prospects. [emphasis added]
>
> (Coventree 2006 Annual Report, "Letter to Owners" at p. 3)

[317] The Letter to Owners then commented on DBRS's criteria for credit arbitrage transactions:

> The one issue we would like to address here is that DBRS is increasingly concerned about the rapid growth in credit-arbitrage transactions, which now represent approximately 30% of the Canadian ABCP market. *DBRS recently issued a letter stating that they are going to dramatically increase the criteria required to execute credit-arbitrage transactions. As we have discussed in previous letters, the leveraged super senior "arbitrage" transactions are finally going away as many new participants have entered the market to eliminate the arbitrage*. [emphasis added]
>
> (Coventree 2006 Annual Report, "Letter to Owners" at p. 7, under "Industry Overview")

[318] Coventree concluded the "Industry Overview" section of the Letter to Owners by stating that it believed that DBRS's new criteria would bring stability to the ABCP market:

> We welcome this news as it will provide more stability in the capital markets that we fund. We have long foreseen these events and have actively started to diversify into areas such as conduit administration and geographies such as Denver. Although we have continued to execute this type of business, we have also insulated ourselves to a certain extent through the spin-off and creation of Nereus. Unfortunately, Nereus has not actively branched out into other financial intermediation businesses, as we further discuss in a later section. In the short-term, this will invariably slow our growth, but this will give us more time to tend to the new seeds we are planting and we continue to view our long-term prospects positively.
>
> (Coventree 2006 Annual Report, "Letter to Owners" at p. 7)

[319] Finally, in the portion of the Letter to Owners addressing Coventree's investment in Nereus, Coventree stated that:

> Although our original objective in creating Nereus was to focus on credit arbitrage transactions, our long term plan for Nereus was to diversify into other

> capital intermediation businesses. Our view was that the credit arbitrage business alone was not sustainable in the long term. In addition, we wanted to bring other business partners into Nereus. This would have provided Coventree with an opportunity to realize on a portion of its investment in Nereus and also would have provided Nereus with the opportunity to reduce its reliance upon Coventree and to build a more diversified shareholder base. *As events have unfolded, our original view of the credit arbitrage business has proven to be all too accurate. As previously discussed, DBRS has recently taken a series of steps that will likely substantially curtail the growth of the credit arbitrage business (as opposed to the traditional securitization transactions*). *However, Nereus did not diversify its business as originally intended. In our view, Nereus' current business model is not viable in the long term …* . [emphasis added]
>
> (Coventree 2006 Annual Report, "Letter to Owners" at p. 22, under "Nereus Financial Inc.")

[320] It appears that the comments reproduced in paragraphs 316 to 319 of these reasons address the DBRS November Letter, although there are references in the Letter to Owners that could be to the DBRS January Release. The Letter to Owners was publicly filed on February 14, 2007, after the issue of the DBRS January Release.

Q1 MD&A

[321] In its first quarter MD&A for the three months ended December 31, 2006 ("**Q1 MD&A**") (filed on SEDAR on February 14, 2007), Coventree made the following statement with respect to its credit arbitrage business and the effect of the DBRS initiatives:

> The leadership of Coventree continues to see increasing competition in the Company's existing markets. There are a number of new entrants that have entered or intend to enter the marketplace. This has the potential of impeding the Company's ability to grow at the same rates it has in the past. Furthermore, it places additional pressures on margins in the credit arbitrage business where spreads have narrowed dramatically compared to when Coventree first started financing this asset class through Canadian asset-backed commercial paper ("ABCP") conduits. With the increase in competition, Dominion Bond Rating Service Limited ("DBRS") has recently announced changes relating to the Canadian ABCP markets that are intended to protect or enhance the stability of that market. *While Coventree supports these initiatives, many of them will have the effect of reducing the profitability of the Company by substantially curtailing the ability to grow its credit arbitrage business*. [emphasis added]

That disclosure says essentially that the actions of DBRS will substantially curtail the ability of Coventree *to grow its credit arbitrage business*. That is quite different than saying that the credit arbitrage business is dead or dying or is no longer viable.

April Investor Presentations

[322] Allan prepared an image that was included in the April Investor Presentations (referred to in paragraph 297 of these reasons) to depict the effect of the DBRS January Release. That depiction showed a bicycle with a pole through the spokes. That meant that, at least by April 25, 2007, Allan considered the DBRS January Release to have essentially ended Coventree's credit arbitrage business including the issue of extendible ABCP in such transactions.

New Fundings

[323] New ABCP fundings were an important measure of the performance of Coventree's business. Coventree acknowledged in the Prospectus that new fundings were a "key driver for revenue" (see paragraphs 357 and 358 of these reasons).

[324] At a Coventree Board meeting held on May 11, 2007, Coventree senior management presented a "planning pyramid" document to the Board, which showed that Coventree was performing below plan in terms of new fundings and new revenue backlog. Coventree's failure to achieve the projected revenue backlog targets and fundings was attributed by management to the recent DBRS changes, namely, the DBRS January Release. Cornish testified that he did not agree with that assessment, but he agreed that "[t]he DBRS changes would have contributed to that to some degree" and that "the DBRS changes that had been occurring throughout the year in fiscal '06 is what – finishing up with or culminating in the January 19th release had an impact as well".

[325] Coventree's new fundings for the quarter ended March 31, 2007 were $0.5 billion, only half of its target for the quarter of $1 billion. With respect to new revenue backlog, Coventree had generated $2.1 million of new revenue backlog, only a fraction of its target for the quarter of $23 million. Mowat described these numbers as a "drastic fall off from plan" (see paragraph 329 of these reasons).

[326] We understand that the only Coventree sponsored CDO related SFA transaction pending at the time of the DBRS January Release was a transaction that Coventree and Nereus were working on with Merrill Lynch that was to be managed by Barclays Global Investors (the "**BGI Deal**"). The BGI Deal was negotiated in fall 2006 and was meant to close in December 2006. The transaction would have resulted in Coventree and Nereus conduits acquiring $600 million of new assets. The transaction was later lowered to $500 million (to be divided equally between a Coventree conduit and a Nereus conduit). During this time, Coventree and Nereus were involved in litigation against each other and DBRS decided that it would not rate the BGI Deal until Coventree and Nereus resolved the dispute. The dispute was settled but DBRS ultimately withdrew the grandfathered status of the BGI Deal in late April/early May 2007, just before Coventree issued its Q2 MD&A. DBRS required, in effect, global style liquidity for the BGI Deal. Cornish testified that the BGI Deal was financially significant to Coventree and that, had it closed, it would have created significant additional revenue backlog.

Q2 MD&A

[327] Coventree stated in its Q2 MD&A for the period ending March 31, 2007 that:

> … in January 2007, DBRS announced new criteria relating to transactions involving the purchase of structured credit products by Canadian ABCP conduits. The Company's view is that it will be very difficult, if not impossible, to satisfy these new criteria. *As a result, these changes will have the effect of reducing the profitability of the Company by substantially curtailing its ability to grow, if not halt in the short-term, its credit arbitrage business*. [emphasis added]

The Q2 MD&A was filed on SEDAR on May 14, 2007. Cornish testified that this disclosure was made because Coventree realized by that time that the DBRS January Release was being applied by DBRS to all credit arbitrage transactions.

[328] The statement in the Q2 MD&A set out in paragraph 327 of these reasons indicates for the first time that it will be "very difficult, if not impossible", to satisfy DBRS's new criteria and that the DBRS January Release will have the effect of "substantially curtailing its ability to grow, if not halt in the short-term," Coventree's credit arbitrage business. *In our view, that disclosure was an acknowledgement by Coventree on May 14, 2007 of the materiality of the DBRS January Release and, in effect, that it constituted a material change with respect to Coventree. Approximately 80% of Coventree's revenues for the quarter ended March 31, 2007, and for the previous quarter, were derived from credit arbitrage transactions* (see paragraph 222 of these reasons). The Q2 MD&A stated that this business may have been halted in the short term.

[329] On May 22, 2007, Mowat sent an e-mail to Child and the other Coventree directors, including Tai and Cornish, that stated:

> Regarding the Results of Operations there was discussion surrounding the New Backlog and the New Fundings and the drastic fall off from plan in the most recent quarter which was attributed to the recent DBRS changes? In the future plans it was discussed having these targets broken out between end user transactions vs. CDO type transactions. The recent DBRS changes have had a significant impact to the business and the MDA [*sic*] while stating this does need to make this plainer as well.

That e-mail suggests that the DBRS January Release had a significant adverse financial impact on Coventree's second quarter of 2007 (ending March 31, 2007) and that Coventree's Q2 MD&A needed to be clearer in breaking out financial targets based on whether they related to traditional securitizations or credit arbitrage transactions.

Comment on the Letter to Owners

[330] We would make the following further comments on the disclosure made by Coventree in the Letter to Owners.

[331] First, we note that the disclosure relates to credit arbitrage transactions generally, and not to any subset of such transactions such as CDO related SFA transactions or LSS transactions. Further, given Coventree's very significant involvement in credit arbitrage, it seems misleading to say that the DBRS November Letter "could have a negative impact on Coventree's business, but likely will have a more serious effect on … Nereus, given that it is less diversified than

Coventree" (see paragraph 316 of these reasons). That statement is similar to the statement in the Prospectus referred to in paragraph 238 of these reasons. At the time, Nereus was a 75.5% owned subsidiary of Coventree and 80% of Coventree's revenues were derived from credit arbitrage transactions.

[332] The Letter to Owners also indicates that Nereus' current business model was not viable in the long term. In contrast, the conclusion from the Letter to Owners with respect to Coventree's business appears to be that DBRS's actions "will likely substantially curtail the *growth* of the credit arbitrage business…" [emphasis added] (see paragraph 319 of these reasons). That is quite different than saying that the credit arbitrage business will be stopped in its tracks. Further, one is left with the impression that the DBRS initiatives will be less important to Coventree because of its traditional securitization business and its diversification. In the circumstances, we consider that to be a misleading impression.

[333] Further, the disclosure is made in a letter to owners, which suggests that the events discussed did not constitute a material change with respect to Coventree necessitating the issue of a news release.

[334] Finally, in our view, public shareholders and investors had insufficient information to be able to fully understand and assess whether a material change had occurred by reason of the DBRS actions described in the Letter to Owners. As discussed in these reasons, public shareholders and investors did not fully understand the importance of credit arbitrage transactions to Coventree's business. Further, public shareholders and investors did not know the business implications of the statement that "leveraged super senior "arbitrage" transactions are finally going away …" (see paragraph 317 of these reasons) or what substantially curtailing the "growth of the credit arbitrage business" likely meant to Coventree (see paragraph 319 of these reasons). Nor did public shareholders or potential investors know the timeframe over which such events would occur. Understanding the implications to Coventree's business of the statements made about the credit arbitrage business was also complicated by the fact that Nereus was a 75.5% subsidiary of Coventree at the time. In our view, the result is that public shareholders and investors could not fully understand or assess the materiality of the statements made in the Letter to Owners referred to above.

(d) Conclusions

[335] As we have concluded above, the DBRS January Release gave rise to a change in Coventree's business. At the time the DBRS January Release was issued, it in effect prevented Coventree from carrying out any future CDO related SFA transactions (other than any grandfathered transactions). The DBRS January Release also contemplated a case by case review by DBRS of non-CDO related SFA transactions.

[336] Cornish testified that approximately 40% of the assets of Coventree and Nereus sponsored conduits were attributable at the time to traditional securitizations, approximately 20% of assets were attributable to credit arbitrage transactions that did not involve CDOs and approximately 40% of conduit assets were attributable to CDO related SFA transactions. In our view, a reasonable shareholder or investor would consider Coventree's inability to carry out any future CDO related SFA transactions important information in making an investment decision

with respect to Coventree shares. It is only common sense that a shareholder or investor would want to know that Coventree was unable to carry on in the future a business that represented 40% of conduit assets.

[337] Accordingly, in our view, the DBRS January Release constituted a change in Coventree's business that would reasonably be expected to have had a significant effect on the market price or value of Coventree shares within the meaning of the term "material change" in the Act. As a result, we conclude that Coventree was obligated to disclose that material change in accordance with section 75 of the Act on January 22, 2007, the day that Coventree confirmed with DBRS that the DBRS January Release required global style liquidity for CDO related SFA transactions.

[338] Further, by April 25, 2007, Coventree knew that DBRS was applying the DBRS January Release to all credit arbitrage transactions, not just CDO related SFA transactions. Credit arbitrage transactions represented approximately 60% of conduit assets (40% of assets attributed to CDO related SFA transactions and 20% to credit arbitrage transactions not involving CDOs (see paragraph 336 of these reasons)) and approximately 80% of Coventree's revenues for its first, second and third quarters of 2007. In our view, a reasonable shareholder or investor would consider Coventree's inability to carry out any future credit arbitrage transactions important information in making an investment decision with respect to Coventree shares. Even if the materiality of the DBRS January Release was not reasonably apparent to Coventree on January 22, 2007 (which we do not accept), the materiality of that release should have been clear to Coventree by April 25, 2007 (see paragraph 322 of these reasons).

[339] Accordingly, in our view, by April 25, 2007, it was apparent that the DBRS January Release constituted a change in Coventree's business that would reasonably be expected to have had a significant effect on the market price or value of Coventree shares. Accordingly, in our view, it is absolutely clear that Coventree had an obligation by April 25, 2007, at the latest, to disclose the material change that occurred as a result of the DBRS January Release.

[340] We would add that Coventree would have known the full implications of the DBRS January Release for its business before April 25, 2007. We have focused on the April 25, 2007 date simply because it is clear based on the evidence related to the April Investor Presentations that Coventree had that knowledge by that date.

[341] Further, in our view, Coventree acknowledged on May 14, 2007 by its statements in its Q2 MD&A, the materiality of the DBRS January Release and, in effect, that it constituted a material change (see paragraph 328 of these reasons).

[342] Because the DBRS January Release constituted a "material change" within the meaning of the Act, Coventree was required to forthwith issue a news release on January 22, 2007, and to file a material change report as soon as practicable and in any event within 10 days following that date. Coventree failed to do so. Coventree thereby breached subsections 75(1) and (2) of the Act.

(e) Responses to Coventree's Other Submissions

CDO related SFA Transactions

[343] Coventree submits that Staff failed to prove the proportion of its revenues derived from CDO related SFA transactions at the time of the DBRS January Release and that failure was fatal to Staff's case.

[344] While there is evidence before us of the proportion of Coventree's revenues derived from credit arbitrage transactions as of the date of the DBRS January Release, there is no evidence as to the proportion of its revenues derived from CDO related SFA transactions. The latter are a subset of credit arbitrage transactions.

[345] Given our findings in paragraphs 337 and 339 of these reasons, it is not necessary for us to address this submission.

No Change in Market Price of Coventree Shares

[346] Coventree also submits that there was no change in the market price of its shares as a result of the disclosure in its Q2 MD&A related to the effect of the DBRS January Release on its credit arbitrage business (see paragraph 327 of these reasons). As a result, Coventree submits that the DBRS January Release cannot have constituted a material change.

[347] There are a number of responses to that submission.

[348] First, section 75 of the Act requires an issuer to forthwith issue and file a news release, and to file a material change report, in order to highlight to the market that a material change has occurred. Coventree's disclosure in its Q2 MD&A suggests to the market that no material change had occurred in Coventree's business. Accordingly, public shareholders and investors may have legitimately assumed that no material change had occurred as a result of the matters discussed in the Q2 MD&A.

[349] *Second, as discussed in these reasons, public shareholders and investors did not know how important credit arbitrage and CDO related SFA transactions were to Coventree's business and would likely not have known that (i) the DBRS January Release required global style liquidity for CDO related SFA transactions, or (ii) global style liquidity was not available to Coventree*. We note, in particular, that Coventree's disclosure in its Q2 MD&A does not address or disclose the importance of credit arbitrage to Coventree's business. It says that the DBRS criteria will have the effect of "reducing the profitability of the Company by substantially curtailing its ability to grow, if not halt in the short-term, its credit arbitrage business". Public shareholders and investors had insufficient information to be able to fully understand and assess the implications of that statement for Coventree and its business. Accordingly, we are not satisfied that the disclosure in respect of these matters in Coventree's Q2 MD&A (or, for that matter, in the Letter to Owners or Q1 MD&A) was adequate.

[350] Coventree submits that a conclusion that a material change occurred as a result of the DBRS January Release is, in effect, requiring Coventree to issue a Coventree news release in respect of a DBRS news release (i.e., the DBRS January Release). That is exactly what was

required in order to communicate to public shareholders and investors the material impact of the DBRS January Release on Coventree and its business.

[351] We also note that the volume of trading in Coventree shares was relatively low given that a majority of its outstanding shares were owned by Cornish and Tai and related entities or persons. That meant that information with respect to Coventree and its business was less likely to be reflected in the news media and reviewed and commented upon by analysts. It appears that there were no other comparable public companies in Canada that were third-party sponsors of ABCP.

[352] Accordingly, the fact that the disclosure made in Coventree's Q2 MD&A did not affect Coventree's share price does not mean that no material change had occurred. MD&A disclosure in these circumstances is not a substitute for, and does not relieve Coventree from the legal obligation of, complying with section 75 of the Act. *Coventree made a critical error if it assumed that disclosure in its Q2 MD&A of the effects on its business of the DBRS January Release constituted adequate disclosure to public shareholders and investors and compliance with its disclosure obligations under section 75 of the Act.* The same comment applies to the disclosure contained in the Letter to Owners (referred to in paragraphs 316 to 319 of these reasons and in its Q1 MD&A (see paragraph 321) of these reasons).

[353] We note that Coventree had previously stated that its principal form of communication to public shareholders would be through Coventree's annual report and letter to shareholders. Disclosure by those means does not affect Coventree's legal obligations under section 75 of the Act.

[354] The legal question we are addressing is whether the DBRS January Release would reasonably be expected to have had a significant effect on the "market price or value" of Coventree shares. That is applying an objective test that focuses on both the market price *and value* of Coventree shares. Clearly, if disclosure when made actually has a significant effect on the market price of securities, that is strong evidence suggesting that the test for materiality may have been satisfied at an earlier time. One cannot assume, however, that the lack of impact on market price means that the information disclosed was not material. There may be a number of different explanations why particular disclosure has no market impact (such as those referred to in paragraphs 348 to 351 of these reasons). In any event, one must also consider whether particular information would reasonably be expected to have a significant effect on the "value" of securities even if that disclosure would not, for some reason, be expected to affect the market price of the securities. We find in these circumstances that the DBRS January Release would reasonably be expected to have had a significant effect on the value of Coventree shares.

Revenue Backlog

[355] Coventree also submits that the DBRS January Release was not a material change because of Coventree's substantial revenue backlog. Coventree's revenue backlog represents the present value of estimated future revenues Coventree would receive based on total fundings then outstanding (see paragraph 81 of these reasons). As of February 14, 2007, Coventree's estimated revenue backlog for the 2007 fiscal year was approximately $34.4 million (revenue backlog for 2008 was estimated to be approximately $30.7 million and for 2009 to be approximately $30.4

million). Coventree submits that these numbers are very conservative because it used a 15% discount rate in determining the present value of its future revenues.

[356] Staff submits that all of the revenue backlog was committed to the costs related to the Chapter Two initiatives and that, in any event, possible future sales of assets by Coventree sponsored conduits, or defaults, would reduce revenue backlog.

Discussion

[357] Revenue backlog reflects estimated future revenue to Coventree from past funding transactions. Accordingly, if no fundings can be carried out by Coventree sponsored conduits in the future, the revenue backlog will reduce and ultimately reach zero over a period of years. Coventree emphasized in the Prospectus the importance of fundings:

> The Company's leaders monitor the level of fundings outstanding because it is a key driver for revenue as the Company typically earns fees calculated as a percentage of fundings outstanding. The leaders believe this is an important measure in assessing the Company's business operations.
>
> (Prospectus, at p. 35)

[358] It was also stated in the Prospectus that:

> As the maturities of assets increase, the annual volumes of new deals would need to incrementally increase in order to maintain or grow the current levels of fundings outstanding.
>
> (Prospectus, at p. 38)

[359] Coventree did not disclose the amount of its revenue backlog in the Prospectus. That may have been because such information would have been future oriented financial information, the disclosure of which was subject to various requirements and restrictions.

[360] In any event, Coventree did show year-over-year revenue backlog numbers in its 2006 Annual Report. Coventree stated in the Annual Report that:

> … We strongly recommend that our owners only use these numbers as high-level indicators of our future financial growth prospects rather than specific year-over-year forecast numbers – especially since these numbers are neither broken up [*sic*] by year nor do they include any expenses both variable and fixed including taxes, salaries, bonuses, etc. …
>
> (Coventree 2006 Annual Report, at p. 9)

That is to say that revenue backlog is not a net income number.

[361] While revenue backlog is clearly a valuable Coventree financial asset, it was created by past funding transactions. The continued execution of funding transactions was key to

Coventree's ongoing business and financial performance. As noted above, the Prospectus did not disclose revenue backlog at the date of the Prospectus and we doubt that any investor purchased shares under the Prospectus because Coventree would receive future revenues from previous fundings. Ultimately, if Coventree was not able to complete future funding transactions, those revenues would run off and ultimately reach zero. Accordingly, if Coventree cannot carry out future funding transactions, the revenue backlog would represent, in effect, declining revenues from the winding down or amortizing of Coventree's securitization business.

[362] *Put another way, the value of Coventree's business had very substantially declined if that business was valued based only on revenue backlog and the relatively nascent Chapter Two initiatives*.

[363] Accordingly, the existence of revenue backlog does not detract from or negate the importance to Coventree of being able to continue to carry out credit arbitrage transactions and traditional securitizations through its sponsored conduits. To the contrary, the existence of the revenue backlog underscores the importance of future fundings to Coventree and its business. The DBRS January Release ultimately prevented Coventree from carrying out future credit arbitrage transactions, the source of more than half of its revenue backlog for 2007.

[364] We also note that future events could negatively affect revenue backlog. Any sale of assets by Coventree or Nereus sponsored conduits has the effect of eliminating the revenue backlog associated with the assets sold. In addition, any default by a Coventree or Nereus sponsored conduit that resulted in a disposition or loss of assets would also reduce revenue backlog. We are not suggesting that Coventree should have predicted, as of January 22, 2007, future asset sales or defaults. We are simply noting that future events could reduce revenue backlog.

[365] In our view, the existence of revenue backlog does not mean that significant changes in Coventree's business or operations cannot be material and a basis for concluding that a "material change" had occurred with respect to Coventree within the meaning of the Act.

Possibility of DBRS Changing its Approach in the DBRS January Release

[366] Coventree also submits that it had a reasonable expectation following the DBRS January Release that, as a result of suggestions or proposals made by Allan to Loke, DBRS might change its requirement for global style liquidity.

[367] In our view, it was clear from the DBRS January Release that DBRS was not prepared thereafter to accept Canadian style liquidity arrangements for CDO related SFA transactions. DBRS knew the impact that position would have on the Canadian market when it issued the DBRS January Release, including the negative consequences for its own business. The fact that Allan made some alternative suggestions or proposals to Loke does not mean that Coventree could assume that DBRS would change its position. The DBRS January Release, preceded as it was by the DBRS November Letter, was not a trial balloon that Coventree could reasonably expect would be changed or modified like a number of other previous DBRS policy initiatives. In the circumstances, until DBRS confirmed otherwise, Coventree had to assume that DBRS

meant what it stated in the DBRS January Release with respect to the requirement for global style liquidity, and what it confirmed to Coventree on January 22, 2007.

[368] In *Rex Diamond (Div. Ct.)*, the Court stated:

> The fundamental flaw in the appellants' position is that they attempt to replace the objective requirement for the determination of a material change under the provisions of the *Securities Act* with the subjective assessment of the Rex executives regarding the status of the leases. Regardless of the optimistic view of the outcome of the dispute that appears to have been taken by the Rex executives, the Commission reasonably concluded that public disclosure of the problems with the leases ought to have been made by the company so that individual investors could reach their own conclusions regarding the state of the business affairs of Rex armed with all of the relevant information.
>
> (*Rex Diamond (Div. Ct.)*, *supra*, at para. 6)

[369] While circumstances may vary, the subjective and optimistic hope or view of senior officers that they may be able to negotiate a different outcome or solution with a third party is not generally going to be sufficient to relieve an issuer from forthwith disclosing events that would otherwise constitute a material change (see also the discussion of the "soft landing" commencing at paragraph 629 of these reasons). In making that statement, we are not suggesting that an issuer may not have to make inquiries of a third party in order to determine whether a material change has occurred (as Coventree did with respect to the DBRS January Release on January 22, 2007). That is, however, a different matter.

[370] In any event, by the middle of February 2007, it was clear to Coventree that DBRS was not going to change or modify the requirements of the DBRS January Release as they related to requiring global style liquidity.

External Events or Developments

[371] Coventree also submits that DBRS's decision to issue the DBRS January Release was an external or outside event or development that did not affect Coventree or its business or operations in a manner different than other third-party sponsors that carried out CDO related SFA transactions. Coventree says that, by analogy, this is similar to an external political, economic or social development within the meaning of section 4.4 of NP 51-201 (see paragraph 152 of these reasons). Coventree submits that in accordance with the principle reflected in that section, there is no requirement to disclose such a development or to interpret the effect of it on its business and affairs. We address that issue below when we discuss the events of late July and early August 2007 (see the discussion commencing at paragraph 621 of these reasons). Based on the conclusions reached in that discussion, which we will not repeat here, we reject the submission that Coventree had no obligation to disclose the material change in its business arising from the DBRS January Release by reason of the principle reflected in section 4.4 of NP 51-201.

XI. COVENTREE'S DISCLOSURE OF U.S. SUBPRIME EXPOSURE IN APRIL 2007

1. Staff Allegations

[372] Staff alleges that Coventree made a materially misleading statement to the market at the April Investor Presentations by telling Coventree sponsored ABCP investors that the total U.S. subprime mortgage exposure of its conduits was 7.4% (that statement is referred to as the "subprime statement" in these reasons). Staff submits that statement was misleading because Coventree failed to provide a breakdown of that exposure by conduit and ABCP note series. Staff alleges that the subprime exposure at the time was more than 15% in three conduits and more than 40% in one note series. As a result, Staff alleges that Coventree made a statement that it knew or reasonably ought to have known was (i) in a material respect, misleading or untrue or did not state a fact that was required to be stated or that was necessary to make the statement not misleading, and (ii) that would reasonably be expected to have a significant effect on the market price or value of a security, within the meaning of subsection 126.2(1) of the Act (see paragraph 384 of these reasons for the provisions of subsection 126.2(1)). Accordingly, Staff alleges that Coventree contravened subsection 126.2(1) of the Act. That allegation is not made against Cornish or Tai.

2. Coventree Submissions

[373] Coventree submits that the subprime statement was clearly expressed as the conduits' total subprime exposure. Coventree submits that no reasonable ABCP investors could have believed that the subprime exposure of every conduit and note series was precisely 7.4%. Rather, the only reasonable conclusion that an investor could have drawn was that some conduits had more than 7.4% subprime exposure and others had less. Further, Coventree submits, and Cornish testified, that it was common industry practice to disclose information such as subprime exposure on an aggregate basis in this way. Coventree also submits that making the subprime statement went well beyond what other ABCP sponsors were then disclosing.

[374] Coventree submits that Staff led no evidence to establish the precise U.S. subprime exposure of any of the Coventree sponsored conduits, or of any of their note series, at the time of the April Investor Presentations on April 25 and 26, 2007. Coventree submits that is one of the central foundations of Staff's allegation that must be proven on the basis of clear, cogent and convincing evidence, rather than on the basis of speculation, conjecture or extrapolation. Further, Coventree submits that the actual subprime exposure of each note series can vary very significantly on a daily basis.

[375] Coventree submits that there is no evidence that the precise subprime exposure of a particular conduit or note series was important to ABCP investors in late April 2007. Coventree submits that investors were largely indifferent to the subprime issue at that time. Moreover, Staff did not identify even one investor who was allegedly misled by Coventree's disclosure.

3. Background

[376] Beginning in February 2007, Coventree began making disclosure to its dealers and ABCP investors as to the proportion of U.S. subprime mortgage assets contained in and backing

Coventree sponsored ABCP. Initially, that information was provided only to those dealers or investors who requested it and was broken down by conduit but not by note series.

[377] On March 12, 2007, Cornish sent an e-mail to Allan and others at Coventree commenting on a series of articles in the New York Times discussing the "collapse of the US subprime residential mortgage lending business". Cornish noted that "ABS investors may end up getting hurt through exposures that they did not even know that they have through CDOs etc etc." Cornish stated that "if ABCP investors have not been raising this as an issue, I would expect that this will become a focus of their questions soon". Cornish concluded that "… if we have not already done so, we should do whatever analysis we need to put ourselves in a position to say to investors 'no need to worry and here's why'".

[378] In an e-mail dated March 15, 2007 sent by Dalton to NBF, Dalton attached information providing details of the subprime exposure of each Coventree sponsored conduit as of February 28, 2007 (the "**February Subprime Data**"). The February Subprime Data indicated that the Comet, Planet and Slate conduits had a subprime exposure of 15.8%, 19.1% and 21.3%, respectively. Although subprime exposure of each note series was not shown, the last page of the e-mail provided the dollar amount of subprime exposure on a combined basis in each conduit for A notes and E notes. Accordingly, a reader would have been able to determine the subprime exposure on a combined basis for the A notes and E notes issued by each conduit, but not the separate subprime exposure of A notes or E notes.

[379] When information was sent by Coventree to a dealer such as NBF, it was open to the dealer to provide that information to ABCP investors "if they saw fit". Accordingly, in providing the February Subprime Data to NBF, Coventree was potentially providing that information to investors who purchased Coventree sponsored ABCP through NBF.

[380] By April 2007, Coventree had received enquiries with respect to the subprime exposure of its conduits from approximately five investors and two dealers. We understand that Coventree provided accurate information in response to those enquiries. By that time, Coventree also knew that some investors in Coventree sponsored ABCP were aware of the subprime issue and had a preference not to invest in ABCP that was backed by subprime assets. Other investors had a preference not to invest in ABCP backed by CDOs.

[381] On April 25, 2007, Coventree gave a presentation to approximately 40 ABCP investors in Toronto entitled "Coventree Investor Update". Coventree gave the same presentation on April 26, 2007 to ABCP investors in Montreal (the Toronto and Montreal presentations are referred to in these reasons as the "April Investor Presentations"). In the portion of the presentation entitled "Demystifying the Subprime Market", Coventree stated that the total subprime exposure in its conduits was 7.4%, with 3.7% in conduits containing CDOs and 3.7% in non-CDO conduits. The April Investor Presentations also noted that there was "[n]o reason to believe that Canadian Subprime performance will follow the unfolding US experience".

[382] It does not appear that a distinction in terms of interest rate spreads or pricing was ever made by Coventree sponsored conduits between those note series with the highest subprime exposure and those with no subprime exposure. Paul testified that a distinction was made in the spreads on certain ABCP series with higher subprime exposure, but we have no other evidence

of that. Further, it appears that until the market disruption on August 13, 2007, all maturing Coventree sponsored ABCP was, in fact, rolled or taken into dealer inventory at substantially the same interest rate spreads irrespective of subprime exposure (see paragraph 461 of these reasons).

[383] Cornish testified that he considered the subprime issue to be a "good news story" for Coventree because the subprime assets in Coventree sponsored conduits dated from 2004 and 2005 (Coventree submits that the credit quality of U.S. subprime mortgages began to significantly decline for mortgages entered into in 2006 and thereafter) and because the overall percentage of such assets was small. Cornish testified that:

> The point that we really wanted to convey was that there was some exposure to subprime and just kind of leave it at that in terms of the numbers.
>
> …
>
> From our perspective, it's accurate and it conveys the information that we were trying to get across to investors accurately and without more.

4. Analysis

(a) Subsection 126.2(1) of the Act

[384] Staff alleges that Coventree contravened subsection 126.2(1) of the Act by making the subprime statement. Subsection 126.2(1) of the Act provides as follows:

> 126.2(1) Misleading or untrue statements – A person or company shall not make a statement that the person or company knows or reasonably ought to know,
>
> > (a) in a material respect and at the time and in the light of the circumstances under which it is made, is misleading or untrue or does not state a fact that is required to be stated or that is necessary to make the statement not misleading; and
> >
> > (b) would reasonably be expected to have a significant effect on the market price or value of a security.

[385] Clause (a) of that provision requires a determination whether the particular statement or omission is, in a material respect, misleading or untrue or does not state a fact that is required to be stated or that is necessary to make the statement not misleading. Those requirements must be assessed at the time and in the light of the circumstances under which the relevant statement was made. Even if the statement is misleading or untrue within the meaning of clause (a), clause (b) requires that the statement also "reasonably be expected to have a significant effect on the market price or value" of a security.

(b) Subprime Exposure by Note Series

[386] By making the subprime statement in the April Investor Presentations, Coventree was attempting to reassure investors that Coventree sponsored conduits had, in total, a relatively

small subprime exposure. The 7.4% average disclosed was accurate as far as it went. That is to say that it was the total concentration of subprime assets across all Coventree sponsored conduits and note series.

[387] On July 24, 2007, Dalton sent an e-mail to the dealer syndicate with the following table summarizing the U.S. subprime exposure of Coventree and Nereus sponsored conduits, by conduit and note series, as of June 28, 2007 (the "**July 24 e-mail**"):

Conduit	Series A	Series E	Total ABCP	FRNs	Total ABCP and FRNs
Aurora Trust	0%	**8%**	3%	2%	3%
Comet Trust	0%	**42%**	16%	12%	16%
Planet Trust	**26%**	3%	17%	0%	15%
Slate Trust	0%	**16%**	13%	0%	13%
Apollo Trust Gemini Trust Rocket Trust Venus Trust	0%	0%	0%	0%	0%
SAT	0%	0%	0%	0%	0%
SIT III	1%	0%	1%	0%	1%
TOTAL	3%	6%	5%	2%	4%

[emphasis added]

[388] Accordingly, as of June 28, 2007, of the 16 Coventree sponsored series A notes and E notes outstanding, 11 note series had no subprime exposure and one note series had approximately 3% subprime exposure. The remaining four note series had subprime exposures of approximately 8%, 16%, 26% and 42%.

[389] Subprime exposure could change as further assets were added to the conduits. It does not appear, however, that such changes were significant during the relevant time. The number and size of transactions completed by Coventree in 2007 was not significant (see paragraph 302 of these reasons). Paul confirmed that in his testimony. We also recognise that the subprime exposure of a conduit or note series could change as a result of the amortization of transactions and assets, as well as the sale of assets. No public disclosure of these factors was made by Coventree at the time it made the subprime statement.

[390] In these circumstances, we conclude based on (i) the February Subprime Data, (ii) the subprime information set out in the July 24 e-mail, and (iii) the relatively few transactions carried out by Coventree sponsored conduits between April and July 24, 2007, that the subprime exposure of Coventree sponsored conduits by note series as of April 25 or 26, 2007 would have been substantially similar to the subprime information set out in the July 24 e-mail (see paragraph 387 of these reasons).

[391] *The subprime statement was made to existing investors in Coventree sponsored ABCP, the persons most likely to purchase or roll Coventree sponsored ABCP in the future. As such, it was a statement intended to influence investors in purchasing Coventree sponsored ABCP.* We have no doubt that an investor who purchased Comet E notes based on a representation that total subprime exposure of Coventree sponsored conduits was 7.4%, would have been shocked to

learn that the Comet E notes were backed by 42% subprime assets. Miller expressed that view in his testimony.

[392] In our view, communicating an average in these circumstances was misleading. While one would expect some variation in concentrations around the average disclosed, one would not expect the distribution of subprime assets set out in the July 24 e-mail. The average was significantly skewed by the eleven note series with no subprime exposure whatsoever. In our view, the subprime exposures by note series shown in the July 24 e-mail demonstrate why the subprime statement was misleading as it related to the note series with the highest subprime exposure (i.e., the Comet E and Planet A notes).

[393] Coventree submits that industry practice was to disclose conduit assets on an aggregate basis. Whether or not that is the case, in determining whether a particular statement is misleading or untrue, it is clearly relevant to whom the statement is made and in what circumstances.

[394] Coventree also submits that purchasers of Coventree sponsored ABCP were sophisticated investors and, if they were concerned about subprime exposure, they would have inquired before making any purchase of a specific ABCP note series. There is no evidence that further inquiries as to subprime exposure were made by any investors at the time of the April Investor Presentations. Nor is there any evidence that any representation concerning total subprime exposure was ever made by Coventree to an investor in connection with the actual purchase of ABCP of one of the note series that had the highest subprime exposure. Further, we have no reason to doubt Coventree's statement that, when asked, it provided the accurate information.

(c) Subprime Statement Misleading

[395] Clause (b) of subsection 126.2(1) of the Act requires a determination of the effect of a statement on the market price or value of *a security*. The relevant securities in this case are either Coventree sponsored ABCP or Coventree shares. We note, in this respect, that the subprime statement was made to investors or potential investors in Coventree sponsored ABCP. Further, in our view, it is unlikely that the subprime statement would have had any significant effect on the market price or value of Coventree shares. The value of those shares was only indirectly affected by the subprime statement. In our view, the question is whether the subprime statement would reasonably be expected to have had a significant effect on the market price or value of any Coventree sponsored ABCP.

[396] Subsection 126.2(1) of the Act does not require that the relevant statement be made to or be relied upon by any investor. It is sufficient if a statement is made that is misleading or untrue in accordance with clause (a) of subsection 126.2(1) of the Act, and that the statement would reasonably be expected to have a significant effect on the market price or value of the relevant securities in accordance with clause (b) of subsection 126.2(1) of the Act. As noted above, there is no evidence that the subprime statement was actually relied upon by an investor in purchasing Coventree sponsored ABCP with the highest subprime exposure.

[397] On balance, in our view, by making the subprime statement in the April Investor Presentations, Coventree failed to state a fact (the actual subprime exposure of each affected note series that had the highest subprime exposure) that was necessary to make the subprime

statement not misleading. Further, Coventree knew or reasonably ought to have known that statement was misleading. Accordingly, we find that the subprime statement was misleading within the meaning of clause (a) of subsection 126.2(1) of the Act.

(d) No Significant Effect on Market Price or Value

[398] At the time of the April Investor Presentations, the issue of whether ABCP was backed by subprime assets had not become a significant issue to Canadian investors in the ABCP market. It appears that in April 2007, Coventree had received enquiries with respect to the subprime exposure of its conduits from approximately five investors and two dealers. The dealers may have passed on that information to certain of their clients. Loke testified that the question of subprime exposure did not become an issue for DBRS until July 2007. Accordingly, at the time of the April Investor Presentations, while there appears to have been a few investors who preferred to avoid purchasing note series backed by subprime assets, most investors were not aware of or sensitive to that issue. Further, the credit quality of the subprime assets in Coventree sponsored conduits does not appear to have ever been an issue, in part, because those assets were acquired prior to 2006 (as noted above, Coventree submits that the credit quality of U.S. subprime mortgages began to significantly decline for mortgages entered into in 2006 and thereafter).

[399] Had Coventree disclosed in April 2007 the accurate subprime exposure in each of its sponsored note series, in our view it is unlikely that disclosure would have had a significant effect on the market price or value of the ABCP with the highest subprime exposure. Cornish viewed the subprime exposure of Coventree sponsored conduits as a positive story and Coventree made disclosure of the accurate subprime exposure of its note series to the dealer syndicate in the July 24 e-mail (see paragraph 387 of these reasons). We know that information was passed on to some investors. By then, subprime exposure had become a much more significant issue, in part, because of the very substantial downgrades of ABCP backed by subprime mortgages in the United States on July 10, 2007 (see paragraph 444 of these reasons).

[400] We have concluded in all the circumstances that the most one could say as of April 25 or 26, 2007 is that the level of subprime assets backing a note series was a relevant consideration for a few investors in deciding whether to purchase ABCP of a particular series. Most ABCP investors, and DBRS, were not sensitive to the subprime issue at that time. Further, we are not satisfied that any distinction was ever made by Coventree in the interest rates payable on ABCP backed by the highest levels of subprime assets and interest rates payable on ABCP with no subprime exposure (see paragraph 382 of these reasons). There was some discussion on July 30, 2007 between Coventree and NBF of increasing those spreads (see paragraph 461 of these reasons) but no action was taken. Nor is there any evidence that any Coventree sponsored ABCP failed to roll or be taken into dealer inventory before August 13, 2007.

[401] The foregoing analysis is relevant to determining whether an accurate subprime statement would have been important to any ABCP investors. However, the question we must determine is whether the subprime statement itself would reasonably be expected to have had a significant effect on the market price or value of any Coventree sponsored ABCP. That statement was to the effect that the total subprime exposure of Coventree sponsored conduits was 7.4%. Even if that statement was misleading (as we have found), we do not believe that *the making of that*

statement would reasonably be expected to have had a significant effect on the market price or value of any Coventree sponsored ABCP (within the meaning of clause (b) of subsection 126.2(1) of the Act). That is to say that subsection 126.2(1) of the Act does not apply to misleading statements that have no impact or effect on the market price or value of a security. The making of a misleading statement may have other regulatory consequences, but it does not contravene subsection 126.2(1) of the Act.

[402] Accordingly, we find that the subprime statement made by Coventree in the April Investor Presentations, in the circumstances in which that statement was made on April 25 and 26, 2007, would not reasonably be expected to have had a significant effect on the market price or value of any Coventree sponsored ABCP. As a result, we find that the requirements of clause (b) of subsection 126.2(1) of the Act have not been established by Staff and that, accordingly, Coventree did not contravene subsection 126.2(1) of the Act by making the subprime statement.

(e) Dissemination of Correcting Disclosure

[403] Staff also alleges in the Statement of Allegations that, by sending the July 24 e-mail, Coventree advised the dealer syndicate of the subprime exposure of Coventree and Nereus sponsored conduits, by conduit and note series, but did not generally disclose to the market the facts required to be stated or necessary to make the subprime statement not misleading.

[404] Coventree did not have a securities law obligation to make any statement as to the subprime exposure of its sponsored conduits or note series and the conduits themselves were not reporting issuers. As discussed above, however, we have concluded that the subprime statement was misleading in the circumstances in which it was made. We note that disclosure correcting that misstatement was made by Coventree in the July 24 e-mail, which was sent to all of the members of the dealer syndicate and, through them, to at least some ABCP investors. We note, for instance, that the information in the July 24 e-mail was forwarded by RBC to its clients on July 30, 2007.

[405] However, the question of the timing and the means and adequacy of dissemination of that corrective disclosure is not a question that Staff expressly addressed in its submissions. Nor does it form the basis of any Staff allegation as to the breach of any provision of the Act or as to conduct that may be contrary to the public interest (see paragraph 775 of these reasons). Accordingly, we will not address those questions.

XII. DID A MATERIAL CHANGE OCCUR PRIOR TO AUGUST 13, 2007?

1. Staff Allegations

[406] Staff alleges that Coventree failed to comply with its continuous disclosure obligations by failing to publicly disclose the liquidity and liquidity-related events, and the increasing risk of a market disruption, in the days leading up to the disruption in the ABCP market that occurred on August 13, 2007. Staff alleges that those events and that change in risk constituted a "material change", within the meaning of section 75 of the Act, that was required to be disclosed by Coventree on August 1, 2007 or thereafter, in accordance with that section.

[407] Staff submits that by early August 2007, a number of material risks that Coventree had identified and disclosed in its Prospectus had occurred, in particular:

(a) Coventree was experiencing a sharp and substantial loss of demand for Coventree sponsored ABCP, which Coventree expected to continue;

(b) by July 31, 2007, Coventree had begun selling assets from its conduits to accumulate cash so that the conduits would be able to honour anticipated collateral calls. Coventree continued to sell assets of the conduits thereafter for that purpose; and

(c) by August 7, 2007, Coventree was unable to purchase new assets from its asset suppliers. Staff submits that Coventree continued to be unable to fund purchases of assets after that date until the market disruption on August 13, 2007.

[408] Staff submits that the evidence shows that these events and developments, individually and collectively, constituted a material change in Coventree's business or operations (as opposed to its "capital", within the meaning of the definition of "material change" in the Act). In addition, in Staff's submission, Coventree's liquidity and liquidity related problems and the risk of a market disruption continued after August 1, 2007 and, in fact, became more severe.

[409] Staff alleges that the sharp and substantial loss of demand for Coventree sponsored ABCP, which had occurred by early August, 2007, and worsened thereafter, manifested itself in several ways:

(a) Coventree's dealer syndicate was reporting difficulties selling Coventree sponsored ABCP, especially ABCP with subprime exposure and E notes. The maturity dates for ABCP became shorter and a substantial amount of ABCP was rolling only on an overnight basis;

(b) members of Coventree's dealer syndicate had substantially reduced their participation in the market for Coventree sponsored ABCP (by turning back unsold ABCP to NBF, by declining to bid on Coventree sponsored ABCP in the secondary market and by reducing their market-making lines);

(c) RBC resigned from Coventree's dealer syndicate on July 27, 2007, further contributing to the liquidity issues that Coventree sponsored ABCP was facing;

(d) Coventree had been advised by the Caisse, and by its dealers, that the Caisse was reducing its holdings of Coventree sponsored ABCP with subprime exposure and, if it continued to do so, Coventree knew that would cause a market disruption; and

(e) by August 1, 2007, spreads on Coventree sponsored E notes had widened to above 25 basis points over CDOR. The spreads on A notes had widened to above 10 basis points. Spread widening to these levels was well beyond historical levels.

2. Coventree Submissions

[410] Coventree submits that none of the "liquidity and liquidity-related issues" identified by Staff in the Statement of Allegations or in its opening submissions constituted a change in Coventree's "business, operations or capital", either individually or collectively. Accordingly, Coventree submits that it had no obligation to issue any news release or file a material change report as a result of those events, considered either individually or collectively. The events that Staff alleges constituted material changes were the effect of an unprecedented and unexpected global liquidity crisis that was entirely external to the business and operations of Coventree and was well reported in the news media. Accordingly, Coventree submits that no material change within the meaning of the Act occurred as a result of those events.

[411] Coventree submits that it acted prudently and responsibly in not issuing a news release in these circumstances because any such release would have been based on rumour, speculation, misinformation and conjecture and would have potentially exposed Coventree to liability for what was said.

[412] Coventree also submits that Staff would not have made these allegations if the market disruption had not occurred on August 13, 2007. Accordingly, Coventree submits that Staff is improperly applying hindsight in making these allegations.

3. Cornish Submissions

[413] Cornish adopts Coventree's and Tai's submissions with respect to Staff's allegations on this issue and makes the following additional submissions.

Spread Widening

[414] Cornish submits that he participated in a telephone call with Tai and Allan on July 30, 2007, in which they concluded that spread widening would have to continue for a considerable period of time to have any material impact on Coventree's business or financial performance.

[415] Given that the credit quality of the underlying assets in Coventree sponsored conduits was unchanged, Cornish submits that he, Tai and Allan appropriately concluded that the spread widening was the result of an imbalance in supply and demand in the ABCP market and was not related to Coventree sponsored conduits or their assets.

Uncertainty as to Investor Concerns

[416] Cornish submits that, as of July 30, 2007, Coventree had incomplete information about what was happening in the ABCP market from an investor perspective. Coventree had been given different reasons by its dealers why some investors were not rolling Coventree sponsored ABCP, including concerns as to subprime exposure, resistance to investing in CDOs, "corporate window dressing", investor preference for money market alternatives, and the need to fund margin calls on equity investments.

RBC Resignation

[417] Cornish submits that he turned his mind to the question of whether Coventree should issue a news release in connection with RBC's resignation from the dealer syndicate. Coventree's management team ultimately concluded that RBC's resignation did not warrant issuing a news release. Cornish submits that it was not material from either an ABCP investor perspective or a Coventree shareholder perspective.

Taking Prudent Actions

[418] Cornish submits that, as a prudent and diligent business person, he recognized the importance of (i) identifying potential risks and ensuring that Coventree was prepared for all eventualities, and (ii) making certain that Coventree was properly carrying out all of its obligations and responsibilities as a conduit manager.

[419] This led Coventree by late July and early August to generate cash in its conduits by selling assets, to monitor the amounts of maturing ABCP and the status of collateral call triggers, and to take steps to prepare for a possible market disruption, including preparing notices for liquidity calls and extensions of extendible ABCP. Cornish submits that Staff's reliance on Coventree's risk management strategies as evidence that a material change had occurred is misguided. Cornish submits that if Staff's argument is accepted, then anytime a company implements prudent risk management strategies, Staff can draw the inference that a material change has occurred. This would result in an inevitable chilling effect on prudent risk management efforts that would otherwise be undertaken for the benefit of shareholders.

The Disclosure Committee Deliberations

[420] Cornish submits that throughout late July and early August 2007 members of the disclosure committee were considering Coventree's disclosure obligations on a continuous basis.

[421] Cornish submits that the disclosure committee met prior to the August Board Meeting (referred to in paragraph 550) and on the following day, August 2, 2007, and concluded that no material change had occurred.

[422] Cornish also submits that the disclosure committee held a meeting on August 7, 2007, which was attended by Cornish, Tai and Child. Together, they considered the issue of disclosure and materiality in light of the information then available and the circumstances that existed that day. The disclosure committee concluded that the events and developments that had occurred up to August 7, 2007 had no material impact on Coventree's business or operations. Cornish submits that it was right not to draw conclusions based on incomplete and unreliable information.

[423] Thereafter, Cornish and others at Coventree continued to monitor on a day-to-day basis developments in the credit markets and spread widening, and the financial implications for Coventree's business. At each point, Coventree's management team collectively considered issues of disclosure and materiality and concluded that, provided the Caisse continued to support the market for Coventree sponsored ABCP, Coventree's disclosure obligation under section 75 of the Act was not triggered.

Outside Legal Advice

[424] Given the legal background of Cornish and Allan, the expertise of members of the Board, and the fact that Coventree's management knew its business better than any outside lawyer would, Cornish submits that he reasonably believed that Coventree was in a better position than outside legal counsel to make judgements regarding disclosure and materiality in the circumstances.

The "Soft Landing"

[425] Cornish submits that he had a reasonable belief that the supply/demand imbalance in the ABCP market would be resolved by market participants through a negotiated reduction in the amount of ABCP outstanding (the so-called "soft landing"). Based on Tai's report from the Montreal meeting on August 10, 2007 (referred to in paragraph 749 of these reasons), Cornish submits that he understood that the meeting had achieved a consensus around a solution to move forward, which involved an overall reduction in the amount of outstanding ABCP sponsored by all independent sponsors and the banks. He understood that, in turn, the dealers would step back into the market and resume their typical market-making activities.

[426] Accordingly, Cornish submits that he reasonably formed the conclusion that the Montreal meeting was a positive step and that, as testified by Allan, Coventree could participate in the solution with "virtually … no impact on Coventree".

4. Tai Submissions

[427] Tai adopts Coventree's and Cornish's submissions on this issue.

[428] Tai also submits that having clearly disclosed the risks of its business in its public filings, Coventree was under no obligation to make further disclosure unless and until those risks actually occurred *and* the occurrence of them resulted in a material change to Coventree's business, operations or capital, such that disclosure was required. Tai submits those conditions were not satisfied.

[429] Tai submits that Staff is incorrect in arguing that the risks identified by Coventree "had occurred" by early August 2007. Many of those events were in a state of flux and Coventree was unable to decipher clear facts in the circumstances.

Risk of a Market Disruption

[430] Tai submits that Staff is arguing with respect to its other disclosure allegations that the risks Coventree had disclosed in the Prospectus had become facts and resulted in a material change. Yet, with respect to the allegation that the increased risk of a market disruption had to be disclosed, Staff appears to argue that the risk does not need to become a fact in order to constitute a material change. Tai submits that there is no rational basis for this inconsistency in Staff's position.

[431] Tai submits that what Staff has ignored in making this allegation is that the risk of a market disruption *had* already been fully and fairly disclosed in the Prospectus. Tai submits that

Coventree was not obligated to disclose to its public shareholders on each and every day after the Prospectus filing that the risk of a market disruption remained a risk.

Coventree Decision Not to Issue a News Release

[432] Tai notes that Staff alleges that "[t]he decision by Coventree not to disclose the material change was substantially influenced by its perception that disclosure would have an adverse market impact." Tai submits this allegation is untrue and unfair for three reasons.

[433] First, it assumes what Staff must prove: that there *was*, in fact, a material change. Tai submits that all of the evidence is that Coventree and its senior officers (including but not limited to Tai) did *not* believe there was a material change prior to August 13, 2007. Tai objects to Staff's suggestion that Coventree believed that a material change had occurred and intentionally refused to disclose that material change because of a concern about the market impact of that disclosure.

[434] Second, the question of whether to issue a news release was considered thoroughly at the August Board Meeting and only one director expressed the concern that issuing a news release might "generate a run on the bank" (see paragraph 564 of these reasons).

[435] Third, Tai submits that when he raised concerns about the impact that a news release might have on the "market", he clearly was not talking about the stock market. He was talking about the ABCP market. This was not a self-interested concern on Tai's part about what might happen to Coventree's share price if it disclosed bad news. This was an honest and reasonable concern that Coventree's shareholders would benefit from stability in the ABCP market and that disseminating speculative information about what might or might not happen would only create more uncertainty. Tai submits that recommending against issuing a news release when there were not enough "observable data points" was a decision made in accordance with good practice and consistent with the Act's objective of ensuring that the capital markets are not inundated with information that falls short of being plain and true.

5. Summary of Events Leading Up to August 1, 2007

[436] In order to address Staff's allegation that Coventree failed to disclose a material change on August 1, 2007, or thereafter and prior to the market disruption that occurred on August 13, 2007, we will summarize the events and developments that occurred during the period from late July to August 1, 2007, and thereafter leading up to the market disruption on August 13, 2007. In providing those summaries, we recognise that they are summaries and are necessarily incomplete. They do not include all of the events and developments referred to us during the hearing or all of the documents and evidence that were submitted to and reviewed by us.

[437] With respect to the recorded telephone calls between representatives of Coventree and the various dealers, Staff and the Respondents agreed that those recordings are authentic and accurately represent what was said, but are not necessarily evidence of the truth of the statements made. We acknowledge that only a limited number of conversations among representatives of Coventree and members of the dealer syndicate during the relevant period were recorded and introduced as evidence.

[438] Further, there is no question that the participants on the recorded calls all had their own agendas and financial interests and wanted to hold their cards as close to the vest as possible. For example, it was in the interests of the dealers not to disclose to Coventree who their clients were or the amounts of their market-making lines available to purchase Coventree sponsored ABCP. To the contrary, the interest of each dealer during the period from late July to August 13, 2007 was to encourage others, including Coventree, to provide liquidity by purchasing Coventree sponsored ABCP that was maturing. Each dealer wanted to preserve its market-making lines and to take into inventory as little Coventree sponsored ABCP as possible. As a result, we do not take at face value all of the statements made on the various recorded calls. At the same time, we believe that it is clear from those conversations that there were very serious concerns being expressed by the dealers by late July and early August 2007 as to the liquidity in the ABCP market and their ability to roll Coventree sponsored ABCP during that period (see our conclusions in paragraph 570 of these reasons as to general market conditions by the close of business on August 1, 2007).

[439] During this period, Coventree was struggling in its conversations with dealers to determine what was happening in the ABCP market and what was causing the illiquidity in Coventree sponsored ABCP. It is clear that Coventree did not know the amounts of the market-making lines available to the dealers at any particular time to purchase maturing Coventree sponsored ABCP. Nor could Coventree predict whether, and to what extent, the dealers would on any day purchase Coventree sponsored ABCP into inventory. Similarly, Coventree could not predict at any time what the Caisse would do in terms of rolling its maturing Coventree sponsored ABCP and Coventree could not predict whether a market disruption would occur on August 13, 2007 or any other date.

[440] We have organised the following summary of events and developments leading up to August 1, 2007 around specific topics and issues we must consider. In some cases, we have referred to events that occurred shortly after August 1, 2007, because they have some relevance to assessing the circumstances as they existed on August 1, 2007. We believe that this is a more useful approach than simply providing a chronology of all of the relevant events and developments as they occurred. We have provided a separate summary of events and developments after August 1, 2007, leading up to the market disruption that occurred on August 13, 2007, beginning at paragraph 655 of these reasons. We have also provided an overall chronology of significant events relevant to this proceeding in Schedule E.

(a) Difficulty Selling ABCP Prior to July 2007

[441] Prior to late July 2007, members of the syndicate infrequently reported to Coventree's funding group that they were experiencing difficulty selling or "rolling" Coventree sponsored ABCP. However, such difficulties had sometimes occurred in the past, such as leading up to December 31 of a particular year or at bank quarter ends.

(b) U.S. Subprime Exposure

[442] One of Staff's allegations is that, by late July 2007, Coventree was experiencing significant difficulties in rolling Coventree sponsored ABCP that had the highest levels of

subprime exposure. Staff alleges that is a liquidity concern related specifically to Coventree sponsored ABCP.

[443] We have discussed some of the circumstances related to the subprime exposure of Coventree sponsored conduits in addressing whether the subprime statement made by Coventree in April 2007 was misleading. We must now consider the extent to which that subprime exposure contributed to the illiquidity of Coventree sponsored ABCP in late July and early August 2007. Staff alleges that the Caisse began substantially reducing its holdings of Coventree sponsored ABCP with subprime exposure on July 23, 2007 after receiving information with respect to that exposure by conduit and note series. Staff also submits that certain dealers reduced or temporarily eliminated their market-making lines and adjusted their inventory holdings of Coventree sponsored ABCP when they learned of that information on July 24, 2007. The discussion below provides further background related to the alleged illiquidity of Coventree sponsored ABCP that had significant subprime exposure.

Disclosure of Subprime Exposure

[444] Cornish attended a Standard & Poor's Financial Services LLC ("**S&P**") conference in the U.S. on July 11, 2007 where he heard S&P's public announcement of hundreds of downgrades of notes backed by U.S. subprime assets. (Those downgrades did not directly affect Coventree sponsored ABCP.) In an e-mail dated July 11, 2007 to Dalton, Allan and others at Coventree (copied to Tai), Cornish noted that U.S. investors were demanding that conduit sponsors provide information about subprime exposure and that if the information was not furnished, investors would "vote with their feet and will not buy their ABCP". He suggested that Coventree should get in front of this issue "by preparing information that Coventree could either issue as a press release or give as an info sheet to our CP dealers on where we are at – clearly investors are going to be asking a lot of detailed questions on what we have in our conduits in this asset class in the near future".

[445] On July 11, 2007, Paul sent an e-mail to Christian Gaucher ("**Gaucher**") at NBF disclosing subprime exposure by conduit and note series, as of June 29, 2007 (the "**June Subprime Data**"). The June Subprime Data indicated that subprime exposure in Comet E notes was 41%, in Planet A notes was 30% and in Slate E notes was 22%. Coventree indicated that NBF was free to provide the June Subprime Data to ABCP investors as it saw fit. We note that the June Subprime Data is somewhat different than the subprime information set out in the July 24 e-mail and determined as of June 28, 2007 (see paragraph 387 of these reasons).

[446] On July 12, 2007, Dalton responded to Cornish's e-mail referred to in paragraph 444 of these reasons and commented that Coventree had begun to receive inquiries about subprime assets. She noted that Coventree could respond by disseminating information about U.S. subprime exposure in Coventree sponsored conduits by (i) issuing a press release, (ii) sending a summary and "talking points" to dealers so they could respond, or (iii) dealing with investor inquiries on a case-by-case basis. Because Coventree did not know who all of the investors in Coventree sponsored ABCP were, it could not do a direct distribution of information to all investors. Any such distribution to investors would have to be effected through Coventree's dealer syndicate or by means of a news release. Dalton listed the "pros and cons" of each alternative and concluded in her e-mail:

> I am sure there are many other pros and cons and as a public company we may not have the luxury to go anywhere but option 1, but we need to send this out tomorrow at the latest…

[447] Mavrix received a copy of the June Subprime Data from Coventree on July 6, 2007. Gaucher forwarded it to the Caisse on July 20, 2007.

[448] In the days prior to July 23, 2007, Paul testified that he was advised by dealers that some investors were not rolling Coventree sponsored ABCP or were rolling ABCP for shorter durations including only overnight. When investors did not roll their maturing ABCP, the options were that (i) the ABCP be sold to another ABCP investor, (ii) a dealer purchase the ABCP and take it into inventory for a short period, or (iii) the conduit buy back the ABCP.

[449] On July 23, 2007, Dalton sent subprime data by conduit and note series to the members of Coventree's strategic council, which met that day and discussed how to distribute the information based on the three options that Dalton had outlined in her e-mail of July 12, 2007 (referred to in paragraph 446 of these reasons). The strategic council decided to distribute the subprime information to investors through the members of Coventree's dealer syndicate.

[450] Accordingly, on July 24, 2007, Dalton sent the July 24 e-mail to the dealer syndicate with subprime exposure shown by conduit and note series (see paragraph 387 of these reasons).

[451] In the July 24 e-mail, Dalton commented:

> We have given this to everyone in our Dealer group so they can use their own judgement to send it to clients with the sophistication to use the information (we figure you have the best read on this). Otherwise, the Dealers are armed with enough information to provide timely and accurate replies when asked …

[452] Shortly after sending the July 24 e-mail to members of its dealer syndicate, Coventree also forwarded it to DBRS stating that Coventree "wanted to ensure that both DBRS and our dealer syndicate are informed and able to answer direct enquiries from investors with a consistent set of information."

[453] In response to the July 24 e-mail, James Feehely (of DBRS) enquired whether Coventree "had any plans to reduce its subprime exposure by selling off some of the old transactions". Dalton replied that Coventree did not have any intention of selling off its subprime investments because the transactions were performing well and there would not be strong bids in the market for the subprime assets.

[454] Homer testified that the risk related to subprime exposure was low in March but became an issue for him by July. Citibank received the June Subprime Data on July 12, 2007 and responded by selling Comet E notes the following day. Citibank had sold all of its holdings of Comet and Slate ABCP by July 24, 2007 (Comet E notes had 41% subprime exposure and Slate E notes had 22%, based on the June Subprime Data). On the other hand, Miller testified that knowledge of the subprime exposure did not change his trading of Coventree sponsored ABCP. He also testified, however, that when he learned after the market disruption on

August 13, 2007 that Comet E notes had 42% subprime exposure, he considered that a "rather shocking figure".

[455] In response to a question about whether the July 24 e-mail had any effect on the dealers' sale of Coventree sponsored ABCP, Paul testified that "in the grand scheme of things it looks like, you know, things do get a bit – a bit tougher after this".

(c) Liquidity for Coventree Sponsored ABCP

[456] Coventree's dealers began reporting "stickiness", that is, difficulties in the market in rolling some Coventree sponsored ABCP by July 23, 2007. On July 25, 2007, in response to a question from Paul about market conditions for selling or rolling ABCP that day, Gaucher responded that "it's very tough. Very, very, very, very, very tough, even at the level we have been posting".

[457] The same day, dealers reported difficulties selling Comet E notes and Cornish first reviewed the July 24 e-mail that had been sent to the dealer syndicate. Cornish noted that the subprime exposure for Comet E notes was 42% and that it "stands out like a sore thumb". Cornish told Tai and others that Coventree was likely to also experience issues in rolling Planet A notes because of the 26% subprime exposure of that note series.

[458] On a taped call on July 25, 2007, Gaucher stated to Paul that "Slate E is very tough to sell right now, and Rocket E". Both those series were extendible ABCP; Slate E had subprime exposure of 16% but Rocket E had no subprime exposure. Gaucher also stated that some clients did not want to purchase ABCP with exposure to subprime assets of more than 5%. On the same day, Coventree learned that CIBC had purchased, pursuant to its market-making line, $67.8 million of Coventree sponsored ABCP overnight, including $30.7 million of Slate E notes.

[459] The dealers continued to report difficulties selling Coventree sponsored ABCP backed by subprime assets on July 26, 27 and 30, 2007.

[460] Approximately $8.5 billion of Coventree sponsored ABCP outstanding consisted of extendible E notes representing approximately 57% of the total outstanding E notes in the market. By July 30, 2007, Coventree was advised by its dealer syndicate that investors were moving away from E notes, and towards bank-sponsored ABCP, because bank-sponsored ABCP was viewed as a safer investment. This was described by dealers as a "flight to quality". Allardyce testified that by late July and early August there was pressure on spreads and a flight to quality, by which he meant investment in bank-sponsored ABCP and government debt. Allan stated in a conference call on July 30 with Coventree's three largest dealers (the "**July 30 Conference Call**") that "some of the nervousness around the E notes is that in this market, people are migrating to what they consider to be safer programs, and liquidity-based programs are viewed as being safer programs". On that call, Greg Smith of Scotia ("**Smith**") said "… it is reality that the investor treats bank-sponsored conduits as more quality".

[461] At this time, Coventree was attempting to determine whether the liquidity issues around rolling Coventree sponsored ABCP were related to subprime exposure (a cause specific to Coventree sponsored ABCP) or reflected a general lack of liquidity in the market. In the July 30 Conference Call, Allan raised the possibility of increasing spreads on Coventree sponsored

ABCP backed by subprime assets. Smith concluded, however, that this was not a good strategy, because "whether there's a problem or not, you are highlighting it as a problem …".

[462] During the July 30 Conference Call, the dealers gave Coventree feedback on what they thought was happening in the ABCP market. The dealers commented that there was spread widening and a lack of cash available in the market and that Coventree was feeling the pressure more than other third-party sponsors. Smith said they were in "uncharted territory" and there was a lot of headline risk from the media and ratings agencies. They discussed a number of issues including the possibility of DBRS issuing a public statement with respect to subprime assets generally, RBC's resignation from the dealer syndicate (see the discussion beginning at paragraph 541 of these reasons), and the possibility of market participants taking co-ordinated steps to shrink the overall ABCP outstanding in the market. The July 30 Conference Call ended with Coventree and the dealers concluding that they would have to increase spreads on Coventree sponsored ABCP. Coventree also proposed to reduce the subprime exposure of each conduit and note series to below 15% by transferring assets among conduits and note series.

[463] Loke testified that within a week of receiving the July 24 e-mail from Coventree, he received a call from Luc Verville ("**Verville**") of the Caisse. Verville stated that he was concerned about subprime exposure and wanted to know from Loke generally how the affected transactions were performing. Dalton received a call from Verville on July 25, 2007 and she recalled speaking with him about the subprime exposure in Coventree sponsored conduits.

[464] Paul testified that, in the period leading up to Friday, August 3, 2007, it seemed to be taking longer each morning for the dealers to sell Coventree sponsored ABCP. Sales were historically completed by approximately 9:00 a.m. The audio taped calls submitted in evidence also indicated that it was taking longer for dealers to complete sales of Coventree ABCP each day: on July 25, 2007, NBF reported to Coventree at 9:05 a.m. that Scotia had just returned unsold Coventree sponsored ABCP to NBF; on July 26, 2007, NBF reported at 10:19 a.m. that Coventree sponsored ABCP remained unsold; on July 27, 2007, NBF reported at 11:00 a.m. that CIBC had returned unsold ABCP; and on July 30, 2007, Bob Courchesne ("**Courchesne**") of NBF reported to Dalton at 10:35 a.m. that CIBC still had not sold all of its allocation.

[465] During the period from late July 2007 to Friday, August 3, 2007 (the day before the August long weekend), Paul observed that Coventree sponsored ABCP was often just rolling overnight. Paul testified that by August, "I was starting to see large numbers. I'm not sure we ever got into the billions across a series but we may have and if we didn't I think it was getting close on certain days, which in my mind was a lot." Paul testified that having dealers take ABCP into inventory overnight was a concern because it meant that they were having difficulty selling Coventree sponsored ABCP. In addition, increasing amounts of overnight "rolls" of Coventree sponsored ABCP resulted in larger amounts of ABCP that needed to be sold the next day or thereafter.

[466] Paul testified that liquidity agreements related to specific series of Coventree sponsored ABCP generally had provisions that restricted the overall percentage of ABCP that could mature within a five-day period. In the usual course, Coventree's back office would monitor the maturities and, prior to July 2007, Paul would "occasionally" have to contact a dealer and request that they "move" a maturity date in order to remain onside the relevant liquidity

agreements. Paul testified that as July progressed and overnight rolls increased, compliance with those provisions became a bigger issue.

[467] Accordingly, Coventree attempted each day to allocate the ABCP that matured so that the conduits would remain onside the liquidity agreements. Cornish testified that Coventree's administration group was "… struggling with the allocation or – we called it splitting, but same concept of the ABCP that had been sold on any given day, and how to divide it up amongst the various agreements to make sure that we were still within the rules provided for by each agreement." Allan later expressed concern that non-compliance with liquidity agreements could preclude the exercise of liquidity draw rights for the benefit of holders of a note series even if a general market disruption had occurred.

[468] On July 25, 2007, Natalie Davidson of CIBC ("**Davidson**") reported to Allan that market concerns were specific to Coventree sponsored ABCP and were also focused on extendible E notes, with Comet E notes being singled out (Comet E notes had subprime exposure of 42%). Allan testified that Verville told him on the same day that the Caisse had sold some third-party sponsored ABCP (including Coventree sponsored ABCP) and purchased bank-sponsored ABCP instead, and that the Caisse had the same overall holdings of ABCP that it had had two weeks earlier.

[469] On July 26, 2007, Dymott sent an e-mail to another RBC employee in response to a question about how the ABCP issued by non-bank conduits was doing in the market. Dymott replied that:

> Calmer than you'd expect, I'm on holidays but have been on the phone about Coventry [*sic*]. They have sub-prime exposure which they've told Caisse and the dealers about but not other clients! Also Caisse, which has 50% of the 8 billion [*sic*] outstanding, isn't rolling all of their maturities. Now that the model is dead for Coventry [*sic*] I want out …

This e-mail is relevant for our purposes for two reasons. First, it indicates that a further complicating factor for the liquidity of Coventree sponsored ABCP was the decision by the Caisse not to roll all of its Coventree sponsored ABCP as it matured. Second, it indicates that as a result of market developments, "the model is dead for Coventry [*sic*]". That suggests a significant change had occurred in Coventree's business. In making these comments, we recognise that this e-mail was not sent to Coventree and, accordingly, Coventree had no opportunity at the time to respond to it. Further, the e-mail reflects only the personal views of Dymott. Having said that, however, the e-mail does reflect the views of a very experienced market participant who was familiar with what was happening in the ABCP market at the time.

[470] On July 30, 2007, Paul sent an e-mail to a representative of Swiss Re with an update on market conditions. Paul stated:

> The market continues to be shaky this week, particularly among independent conduits. The spread versus bank sponsored ABCP has widened to 5 to 7 bps this morning, as the credit spread headlines going around the market, in addition to the Canadian bank quarter end tomorrow, has brought on this heavy tone.

> Even if someone had an overfunding initiative already set up with DBRS, there is no appetite for new funding in the Canadian marketplace right now. Once things settle down, hopefully in a couple of weeks, it will be better to have a more fulsome discussion of overfunding.

[471] On the July 30 Conference Call, Smith speculated that the Caisse had sold Comet E notes (that had 42% subprime exposure) to Scotia the day before the July 24 e-mail was sent. Smith told Coventree on that call that Scotia had Comet E notes in inventory "that's pretty much not saleable". Scotia said that the liquidity issue "is specific to subprime and it's specific to Coventree".

[472] Davidson also stated on the July 30 Conference Call that:

> … if anybody is going to feel any pain, it's going to be you guys first because you have the largest E notes outstanding. And the biggest supporter of the E note market [the Caisse] has probably paid down a billion dollars in E notes.

[473] On July 30, 2007, Allan sent an e-mail to Cornish that "… our funding situation continues to deteriorate. I will definitely need to brief you and Dean [Tai] at the end of the day".

[474] By July 31, 2007, Cornish, Tai and Allan were aware that DBRS thought the liquidity issue was limited to Coventree sponsored ABCP, rather than the ABCP market generally. In an e-mail Cornish sent to Allan that day regarding the Caisse, he stated:

> David, as I keep thinking about this, if this issue is really limited to Coventree, as suggested by DBRS, that fact may actually help us with Luc [Verville of the Caisse]. …
>
> Anyway, I am wondering if that piece of info i.e. that DBRS has advised us that the issue is not widespread in the industry is one that we should pass on to him. …

[475] Beginning on or around Wednesday, August 1, 2007, Paul began running a "maturity report" on a daily basis so that Coventree would know the relative size of Coventree sponsored ABCP maturities each day.

[476] Deutsche Bank published a report dated August 2, 2007, commenting on developments in global credit markets as follows:

> By any meaningful definition, subprime contagion finally arrived on Thursday, July 26th. The potent combination of continued subprime collateral deterioration, enormous expected losses in ABS [Asset Backed Securities] CDOs and accelerating dislocation in leveraged loans broke the back of the global credit market, sending investors running for the proverbial hills. Credit spreads widened dramatically across the globe. By the following day, almost all new issue markets were shuttered. Since that time, markets have shown some signs of life, but have largely been unable to get moving again, as investors prefer to sit on the sidelines amidst the global downdraft.

That report was not commenting specifically on the Canadian credit market and was characterized by a Coventree employee in an e-mail to Cornish on August 3, 2007 as representing some of the "doom and gloom" in the media at that time.

[477] At 7:43 p.m. on August 2, 2007, Allan sent an e-mail to Dalton saying "I felt terrible seeing how this situation is wearing on you this evening" and that Coventree was "operating with little room to manuveur [*sic*] and few tools at our disposal", and "[i]n truth, our future is in the hands of the market". Allan went on to state that "[w]e are making small adjustments in the hope that the little that we can do might make a difference in the outcome. We cannot make anything happen here. Know that you have done your best, and that what will be, will be." In response to Allan's e-mail, Dalton e-mailed at 10:05 p.m. that she could sense the "desparation [*sic*] and frustration" that Paul was feeling at that time, which added to her own, and she stated that Coventree needed to be "insulated from the credit requests we are getting buried with". She said that she needed the "long weekend to rejuvinate [*sic*]".

(d) ABCP Turned Back to NBF

[478] During the week of July 23, 2007, dealers were turning back Coventree sponsored ABCP to NBF as leader of the dealer syndicate. That meant that the dealers were unable to roll all of the maturing ABCP held by their clients and were unwilling or unable to take that ABCP into inventory. As a result, dealers were returning unsold ABCP to NBF. It was difficult for NBF to immediately sell the ABCP turned back because most sales are made by 9:00 a.m. on each trading day and NBF would often have to take the unsold ABCP into its inventory using its market-making lines.

[479] Coventree was aware, on July 23, 2007, that RBC had turned back $25 million of Slate E notes that NBF took into inventory overnight. Dymott testified that, during that week, RBC did not sell any Coventree sponsored ABCP with subprime exposure. He testified that RBC turned back its allocation of Coventree sponsored ABCP with subprime exposure to NBF because it had reached its maximum capacity on its market-making lines and could not inventory any more Coventree sponsored ABCP. Coventree believed that RBC was not actively attempting to sell Coventree sponsored ABCP.

[480] On July 25, 2007, Paul was advised by Gaucher that Scotia had turned back some Coventree sponsored ABCP to NBF. Paul testified that in his experience, Scotia had never turned back ABCP to NBF. Allan later spoke to representatives of Scotia and was reassured that Scotia would continue to make its market-making lines available to support Coventree sponsored ABCP. Coventree submits that Scotia turned back a relatively small amount of Coventree sponsored ABCP during a short period in late July because it was involved in distributing a significant amount of ABCP in a transaction not involving Coventree.

[481] On July 26, 2007, Allan sent an e-mail to RBC saying NBF was "fed up" with RBC's lack of support and demanded that Coventree drop RBC from the dealer syndicate.

[482] On a call with Paul on July 26, 2007, Courchesne complained that NBF had had to take back a large amount of Planet A notes from other dealers. He said that Coventree was not receiving support in the market from other members of the dealer syndicate. Courchesne

concluded, "I can't buy all the Planet A on earth here" and that Coventree did not "seem to have a dealer group here".

[483] On that call, Paul asked whether NBF had reached its limits on its market-making lines and Courchesne stated that NBF was close to its limits. Cornish testified that he was aware that NBF had approximately $500 million in market-making lines available for Coventree sponsored ABCP. Paul testified that Coventree could not do much in terms of taking action against dealers that were refusing to support Coventree sponsored ABCP, other than calling them to discuss it.

[484] On July 30, 2007, NBF advised Coventree that NBF was reaching the limits of its market-making lines and that Scotia was "close to falling off the cliff". By July 31, 2007, Cornish was aware that Scotia wanted to reduce the amount of its market-making lines for Coventree sponsored ABCP.

[485] Allan acknowledged in his testimony that he knew that all of the dealers "had issues" with the availability of their market-making lines by July 30, 2007.

(e) The Caisse Reduced its Holdings

[486] Coventree also knew that the Caisse held approximately one-third to one-half of all outstanding Coventree sponsored ABCP as of the first half of July 2007. As a result, the Caisse's decision whether to roll maturing Coventree sponsored ABCP would have a very significant impact on Coventree and the ABCP market. No one disputed that if the Caisse did not support Coventree sponsored ABCP by rolling its ABCP as it matured, a default and a market disruption could occur.

[487] On July 20, 2007, NBF forwarded to the Caisse the June Subprime Data (which Coventree had provided to NBF on July 11, 2007). On Monday, July 23, 2007, the Caisse began reducing its holdings of Coventree ABCP with subprime exposure.

[488] By July 27, 2007, Coventree was aware from the dealers that Verville was attempting to reduce the Caisse's overall ABCP holdings by $1 billion, starting with ABCP issued by third-party sponsors and ABCP that had subprime exposure. On the July 30 Conference Call, Davidson advised Allan that when the Caisse became "squeamish" about subprime, that started a chain reaction with the dealer syndicate. Davidson stated that:

> David, you know, getting back to your question, is it the market or is it us, there's both because, you know, generally, you know, there's not a lot of cash in the market right now but unfortunately your largest investor decided to get squeamish about subprime and that started a chain – chain reaction with the dealer group because the dealers only have so much market making liquidity line[s] available to these sorts of products. We don't typically bid back on, you know, 200 million or 100 million or whatever it is, right.

[489] In a telephone conversation with Allan during the week ending July 27, 2007, Verville indicated that the Caisse had to shrink its overall portfolio and that Verville's strategy for doing so was to switch from Coventree sponsored ABCP to bank-sponsored ABCP. Verville said he

was doing this because he thought there would be more market-making support for bank-sponsored ABCP.

[490] According to Allan, when Verville explained to him how he was "lightening up" on Coventree sponsored ABCP, Verville said that, from an optics standpoint, "well, if you have to lighten up, lighten up from those that have more subprime exposure".

[491] This prompted Allan to ask Verville whether it would help if Coventree reduced the subprime exposure in the note series with the highest subprime exposure by shifting assets to other Coventree conduits or note series. According to Allan, Verville thought that might improve the optics and allow him to lighten his holdings of Coventree sponsored ABCP on a pro rata basis by note series.

[492] Allan testified that this rebalancing of conduit assets appeared to be important to Verville only on the day they discussed it. After that, when Allan raised the rebalancing plan, Verville did not seem interested. (Nevertheless, Coventree continued to work on a rebalancing plan into early August (see the discussion below and Tai's report to the Board on August 3, 2007 referred to in paragraph 667 of these reasons)).

[493] Cornish testified that Coventree expected that the Caisse would eventually agree to "manage their exposure down" in a way that did not create problems for the market. He noted that, if the Caisse's actions led to a market disruption, the Caisse would itself suffer a substantial loss on its ABCP investments. That was something the Caisse would want to avoid.

(f) Dealers Declined to Bid in the Secondary Market

[494] By July 28, 2007, Coventree was aware that there were dealers in the syndicate who had not been providing bids to purchase Coventree sponsored ABCP in the secondary market during the previous week. Paul testified that, particularly in the latter half of July 2007, Coventree was receiving feedback from dealers that some holders of Coventree sponsored ABCP were seeking bids in the secondary market. Paul testified that was a "red flag" because ABCP, by its very nature, is a short-term investment. In an e-mail from Allan to Cornish and others at Coventree on July 28, 2007, Allan stated that the dealers were repeatedly "no bid" on Coventree sponsored ABCP the previous week. RBC was among the dealers that were not bidding on Coventree sponsored ABCP in the secondary market.

(g) Spread Widening

[495] "Spread widening" means that the interest rates payable on newly issued or rolled ABCP are increased, as measured by the number of basis points (one one-hundredth of 1%) that such rates are above the CDOR reference rate. Spread widening encourages investors to purchase ABCP by making the purchase of ABCP more financially attractive. Spread widening can occur for a number of reasons including an increase in the credit risk of the ABCP or because the supply of ABCP exceeds investor demand for it. Spread widening has an adverse effect on Coventree's revenues and net income as Coventree sponsored ABCP matures and is rolled at higher interest rates. Spread widening can also affect the economics and viability of Coventree's securitization business because that business relies on the difference between the cost of funds (represented by ABCP) and the returns on conduit assets.

[496] Cornish testified that the usual spread for A notes was in the range of one to three basis points over CDOR, and for E notes was 11 to 13 basis points over CDOR. In its response to a continuous disclosure request by Staff, Coventree advised that the usual spread for A notes was two to four basis points over CDOR and the usual spread for E notes was 11 to 13 basis points over CDOR.

[497] Coventree first observed spread widening in the market on Monday, July 30, 2007. That day, spreads widened modestly across the market for all third-party sponsored ABCP. Quoted spreads for A notes were approximately 3.7 basis points over CDOR and quoted spreads for E notes were approximately 15 basis points over CDOR. At these levels, Coventree viewed the spreads as still being within a normal range.

[498] At the end of the July 30 Conference Call, a decision was made to increase spreads on Coventree sponsored E notes. Scotia noted that this would result in the spreads on all Coventree sponsored ABCP increasing and that Coventree's competitors would likely all move to the same spreads. Tai acknowledged on the July 30 Conference Call that the spread widening would likely remain in place for three to six months.

[499] On August 1, 2007, spreads on A notes widened substantially to approximately 12.8 basis points over CDOR and spreads on Coventree sponsored E notes widened to approximately 26.8 basis points over CDOR. At those levels, spreads on the A notes had increased approximately four times the usual spread, and spreads on E notes had approximately doubled. These were large and unprecedented increases in interest rate spreads for Coventree sponsored ABCP.

[500] Paul testified that banks and their controlled dealers would generally want to reduce the assets on their balance sheets at quarter or year end and have relatively less ABCP in inventory. This was colloquially known as "window dressing". Paul stated that during these periods, spreads on Coventree sponsored ABCP would increase in order to encourage investors to purchase Coventree sponsored ABCP.

[501] Dalton testified that she could not recall spreads ever widening to the levels they did on either August 1 or August 7, 2007 (for the latter, see paragraph 707 of these reasons).

[502] Paul testified that prior to July 2007, the spread between bank-sponsored and third-party sponsored ABCP rarely, if ever, changed and was usually in the range of two to three basis points. In an e-mail dated August 2, 2007 from Paul to a representative of the Bank of Canada, Paul stated that:

> The spreads of the independents versus the banks has widened about 12 bps over the past week. … Bank ABCP funding has widened only marginally versus CDOR, maybe by a bp. …The independents have suffered spread widening due to some exposure to US subprime lending, a large reliance on funding CDO's through ABCP, and the lack of a big bank perceived as a backstop to the ABCP.

[503] Allan testified that in the period beginning with the week of July 30, 2007, he was aware from the dealers that the interest rate on bank-sponsored ABCP did not widen as much as Coventree sponsored paper: "when we moved 2, they probably moved 1, when we moved 5, they moved 2, when we moved 10, they moved 4, that sort of relationship".

[504] For purposes of comparison, on August 22, 2007, after the market disruption, Coventree issued a news release that stated, among other things, as follows:

> As a result of the market disruption, spreads on the A notes and E notes issued by Coventree sponsored conduits have widened to approximately 50 and 110 basis points above CDOR, respectively, for ABCP that is rated R-1 (high). At these spread levels, Coventree's revenues from credit arbitrage transactions will in the short-term be reduced to zero.
>
> (*Coventree Provides Update on ABCP Market Disruption*, August 22, 2007)

(h) Concerns about Potential Collateral Calls

[505] In an LSS transaction, Coventree sponsored conduits sold credit protection against a default in, or loss in value of, the reference portfolio and were required to post collateral in support of their obligations in certain circumstances (upon a collateral call). This contingent liability is referred to as "contingent funding risk". When a collateral call occurred, there were two options available to the conduit receiving the collateral call (i) issue new ABCP to fund the collateral call, or (ii) use available cash in the conduit, or from the sale of assets, to fund the collateral call. If a collateral call occurred and the conduit was unable to satisfy it, a default would occur.

[506] On July 30, 2007, Citibank made collateral calls with respect to two Coventree sponsored transactions, but withdrew those collateral calls the next day after Coventree persuaded Citibank that its calculations were incorrect.

[507] On August 8, 2007, Coventree voluntarily posted collateral of $25 million for each of two Citibank transactions in order to provide an additional cushion before a collateral call would be triggered.

[508] Coventree typically monitored the potential for collateral calls on a monthly basis by performing various calculations based on Coventree financial models. Beginning on August 1, 2007, Coventree's risk management group performed daily calculations for leveraged transactions that appeared to be close to triggering a collateral call. On August 1, 2007, Coventree's models indicated that it had gone through the collateral call trigger for one transaction, but the counterparty advised that it would not be making a collateral call that day. By August 7, 2007, Coventree's models indicated that four transactions were close to or had crossed collateral call triggers.

[509] Allan testified that the collateral call triggers were affected by two things: a change in spreads for credit default swaps and a change in the risk correlation among the relevant assets. By August 1, 2007, the risk of collateral calls was increasing in LSS structures because of unprecedented spread widening in credit default swaps and large increases in risk correlation.

[510] In her notes of the August Board Meeting, Child recorded that Coventree was "perched on triggers" for collateral calls (see paragraph 559 of these reasons).

[511] Allan stated to Davidson during a call on August 4, 2007 that, while he had anticipated when he joined Coventree that Coventree sponsored conduits would be highly leveraged to the credit cycle, they were much more highly leveraged than he had expected. He noted that Coventree was developing a strategy to step back from "the abyss", but that strategy could not be implemented in two months, more likely in two years; but only if the credit cycle stayed reasonably benign.

(i) Coventree Sponsored Conduits Sell Assets

[512] Coventree stated in its third quarter MD&A for the period ending June 30, 2007 that it was its "practice to explore all available options before selling and unwinding a transaction for risk management reasons".

[513] By late July 2007, Coventree had begun selling conduit assets in order to accumulate cash or so-called "dry powder". Based on evidence submitted by Staff, it appears that the first significant asset sale by a Coventree or Nereus sponsored conduit occurred on July 20, 2007 and generated cash of approximately $173 million. By August 1, 2007, asset sales aggregating approximately $188 million had been completed. Tai's e-mail to the Board on August 3, 3007 indicated that Coventree had accumulated by that time approximately $610 million of cash in its conduits. By August 8, 2007, the aggregate amount of cash was approximately $625 million. Cornish stated in his testimony that approximately $225 million of that amount arose from asset sales in January and February 2007, and not sales in August 2007 as submitted by Staff. From our perspective, nothing turns on that particular question. Cornish testified that, as of the market disruption on August 13, 2007, Coventree and Nereus sponsored conduits had accumulated approximately $1 billion of cash.

[514] Coventree's initial objective in generating cash in its conduits was to be able to fund the possible repurchase of maturing ABCP or to fund collateral calls. Approximately $60 million of available cash was used to purchase Planet A notes over the August 3rd long weekend (see paragraph 678 of these reasons). Tai was not happy with the use of cash for that purpose and instructed that no further cash should be used to purchase Coventree sponsored ABCP without the approval of the strategic council. Cash was to be preserved exclusively to fund collateral calls.

[515] This was a potentially significant decision by Coventree not to support the rolling of ABCP by its conduits. (See paragraph 584 of these reasons for the relevant disclosure in the Prospectus of the potential effect on Coventree's business if it did not support the rolling of Coventree sponsored ABCP.)

[516] As discussed below, by July 30, 2007, there was no capacity for Coventree or Nereus sponsored conduits to issue any new ABCP. As a result, any collateral call had to be funded from cash in the conduits or the sale of conduit assets to generate cash.

[517] Allan testified that there were two problems associated with selling CDO assets in late July and early August 2007:

(a) the assets would likely be sold at a loss and Coventree might have to cover those losses itself; and

(b) selling assets in that environment could cause credit default swap spreads to widen further, leading to further increased risk of collateral calls for Coventree sponsored conduits.

[518] In addition, as a result of asset sales:

(a) Coventree permanently lost the revenue backlog associated with the assets sold; and

(b) conduits experienced "negative carry" on the reinvestment of the proceeds of sale (see paragraph 520 below).

Further, conduits could not replace any CDO assets sold with new CDO assets because the DBRS January Release prevented Coventree sponsored conduits from carrying out such transactions.

[519] As noted above, the sale of assets by Coventree sponsored conduits would have the effect of eliminating the revenue backlog associated with the assets sold. The evidence is that the actual sales of assets by conduits for this purpose did not significantly reduce revenue backlog (backlog was actually reduced by less than approximately $1.0 million).

[520] The accumulated cash from asset sales was invested in short-term highly liquid investments which earned a lower rate of return than the interest rate paid to investors on the outstanding ABCP, giving rise to "negative carry".

(j) Inability to Fund Purchases of New Assets

[521] Xceed sold mortgages to Coventree sponsored conduits in connection with traditional securitization transactions approximately every two weeks during the period from 2006 to mid-July 2007. Xceed had been an asset supplier of traditional mortgage assets to Coventree sponsored conduits since 2002.

[522] On July 31, 2007, Coventree was scheduled to close a purchase of approximately $66 million of mortgages from Xceed. On July 30, 2007, Allan advised Jones that the transaction was not going to be funded by Coventree. Allan said that the transaction was being postponed because of "turbulent market conditions" at the time. Allan also referred to widening interest rate spreads, investor rebalancing of portfolios and contagion from the collapse of the U.S. subprime mortgage market as reasons for the postponement.

[523] Jones testified that some asset sales to Coventree sponsored conduits had been postponed or delayed in the past, usually for administrative reasons, and only for a day or two. He testified that Xceed had never before had a sale delayed for the reasons stated by Allan. After being advised that the sale would not proceed, Xceed sought information confirming Allan's characterization of market conditions from various sources, including CIBC and Deutsche Bank, each of whom confirmed Coventree's assessment.

[524] In an e-mail dated July 30, 2007 to Tai and Cornish, Toten recounted the "uncomfortable call" with Xceed that day, advising Xceed that Coventree was not able to fund the transaction the

next day. He noted that "the liquidity in the markets is very, very bad, particularly in the ECP [extendible commercial paper] market. We are struggling to have our existing ECP roll over and are simply not in a position to add new issuance".

[525] Coventree did not have a legal obligation to complete the Xceed purchase and, accordingly, the deferral was not a default under the arrangements with Xceed. Jones testified that he considered the delay in the transaction to be temporary.

[526] Dalton testified that deferring funding for a long-term client like Xceed was a serious matter. During a call on July 30, Allan and Dalton commented to Courchesne on Coventree's failure to fund the asset purchase from Xceed as follows:

> DAVID ALLAN: Well, when you say dangerous, I mean we – we've just deferred a funding for a client that – that is – that's pretty – I mean, in the hierarchy of – of – of notches we have fallen down to, obviously, uh, drawing upon a liquidity line or extending an ABCP holder is – is obviously the – the most draconian thing we can do in this situation. But, you know, certainly deferring funding for the long term clients is – is –
>
> JUDI DALTON: Is the next.

[527] Allan testified that "if we were uniquely unable to fund clients, it would be a huge problem for Coventree's franchise, absolutely". The concern was that clients would turn to bank-sponsored transactions for funding. We do not have any evidence that Coventree was "uniquely" unable to fund transactions. Further, not all Coventree clients would have been able to access bank sponsored transactions in any event. Nonetheless, this was a very significant event for Coventree and its ongoing business.

[528] In her handwritten notes of a meeting held on July 31, 2007, Child wrote "if it gets in market that we're not a reliable funder we won't have business … right now with our spreads widening, there is a huge premium to do business with us". Child testified that she was referring to a statement made to her by someone else at Coventree, but she could not recall which meeting the notes were from, or who made the statement.

(k) Rebalancing Conduit Assets

[529] The assets of Coventree sponsored conduits were "siloed" or "ring-fenced", meaning that the assets backing each note series were segregated from assets backing other note series or held by other conduits. For example, the assets supporting Planet E notes were completely separate from those supporting Planet A notes.

[530] The Caisse's actions in reducing its holdings of Coventree sponsored ABCP with subprime exposure was of sufficient concern to Coventree that Coventree proposed to transfer or reallocate subprime assets among its conduits and note series to attempt to satisfy the Caisse's concerns (this was referred to as "**rebalancing**" the assets of the conduits). Because of the size of the Caisse's holding of Coventree sponsored ABCP, it was critically important to Coventree that the Caisse be comfortable with, and support, Coventree sponsored ABCP. Based on feedback Allan received from the Caisse, Coventree proposed to reduce the subprime exposure in each of

its conduits or note series to a maximum of 15% by transferring subprime assets from one conduit or note series to another.

[531] Coventree contacted DBRS in order to begin the process of rebalancing assets, which required DBRS to confirm, after any asset transfer, the credit rating of all note series affected.

[532] On or around July 30, 2007, assets supporting Comet E notes totalling $58 million were transferred to support Planet E notes. This had the effect of reducing the subprime exposure of Comet E notes from approximately 42% to 38% and increasing the subprime exposure of Planet E notes from approximately 3% to 11%. This was the only transaction that Coventree actually implemented in which assets were reallocated as a part of the rebalancing plan.

[533] On July 31, 2007, Dalton sent an e-mail to NBF, Scotia and CIBC, copied to Allan and Paul, commenting on the increased subprime exposure in Planet E notes. She stated that "[t]he investor who bought the Planet E is aware of this small increase in % US residential subprime and our intention to continue to reduce the Comet E US subprime levels".

[534] In any event, Coventree abandoned its plan to rebalance the subprime exposure of its conduits by August 6, 2007.

[535] Any reallocation of subprime assets that increased the subprime exposure of another note series raises an obvious question of fairness to investors. However, except for the transaction referred to in paragraph 532 of these reasons, no further rebalancing transactions were carried out. The question of the fairness of the rebalancing of assets is not an issue raised by Staff in the Statement of Allegations. Accordingly, we will not address it.

(l) Dealer Information Requests

[536] After the July 24 e-mail was sent, Coventree began receiving numerous information requests from the credit departments of the various dealers asking for information with respect to the assets backing Coventree sponsored ABCP. Dalton stated in the August 2, 2007 e-mail referred to in paragraph 477 of these reasons that Coventree was "getting buried" with credit requests.

[537] From July 25, 2007 to July 27, 2007, Allan communicated frequently with CIBC risk management, providing information both on subprime and CDO exposure.

[538] Paul proposed to Child on July 28, 2007 that Coventree "set up a data room and invite the credit department[s] of all our dealers". During his testimony, Paul characterized the requests for information from dealers as "overwhelming" and he suggested a data room be established so Coventree was not "trying to push a large amount of information through a small pipe".

[539] On July 29, 2007, Dalton e-mailed Allan advising him that NBF was seeking more information with respect to subprime assets, LSS transactions and all other assets backing Coventree sponsored ABCP. She also recommended that they agree on a plan and call their three "top" dealers, NBF, CIBC and Scotia, to address specific days that might have high maturities. In responding to her e-mail and the data room suggestion, Allan noted "[b]elieve me, I do understand the peril of our current situation."

[540] Paul testified that he cancelled his vacation scheduled for the week of July 30, 2007.

(m) RBC's Resignation

[541] RBC resigned as a member of the Coventree dealer syndicate on July 27, 2007.

[542] Dymott testified that, after receiving the July 24 e-mail (setting out the subprime exposure of Coventree sponsored conduits and note series), RBC expressed concern about Coventree's direction that dealers should use their discretion in selectively sending out that information to clients "with the sophistication to use it". Dymott testified that RBC believed that the information should have been posted publicly on Coventree's website so that investors would have direct access to it. Dymott testified, however, that RBC had not specifically requested that Coventree do that.

[543] Dymott testified that:

> Well, again, you know, we just received this document [the July 24 e-mail]. We felt that it should be posted on a web site, and we had seen activity the previous week with several large institutional investors that suggested to me that they'd had the document ahead of when I was sent it. So I believed that there were problems at this point...

[544] Dymott testified that in the week prior to RBC receiving the July 24 e-mail, the Caisse had failed to roll some Coventree sponsored ABCP that had been purchased from RBC. Dymott stated that during this time, Citibank had requested a bid on Coventree sponsored ABCP that RBC had declined to provide because of limits on its market-making lines. Dymott characterized both of these occurrences as "unusual". Dymott stated that he was unaware of the extent of the subprime exposure underlying Coventree sponsored ABCP prior to receiving the July 24 e-mail. RBC forwarded the July 24 e-mail directly to its clients on July 30, 2007.

[545] On July 30, 2007, RBC also contacted its clients holding Coventree sponsored ABCP and advised that it had resigned from the Coventree dealer syndicate. RBC indicated that its resignation was because of RBC's small role in the distribution of Coventree sponsored ABCP relative to the overall size of the market. RBC advised its clients that it would no longer provide bids on Coventree sponsored ABCP. With respect to maturing Coventree sponsored ABCP, RBC directed its clients to NBF. At the time, RBC had approximately $880 million, or approximately 8.3%, of Coventree sponsored ABCP outstanding with its clients.

[546] Coventree recognized that RBC was the largest dealer in the commercial paper markets in Canada and that its actions influenced investors. Cornish commented that RBC's resignation had the potential to "spook the market further at a critical time". Coventree was also aware that problems with RBC's trading desk (i.e., the RBC employees involved in selling Coventree sponsored ABCP) could also affect the renewal of liquidity agreements entered into between Coventree sponsored conduits and RBC.

[547] Upon learning of RBC's resignation for the first time during the July 30 Conference Call, Smith commented that "every hundred million counts here" and upon being told that RBC's

share of Coventree sponsored ABCP sales was "less than a billion", he said "that's a serious amount of funding". Davidson added that "it's at the worst possible time as well".

[548] During an early morning call with Courchesne on July 30, 2007, Dalton expressed concern about investor reaction to the RBC resignation. She speculated that a large portion of the estimated $880 million of Coventree sponsored ABCP held by RBC clients was held by clients that NBF covered as well. She thought there might be a couple of hundred million dollars that did not involve NBF clients.

[549] Cornish testified that he did not speak to anyone at Coventree about the possibility of issuing a news release about the RBC resignation. Cornish concluded that RBC was a relatively small player in Coventree's dealer syndicate and he was confident that the other dealers could "pick up the slack". Nonetheless, Cornish acknowledged that RBC's refusal to offer Coventree sponsored ABCP for sale "exacerbated the liquidity difficulties that had started at that stage".

(n) August 1, 2007 Board Meeting

[550] Coventree's management convened a Board meeting on August 1, 2007, on only a few hours' notice, to discuss deteriorating market conditions (the "**August Board Meeting**"). In an e-mail to the Board setting up the meeting, Child stated that "as the markets are going crazy, we would like to convene an emergency board meeting today". Cornish testified that senior management began to consider calling the Board meeting on the morning of August 1, 2007 as a result of events that had occurred to that point. Cornish testified that "this is not a case of business as usual. That's for sure. The markets aren't settled". At the Board meeting, at least five issues or developments respecting Coventree's business were discussed. The minutes of the August Board Meeting provide as follows:

> The meeting was convened by management of the Corporation to allow it to update the Board on recent developments in the Canadian asset-backed commercial paper ("ABCP") market and their potential impact on the Corporation's business operations and assets, including the financing activities of the conduits (the "Conduits") sponsored by the Corporation. Geoff [Cornish] and David [Allan] presented this update to the Board which include, among other things, a summary of the following:
>
> > 1. spread widening (that is, increasing financing rates) in the issue discount rate of liquidity backed ABCP ("A notes") and extendible ABCP ("E notes") issued on a daily basis by the Conduits;
> >
> > 2. the Conduits' ability to place new issuances of their A notes and E notes;
> >
> > 3. the Corporation's sense of a decreased market making capacity of the Conduits' syndicate of dealers for the Conduits' A notes and E notes;
> >
> > 4. movement in both international credit spreads and risk correlation, and the resulting in [*sic*] increased probability of collateral calls being issued by

the conduits' counterparties in respect of their leveraged super senior transactions; and

5. the Corporation's possible responses to the recent developments in the ABCP market.

> Following a lengthy discussion which included numerous questions and answers, the Board instructed management of the Corporation to continue to monitor and update the Board by email and/or other means on developments in the ABCP market and their impact on the Corporation's business operations and assets. The Board further instructed Management to convene a Board meeting for an update on and possible considerations of any event(s) or occurrence(s) in the ABCP market which is significant to the Corporation's business operations or assets.

That excerpt represents the entire minutes addressing the substantive business at the meeting.

[551] In an e-mail the previous day to Tai, Cornish suggested that legal counsel should be retained for the Board meeting. The legal advice that Cornish wished to obtain related to balancing Coventree's fiduciary duties as securitization agent owed to ABCP investors and Coventree's obligations to its own shareholders. There was no evidence tendered that such legal advice was obtained.

[552] Cornish testified that, in his comments to directors at the August Board Meeting, he conveyed that:

(a) there seemed to be a retracting in the ABCP marketplace in Canada, in that it seemed like investors were taking their cash and putting it elsewhere, and that was causing difficulty in placing Coventree sponsored ABCP;

(b) the dealers' risk management groups were reviewing in detail the assets in Coventree sponsored conduits, and it was Coventree's impression that some of the dealers' market-making lines had been reduced or eliminated;

(c) there was a lot of volatility in the marketplace and the spreads on Coventree sponsored ABCP had been widened in order to induce investors to stay in the market and continue to roll Coventree sponsored ABCP, or to induce new money to come in;

(d) there was an increased probability of receiving collateral calls as a result of increased volatility, changes in the marketplace and spread widening with respect to credit default swaps, and there had been a collateral call from Citibank that had been withdrawn;

(e) one of the possibilities that Coventree was considering was selling some transactions held by the conduits, even if the sale produced a loss from the conduits' perspective, in order to provide funds to meet potential collateral calls;

(f) if the situation continued, the Board might have to make a choice between selling assets at a loss and using Coventree's equity to make the conduits whole, or letting the conduits default and preserving Coventree's equity; and

(g) he thought that the situation could last to the end of October, but he thought it would be resolved considerably sooner than that.

[553] At the August Board Meeting, Tai commented that if the circumstances were an industry-wide problem, there was likely very little Coventree could do. He noted management "to-do's" from the board meeting as (i) announce something to the public and send a draft to the Board for a quick look, and (ii) lay out some options or ideas about what Coventree should do in the future. After briefing the Board, Coventree management was asked to keep the Board advised of further developments and to provide a daily update on market conditions and the rolling of Coventree sponsored ABCP. Tai thereafter provided daily updates to the Board (see, for instance, the first e-mail update to the Board at paragraph 657 of these reasons).

[554] Tai's daily updates to the Board attempted to provide directors with a high-level assessment of events in the market related to the rolling of Coventree sponsored ABCP. Clearly, there continued to be concerns about whether Coventree sponsored ABCP would roll each day. Generally, Tai characterized a day as a "good day for Coventree" if its ABCP was rolled, whether or not the ABCP was taken into inventory by the dealers.

[555] Management and the directors of Coventree appear to have been acting responsibly in monitoring events as they unfolded with a view to Coventree complying with its disclosure obligations.

[556] The question whether or not a news release should be issued immediately was discussed at the August Board Meeting. At the meeting, Mowat went through a list of items that she speculated a Coventree shareholder might want to hear about. Those items included: (i) RBC's resignation from the dealer syndicate, (ii) collateral calls, (iii) the selling of assets that affected a material amount of backlog, and (iv) whether any agreement was breached by Coventree's failure to fund the Xceed transaction (referred to in paragraph 522 of these reasons). Cornish and Mowat testified that the outcome of the discussion was a preference by directors for Coventree to issue a news release the next day, but that was not conclusively decided. Child's notes of the August Board Meeting (referred to in paragraph 558 below) indicate that there was an "intention of releasing it before the markets open tomorrow morning …".

[557] At the August Board Meeting, Mowat asked for management's assessment of the level of concern. Tai commented that in the last 48 hours it had gone from 10 to a 7 or 6. Cornish commented that if 10 is "very, very concerned", he was high on that scale and at 7. Cornish testified that the reason he was at 7 was that Coventree still did not have a good read on exactly what the Caisse was intending to do. Mowat asked for an indication in the daily Board updates of management's level of concern.

[558] Child made handwritten notes of what we believe was the August Board Meeting, in which she listed seven issues for possible disclosure:

1. No new issue capacity

2. LSS triggers proximity
3. spread widening – growth
4. selling deals – impact on backlog
5. RBC terminated
6. Xceed funding
7. Negative carry on overfunding

[559] Child's notes also attribute to Allan the statement that "before today hadn't communicated that we don't have any new issue capacity, we're only able to roll paper". Those notes also state that "we've had unprecedented movement with both spreads + correlation". With respect to collateral calls, the notes state that "what started as US subprime caution has migrated to LSS trades + we're perched on triggers".

(o) The Draft Press Release

[560] As requested by the Board, Cornish prepared a draft news release immediately after the August Board Meeting. He decided to focus only on the issue of spread widening. He did not consult external legal counsel in preparing the draft release, but he testified that he considered the advice that Coventree had received previously from Davis & Co. to the effect that there was a rule-of-thumb that a financial impact of 5% of net income was considered material. The strategic council met first thing in the morning on August 2, 2007 to review Cornish's draft news release and their meeting focused on the question of what impact spread widening would have on Coventree's financial performance.

[561] After the strategic council meeting, Coventree management circulated a draft press release (the "**Draft Press Release**") to the Coventree Board for review. The Draft Press Release did not mention any of the other items identified in the Board minutes (referred to in paragraph 550 of these reasons), conveyed by Cornish at the meeting (see paragraph 552 of these reasons), raised by Mowat at the meeting (see paragraph 556 of these reasons) or in Child's notes of the meeting (see paragraph 558 of these reasons). The Draft Press Release provided substantially as follows:

> … [Coventree] today announced that current conditions in the Canadian ABCP market are adversely affecting current revenues and will adversely affect future revenues of Coventree if those conditions continue.
>
> Coventree sponsors and administers asset-backed commercial paper ("ABCP") conduits that in the aggregate have approximately [$16 billion] in fundings outstanding. Pricing for ABCP generally is typically based on a spread between the Canadian Deposit Offering Rate ("CDOR") or bankers' acceptance rates and the ABCP. Spreads on liquidity-backed ABCP and extendible ABCP issued by Coventree sponsored conduits have typically been in the range of [x

to y] and [a to b] basis points above CDOR, respectively, for 30 day maturities. These spreads have historically been relatively stable.

> However, in recent weeks, spreads on ABCP issued by conduits sponsored by independent (or non-bank) conduit sponsors, like Coventree, have widened from historical levels. For example, spreads on 30-day liquidity-backed ABCP and extendible ABCP issued by Coventree sponsored conduits during the last two weeks have ranged from [x to y] and [a to b] basis points above CDOR, respectively. Because many of the investments held by Coventree's conduits earn a fixed spread above CDOR, this spread widening has decreased the current revenues of Coventree and, if it were to continue, will result in a material decrease in the future revenues of the Company and therefore its profitability.

> Coventree believes that the current spread widening was initially triggered by investors' concerns about exposure in asset-backed securities to U.S. subprime mortgages. Coventree's conduits have limited exposure to this asset class – less than 4% of the total assets in Coventree's conduits are backed by assets related to U.S. subprime mortgages, and those assets continue to perform [as expected]. However, those initial concerns appear to have lead [*sic*] to broader concerns relating to credit markets generally, including the Canadian ABCP markets. As a result, the Company is unable to predict whether ABCP spreads will return to historic levels and, if so, when, or whether Canadian ABCP spreads will continue to widen and further reduce Coventree's revenues and profitability.

> …

Cornish confirmed in his testimony that Coventree was unable to predict whether spreads would return to historic levels and, if so, when.

[562] On August 2, 2007, Tai circulated the Draft Press Release to members of the Board by e-mail. The e-mail included a recommendation that the press release not be issued, but that it be held for possible future release. That e-mail put the onus on the directors to advise Coventree if they disagreed with that recommendation. Ultimately, no press release was issued. The reasons for not issuing a press release on August 2, 2007 were set out in the e-mail as follows:

1. We just don't feel we have enough observable data points. We just don't know what is going to happen tomorrow.

2. We are currently doing the analysis on the materiality of spread widening over the last 48 hours. At this point, we don't believe things have reached that level although if things persist at this level they will shortly cross the materiality threshold.

3. In the context of Khalil [*sic*] comments [Khalil Barsoum was a member of the Board], we feel that a press release of this nature could contribute to the uneasiness of the ABCP markets.

> Our recommendation is to hold off on the press release, but have it ready if the uneasiness in the markets persist. Given the board decision was to consider issuing a press release, what I suggest we do is call an emergency board meeting if anyone feels strongly that we absolutely have to issue a press release today.

We comment on those reasons for not issuing a news release in paragraph 756 of these reasons.

[563] Cornish testified that from Coventree's perspective, issuing a press release of this nature "could do more harm than good".

[564] According to Child's notes of the August Board Meeting, Khalil Barsoum, a director, commented during the meeting that "at the same time, we don't want to generate a run on the bank".

[565] He also commented that "I do not feel strongly yet about issuing the press release. I do feel however, that it is a good idea to issue one; it should reflect the facts and reality as we all see it, without raising alarm beyond what is appropriate".

[566] Mowat's feedback on the Draft Press Release was that if "the world can stay as it is today", the proper place for the disclosure of these events would be in Coventree's MD&A. The Board was scheduled to review and approve third quarter MD&A at a Board meeting on August 13, 2007. Brendan Calder, another board member, responded that "the situation isn't clear enough or material enough yet". Another board member, John Rogers, stated that "I suspect we may have a few more bad days…".

(p) Preparations for a Market Disruption

[567] If a market disruption occurred, there were protocols that had to be followed by Coventree as securitization agent, and notices that were required to be given, in order for a conduit to access the liquidity provisions backing the ABCP issued by that conduit or to extend the term of extendible ABCP.

[568] On July 25, 2007, Coventree called an internal meeting to discuss and review market disruption procedures. By that date, dealers had been asking Coventree for details respecting liquidity agreements and the liquidity drawdown protocols. Paul testified that the meeting on July 25, 2007 was called because Coventree had observed enough days in a row that gave them cause for concern and that "it was certainly conceivable at some point that the market disruption protocols might be required".

[569] Scotia, Nereus's lead dealer, also recognized that a market disruption was a possibility. On July 27, 2007, Scotia asked for the drawdown protocols for each transaction in the Nereus conduits. Morley Conn of Scotia said, "don't want to alarm, but I should have this at my fingertips".

(q) Summary of Market Conditions as of August 1, 2007

[570] In summary, after the July 24 e-mail was circulated to dealers, and over the period leading up to and including Wednesday, August 1, 2007, the evidence leads us to conclude that there were the following changes in market conditions applicable to Coventree sponsored ABCP:

(a) there was no new issue capacity for Coventree sponsored ABCP;

(b) there was a significant reduction in demand for ABCP issued by Coventree sponsored conduits including, in particular, extendible E notes and those note series with the highest subprime exposure;

(c) dealers reported difficulty in rolling ABCP issued by Coventree sponsored conduits;

(d) the term for which some investors "rolled" their ABCP became shorter and there was a significant increase in overnight rolls;

(e) it took longer each morning for the dealers to complete sales of Coventree sponsored ABCP and more ABCP was being returned to NBF as leader of the syndicate;

(f) there appeared to be some flight to quality, meaning some investors were trading out of third-party sponsored ABCP to bank-sponsored ABCP or government debt;

(g) dealers were reporting that their market-making lines for Coventree sponsored ABCP were fully or close to fully extended; and

(h) dealers were not providing bids for Coventree sponsored ABCP in the secondary market.

All of these developments and changes in market conditions also applied to and affected Nereus sponsored conduits.

(r) Public Information as to Interest Rate Spreads

[571] We understand that there is no publicly available source of historical interest rate data for the Canadian ABCP market. At the hearing, Cornish provided information with respect to spread widening in the July and August 2007 time period, based on the trading of ABCP issued by its Rocket Trust. Staff submits that the Rocket Trust was the largest and most liquid of Coventree's conduits with the most ABCP outstanding. Neither Rocket A nor Rocket E notes had any subprime exposure and would therefore not have been affected by the same liquidity issues experienced by Comet E and Planet A notes, which had the highest subprime exposure (42% and 26% subprime exposure, respectively, based on the July 24 e-mail).

[572] In contrast, Staff relied upon the spread widening shown in Coventree's daily data summaries which were prepared by Coventree at the end of each trading day. However, there is

not a great deal of difference between the interest rate spreads relied on by Coventree and those relied upon by Staff.

[573] Cornish also testified that there were occurrences in the past of significant spread widening in Canadian credit markets. These included:

(a) in 1992 and 1993, spread widening associated with credit concerns relating to the solvency of Olympia & York;

(b) in 1995, spread widening around the time of the Quebec referendum;

(c) in 1998, spread widening associated with the collapse of Long-term Capital Management and with the Russian debt crisis;

(d) in 1999, spread widening associated with Y2K; and

(e) in 2005, spread widening associated with General Motors Acceptance Corporation ("**GMAC**") credit rating downgrades.

Allan testified that Coventree was not selling ABCP prior to the fall of 1998 and that Coventree sponsored ABCP was not directly affected by the spread widening associated with the GMAC downgrades.

[574] Clearly, all of these examples relate to extraordinary outside events or developments and are quite different from the circumstances facing Coventree in 2007. During the July 30 Conference Call, Smith noted, "I mean, we have to remind ourselves, we are in uncharted territory". Allan testified that he agreed with this statement. In the same call, Allan noted "in 1998, we didn't have extendables [*sic*]. We didn't have CDO assets. … The contagion didn't really touch as closely as it does to the actual assets that are in the conduits as what we are talking about now … the subprime explosion is going to be felt through the whole CDO market throughout the globe this time".

[575] Allan testified that, in previous periods of illiquidity which affected the bank-sponsored ABCP market, banks used their market-making lines to support the market. Allan indicated, for example, that there was an oversupply of ABCP in the winter of 1998 and again in 1999 when issuances of ABCP outpaced the absorption rate of the market; these challenges were buffered by the purchases of ABCP by the banks. Allan testified that in those two time periods, the banks simply increased their inventories of ABCP. In connection with the GMAC-related liquidity issues in 2005, Allan testified that bank market-making lines were used to take ABCP into inventory until investor confidence returned.

[576] Both Cornish and Allan testified that past crises involving spread widening gave them some comfort that spreads would eventually narrow again. But in the "Frequently Asked Questions" speaking notes prepared on August 7, 2007, it was stated that:

> There have been credit events that have occurred throughout the history of the credit markets; however, we believe that this current situation is unique and we

> are not able to use the past to predict the future of the current situation with which we are faced.

(See paragraph 712 of these reasons.)

[577] It appears to us that, by the close of business on August 1, 2007, spread widening was at an unprecedented level with respect to Coventree sponsored ABCP.

6. Analysis and Conclusions

[578] The question we must determine is whether a material change occurred with respect to Coventree on August 1, 2007, or thereafter and prior to the market disruption that occurred on August 13, 2007. Because of our conclusion below that material changes occurred with respect to Coventree by the close of business on August 1, 2007, we will first address the events and developments as they existed by the close of business on August 1, 2007. We summarise the events and developments in the period after August 1, 2007 commencing at paragraph 655 of these reasons.

[579] The first question we must address is whether a change in Coventree's business or operations occurred as a result of events and developments during the period leading up to and including August 1, 2007.

(a) Did a Change Occur in Coventree's Business or Operations?

Coventree's Business

[580] The definition of "material change" in the Act requires us to determine whether there was a change in the "business, operations or capital" of Coventree during the relevant period. There is no evidence to suggest that there was any change in Coventree's "capital" for this purpose.

[581] We have described Coventree's business beginning at paragraph 76 of these reasons. Coventree was in a capital markets business focused principally on carrying out through its sponsored conduits traditional securitizations and credit arbitrage transactions. That business includes the business of Nereus, its wholly owned subsidiary as of May 10, 2007, and the conduits sponsored by Nereus.

[582] In our view, one should not take a supercritical or technical approach to the interpretation of what constitutes a change in the business or operations of an issuer for purposes of the definition of "material change" in the Act (see paragraph 146 of these reasons). It is clear in this case that actions taken by DBRS and other external events and developments that were affecting the ABCP credit market had direct effects on and changed Coventree's business. Coventree's principal business involved acting as securitization agent in sponsoring and managing conduits that issued ABCP. At the date of the Prospectus, Coventree sponsored conduits had fundings outstanding of more than $12 billion (not including Nereus fundings) (see the excerpt from the Prospectus set out in paragraph 584 of these reasons). Coventree received fees and other revenue based on the funding transactions carried out by Coventree sponsored conduits and its revenue backlog was derived from the fundings outstanding (see paragraph 355 of these reasons). Accordingly, the ability of Coventree sponsored conduits to carry out securitization transactions,

to issue ABCP and to "roll" ABCP as it matured, was a crucial part of Coventree's business. That is clear from the disclosure in the Prospectus.

[583] We discussed earlier in these reasons the Commission's conclusion in *Re Rex Diamond* that a change occurred in Rex Diamond's business and operations when it became legally unable to access its mining properties in order to extract diamonds (see paragraph 154 of these reasons). We note, in this respect, that the inability of Coventree sponsored conduits to issue ABCP is analogous to the inability of Rex Diamond to access the relevant mining properties and to extract diamonds. In both cases, the result is that the relevant issuer became unable to carry on its principal business.

[584] Accordingly, any substantial disruption in the business activities of a Coventree or Nereus sponsored conduit directly affected and changed Coventree's business. The Prospectus notes the potential consequences to Coventree of a disruption in the ABCP market:

> If the Canadian ABCP marketplace were to encounter a circumstance of crisis proportions resulting in a cessation or fundamental adverse shift in the normally highly liquid market, such a disruption would pose a serious funding problem for Coventree. The disruption could be a general market disruption or one focused on ABCP issued by Coventree's conduits, where investors no longer purchase ABCP issued by the Company's sponsored conduits. *In either case, such a market disruption would not only prevent conduits sponsored by Coventree from issuing new paper necessary to acquire new deals, but also could prevent the conduits from rolling their outstanding ABCP*. With more than $12 billion[1] of ABCP outstanding, which ordinarily matures over varying durations ranging from overnight to more than 90 days, Coventree's conduits rely on their ability to issue new ABCP to finance the payout on the maturing ABCP on a daily basis. Given that conduits sponsored by the Company typically roll over a quarter of a billion dollars of commercial paper per day, if a disruption were to occur, Coventree's sponsored conduits could be exposed to a demand for payment well in excess of the Company's cash reserves. *Although Coventree has no legal obligation to fund the conduits to buy back ABCP from investors in the event of a disruption, Coventree's reputation in the industry and ongoing ability to access the capital markets could be severely adversely impacted if it did not or could not do so*.
>
> Further, if Coventree did not support a conduit that was unable to roll its outstanding ABCP as a result of a market disruption, it is likely that this circumstance would lead to an event of default, as defined in the constating documents that established the conduit. *Such an event of default could result in the termination of the contractual arrangements between Coventree and the conduit pursuant to which Coventree acts as the securitization agent of that conduit and which are the primary source of Coventree's revenues*. As noted above, a market disruption is, in effect, a severe imbalance between the supply and demand for the ABCP issued by Coventree-sponsored conduits and could be

[1] As of June 30, 2006, excluding Nereus.

> caused by factors that relate to the ABCP market generally … or factors that relate solely to the ABCP issued by Coventree-sponsored conduits … [emphasis added]
>
> (Prospectus, p. 59)

That is a fair summary of the circumstances Coventree was facing in the days leading up to the market disruption on August 13, 2007.

[585] Further, Coventree did not dispute that when Coventree sponsored conduits became unable to roll a portion of their maturing ABCP on Monday, August 13, 2007, that event constituted a material change with respect to Coventree. Coventree immediately issued a news release as a result of that material change.

[586] The fact that Coventree sponsored conduits are separate legal entities and that Coventree is not legally liable to repay the ABCP issued by those conduits does not affect our conclusion in paragraph 582 of these reasons.

[587] We discuss below the specific changes in Coventree's business or operations that occurred as a result of the events and developments during the period leading up to August 1, 2007 (see paragraph 590 of these reasons).

[588] In *Danier*, the Supreme Court of Canada held that changes in the intra-quarterly results of operations of an issuer as a result of an external factor or event such as the weather, does not, by itself, constitute a change in the business, operations or capital of an issuer for purposes of the definition of "material change" in the Act. The Court noted, however, that changes made by an issuer to its business *in response to an external event or development* can give rise to a material change. We also consider it clear that where an external event or development has a direct effect on, and changes or interferes with, the business or operations of an issuer, that external event or development can give rise to a change in the issuer's business or operations for purposes of the definition of "material change" in the Act. The changes in Coventree's business and operations discussed below are not limited to changes in financial results caused by external events or developments.

[589] Further, we interpret Child's notes from the telephone call with legal counsel on August 6, 2007 as suggesting that substantially similar legal advice was given to Child (see paragraph 698 of these reasons). Child's notes indicate that events "whether market forces" or not that are "likely to impact" the business must be disclosed. Accordingly, at least by August 6, 2007, Coventree was aware of the possibility that changes to its business as a result of external events or developments were required to be publicly disclosed.

(b) Changes in Coventree's Business by the Close of Business on August 1, 2007

[590] In our view, the following changes in Coventree's business or operations had occurred by the close of business on August 1, 2007:

(i) Inability to Issue New ABCP

By August 1, 2007, Coventree sponsored conduits were unable to issue any new ABCP because of the lack of liquidity in the market. As a result, Coventree could not, through those conduits, carry out any traditional securitization transactions and could not purchase assets from its traditional asset providers. That resulted in Coventree being unable to fund the purchase of mortgages from Xceed, one of its important asset providers, on July 30, 2007. Further, Coventree sponsored conduits could not enter into new credit arbitrage transactions because of the lack of liquidity in the market and because of the DBRS January Release. (We recognise, in this respect, that we have previously concluded that the DBRS January Release itself constituted a material change with respect to Coventree.)

That meant that by August 1, 2007, Coventree was unable to carry out through Coventree or Nereus sponsored conduits either traditional securitizations or credit arbitrage transactions. Those transactions represented approximately 90% of Coventree's revenues for the period ending June 30, 2007.

Further, because Coventree was unable to issue any new ABCP, it could not fund the purchase of maturing ABCP or potential collateral calls, or replace assets that were sold by the conduits to generate cash.

In effect, Coventree could not carry on its securitization business because its sponsored conduits could not do any new fundings.

(ii) Difficulty Rolling Outstanding ABCP

By August 1, 2007, Coventree sponsored conduits were having difficulty rolling outstanding ABCP as it matured because of the lack of liquidity in the ABCP market. Coventree knew from conversations with its dealers that the dealers were finding it increasingly difficult to roll Coventree sponsored ABCP and were having to purchase Coventree sponsored ABCP into inventory pursuant to their market-making lines. By August 1, 2007, those dealers were expressing high levels of concern that their market-making lines were fully or close to fully extended. The lack of liquidity in the market also meant that a substantial amount of ABCP was being rolled on an overnight basis. That increased the amount of maturing ABCP on the following days. Coventree knew that if any maturing ABCP did not roll, there would be a default.

Increased overnight rolls also required Coventree to monitor the liquidity agreements related to A notes, on a daily basis, to ensure compliance with those agreements (see paragraphs 466 and 467 of these reasons). Overnight rolls increased the risk that holders of A notes might lose the benefit of the liquidity agreements.

Coventree also knew that the Caisse wished to reduce its holdings of Coventree sponsored ABCP as well as its overall exposure to the ABCP market. While the Caisse supported the ABCP market for the short-term after the August 4, 2007 long weekend, the decision by the Caisse to reduce its holdings had the potential to significantly and adversely affect the ABCP market as a whole, and Coventree's business in particular. By saying that, we are not suggesting that the Caisse's decision to reduce its overall holdings of ABCP constituted a change in Coventree's business. Rather, that was an important factor, known by Coventree, affecting market liquidity for Coventree sponsored ABCP.

The ability of Coventree sponsored conduits to roll maturing ABCP was a critical element of Coventree's business. If there were no purchasers of Coventree sponsored ABCP, there would be a default by its conduits in repaying maturing ABCP regardless of the credit quality of the assets backing that ABCP. Adequate market liquidity and the ability to roll ABCP were essential to a business model that used short-term borrowings (in the form of ABCP) to finance longer-term assets (held by Coventree sponsored conduits or to which those conduits had exposure).

(iii) ABCP Spread Widening

There was a very substantial widening of interest rate spreads for Coventree sponsored ABCP on August 1, 2007 (see paragraph 499 of these reasons). That spread widening was, at least in part, the reason for Coventree calling the August Board Meeting and led Cornish to prepare the Draft Press Release describing the impact of spread widening on Coventree's revenues. While we recognise that by August 1, 2007, spread widening had occurred over only a relatively few days, nonetheless we believe, based on the evidence, that Coventree viewed that spread widening as unprecedented with respect to Coventree sponsored ABCP. Child's e-mail to the Board calling the August Board Meeting indicated that "the markets are going crazy". In addition, spreads on Coventree sponsored ABCP relative to the spreads on bank sponsored ABCP had widened dramatically.

Spread widening affected Coventree's revenues and net income as ABCP matured and was rolled at higher interest rates. It also affected the viability of Coventree's securitization business. If spread widening made the cost of funds from issuing ABCP too high, then the return on the underlying assets of a conduit would not be able to support the payment of interest on the ABCP. That meant that Coventree had to also consider whether spread widening had reached a level at which Coventree would not be able to compete for the business of its traditional asset originators (see paragraphs 526 and 527 of these reasons).

While significant spread widening had occurred in the past based on extraordinary events such as the Russian debt crisis (see paragraph 573 of these reasons), there is no question that the spread widening that occurred in the ABCP market by the close of business on August 1, 2007 was unprecedented with respect to Coventree sponsored ABCP and reflected very significant changes in the level of liquidity available in the market.

We reach that conclusion notwithstanding the fact that Coventree concluded that the immediate financial impact of increased interest rate spreads was negligible and had not reached a level of materiality by August 1, 2007. We recognise that increased spreads only affect ABCP as it matures. However, the immediate financial impact of spread widening was only one quantitative consideration in assessing the materiality of spread widening. The qualitative impact of spread widening on Coventree's business also had to be considered.

ABCP was sold as a very safe short-term investment and historically was issued at very small interest rate spreads above CDOR (A notes were typically issued, for example, at one to three basis points over CDOR). Any substantial increase in interest rate spreads could affect the viability of Coventree's business.

(iv) Credit Default Swap Spread Widening

Spread widening with respect to credit default swaps meant that Coventree sponsored conduits were close to triggers for collateral calls on LSS transactions. If collateral calls occurred, the financial impact could be extreme given the high leverage inherent in LSS transactions. Coventree did not have the ability to issue new ABCP to fund collateral calls. The conduits' only source of cash for this purpose came from normal course amortization of transactions and asset sales.

Childs' notes of the August Board Meeting indicate that "we've had unprecedented movement with both spreads + correlation" (see paragraph 559 of these reasons).

It is clear from the evidence that, by August 1, 2007, Coventree, Cornish, Tai and Allan were extremely concerned about the possibility of collateral calls.

(v) Sales of Assets

By July 20, 2007, Coventree was selling conduit assets to generate cash in the conduits. That was a change made by Coventree in its business in response to external events and developments in credit markets.

By August 1, 2007, Coventree sponsored conduits had accumulated cash of approximately $188 million that was expected to increase to $610 million by Tuesday, August 7, 2007 (see paragraphs 513 and 667 of these reasons). The sale of assets to generate that cash reduced Coventree's revenue backlog, although we note that Coventree had concluded that the reduction in revenue backlog was not material at that time because of the particular assets that had been sold.

In addition, where assets were sold by the conduits to generate cash, there were potential losses on those sales and "negative carry" in terms of the return on the liquid assets held relative to the interest being paid on the affected ABCP (see paragraphs 517 to 520 of these reasons).

[591] In our view, each of the events and developments referred to in paragraph 590 of these reasons, were changes in Coventree's business or operations. Among other changes in its business, Coventree was unable to carry out through its sponsored conduits any traditional securitization transactions or any credit arbitrage transactions and there was increasing difficulty rolling Coventree sponsored ABCP as it matured. Spread widening was beginning to affect Coventree's financial returns but, more important, had implications for the ongoing viability of its business. In response to these developments, Coventree sponsored conduits were selling assets worth millions of dollars to generate cash for possible collateral calls. Coventree sponsored conduits were "perched on" collateral call triggers. In our view, these events and developments were changes in Coventree's business or operations. While external events and

developments gave rise to those changes, it is the changes in Coventree's business or operations as a result that form the basis for a potential material change.

[592] *We would add that public shareholders and investors would have been unaware of the changes in Coventree's business or operations referred to in paragraph 590 of these reasons.*

(c) Material Changes Occurred

[593] In our view, the events and developments referred to in clause (i) of paragraph 590 of these reasons constituted changes in Coventree's business or operations that would reasonably be expected to have had a significant effect on the market price or value of Coventree shares. Those events and developments therefore constituted a "material change" with respect to Coventree, within the meaning of section 75 of the Act, that occurred by the close of business on August 1, 2007.

[594] Further and in any event, the events and developments referred to in clauses (i) to (v) inclusive of paragraph 590 of these reasons, taken together, constituted changes in Coventree's business or operations that would reasonably be expected to have had a significant effect on the market price or value of Coventree shares. Those events and developments therefore constituted a "material change" with respect to Coventree within the meaning of section 75 of the Act, that occurred by the close of business on August 1, 2007.

[595] As a result of our conclusions in paragraphs 593 and 594 of these reasons, Coventree was required to forthwith issue a news release on August 2, 2007, and to file a material change report as soon as practicable and in any event within 10 days following that date. Coventree failed to do so. Coventree thereby breached subsections 75(1) and (2) of the Act.

[596] We would add that the test to determine materiality is whether any of the events and developments referred to in paragraph 590 of these reasons, considered separately or together, would reasonably be expected to have had a significant effect on the market price or value of Coventree shares. Clearly, an event or development that would have that effect would be important to a reasonable shareholder or investor in making an investment decision with respect to Coventree shares. It is clear to us that if Coventree had informed a reasonable shareholder or investor of the facts that:

(a) its conduits were unable to carry out any new securitization transactions, whether traditional securitizations or credit arbitrage transactions;

(b) its conduits were unable to purchase assets from Coventree's traditional asset originators;

(c) its credit arbitrage business, which until very recently had represented approximately 80% of its revenues, was viewed by Coventree as dead or dying;

(d) the business of its wholly-owned subsidiary, Nereus, was no longer viable;

(e) its conduits were unable to issue any new ABCP for any purpose including for buying back maturing ABCP or funding possible collateral calls;

(f) its conduits were having increasing difficulty rolling their maturing ABCP and were doing so only with the reluctant market support of the Caisse in rolling its holdings of Coventree sponsored ABCP;

(g) interest rate spreads on Coventree sponsored ABCP had widened to an unprecedented level;

(h) its conduits were "perched on" collateral call triggers;

(i) its conduits were selling assets worth millions of dollars to accumulate cash to fund possible collateral calls;

(j) there was a very substantial supply/demand imbalance in the ABCP market (see paragraph 598 below); and

(k) Coventree had no way of knowing if or when market conditions would return to normal;

that shareholder or investor would have considered that information critically important in making an investment decision with respect to Coventree shares. That means, in our view, that those events and developments would reasonably be expected to have had a significant effect on the market price or value of Coventree shares. That is the common sense conclusion in all of the circumstances.

[597] We note in this respect that all of the events and developments referred to in paragraph 590 of these reasons had been communicated to the Board at the August Board Meeting (as reflected in a combination of the minutes of the August Board Meeting (see paragraph 550 of these reasons), the matters conveyed by Cornish at that meeting (see paragraph 552 of these reasons) and Child's notes of the meeting (see paragraph 558 of these reasons)).

[598] It is not important to our conclusions what was causing the liquidity related problems Coventree sponsored conduits were experiencing by August 1, 2007. Staff submits that an important factor was the subprime exposure of certain Coventree sponsored conduits or note series. On the other hand, Coventree submits that, by July 31, 2007, it was clear that the liquidity related issues and spread widening were due to a supply and demand imbalance in the ABCP market caused by the global credit crisis.

[599] The question we are addressing is whether a change or changes occurred in Coventree's business or operations for purposes of the definition of "material change" in the Act. We have concluded above that there were a number of such changes to Coventree's business or operations and that those changes were material within the meaning of the definition of "material change" in the Act. Subject to the discussion commencing at paragraph 621 of these reasons, the question of what gave rise to those changes in Coventree's business or operations does not ultimately affect our analysis or conclusions.

(d) RBC's Resignation

[600] RBC resigned as a member of the dealer syndicate on Friday, July 27, 2007. The RBC resignation is a relevant consideration because (i) it would have raised a question for investors as to why RBC resigned, and (ii) it meant that other members of the dealer syndicate would have to address the rolling of Coventree sponsored ABCP previously sold by RBC, as it matured. That potentially affected the liquidity of Coventree sponsored ABCP.

[601] Both Cornish and Allan acknowledged that RBC was the largest dealer in the Canadian commercial paper market. Cornish testified that RBC's resignation had the potential to "spook the market further at a critical time".

[602] We believe that the RBC resignation caused a change in Coventree's business or operations. As a result of that decision, which was clearly an external or outside event beyond Coventree's control, the make-up of Coventree's dealer syndicate changed and Coventree was no longer able to distribute ABCP through RBC. The question is whether that change was material.

[603] RBC appears to have distributed approximately 5% of the Coventree sponsored ABCP then outstanding. At the time of RBC's resignation, that meant that approximately $880 million of Coventree sponsored ABCP was held by RBC clients, many of whom would also have been clients of other members of the dealer syndicate. While RBC's resignation meant that those other members of the dealer syndicate would have to address the rolling of the affected ABCP as it matured, it does not appear to us, based on the evidence, that they were unable to do so. Nor does it appear to us, based on evidence, that the reason why RBC resigned was a significant factor in the circumstances in assessing the materiality of that event.

[604] Accordingly, we conclude, on balance, that the resignation of RBC from the dealer syndicate would not reasonably be expected to have had a significant effect on the market price or value of Coventree shares. We find, as a result, that the RBC resignation from the dealer syndicate did not itself constitute a "material change" with respect to Coventree within the meaning of the Act.

(e) Events Subsequent to August 1, 2007

[605] Following August 1, 2007, events and developments continued to occur that affected Coventree's business or operations. Those events and developments are summarized beginning at paragraph 655 of these reasons. They include the following:

(a) There continued to be liquidity related issues affecting the ability of the dealers to roll Coventree sponsored ABCP. We note, in this respect, that the decision of the Caisse to support Coventree sponsored ABCP during the week commencing Tuesday, August 7, 2007 relieved some of that pressure and temporarily avoided a default by Coventree sponsored conduits. Coventree knew, however, that was a short-term solution;

(b) Market liquidity for ABCP was negatively affected by the $3 billion ABCP issuance on Friday, August 3, 2007 sponsored by RBC and TD Bank. Allan believed that a substantial portion of that issuance was taken into inventory by

RBC and TD Bank and would have to be sold in the market in the future. There is no question that issuance had a significant adverse effect on liquidity in the ABCP market (as reflected by Allan's comments at the time (see paragraph 671 of these reasons)). That transaction also demonstrated that liquidity for bank-sponsored ABCP was greater than for third-party sponsored ABCP;

(c) The risk of collateral calls continued to increase. On Friday, August 3, 2007, Coventree's calculations showed that collateral calls had been triggered for two transactions and that two other transactions were close to the triggers. We acknowledge in this respect that no valid collateral calls were ultimately made before the occurrence of the market disruption on August 13, 2007;

(d) On Friday, August 3, 2007, Tai confirmed that $60 million of cash had been used by a Nereus conduit to purchase Planet A notes. That is evidence that the liquidity for Coventree sponsored ABCP with subprime exposure had been negatively affected;

(e) By Sunday, August 5, 2007, legal counsel had been retained and was working to prepare the notices and documents necessary for possible liquidity calls on A notes and for extensions of E notes;

(f) Spreads on Coventree sponsored ABCP continued to widen on Tuesday, August 7, 2007, to 23 basis points over CDOR for the A notes and to approximately 37 basis points over CDOR for the E notes. That spread widening was unprecedented with respect to Coventree sponsored ABCP and was in part the price for the Caisse's market support during the week of August 7, 2007. At that time, there was a gap of approximately 15 basis points between the interest rates on Coventree sponsored A notes and on bank sponsored ABCP. That was approximately double the typical difference in spreads; and

(g) As previously noted, on August 8, 2007, after Citibank had earlier agreed to rescind its two collateral calls (see paragraphs 506 and 507 of these reasons), Coventree voluntarily posted cash collateral of $25 million for each of two Citibank transactions in order to provide an additional cushion before a collateral call could be triggered.

[606] Given the conclusion we have reached that material changes in Coventree's business occurred by the close of business on August 1, 2007, it is not necessary for us to assess the materiality of these further events and developments. Most of them were a continuation of events and developments that were occurring by August 1, 2007.

(f) Risk of Market Disruption

Submissions

[607] Staff also alleges that Coventree was aware by August 3, 2007 that the level of risk of a market disruption had significantly increased and that there was an imminent risk of a market

disruption occurring. Staff submits that constituted a "material change" with respect to Coventree within the meaning of the Act.

[608] Coventree submits that a change in risk does not constitute a change in its business, operations or capital for purposes of the definition of "material change" in the Act. Coventree says that a change in risk relates to a prospective change that becomes an actual change in its business only when the events or developments reflected in the risk actually occur. Coventree submits that it is not appropriate for an issuer to be required to predict and publicly disclose the possibility of a future material change; disclosure is only required when a material change has actually occurred.

[609] Coventree also submits that the only Commission decisions that address a change in risk as constituting a possible material change are *Re YBM Magnex* and *Re Rex Diamond*. In both these cases, Coventree says there was an actual change in business associated with the relevant increased risk. In *Re YBM Magnex*, that change was the decision of the auditors of YBM Magnex International Inc. ("**YBM**") not to perform any further audit procedures until a forensic audit was carried out. That meant that YBM would be unable to file audited financial statements as required by applicable securities law and that a cease trade order would be issued by the Commission. In *Re Rex Diamond*, Rex Diamond knew that the Sierra Leone government had given notice of the termination of its key mining leases. That meant that a risk of the termination of those claims had become a reality. As a result, Coventree submits that the references in *Re YBM Magnex* and *Re Rex Diamond* to a risk giving rise to a material change should be understood in that context.

Analysis

[610] In our view, there is a real legal question whether a change in a risk to which a business is subject constitutes a change in the business itself that can form the basis of a "material change" within the meaning of the Act. In this respect, it may be that some risks form part of an issuer's business while other risks are properly viewed as outside or external risks not forming part of the business.

[611] The Commission concluded in *Re YBM Magnex* that "facts that give rise to a material risk are material facts" within the meaning of the Act (*Re YBM Magnex, supra,* at para. 87). As a result, material risks were required to be disclosed by YBM in its prospectus and certain of those material risks were not disclosed. The Commission also considered whether the audit suspension by YBM's auditors was a change in the business, operations or capital of YBM within the meaning of the definition of "material change" in the Act. The Commission stated that, in the particular circumstances, "the risk regarding the filing deadline and likely cease trade order constituted a material change". That conclusion was reached, however, based on the auditors' communication to YBM that they would not carry out the YBM audit unless a forensic audit was done. As a practical matter, YBM knew that it would not be able to file audited financial statements by the filing deadline and that, as a result, a cease trade order would be issued by the Commission in respect of YBM securities.

[612] In *Re Rex Diamond*, the Commission commented that:

> We find it problematic that Rex had knowledge of the fact that it could potentially lose its Leases and Rex never revealed the final notice warning letter dated June 5, 2003 to the public. In our view, Rex should have issued a material change report when it initially learned that there was a risk that it would lose the Leases. This is because the loss of a right to mine for diamonds would impact the operations of a diamond exploration company such as Rex and this in turn would affect Rex's ability to generate profit and share price would be affected accordingly.

[613] The Commission also stated, however, that:

> Similar to the Notice of Tender, the Tender Evaluation signalled that a change occurred in Rex's operations and assets because it established that the Leases once belonging to Rex had been officially transferred to another company. Rex's ability to operate in Sierra Leone was significantly changed.

[614] As a practical matter, Rex Diamond knew that its mining leases were being terminated by the Sierra Leone Government and transferred to another company. Rex Diamond failed to make any disclosure of those circumstances.

[615] We do not read the decisions in *Re YBM Magnex* or *Re Rex Diamond* as concluding more generally that any significant change in the risks to which a business is subject necessarily constitutes a change in the issuer's business, operations or capital for purposes of the definition of "material change" in the Act.

[616] In the circumstances before us, we are not prepared to conclude that the change in the risk of occurrence of a market disruption in the ABCP market in the days leading up to August 13, 2007, constituted a change in Coventree's business or operations for purposes of the definition of "material change" in the Act. That was an external risk dependent on a complex interaction of market forces and the individual actions of market participants, that were beyond the control and knowledge of Coventree. We do not believe that the obligation to disclose material changes under the Act required Coventree to issue a news release speculating on or attempting to predict whether a market disruption would occur.

[617] At some point, a material risk may, for practical purposes, become a reality. That was the case in *Re YBM Magnex* and *Re Rex Diamond*. In our view, it was not the case in this matter.

[618] We have concluded that there were changes in Coventree's business or operations as a result of the events and developments referred to in paragraph 590 of these reasons that constituted a "material change" within the meaning of the Act. Further, in our view, the imminent risk of a market disruption in the days leading up to August 13, 2007 constituted a "material fact" with respect to Coventree within the meaning of the Act. In our view, however, the change in the risk of occurrence of a market disruption did not constitute a "material change" within the meaning of the Act.

[619] Determining whether a change has occurred in an issuer's business, operations or capital is a different question than determining the materiality of a contingent or speculative event. The Commission has in certain decisions applied the "probability/magnitude test" under U.S. securities law in making determinations as to the materiality of contingent or speculative events (see, for instance, *Re Donnini, supra,* at para. 131, and *Re YBM Magnex, supra,* at para. 92). The Commission stated in *Re AiT*, however, that the probability/magnitude test "is not particularly useful in determining whether a change has occurred, which is crucial in this case" (*Re AiT, supra,* at para. 207, *Re Rex Diamond, supra,* at para. 202). The question whether a change had occurred in Coventree's business or operations is the crucial question in this case. Further, in determining materiality in this matter, we are applying a statutory definition that requires a determination whether an event or development would reasonably be expected to have had a significant effect on the market price or value of Coventree shares. *In our view, there is no question as to the materiality to public shareholders and investors of the events and developments affecting Coventree and its business by the close of business on August 1, 2007.*

[620] Finally, we note that an issuer is required to disclose material risks in a prospectus and in its MD&A. Section 21.1(3) of the Prospectus Form requires an issuer to "describe any risk factors material to the issuer that a reasonable investor would consider relevant to an investment in the securities being distributed …" Further, Part 1(a) of Form 51-102F1 – *Management's Discussion and Analysis* – requires an issuer to "discuss important trends and risks that have affected the financial statements, and trends and risks that are reasonably likely to affect them in the future …". Accordingly an issuer is required to disclose material risks and significant changes in those risks in its MD&A.

(g) Changes as External Events or Developments

[621] Coventree submits that the events and developments affecting its business during the period from late July to August 13, 2007 were quintessential external events or developments that were beyond its control. Coventree submits that the principal external development affecting its business was the lack of liquidity in Canadian and international credit markets triggered by the subprime mortgage crisis in the United States. Coventree described those external factors in the Draft Q3 MD&A sent by Child to Tai on August 8, 2007 as follows:

> In recent weeks, the market value of many investments around the world has fallen beginning with U.S. subprime mortgage loans and related securities and then spreading outwards. Problems that initially seemed isolated to a few U.S. subprime mortgage lenders are beginning to propagate across markets and borders in anomalous and unpredicted ways and degrees. Those problems have led to broader concerns relating to debt capital markets generally and it now appears that they have begun to affect the Canadian asset-backed commercial paper ("ABCP") market. It appears that some investors are reducing, or eliminating, their investments in the Canadian ABCP market, including ABCP issued by conduits sponsored by independents such as Coventree. Combined with recent large new ABCP issuances from bank-sponsored conduits, this has resulted in what we believe to be an imbalance between the supply and demand for ABCP in Canada. This imbalance has resulted in a widening of spreads

generally in the Canadian ABCP market and the absence of capacity for new issuance by independent conduit sponsors.

(See the discussion of the Draft Q3 MD&A commencing at paragraph 730 of these reasons.) Because these were external events or developments, Coventree submits that it was not required to disclose them by news release in accordance with section 75 of the Act. Coventree relies in this respect on the principle reflected in section 4.4 of NP 51-201 (see paragraph 152 of these reasons).

[622] Section 4.4 of NP 51-201 is premised on the assumption that investors will be aware of external economic developments and their general effects on reporting issuers. Where those developments occur, and do not have an uncharacteristic effect on a particular issuer, no material change disclosure by a reporting issuer may be required. In our view, the circumstances we are addressing in this proceeding are not economic developments of the nature contemplated by section 4.4 of NP 51-201. There is no question that the international credit crisis in 2007 affected the Canadian ABCP market and that those events and developments were external and beyond Coventree's control. However, public shareholders and potential investors in Coventree shares had very limited knowledge of the ABCP market and of events and developments affecting that market (see, for instance, the risk factor referred to in paragraph 267(j) of these reasons). Public shareholders and investors would certainly not have known or been able to fully assess the implications of those events and developments on Coventree and its business.

[623] Accordingly, in our view, neither section 4.4 of NP 51-201, nor the principle reflected in that section, applies in the circumstances before us.

[624] We would add that, even if section 4.4 of NP 51-201 did apply, we would conclude that the events and developments before us had, in important respects, a direct effect on the business of Coventree that was uncharacteristic of the effect generally experienced by other issuers engaged in the same business or industry. Coventree was the largest third-party sponsor of Canadian ABCP and its conduits had outstanding more than 50% of the extendible ABCP in the market. Further, certain Coventree sponsored conduits had significant subprime exposure. Bank sponsored conduits in the ABCP market were affected differently than Coventree sponsored conduits in terms of, for instance, the level of liquidity available and the extent of spread widening. Evidence was submitted to the effect that, during late July and early August 2007, there was a "flight to quality" by some investors from third-party sponsored ABCP to bank sponsored ABCP and government debt. Further, bank sponsored ABCP continued to roll on August 13, 2007, although it was ultimately also affected by the general market disruption that occurred. Accordingly, in our view, Coventree cannot rely on section 4.4 of NP 51-201, or the principle reflected in that section, as a basis for not complying with its disclosure obligations under section 75 of the Act. By its terms, section 4.4 is not intended to apply to circumstances such as these where external events and developments had uncharacteristic effects on the businesses of different reporting issuers in the same business or industry.

[625] Coventree made a critical error to the extent that it assumed that these external events or developments could not and did not have direct effects on, and consequences for, its business and operations that constituted changes in that business for purposes of the definition of "material change" in the Act. Further, Coventree appears to have assumed (at least by

August 7, 2007) that investors were generally aware of "the impact of US subprime, "contagion" etc. [which] are widely discussed in the press" (see paragraph 720 of these reasons). To the contrary, public shareholders and investors were in the dark as to the direct consequences for Coventree and its business of U.S. subprime contagion and as to the severe liquidity problems being experienced in the Canadian ABCP market by August 1, 2007. Coventree had a legal obligation to publicly disclose and explain the resulting material changes in its business.

(h) Actions Taken as Prudent Management

[626] Coventree also submits that the sale of assets by its conduits to generate cash was no more than prudent fiscal management. While we do not disagree that that action may have been prudent, it is relevant to us for two reasons. First, the sale of assets was a change made by Coventree in its business in response to external events and developments in credit markets. As a result, the sale of assets was a change in Coventree's business that can form the basis for concluding that a "material change" occurred within the meaning of the Act (see paragraph 588 of these reasons). Second, the sale of assets indicates the seriousness with which Coventree viewed developments in the credit markets and the possibility of collateral calls.

[627] Coventree also submits that other actions alleged by Staff to constitute a change in its business leading up to the market disruption on August 13, 2007 were simply appropriate risk management strategies and responses to market developments. Coventree would include in that category the monitoring of ABCP maturities and the status of collateral call triggers, legal preparations for liquidity notices, E note extensions and a possible market disruption, and the calling of the August Board Meeting.

[628] We agree that we cannot assume that a material change occurred simply because Coventree took such steps and actions. At the same time, however, those steps and actions may suggest that changes in Coventree's business or operations may have occurred for purposes of the definition of "material change" in the Act.

(i) The "Soft Landing"

[629] By August 8, 2007, Allan had concluded that the liquidity issues in the ABCP market reflected an imbalance between the total amount of ABCP outstanding (which was continuing to mature and needed to be "rolled") and investor demand to purchase ABCP. In his view, this was a structural issue that required a reduction in the overall principal amount of ABCP outstanding in the market. The solution, in his view, was for all of the issuers of ABCP to agree to proportionately reduce the amounts of ABCP they had outstanding as part of a negotiated "soft landing" (see paragraphs 735 to 737 of these reasons for a further discussion of the "soft landing"). Allan viewed that outcome as being in the best interests of all market participants. A meeting of market participants was held in Montreal on Friday, August 10, 2007 to attempt to advance that solution.

[630] Coventree submits that the possibility of a "soft landing" is a consideration in assessing the materiality of the events and developments that occurred over the period from late July to August 13, 2007. That submission is, in effect, that the events and developments over that period

did not constitute a material change because Coventree had a reasonable belief in the possibility of a negotiated soft landing.

[631] This issue takes on somewhat less importance because we have concluded that the increase in the risk of a market disruption did not itself constitute a change in Coventree's business or operations for purposes of the definition of "material change" in the Act. We would simply add that while the possibility of a soft landing was one of a number of possible outcomes, it was one that, in our view, did not have a high degree of likely success in the short term. If events occurred that gave rise to a material change with respect to Coventree (as we have found), the materiality of those events is not somehow delayed or qualified because of the possibility of some future negotiated solution or outcome. We do not accept that the possibility of a soft landing was sufficiently certain to justify delaying disclosure of the material changes that had occurred. The effects on and changes to Coventree's business described in paragraph 590 of these reasons were immediate, direct and material; the possibility of a soft landing was contingent, uncertain, and highly speculative. Disclosure to shareholders of the material changes that occurred by the close of business on August 1, 2007 could not await the outcome of a possible negotiated solution among all of the market participants.

(j) Spread Widening

[632] Coventree also submits that spread widening as of August 1, 2007 or thereafter was not material because (i) it had occurred over a relatively few days, and (ii) Coventree had a reasonable expectation, based on past experience, that spreads on Coventree sponsored ABCP would eventually return to normal levels. If that is put forward as a justification for why no disclosure with respect to spread widening was required, it is not compelling. Coventree had an obligation to disclose material changes in its business or operations. As a result of developments in the ABCP market, spreads had widened very dramatically. If Coventree knew why that spread widening had occurred and knew that it was temporary, that would be one thing. But, in this case, Coventree could not be certain of the reasons for the spread widening or, more important, how long the spread widening would last. There was evidence that Coventree expected increased spreads to remain in place for some months (see, for instance, paragraph 724 of these reasons).

[633] It seems to us that, in these circumstances, it was simply wishful thinking to believe that spreads would return to normal levels in the near future. All one can do in assessing whether a material change has occurred is consider the events and developments as they exist at the particular time. It is certainly relevant to that analysis whether those events and developments will be of short-term duration or effect. But one cannot explain them away because it is uncertain how long they will last or by assuming they would be of short duration. The same comment applies to Coventree's inability to issue new ABCP and to the illiquidity in the ABCP market.

[634] We would add that, in determining whether a material change had occurred, Coventree should not have been influenced by the fact that a news release might have had a negative effect on the ABCP market. One of the stated reasons why Coventree did not issue a news release on August 2, 2007 following the August Board Meeting was because it might "contribute to the uneasiness of the ABCP markets" ("uneasiness" in the ABCP markets is rather an understatement in the circumstances; see paragraph 562 of these reasons). A news release disclosing a material change is for the benefit of Coventree public shareholders and potential

investors in Coventree shares. While one cannot ignore the market consequences that a news release is likely to have, where a material change has occurred, a news release must be issued forthwith regardless of those consequences. The only alternative is to file a confidential material change report in accordance with subsection 75(3) of the Act if the issue of a news release would be unduly detrimental to the interests of the issuer.

(k) Premature Disclosure

[635] Coventree also submits that it would have been premature, and would have caused more harm than good, for it to have made disclosure by news release of market events and developments in early August 2007. Coventree says that any such news release would have been based on the rumours, speculation, misinformation and conjecture in the market at the time. One of the reasons that Coventree did not issue a news release on August 2, 2007 was because Coventree did not "have enough observable data points" and just did not "know what is going to happen tomorrow" (see paragraph 562 of these reasons).

[636] We recognise that Coventree did not have clear or complete information as to what was happening in credit markets in late July and early August 2007 or why. Coventree was striving to obtain as much guidance as possible from the dealers as to market developments and the reasons for them. Further, Coventree was not able to predict, and cannot be expected to speculate on, what dealers, investors or the Caisse might do in terms of purchasing or rolling maturing ABCP. Nor should Coventree be expected to have predicted the market disruption that occurred on August 13, 2007.

[637] Having said that, we have concluded that there were direct changes in Coventree's business as a result of the events and developments that had occurred by the close of business on August 1, 2007 and those changes were material. It is not premature disclosure to disclose those actual events and developments, and their consequences to Coventree's business, even if there is uncertainty as to their causes, future effects, financial impact or duration. An issuer can make appropriate disclosure of relevant events and developments as they exist and have occurred, even if the future is uncertain. An issuer does not subject itself to any liability (as suggested by Coventree) for premature disclosure where the disclosure made relates to events and their consequences that have occurred and is accurate, balanced and appropriately qualified.

[638] Further, in assessing whether changes that had occurred in Coventree's business were material, Coventree had to consider the likely future effects and consequences of those changes on its business, both as a quantitative and qualitative matter. That is not the same as requiring premature disclosure of uncertain future events or predicting future financial performance. It is requiring an assessment of the significant effects and consequences that changes in its business or operations may have going forward. That assessment is inherent in determining whether any change in business is material.

[639] Disclosure in this matter was for the benefit of public shareholders and potential investors in Coventree shares. It was not for the benefit of credit markets and purchasers of ABCP (although they would also have benefited from the disclosure). The potential negative impact of disclosure by Coventree on credit markets or its share price did not justify Coventree's failure to comply with its disclosure obligations under section 75 of the Act.

(l) Investor Knowledge of Market Events

[640] Child's notes of the disclosure committee meeting held on August 7, 2007 state that "[i]nvestors are generally aware of the risks of our business and the impact of US subprime, "contagion", etc. …" which is "widely discussed in the press" (see paragraph 720 of these reasons).

[641] As discussed in these reasons, the fact that investors were aware of the material risks of Coventree's business does not relieve Coventree of its disclosure obligations when events reflected in those risks actually occur (see paragraph 268 of these reasons). Similarly, the fact that subprime contagion and the upheaval in U.S. credit markets were widely reported in the media does not relieve Coventree of its disclosure obligations. *The ABCP market was an opaque market about which public shareholders and investors had limited information. Most public shareholders and investors would not have known what was happening in the Canadian ABCP market and would not have been able to fully assess the effects on, and consequences for, Coventree and its business of the events that were unfolding*. Coventree had a legal obligation to publicly disclose that information, when a material change occurred, for the benefit of public shareholders and investors.

[642] We have noted above that any disclosure by Coventree in its MD&A did not satisfy its disclosure obligations under section 75 of the Act. It was a critical error for Coventree to have concluded that disclosure of the material events and developments discussed in these reasons was required to be included only in its MD&A. That error was compounded by the assumption that, as a result of previous disclosures, public shareholders and investors were sufficiently informed to be able to fully understand and assess the effects on, and consequences for, Coventree and its business of the events occurring in credit markets that were being reported in the media. What was required was disclosure by Coventree of how those events and developments were significantly, directly and adversely affecting its business and operations. Public shareholders and investors were in the dark as to those matters.

(m) Preparation of the Draft Press Release

[643] It was decided at the August Board Meeting that Coventree management should prepare a draft news release, disclosing events and developments at that time, for consideration by the Board and for possible issuance on August 2, 2007. One reason for doing so was to assist in determining whether a material change had occurred. It appears that the Board tentatively concluded at the August Board Meeting that a news release should be issued. However, Cornish and Tai decided the next day that it was preferable that Coventree not issue a news release for the reasons set out in paragraph 562 of these reasons. (We comment on those reasons in paragraph 757 of these reasons.) Cornish prepared and circulated the Draft Press Release to members of the Board on August 2, 2007 and it appears that the members of the Board, having reviewed the Draft Press Release, acquiesced to the conclusion reached by Cornish and Tai that a material change had not occurred and that a news release was not required to be issued. The decision was to "hold off on the press release, but have it ready if the uneasiness in the markets persist".

[644] It is surprising to us that the Draft Press Release prepared by Cornish addressed only the issue of spread widening. Further, the analysis as to the materiality of spread widening appears to

focus only on when the direct financial impact of spread widening would materially affect Coventree's financial results. It appears to have been the assumption that no material change would occur as a result of spread widening until Coventree actually suffered a material financial impact as a result of the spread widening.

[645] In *Danier*, the Supreme Court of Canada held that changes only in intra-quarterly results of operations did not, by themselves, constitute a change in the business, operations or capital of an issuer for purposes of the definition of "material change" in the Act (see paragraphs 140 and 588 of these reasons). The Court did not conclude that a material change occurs only when the direct financial effects of the change are actually suffered. We do not accept that no material change occurred as a result of spread widening until the financial effects of spread widening had occurred and were material to Coventree's financial performance. The question that had to be addressed was whether there had been a change in Coventree's business or operations that was material at the time of the relevant events or developments. Clearly, the immediate financial impact of an event is a relevant consideration in determining materiality, but it is only one consideration. What is required is a quantitative and qualitative assessment of the effects and consequences of the relevant events or developments on the business of the issuer. Cornish prepared the Draft Press Release which addressed only the immediate quantitative impact of spread widening on Coventree's financial performance. That was not an adequate analysis.

[646] There is no question that there were other matters discussed at the August Board Meeting relevant to a determination of whether a material change had occurred. Those other matters included the events that were referred to in the minutes of the August Board Meeting, including the conduits' ability to issue new ABCP, Coventree's sense of a decreased market making capacity of the dealer syndicate and the increased probability of collateral calls (see paragraph 550 of these reasons). Child identified in her notes of the August Board Meeting, seven potentially material events for possible disclosure. These included, in addition to spread widening, the impact of selling assets on revenue backlog, the resignation of RBC from the dealer syndicate, the delay of the Xceed transaction and the negative carry on overfunding (see paragraph 558 of these reasons). Cornish's comments to the Board are referred to in paragraph 552 of these reasons. He commented on at least five matters in addition to spread widening.

[647] We note in this respect that Child's notes of the August Board Meeting attribute to Allan the statement that "[b]efore today hadn't communicated that we don't have any new issue capability, we're only able to roll paper". That was very significant information communicated to the Board, for the first time, at the August Board Meeting.

[648] We do not understand why, in these circumstances, Cornish prepared a draft news release for review by the Board that focused only on spread widening. There were other very significant changes in Coventree's business that had occurred by August 1, 2007 that senior management had identified as potentially material. The failure to address those issues in the Draft Press Release may have misled the Board into believing that spread widening was the primary concern.

[649] It is not clear to us that the Board fully appreciated the impact on Coventree's business or operations of the events and developments referred to in paragraph 590 of these reasons. To the extent that the preparation of the Draft Press Release was intended as a means of assisting in the

assessment of whether a material change had occurred, the Draft Press Release prepared by Cornish failed to provide that assistance. We would have expected that a news release prepared for that purpose would have attempted to identify all of the events and developments relevant to determining whether a material change in Coventree's business had occurred, and not merely one of those events.

[650] We comment further on this and other decisions made by the disclosure committee in paragraph 756 of these reasons.

(n) No News Releases Related to Market Events

[651] Coventree was a reporting issuer for only approximately nine months before the market disruption occurred on August 13, 2007. Coventree submits that over that period, it issued 11 news releases, demonstrating the seriousness with which it took its disclosure obligations.

[652] We would note, however, that all of those news releases dealt with routine matters, changes in management personnel or the litigation with Nereus. It is quite striking that over that nine-month period, with the significant events and developments that were occurring in or affecting the ABCP market and Coventree's business, no news release was ever issued by Coventree addressing any of those market developments and their effects on Coventree's business, until the market disruption actually occurred on August 13, 2007.

(o) Obtaining Outside Legal Advice

[653] Cornish testified that, in his view, Coventree did not require outside legal advice as to whether a material change had occurred by early August 2007 (see, for instance, paragraph 699 of these reasons). Those reasons included (i) that the senior officers of Coventree knew Coventree's business better than any outside lawyer, (ii) Cornish's and Allan's background as former securities lawyers, and (iii) the expertise of Board members. We note in this respect that Child did speak to outside legal counsel by telephone on August 6, 2007 to obtain disclosure advice (see paragraph 698 of these reasons).

[654] As the controlling shareholders of Coventree, Cornish and Tai had a potential conflict of interest in deciding whether to disclose information that could have a material adverse effect on the market price of Coventree shares. Obtaining objective outside legal advice would have assisted in addressing that conflict.

7. Summary of Events in the Period after August 1, 2007

[655] The following is a summary of events and developments that occurred after Wednesday, August 1, 2007, leading up to the market disruption that occurred on Monday, August 13, 2007. As set out in paragraphs 593 and 594 of these reasons, we have concluded that material changes occurred with respect to Coventree by the close of business on August 1, 2007. We provide the following summary of events and developments subsequent to August 1, 2007 and leading up to the market disruption that occurred on August 13, 2007 (i) in order to complete the narrative of events and developments leading up to the market disruption, and (ii) because Staff has alleged that Coventree failed to comply with its disclosure obligations in the period after August 1, 2007 and leading up to August 13, 2007. We have organised this summary primarily as a day-by-day

chronology of events as they unfolded (see also the Chronology of Significant Events attached as Schedule E).

(a) Thursday, August 2, 2007

[656] As requested at the August Board Meeting, beginning on Thursday, August 2, 2007, Tai began providing daily e-mail updates on market conditions to the Board.

[657] Tai's first market update was sent to directors at 11:00 a.m. on Thursday, August 2, 2007. That e-mail included a copy of the Draft Press Release and the recommendation to hold off issuing it (see paragraph 562 of these reasons). Tai stated in the e-mail that:

> Every day in a market place where we are able to place all of our paper is a good day. Time is our friend as it will eliminate some of the emotions that are invariably playing in the market place. We continue to investigate transactions that we can unwind with little loss (albeit with decreases in our future backlog) to create more dry powder in the form of overfunding. Both Geoff and I are back from vacation and are now resident in our Toronto office. We are far from being out of the woods but today was a good day for the markets.

At the hearing, Cornish concurred with Tai's statement that any day Coventree sponsored ABCP rolled was a "good day".

[658] Later that day, at 3:30 p.m., Allan and Dalton participated in a conference call with Verville. Following that call, Allan's view was that "the only answer seems to be to convince him that our subprime exposure is not a risk concern. We have to get that information to him FAST". Cornish agreed. Allan also wanted the Caisse to have that information in case the matter was elevated within the Caisse and others there became concerned about subprime exposure.

[659] By August 2, 2007, in response to the narrowing returns on traditional securitizations that were reducing payments to asset originators, Coventree implemented a process whereby Coventree staff were to review invoices prior to sending them to traditional securitization clients. If the staff member anticipated that the client's reaction to the invoice would be shock, the staff member was to call the client in advance.

[660] At the time, Coventree was also working on a general communication and a "Frequently Asked Questions" document addressing how Coventree would inform its traditional securitization clients that Coventree could not fund any new transactions (see paragraph 712 of these reasons).

[661] At 7:43 p.m., Allan sent the e-mail to Dalton referred to in paragraph 477 of these reasons.

(b) Friday, August 3, 2007

[662] Friday, August 3, 2007 was the Friday before the August long weekend in Ontario.

[663] Prior to 8:00 a.m. on August 3, 2007, Tai and Cornish exchanged e-mails agreeing that a news release by DBRS "calming the markets" would be desirable.

[664] At 8:16 a.m., Allan and Cornish received updates on four transactions closest to collateral call triggers. Coventree's calculations showed that collateral calls had been triggered on two transactions and that two transactions were close to the triggers.

[665] At 9:00 a.m., Allan sent Verville a copy of the document from the April Investor Presentations entitled "Demystifying the Subprime Market" with the following message: "I reiterate our desire to get together with you and whoever might assist you from the risk management side to discuss this material and other questions you may have regarding our holdings."

[666] At 11:26 a.m., Tai sent an e-mail to Board members advising "we managed to roll our paper today …" and that Coventree was attempting to get the agreement of the Caisse to the proposed rebalancing of subprime assets to reduce the subprime exposure in those note series with the highest exposure. Tai also advised the Board that approximately $60 million in overfunding had been used to ease some of the "funding tensions" in one conduit with higher subprime exposure. Coventree had caused a Nereus conduit to purchase $60 million of Planet A notes. Cornish testified that he thought the amount of Planet A notes purchased by Coventree was not $60 million but a smaller amount. Both Dalton and Allan testified that $60 million of overfunding was used for that purpose. While nothing turns on it, we have accepted their evidence on the topic over that of Cornish.

[667] Tai's update to the Board that day stated as follows:

> Board Members, it was a quite [*sic*] day in the markets today in anticipation of the long weekend here in Canada. The details on things are still being sorted out, but it looks like we have managed to roll our paper today again. This was good in a heavy trading day of appx. $650M rolls. We ended up using a bit of our over-funding (circa $60M) to ease some of the funding tensions in one of our conduits that has more concentration to US subprime mortgages. We still have $160M of overfundings that increase by $450M on Tuesday with the sale of two deals that we managed to trade out of without too much loss of profits and some future revenue backlog. With $610M of dry power, we are trying to create some breathing room although their [*sic*] is more complexity around when and where we can use this. In addition to this we have a plan to try and re-balance our exposure at a conduit level to US subprime mortgages. Although in total our US subprime mortgages represent less than 4% of our total assets, and continue to perform well from a credit perspective, some of the individual conduits have higher concentrations. We are trying to get buy-in to the plan by one of the largest ABCP buyers (Caisse) and DBRS. Tuesday looks like a lighter day with appx. $300M in rolls.

It was conceded that the word "quite" in the first line of this e-mail should have been "quiet".

[668] At 11:49 a.m., Cornish sent an e-mail to Tai, Allan, Child and another Coventree employee which stated:

> … [i]f we have no new issue capacity, we will have to keep some powder dry to continue to meet the future draws that we may be asked to fund. …

That was a reference to the fact that Coventree had a potential obligation to fund draws by an asset originator (other than Xceed).

[669] Accordingly, by Friday, August 3, 2007, Coventree had available approximately $160 million of overfunding that was expected to increase to $610 million by Tuesday, August 7, 2007.

(c) The $3 Billion New Issuance

[670] Just after 1:00 p.m. on Friday, August 3, 2007, Dalton was told by Courchesne that RBC and the Toronto-Dominion Bank ("**TD Bank**") had sponsored a new traditional securitization in the amount of $3 billion. Dalton said to Courchesne that "we were probably … 9 out of 10 worried before that news. Now we're 10 out of 10". The RBC/TD Bank transaction was effected at CDOR plus five basis points and that spread did not go above eight basis points prior to August 13, 2007.

[671] According to Cornish, "[t]here already was an imbalance between supply and demand before this additional $3 billion came into the marketplace, and that simply exacerbated the problem at that stage". Allan said that only a small portion of the $3 billion amount would have been funded at the time but "[t]he problem is the portion that did get funded might well have been liquidity that otherwise would have gone to rollovers in the non-bank sector". Allan stated on a telephone call with Davidson on Saturday, August 4, 2007 that the RBC/TD Bank transaction was "the straw that broke the camel's back" and that it was "decapitating this market" (see paragraph 688 of these reasons).

[672] In a powerpoint presentation subsequently prepared by Allan and entitled "What the Hell is Going On?" (see paragraph 745 of these reasons for a summary of the issues addressed), Allan commented that the $3 billion issuance by RBC and TD Bank created a real threat of default or liquidity draws on A notes and the extension of E notes.

[673] Cornish spoke to Loke that weekend about the $3 billion transaction and told Loke that he was extremely upset with DBRS for allowing that transaction to occur.

[674] At 4:18 p.m. on August 3, 2007, Paul circulated the maturity schedule for the next five business days to Allan, Dalton, Cornish, Tai and others with a note that Tuesday [the first business day after the long weekend] had turned into a large day with about $625 million in Coventree sponsored ABCP maturities. The maturity report showed that Planet A had $112 million and US $26 million of ABCP maturing that day. Paul testified that a daily maturity of $625 million would be "large enough to be of concern". Coventree called DBRS to advise them of the large maturities on Tuesday, August 7, 2007.

[675] Just before 5:00 p.m., Dalton had two telephone conversations with Davidson. During the first call, Davidson stated that NBF was concerned about the maturities coming due on the upcoming Tuesday and would not be able to stand in and support the Coventree ABCP. As a result, Davidson said that she wanted to talk about the process around drawing down on liquidity arrangements and whether Coventree had alternate liquidity available. During the second call, Davidson stated that none of Coventree's three largest dealers (NBF, CIBC or Scotia) could take any more Coventree sponsored ABCP into inventory. Davidson said that Coventree was going to go into default unless its liquidity providers stepped in as a result of a general market disruption. Dalton noted that if only one conduit defaulted, there would not be a general market disruption (which was a condition for the provision of liquidity under the various liquidity agreements).

[676] Coventree submits that the statement by Davidson to the effect that its three largest dealers would not take any more Coventree sponsored ABCP into inventory was posturing and spreading misinformation. Allan testified that what Davidson said on those calls should not be taken at face value.

[677] Cornish's evidence from his interview with Staff on April 24, 2009 was that "What I was, and still am aware of, is that they were concerned that there was a large amount of CP [commercial paper] that needed to be placed that day, Tuesday, August 7, 2007, that through whatever market-making capacity was left to support the Asset-Backed CP together with their ability to sell to other investors, they were concerned they might not get it all placed".

[678] At 6:40 p.m., Dalton updated Allan, Cornish and Tai on various matters, including that:

(a) it was essential that Allan call the head of credit at NBF on Monday (a holiday in Ontario but not in Quebec);

(b) Coventree had arranged for the purchase of approximately $60 million of Planet A notes "over the weekend";

(c) Tuesday maturities were $650 million for Coventree (including $112 million of Planet A) and $115 million for the Nereus conduits; and

(d) Dalton's group was working on the "splits" or allocations of the maturing ABCP, and Coventree was offside the liquidity requirements for one transaction by $11 million but they were continuing to work on it.

[679] At 8:53 p.m., Tai e-mailed the Board about the $3 billion new issuance and noted that the last time he had seen a transaction of that size it took months to work itself through the system. Tai advised the Board that management was meeting over the weekend to discuss matters internally and draw some conclusions but that their initial inclination was to save Coventree's "dry powder" for another day. He advised the Board that NBF had contacted the Bank of Canada and was in the process of contacting all the heads of the bank-owned dealers to see if there was an "emergency solution" and that Coventree management was in the process of calling all the third-party conduit sponsors to see if they could coordinate a strategy. Finally, Tai mentioned that maturities for the upcoming Tuesday were higher than his report earlier that day because of previous overnight rolls.

[680] Tai's e-mail stated as follows:

> Board Members, although it looked like a good day today and things were starting to look brighter with the hope of containing the market issues, we heard some very distressing news later in the afternoon. We heard today that RBC/TD did a $3 billion issuance into the ABCP market place today. We are still extremely puzzled as to why they would do this at this particular time when the markets are so precarious or why DBRS would let them do it. Our assumption is that the term debt market dried up and they are trying to find any markets that have liquidity still left in them to clean up their balance sheet issues or those of their major clients. This also now explains why RBC backed out of our dealer syndicate late last week (although they were never a big supporter or trader). Even though we have some dry powder left, we just don't believe that it will be enough to deal with this large of an overhang. The last time I remember a deal this size was near when we started about 10yrs ago when BMO did a large issuance to clear up their balance sheets for year end. Although the markets are a lot stronger now than they were, the BMO deal took months to work itself through the system. We are meeting over the weekend to discuss things internally and draw some conclusions, but our initial inclination is to save our powder for another day and let things roll through the markets. Our lead dealer at the National Bank has contacted the Bank of Canada and is in the process of contacting all the heads of the Bank owned dealers to see if there is an emergency solution. We are also in the process of calling all the non-bank owned independent securitization shops to see if we can coordinate a strategy. Roll-overs for Tuesday are higher than my previous note because we found out a lot of the paper was rolled over-night as opposed to my initial assumption that it rolled into 30-day paper. Unfortunate news…

[681] Cornish testified that by Friday, August 3, 2007 there was an increasing recognition that the liquidity issues affecting Coventree sponsored ABCP were not specific to Coventree but represented a bigger supply/demand imbalance in the ABCP market. Cornish was in favour of all of the various market participants getting together to talk through the issues and coming up with a joint solution to that imbalance.

(d) The August 2007 Long Weekend

Saturday, August 4, 2007

[682] On Saturday, August 4, 2007, at 7:40 a.m., Tai e-mailed Cornish and others saying "[i]f things really hit the fan on Tuesday, we should be prepared with draft press releases that are reviewed with legal counsel". There are additional references to preparing draft press releases in Child's notes from a strategic council meeting on August 5, 2007 (see paragraph 691 of these reasons). There was no evidence submitted that any such press releases were ever prepared.

[683] At 8:20 a.m., Tai e-mailed Dalton saying that "we are probably headed in for a worse day than any of the days we have experienced so far". Tai advised that he had spoken to an individual from Deutsche Bank and was trying to organize a call with other third-party ABCP

sponsors so that they would have at least talked through the situation by Tuesday "when either a GMD [general market disruption] or conduit defaults occur".

[684] In that e-mail, Tai indicated to Dalton that the overfunding amounts in Coventree sponsored conduits should not to be used to purchase Coventree sponsored ABCP. Tai indicated that he wanted the overfunding to be used only to meet collateral calls. On Sunday, August 5, 2007, the strategic council discussed whether to use "dry powder" to buy Coventree sponsored ABCP and decided that Coventree would not do so because the liquidity issues were too big for Coventree's available overfunding to handle.

[685] Cornish testified that, although Coventree had no legal obligation to do so, if one of the assets in a conduit ran into difficulties, Coventree would typically support that asset in order to protect Coventree's reputation with investors and sustain its business. Cornish testified that:

> It was theoretically possible that Coventree could simply walk away, but the day that the company decided to do that is probably the day that the company would be out of business in terms of financing new transactions at least in the future.

Cornish's testimony echoes the Prospectus which stated:

> Although Coventree has no contractual obligation to support the conduits that it sponsors, if investors were to suffer any losses as a result of the non-performance of a transaction in a Coventree conduit, Coventree's reputation in the industry and ongoing ability to access the capital markets could be severely affected if it chose not to do so. … In the past, Coventree elected to support one transaction in one of its conduits that failed to perform as expected by posting additional cash collateral to support the transaction in order to maintain the ratings of the ABCP issued by that conduit.
>
> (Prospectus, at p. 33)

[686] At 10:30 a.m., Dalton forwarded to Allan an e-mail she had received from Davidson to the following effect:

> I understand that you spoke to Bob [Courchesne] but I'm not sure if he conveyed exactly what the situation will be on Tuesday. From my understanding, the street cannot inventory any more of your paper including National due to trading lines. Which means that you will have to redeem unfunded commercial paper or the trust(s) may be put into default. This is why I'm trying to reach David [Allan] as well – I'm not sure if your lead dealer has conveyed how grave the situation now is.

[687] At 12:11 p.m., Allan responded to Davidson's e-mail advising "Natalie, don't worry – I am well aware of the gravity of Tuesday's situation. We will be prepared for the worst". At 12:39 p.m., in response to Davidson's question as to whether the "don't worry" message in Allan's e-mail meant that Coventree had available the liquidity necessary to cover any maturities that were not rolled, Allan stated, "[g]iven the size of what is rolling Tuesday and what Bob is

anticipating as the further impact on our liquidity of the overhang from Friday's new issuance, I have no confidence that that is the case". To which Davidson responded, "Can you call me?"

[688] At 12:49 p.m., in a call between Allan and Davidson, Allan confirmed that "believe me, I understand the gravity of what's going on". When Davidson asked him whether he had a liquidity plan, he said "No, I don't think we have liquidity of $1.7 billion", the amount of paper that Coventree had coming due that week. Allan said that if the $3 billion of new ABCP had not been issued by RBC and TD Bank, Coventree might have been able to "plug the holes and see if we can get through it week by week and hope that the liquidity comes back. And quite honestly, we need credit markets to come back considerably as well to take the pressure off the … collateral call side as well…you know, may as well … make our stand on Tuesday as make our stand on Friday". Allan commented that RBC and TD Bank were "decapitating this market" with the $3 billion issuance and "they pushed us right out". Allan said that it was his expectation that, on Tuesday, August 7, 2007, there would be defaults in Coventree sponsored conduits and extensions of E notes, but not a general market disruption.

[689] Allan characterized his comments on these calls as "testy" because he felt Davidson was posturing.

Sunday, August 5, 2007

[690] Cornish told Loke on the morning of Sunday, August 5, 2007 that DBRS should be prepared for the possibility of a market disruption on the upcoming Tuesday. Cornish also encouraged Loke to issue a news release confirming the high quality of the subprime assets in Canadian conduits, something Loke was not enthusiastic about doing. In the conversation, Loke advised Cornish that Verville did not want a news release issued because he believed that a news release from DBRS would not calm the markets but would have the opposite effect.

[691] That morning, Cornish, Tai, Allan and Child participated in a strategic council meeting by conference call. According to Child's handwritten notes:

(a) Cornish had spoken to Loke and Coventree had received advice from NBF that Tuesday would be a difficult day and there was a good chance that there would be market disruption, extension or both;

(b) a lawyer at Davies Ward Phillips & Vineberg ("**Davies**") had been called to provide assistance over the weekend. The three points included under the heading "Review our legal position" included references to details of conditions to liquidity draws and extensions under E notes, defaults by the conduits and "failure to roll but doesn't meet GMD → roll paper for conduits that doesn't constitute market draw on some liquidity Tues";

(c) there was reference to the preparation of multiple versions of a press release addressing what had happened over the last five business days;

(d) there was consideration of whether there should be a voluntary posting of collateral in relation to an LSS transaction; and

(e) there was a note that if Coventree hit “an extension”, Coventree would have to send out a press release immediately.

In respect of clause (e) above, Child testified that she was referring to having to extend the E notes and that Coventree wanted to understand what the outcomes could be and have press releases ready for those outcomes. As noted above, there was no evidence that any such draft press releases were prepared at the time.

[692] At 3:23 p.m., Allan received a call from Davidson in which Davidson stated that CIBC was under a lot of internal pressure to resign as a member of the dealer syndicate and Davidson asked Allan to give her reasons why CIBC should not resign. During that call, Allan acknowledged that he had no better knowledge whether Coventree sponsored ABCP would roll on Tuesday and that Coventree was relying on NBF’s advice.

[693] At 9:06 p.m., members of the strategic council received an e-mail from Allan saying that CIBC was considering resigning from the dealer syndicate if alternative liquidity was not available with respect to Coventree ABCP maturities on Tuesday, August 7, 2007.

[694] Coventree was aware that another third-party ABCP sponsor was experiencing the same liquidity issues, that that sponsor had been in frequent contact with Verville and was concerned that the Caisse would not be “stepping up” at the eleventh hour. Allan reported that the other third-party sponsor’s strategy seemed to be “praying for a GMD [general market disruption] on Tuesday that brings all of the players, including the Canadian banks, into the circle of pain”.

[695] At 10:40 p.m., Cornish sent an e-mail to a Davies lawyer entitled “Mon due diligence review” referring to a due diligence review that was to take place the following day that Cornish and Tai would attend. Cornish indicated that the purpose of the review was “to prepare for a market disruption and/or extension or both”.

Monday, August 6, 2007

[696] At 9:00 a.m. on Monday, August 6, 2007 (a holiday in Ontario but not in Quebec), Dalton contacted Verville to arrange a time to get his feedback on the asset rebalancing plan. The rebalancing plan that she had sent to Verville on August 3, 2007 did not transfer any assets to Coventree conduits that did not already have some subprime exposure. At 3:22 p.m., Verville responded that if Coventree could spread subprime exposures to the “most conduits as possible, it would suit us more”.

[697] Coventree was preparing for a possible market disruption that day, including meeting with its legal counsel to prepare the necessary notices. Allan testified that lawyers from Davies were assisting Coventree in respect of the possibility of a default and liquidity draws on A notes and extensions of E notes.

[698] Child sought legal advice by telephone from Al Hudec (“**Hudec**”) (a lawyer at Davis & Co.) as to Coventree’s disclosure obligations. Child testified that the advice that she received was “[d]isclose as soon as you can and keep very good notes”. Hudec apparently advised Child that there was “[n]o sense talking to MS, they’ll force you to disclose or halt the stock”. Child confirmed that “MS” referred to “Market Surveillance” of the TSX. Child’s notes of the call also

indicate that "*events whether market forces or whatever that were likely to impact had obligation to disclose*". [emphasis added]

[699] With respect to obtaining legal advice, Cornish testified that:

> … from my perspective at least anyway, I didn't think we needed to get additional legal advice beyond that which we already had as to what the test or at least the legal part of the test was.
>
> The critical question was how should that test be applied in these particular circumstances. We knew our business better than most law firms, and, in that context, it didn't seem to me that it would be all that helpful to get yet another piece of advice from outside lawyers in addition to that which we already had access to.
>
> If the key question, the sort of factual part of it of the mixed fact and law test relating to materiality, the key question of how would it be applied, that was a judgment that we thought we were in a better position to reach conclusions or reach a judgment on than additional lawyers would.

[700] In a call at approximately 3:16 p.m. with Davidson, Verville said that CIBC was getting "spooked about everything". Verville said that "Courchesne will be fine tomorrow". Davidson said that Coventree had indicated a default scenario was highly probable the next day. Verville said that was news to him and that he would make some calls. Verville told Davidson that she had to stop "this panic talk to everyone".

[701] In a call with Davidson at 4:22 p.m. that day, Allan told Davidson that there would be no market disruption on the following Tuesday because Verville was going to support third-party sponsored ABCP that day. He said, "Luc is stepping back to hold this market up". Allan also commented that "I understand that at this point, you've only got it from Luc so it's only a day or two days' worth of respite, but I hope [the Caisse] comes out with something that is enough that we can have orderly markets through a transition period while … the books downsize".

[702] Allan testified that Verville agreed that the Caisse would step back into the market and roll Coventree sponsored ABCP on Tuesday, August 7, 2007 and continue to do so through to Friday, August 10, 2007. That was the proposed date of a meeting in Montreal among all key market participants to discuss a possible restructuring of the ABCP market. It was a condition of the Caisse's support that concerted action be taken by market participants to reduce the total amount of ABCP outstanding. The proposed meeting was to be hosted by Verville.

[703] At approximately 5:30 p.m., there was a conference call meeting of the strategic council. According to Child's notes:

(a) Verville imposed the condition that work was being done to shrink the market segment. "He can't sustain the segment, discussing program to share the pain";

(b) the Caisse "needed to lighten up in this market, therefore wanted to transfer to bank sponsored than [*sic*] fade out as market support";

(c) "Banks need to step up";

(d) Coventree had a material overfunded or cash position, "sized for collateral calls, and won't be used to support the market";

(e) Verville believed that it was beneficial for Coventree to carry out the rebalancing related to subprime assets;

(f) Verville did not want a news release on market quality to be issued by DBRS; and

(g) concerning collateral calls, "Luc knows we're close".

[704] At 9:10 p.m., Tai updated the Board advising that:

> Board Members, we are still crossing our fingers, but it seems like we maybe [*sic*] dodging another bullet tomorrow. Through extensive discussions with the Caisse and our dealers, David and the team seem to have negotiated a verbal understanding with the Caisse to support the rolling of our paper tomorrow and/or as long as possible. This will likely mean that the Caisse will be moving paper away from the bank-sponsored conduits to the independents [*sic*] sponsored conduits which means the banks will likely be drawing on their trading lines to support their ABCP paper and thus indirectly the ABCP markets in general (still underlying market liquidity issues). We are under no illusion that the Caisse will be able to provide this support indefinitely.

That e-mail also confirmed that a meeting of market participants in Montreal was proposed to discuss a controlled shrinking of the ABCP market. That portion of the e-mail provided as follows:

> Our current anticipation is that a global meeting between the independents, National Bank, (our lead dealer) and the Caisse will be called shortly to sort through a more permanent and lasting solution (if the Caisse's support holds up). At this meeting, our current assumption is the discussions with [*sic*] surround a controlled shrinking of the market place to allow the Caisse to get down in an acceptable level (we will deal with this as we get closer to the meeting). At this point, we still have some powder left in the form of over fundings that we plan on still keeping as much dry as possible in anticipation of some sort of industry wide restructuring or further problems beyond the Caisse's support. Again, things are going up and down day by day, and it is difficult to figure out where we really stand at any given point in time. As you can imagine, we are dealing with imperfect information much of which is speculation and rumours, but so far I think the team is "containing" things. I will send an update later in the morning after the paper rolls (knocking on wood).

(e) Events Subsequent to the August Long Weekend

Tuesday, August 7, 2007

[705] On Tuesday, August 7, 2007 at 7:43 a.m., Gaucher asked Paul to send him information and materials necessary to prepare for the possibility of liquidity drawdowns in the event of a market disruption. Gaucher predicted that it was going to be a "tough day" in the market.

[706] The Caisse supported Coventree sponsored ABCP that day. It not only rolled its own maturing Coventree sponsored ABCP for a 90-day period but also purchased additional Coventree sponsored ABCP.

[707] The spreads on Coventree sponsored ABCP widened to approximately 25 basis points over CDOR for A notes and approximately 40 basis points over CDOR for E notes. Cornish testified that the increased spreads were attributable to the effect of the $3 billion RBC/TD Bank transaction on August 3, 2007 and to "the price that the Caisse, Mr. Verville, was saying he wanted to extract, if you like, so to speak, for his continued support of the marketplace".

[708] That day there was a gap of approximately 15 basis points between Coventree sponsored A note spreads and bank-sponsored ABCP spreads. This gap, in Allan's view, was too large to allow Coventree to retain its traditional securitization business if the asset originator had the option of using bank-sponsored conduits for funding.

[709] Coventree acknowledged internally that "the spread widening in the Canadian market [is] beginning to adversely affect Coventree's revenues and will adversely affect future revenues of Coventree if those conditions persist".

[710] Coventree's models indicated that four transactions had come close to or crossed collateral call triggers.

[711] Coventree knew that its conduits were unable to purchase new assets in connection with traditional securitization transactions and Coventree made preparations on August 7, 2007 to advise its asset suppliers that Coventree did not know when it would be able to resume offering financing in the ordinary course. Cornish testified that Coventree prepared speaking notes for phone calls that Coventree expected to have with traditional asset originators to explain market circumstances.

[712] The "Frequently Asked Questions" speaking notes prepared on August 7, 2007 included the following statements:

(a) "We cannot predict when past levels of liquidity will return to the market and thus we hesitate to predict when you will be able to fund again".

(b) "We do not believe you will be [able] to fund with us in the short term".

(c) "We strongly urge you to seek out funding from other financing sources with which you currently have an established relationship".

(d) "In the short term, this market turbulence is impacting our ability to offer financing in the normal course of business".

In his testimony, Cornish confirmed the accuracy of each of these statements.

[713] Coventree ultimately decided to wait until Monday, August 13, 2007 to speak to its traditional asset originators about developments in the credit markets. The cover e-mail for the "Frequently Asked Questions" document stated: "The Communication on Monday will coincide with the press release so that any potential shareholder/insider issues are eliminated". According to Cornish:

> We were just trying to be cautious about not getting out and talking to others that were not shareholders about matters that might somehow be relevant to shareholders. We are trying to be careful not to get into selective disclosure issues.

Cornish testified that Coventree did not want to have discussions with asset providers until it issued its third quarter MD&A. If, however, an asset provider needed funding in the week of August 7, 2007, then Coventree would have a conversation with that asset provider that was "much along the same lines that Ken [Toten] has already had with Xceed to explain, look, we can't do this funding at this point in time".

[714] On August 7, 2007, Coventree continued to monitor the increasing daily or short-term maturities of Coventree sponsored ABCP. Allan was concerned that increasing overnight rolls of Coventree sponsored ABCP could result in non-compliance with the liquidity agreements. That could preclude the exercise of liquidity draw rights for the benefit of note holders even if a general market disruption occurred (see paragraphs 466 and 467 of these reasons).

[715] Tai sent an e-mail to the Board at approximately 8:00 p.m. updating the Board on market conditions that day. That e-mail provided as follows:

> Board Members, today was a good day for Coventree. All our paper rolled with the Caisse picking up about $400M in aggregate from the independents. Spreads have widened out (which will begin to impact our revenue) but so far we are hanging in there to fight another day. An additional benefit to what happened today is most of the paper purchased by the Caisse was for 90 day maturities. Although expensive at these spreads, we are hoping that this will start to buy us some breathing room to allow for some stability to enter back into this market. As a result of this, our rolls for tomorrow are down to more manageable levels for tomorrow. OSFI has been in contact with us through David and they are aware of the situation and hopefully will bring their weight behind a permanent solution. It helps to have someone on our team that has been through a similar crisis situation (David with CIBC/Enron) who has always done the right things and as a result has incredible credibility with the market participants…. We understand that what has happened has serious strategic implications for our business and throws many of our assumptions out the window in terms of the planning process we were engage [*sic*] in prior to this market volatility.

[716] When asked about the meaning of the Caisse stepping back into the market for Coventree sponsored ABCP on August 7, 2007, Cornish testified that "in the end, I don't believe, however, that [Verville] changed his ultimate goal of reducing his exposure to the marketplace … longer term, I think he still maintained his objective of reducing his exposure if he hadn't already achieved it at that point".

[717] Cornish and the other Coventree witnesses testified that the Caisse was fully entitled to operate in its own economic self interest and was free to make whatever decisions it wished based on its investment objectives. They testified that it was not possible to predict the Caisse's future actions.

Disclosure Committee Meeting

[718] Coventree's disclosure committee met on Tuesday, August 7, 2007.

[719] Child prepared draft notes of the disclosure committee meeting that were never finalized. Although in draft form, Cornish testified that the notes referred to all of the factors the disclosure committee was considering at the time. The notes refer to the fact that Coventree had previously disclosed in its annual report and quarterly filings the impact of the DBRS announcements in substantially curtailing its ability to grow, if not halt in the short-term, its credit arbitrage business. The notes indicated that "we don't have enough information on what is happening in the markets … Speculating and drawing incorrect conclusions … could contribute to the uneasiness in the ABCP markets and result [*sic*] deteriorating or jeopardizing the Company's viability". The notes then refer to the financial impact of spread widening, negative carry on overfunding, potential losses on reserves, the valuation of intangibles from the purchase of the balance of Nereus shares, the sale/termination of transactions and loss of revenue backlog.

[720] The draft disclosure committee notes also refer to a rule of thumb that an event is material for securities law purposes if it affects at least 5% of net income. The notes in this respect read as follows:

> Al Hudec of Davis & Co advises us that a rule-of-thumb for materiality is 5% of net income … Another similar test is that used by our auditors, E&Y, in doing the audit of our 2006 consolidated financial statements. E&Y considered an error of $3.85 million in the net income excluding VIEs to be significant.
>
> …
>
> Al Hudec also advised that, although conventions such as the 5% rule of thumb can be used, the securities commission doesn't support them. *In their view, the relevant test is whether the information can be reasonably expected to influence investors. Again we concluded that disclosure was not required under this test. Investors are generally aware of the risks of our business and the impact of US subprime, "contagion" etc. are widely discussed in the press.* If disclosed, Coventree could only comment that the current impact. [*sic*] Speculating or forecasting these unprecedented times would not only be not consistent with our disclosure policy but could subject Coventree to liability if erroneous. If at some

> point in the future, additional information that changes the above conclusion [*sic*], the matter will be reconsidered at that time. [emphasis added]

We understand from Child's testimony that these references to legal advice from Hudec relate to advice given by him in the past in connection with the Nereus litigation.

[721] Accordingly, the disclosure committee apparently concluded that investors were generally aware of the risks of Coventree's business and the impact of U.S. subprime contagion. Coventree concluded therefore that no news release was required to be issued under section 75 of the Act.

[722] Child's notes indicate that the disclosure committee reached the following conclusion:

> We concluded that we will include commentary on this matter in our Q3 MD&A as we view it is in the interest of the owners to understand these details but it is not material for a press release at this time. If the market persists or a material event occurs in the interim, we will reconsider…

[723] The disclosure committee notes also indicate that Child provided a calculation of the financial impact of spread widening on profitability based on a spread of 12 basis points over CDOR. Child calculated the impact on gross revenue over 30 days, for a one basis point increase in spread, to be $100,000. Child calculated the financial impact to Coventree over 30 days of a one basis point increase in spread to be $52,000 of net after-tax impact or $624,000 of net after-tax impact for a 12 basis point increase. She stated in her notes that:

> For the investments that earn a fixed spread above CDOR (i.e., securities arbitrage vs. traditional that earn a program fee), the widening will result in decreased revenue [*sic*] future revenue.

[724] On August 7, 2007, Coventree was preparing its third quarter MD&A disclosure, which was to be approved by the Board and issued on August 13, 2007. Cornish testified that Coventree wanted to convey in the MD&A that:

(a) there had been spread widening and what its impact would be;

(b) Coventree's perception of the causes of the situation at the time, that the effects they were seeing were not limited to the Canadian ABCP market but were effects that were being seen in credit markets in Canada, the U.S. and elsewhere;

(c) investors appeared to be reducing or eliminating their investments in the Canadian ABCP market, which had contributed to an imbalance of supply and demand for ABCP; and

(d) Coventree was unable to predict when the supply/demand imbalance would be restored, so there was a risk spreads would continue to widen.

[725] Paul testified that, during the week of August 7, 2007, it seemed that the majority of Coventree sponsored ABCP was being purchased by the Caisse and that if the Caisse did not

continue to roll its Coventree sponsored ABCP there would have been insufficient demand to support maturing ABCP. In a call with Gaucher, Paul expressed his view that if the Caisse had not rolled its ABCP holdings on Tuesday, August 7, 2007, "it would have been over".

Wednesday, August 8, 2007

[726] On Wednesday, August 8, 2007, Coventree advised another traditional asset provider, NorthBrook Capital Corp. ("**NorthBrook**"), that it was unable to fund a purchase of assets from Northbrook.

[727] Coventree also voluntarily posted collateral of $25 million to each of two Citibank transactions, in order to provide an additional cushion before a collateral call could be triggered.

[728] There was a taped telephone call on August 8, 2007 between Allan and Davidson in which Allan criticized CIBC for not following the Caisse when it had "stepped up" on Tuesday, August 7, 2007. On that call, Allan stated that he believed that the ABCP market was headed for a "soft landing", which he said Verville was trying to facilitate, whether or not CIBC participated (see the discussion of the "soft landing" commencing at paragraph 735 of these reasons).

[729] In his evening update to the Board on Wednesday, August 8, 2007, Tai stated:

> The only excitement was provided by the Caisse punishing one of the bank-owned dealers (CIBC) for not behaving in these trying times. CIBC as a result of their legal counsel has informed us that they were not going to offer our paper. Today with the Caisse leading the charge there was a run on CIBC ABCP paper. Senior level folks at CIBC called David to see if we could help to sort things out and things seemed to have settled down. This is all leading to a meeting orchestrated by the Caisse (with our encouragement) on Friday in Montréal with all the key participants on a more permanent solution. Unfortunately for some, the proposed solution will be more painful for some rather than others who have more prudently managed their assets. *It will take some time for people to absorb the enormity of the situation and come willing to entertain solutions.* We are hopeful in this turmoil there may be opportunities. Tomorrow should be another light day and I likely won't give an update unless things are different. I will definitely give an update after the Friday meeting. We are also preparing a fairly detailed account of what has brought us here for the board meeting on Monday that David will present. [emphasis added]

(f) Draft Q3 MD&A

[730] Coventree's third quarter MD&A for the period ending June 30, 2007 was to be considered and approved by the Coventree Board at its scheduled August 13, 2007 Board meeting. That MD&A was not approved as a result of the market disruption that occurred that day. A draft of the third quarter MD&A (the "**Draft Q3 MD&A**") was sent by Child to Tai on August 8, 2007. The Draft Q3 MD&A contained disclosure related to credit market developments and their impact. Coventree addressed the following matters in the MD&A:

(a) the imbalance in supply and demand in the ABCP market;

(b) the cause of spread widening and the financial impact on Coventree;

(c) the high credit quality of the assets held by Coventree sponsored conduits and the limited subprime exposure;

(d) Coventree's inability to predict if or when ABCP spreads and liquidity would return to historic levels; and

(e) the effect on Coventree of the new criteria adopted by DBRS in the DBRS January Release.

[731] In connection with the imbalance in supply and demand, the Draft Q3 MD&A stated that:

> … It appears that some investors are reducing, or eliminating, their investments in the Canadian ABCP market, including ABCP issued by conduits sponsored by independents such as Coventree. Combined with recent large new ABCP issuances from bank-sponsored conduits, this has resulted in what we believe to be an imbalance between the supply and demand for ABCP in Canada. This imbalance has resulted in a widening of spreads generally in the Canadian ABCP market and the absence of capacity for new issuance by independent conduit sponsors.

[732] The Draft Q3 MD&A also commented on Coventree's inability to predict the duration of the supply/demand imbalance:

> … The Company is unable to predict if, or when, the balance between supply and demand for ABCP will be restored. Accordingly, the Company is unable to predict whether ABCP spreads and liquidity will return to historic levels. There is a risk that ABCP spreads may widen further. The Company is continuing to work with its ABCP dealers and other interested parties including key ABCP investors to address the current supply/demand imbalance.

[733] The Draft Q3 MD&A also addressed the cause of spread widening and the credit quality of assets in the Coventree sponsored conduits:

> Management believes that the recent spread widening for the ABCP issued by its conduits is a consequence of the liquidity issues facing the Canadian ABCP market rather than concerns with the quality of the assets in its conduits. Management continues to believe in the high quality of those underlying assets. Coventree-sponsored conduits have limited exposure to U.S. subprime mortgages – less than 4% of the total assets in Coventree-sponsored conduits are backed by assets related to U.S. subprime mortgages.

[734] The Draft Q3 MD&A also commented on the effects of DBRS's new criteria for rating credit arbitrage transactions, as follows:

> Also affecting our business is the continuation of the Dominion Bond Rating Service Limited ("DBRS") changes relating to the Canadian ABCP markets. In particular, in January 2007, DBRS announced new criteria relating to transactions involving the purchase of structured credit products by Canadian ABCP conduits. The Company's view is that these criteria will be very difficult to satisfy. *As a result, these changes have had and will continue to have the effect of reducing the profitability of the Company by substantially curtailing its ability to grow its credit arbitrage business.* [emphasis added]

It is interesting that this paragraph addressed Coventree's "ability to grow" its credit arbitrage business. Coventree had previously stated in its Q2 MD&A that the DBRS changes in criteria would "have the effect of reducing the profitability of the Company by substantially curtailing its ability to grow, if not halt in the short-term, its credit arbitrage business" (see paragraph 327 of these reasons). We are not aware that there was any change in circumstances that would support the more positive change in wording highlighted above. We acknowledge, however, that the Draft Q3 MD&A was a draft that had not been finalised as of August 8, 2007.

(g) The "Soft Landing"

[735] Allan had concluded by Wednesday, August 8, 2007 that the lack of liquidity in the ABCP market reflected a structural problem: there was more ABCP outstanding than there was investor demand to purchase it as it matured. Allan thought that the only solution was for market participants in the issue and sale of ABCP to address this supply/demand imbalance. In the "What the Hell is Going On?" presentation material (see paragraph 745 of these reasons), Allan stated that "[t]his adjustment can be made catastrophically (extensions, liquidity draws and defaults) or in a managed fashion through orderly sequential and proportionate liquidation" of a significant portion of the outstanding ABCP in the market. The latter would involve agreement by market participants to a pro rata reduction in the total amount of ABCP outstanding. Allan referred to this solution as the "soft landing". Allan testified that Coventree's share of such a reduction would likely have been approximately $2 billion. According to Allan, that $2 billion reduction could have been accomplished within 60 days from:

(a) the $800 million of "dry powder" that Coventree sponsored conduits had accumulated up to that point; and

(b) a further $1 billion that could come from the potential early termination of a traditional securitization transaction with HSBC.

[736] According to Tai's e-mails to the Board, by the August long weekend, Coventree had $160 million of excess cash available (after using $60 million to "ease some of the funding tension" in one of its conduits with subprime exposure) and expected to increase cash to $610 million by Tuesday, August 7, 2007 (see paragraph 667 of these reasons). Allan referred to $800 million of "dry powder" in his testimony and Cornish testified that shortly after August 13, 2007, Coventree sponsored conduits would have had approximately $1 billion of "dry powder". Whatever the actual amount of cash available, it was clearly insufficient, absent a soft landing, to resolve the liquidity issues affecting Coventree sponsored ABCP.

[737] Allan testified, however, that by August 8, 2007, he believed that events were coalescing in a manner that made a soft landing increasingly likely.

Thursday, August 9, 2007

[738] On Thursday, August 9, 2007 at 9:11 a.m., Gaucher advised Paul that:

(a) "It's goin' very bad";

(b) "Laurentian dropped today. Deutsche Bank can't place the paper. Royal's dropping, CIBC dropped everything. HSBC can't place the paper. Nobody can place the paper"; and

(c) "there's … 15 minutes left before we decide to do what we do".

[739] Allan testified that "dropping" paper referred to dealers returning unsold maturities to NBF rather than rolling the ABCP or taking the ABCP into inventory.

[740] At 9:23 a.m., Tai reported to the Board that "things have settled down for the moment in our Canadian ABCP markets, but our fears continue to be that there is more to come and this may ultimately be a problem that is not containable by just the support of Quebec Inc.". Staff alleges that this Board update was inconsistent with what was actually happening in the market.

[741] At 10:24 a.m., NBF advised Coventree that there was a backstop for the day. NBF stated "thank God the Caisse is still there 'cause … I don't know what would have happened". NBF also reported that CIBC had been turning back all its Coventree sponsored ABCP for the entire week.

[742] Cornish testified that he considered Thursday, August 9, 2007 another good day in the market. Cornish said there was no issue with Coventree sponsored ABCP rolling and the Caisse was continuing to do exactly what it had said that it would do.

[743] On August 9, 2007, BNP, France's biggest bank, froze $1.6 billion Euros (U.S. $2.2 billion) worth of funds, citing the U.S. subprime mortgage problems that had rattled financial markets worldwide. There were also reports in the media that day that U.S.-based companies were extending payments on commercial paper backed by home loans for the first time as the subprime mortgage crisis spread to debts perceived to be among the safest in the market. Also on August 9, the Bank of Canada issued a news release in an attempt to reassure the markets. It stated: "In light of current market conditions, the Bank of Canada would like to assure financial market participants and the public that it will provide liquidity to support the stability of the Canadian financial system and the continued functioning of financial markets." On Friday, August 10, 2007, the United States Federal Reserve issued a similar release stating that it was providing liquidity to facilitate the orderly functioning of financial markets.

[744] By August 9, 2007, Allan had suggested asking the Bank of Canada to consider accepting any ABCP, including third-party sponsored ABCP, as collateral for Bank of Canada loans to banks, in order to encourage the banks to resume their role as market makers and to provide liquidity in the ABCP market. Allan acknowledged that "this was going to be a bit of a problem

because the Bank's mandate is to support bank liquidity and this would be indirectly supporting non-bank sponsored liquidity".

(h) Draft Board Presentation

[745] Allan prepared a powerpoint presentation for the Monday, August 13, 2007 Board meeting entitled "What the Hell is Going On?". Allan sent that presentation to Tai, Cornish, Child and one other Coventree employee on August 9, 2007. The presentation included comments to the following effect:

(a) the crisis has not passed and there are more shocks to come (p. 3);

(b) contagion has caused a problem in one area to migrate to others due to the influence of the CDO market (p. 4);

(c) there has been a contraction of available cash in the Canadian ABCP market and unprecedented spread volatility and risk correlation in all credit portfolios (p. 5);

(d) conduits sponsored by non-banks have always had poorer liquidity than those sponsored by banks (p. 6);

(e) conduits containing U.S. subprime assets (even where not credit impaired) suffer poorer liquidity than those that do not (p. 6);

(f) the illiquidity in the marketplace started with the highest subprime exposures but spread more generally to the market for ABCP issued by third-party sponsors; spread widening occurred as a result. Spread widening impacts Coventree's net revenue (pp. 7-8);

(g) the illiquidity challenges became even more severe on August 3, 2007 with the issue of $3 billion of new ABCP into the market, such that "default or liquidity draws on A notes and extensions on E notes became a real threat" (p. 9);

(h) collateral call triggers remain perilous and "a prolonged rally in credit markets and a return to the normal differentiated trading patterns among credits is required to bring these levels in and reduce our collateral call risk" (p. 11);

(i) in order to deal with collateral call risks it is necessary to hold overfunding in Coventree conduits. This exposes Coventree to negative carry (p. 13);

(j) in the absence of new issue capacity, Coventree has only two mechanisms to generate overfunding: amortization and asset sales (p. 13);

(k) all remaining investing assets (credit arbitrage assets) have liquidation values between 50 – 90% of their funded value (p. 15);

(l) the cost of funds situation will result in the migration of $3 – 4 billion of assets (p. 15);

(m) there is the potential for liquidity draws to be unavailable to Coventree sponsored conduits because of the size of maturities of Coventree sponsored ABCP on particular days (p. 17);

(n) dealer market-making lines for Coventree sponsored ABCP and other independents are at or close to zero (p. 19);

(o) market disruption liquidity lines are only 364 day commitments; without the prospect of ongoing credit arbitrage transactions to motivate providers to renew, none can be presumed to roll over (p. 21); and

(p) Coventree's profits and losses would be impacted by negative carry on overfundings, reduced margins due to wider spreads, potential "make-wholes" to conduits for losses on sales of assets and lost backlog (pp. 23-24).

[746] In the same presentation, Allan concluded that there had to be a contraction in the overall amount of ABCP in the Canadian credit market and that adjustment could occur "catastrophically" or by a managed proportionate reduction (i.e., the "soft landing", see paragraph 735 of these reasons).

[747] We consider the "What the Hell is Going On?" presentation to be very cogent evidence of Allan's objective assessment of the circumstances by August 9, 2007. A number of those challenges and issues were evident to Coventree well before that date.

(i) Friday, August 10, 2007 to Monday, August 13, 2007

[748] In his daily update to the Board on Friday, August 10, 2007, Tai reported that it was a "tough day" in the markets with all the headline press "but Coventree managed to roll all of its conduits' ABCP with the continuing market support of the Caisse".

[749] On August 10, 2007, Tai, in person, and Allan, by telephone, attended the meeting of market participants hosted by Verville in Montreal. In attendance were representatives of all the major participants in the ABCP market including the dealers, liquidity providers and conduit sponsors. Verville proposed that coordinated steps should be taken to shrink the size of the ABCP market and that all players in the market would be expected to participate in that reduction. On Saturday, August 11, Allan sent an e-mail to Verville saying that Verville "did an excellent job putting some form to the beginning of [the] way out of the crisis the market is in".

[750] By Sunday, August 12, 2007, however, Allan reported that it appeared that the Caisse had been unsuccessful in getting the Bank of Canada to accept third-party sponsored ABCP as collateral for advances to banks. Allan and Verville both believed, as a result, that there was no chance that the Canadian banks would support Coventree sponsored ABCP on August 13, 2007.

[751] Allan stated in an e-mail to Cornish, Tai, Child and others at Coventree on August 12, 2007 at 3:56 p.m. that:

> I have had a number of conversations with Luc Verville today, and I have to report that it is far from clear that he has approval to stand in tomorrow.

> …
>
> Bottom line: I am not optimistic about our chances of dodging the bullet tomorrow. All hands should be on deck; all procedures for extensions, draws and defaults should be ready for execution.
>
> Helmets on; chin straps tightened.

[752] On Monday, August 13, 2007, Coventree agreed with NBF to widen spreads on its ABCP. While some Coventree sponsored ABCP was rolled, the dealers were not able to place all of the maturing Coventree sponsored ABCP. As a result, Coventree widened the spreads on the A notes to 50 basis points and on the E notes to 110 basis points. That allowed Coventree to take immediate steps to make claims under the relevant liquidity agreements and to extend the terms of the E notes. Some of the liquidity providers provided liquidity in response to notices for liquidity draws while others refused on the grounds that the circumstances that existed that day did not constitute a general market disruption within the meaning of the applicable liquidity agreements. Bank-sponsored ABCP continued to roll.

[753] When it became clear on August 13 that not all Coventree sponsored ABCP would be rolled, Cornish contacted Market Regulation Services to request a halt in trading of Coventree shares on the TSX. Cornish was ultimately able to persuade Market Regulation Services to halt trading in Coventree shares to give Coventree sufficient time to prepare and issue a news release that day.

[754] Coventree issued news releases on August 13, 14, 16, 22 and 23, 2007 addressing the market disruption and related matters.

[755] On August 22, 2007, Coventree reported in its news release that the spread widening that had occurred to that date meant that "Coventree's revenues from credit arbitrage transactions will in the short-term be reduced to zero".

8. Decisions of the Disclosure Committee

[756] We have indicated in these reasons a number of our concerns with the decisions made by the Coventree disclosure committee with respect to Coventree's obligations under section 75 of the Act to disclose material changes. We would reiterate here that:

> (a) Coventree's disclosure in its MD&A did not satisfy its obligation to disclose material changes by news release in accordance with section 75 of the Act (see paragraph 642 of these reasons);
>
> (b) the fact that extensive risk factors were disclosed in the Prospectus and that "US subprime "contagion" etc. [was] widely discussed in the press" did not mean that public shareholders and investors had sufficient information to be able to fully assess the effects on, and consequences for, Coventree and its business of the events and developments that were unfolding in late July and early August 2007; to the contrary, we have concluded they did not have sufficient information to do so;

(c) Coventree's obligation was to disclose changes that had occurred in its business or operations that were material; that disclosure obligation was not "premature" and did not require Coventree to speculate about or predict uncertain future events (see paragraphs 637 and 638 of these reasons); and

(d) the Draft Press Release prepared by Cornish addressed only spread widening and thereby failed to address a number of very significant events and developments that were discussed at the August Board Meeting (see paragraph 646 of these reasons) and that we have concluded constituted material changes.

In our view, the various rationalizations of the disclosure committee did not justify the decisions it made not to publicly disclose events and developments that had occurred and constituted "material changes" within the meaning of the Act by the close of business on August 1, 2007.

[757] In particular, in our view, the reasons Tai expressed to the Board for not issuing a news release on August 2, 2007 (see paragraph 562 of these reasons) did not justify that decision.

[758] Further, Child's notes of the disclosure committee meeting on August 7, 2007 indicate that the relevant test used by securities regulators to determine when disclosure is required "is whether the information can be reasonably expected to influence investors". The disclosure committee concluded that "disclosure was not required under this test" (see paragraphs 720 and 721 of these reasons). We see no reasonable basis for that conclusion. To the contrary, we have concluded that a number of the events and developments that had occurred by the close of business on August 1, 2007 would have significantly affected the investment decisions of public shareholders and investors (see paragraphs 336, 338 and 596 of these reasons).

9. Multiple Breaches of the Act

[759] Staff has alleged that by reason of Coventree's failure to comply with section 75 of the Act as a result of the DBRS January Release, Coventree also failed to comply with its disclosure obligations under that section on each day thereafter from January 19, 2007 to August 13, 2007. In essence, that is an allegation that Coventree's failure to comply with section 75 constitutes a continuing breach of the Act until appropriate disclosure is made. Staff makes the same allegation of a continuing breach on each day following the alleged material change that occurred on August 1, 2007 or thereafter. Staff did not address this issue in its submissions. The reason for making these allegations may be simply to ensure that Staff has alleged a breach of the Act on each day upon which we could potentially determine a material change to have occurred. That is more a matter of pleading than substance. At the same time, one consequence of this allegation is that Coventree would potentially be subject to sanctions for breaches of the Act on each day after a material change had occurred until it was properly disclosed.

[760] The Commission may well conclude that it is in the public interest in some circumstances to impose sanctions on an issuer for failure to correct a previously made misstatement. One example may be where an issuer becomes aware that a previous statement was materially misleading and fails to correct it. Similarly, the Commission may conclude in certain circumstances that an issuer repeats a previous misstatement by necessary implication (see, for example, *Re Biovail, supra,* at para. 251).

[761] In this case, however, we do not believe that the circumstances before us justify treating Coventree's failure to comply with its disclosure obligations with respect to the DBRS January Release or by the close of business on August 1, 2007 as giving rise to further multiple breaches of the Act on every day thereafter. The essence of Coventree's contraventions of the Act is the failure to comply with its obligations to issue and file a news release forthwith after the occurrence of those material changes and thereafter to file material change reports. Coventree ultimately made public disclosure related to those circumstances on May 14, 2007 (in its Q2 MD&A, in the case of the DBRS January Release) and on August 13, 2007 (in respect of the market disruption that occurred on that date). We are not satisfied that the disclosure in the Q2 MD&A was adequate (see paragraph 349 of these reasons) and we have not considered the adequacy of disclosure made by Coventree on August 13, 2007. In any event, those disclosures did not absolve Coventree's previous failures to comply with subsection 75 of the Act. In the circumstances, however, we are not prepared to conclude that, having failed to comply with its disclosure obligations on January 22, 2007 and August 2, 2007, Coventree thereby breached the Act on every day thereafter until corrective disclosure was made. The same conclusion applies to Coventree's failure to file required material change reports.

[762] In coming to that conclusion, we should not be taken to have decided that there are never circumstances in which the Commission would take the position that a breach of a disclosure obligation constitutes a continuing breach on each day thereafter until appropriate corrective disclosure is made. We have identified above two circumstances in which the Commission might take that view. We note, in addition, that in imposing sanctions for a breach of the Act or for conduct contrary to the public interest, the Commission will take into consideration all of the relevant circumstances. Those circumstances would include the failure to appropriately and adequately correct a previously made misstatement on a timely basis.

XIII. CONTRAVENTIONS OF THE ACT BY CORNISH AND TAI

[763] We have concluded that Coventree failed to comply with subsections 75(1) and (2) of the Act in respect of the material changes that occurred on January 22, 2007 and by the close of business on August 1, 2007. Staff has alleged that Cornish and Tai, as senior officers and directors of Coventree, authorized, permitted or acquiesced in Coventree's contraventions of the Act and are thereby deemed also to have not complied with the Act in accordance with section 129.2 of the Act.

1. Section 129.2 – Authorize, Permit or Acquiesce

[764] A director or officer of an issuer is deemed not to have complied with securities law where the director or officer authorized, permitted or acquiesced in the issuer's non-compliance with the Act (Act, *supra*, section 129.2).

[765] Staff alleges that Cornish and Tai authorized, permitted or acquiesced in Coventree's breaches of the Act described in paragraphs 342 and 595 of these reasons.

[766] We interpret the words "authorize, permit or acquiesce" as bearing their ordinary or dictionary meaning. In *R. v. Armaugh*, in considering the application of subsection 122(3) of the Act, the Court stated that:

> In *Webster's New World Dictionary*, 3rd college edition acquiesce means to agree or consent quietly without protest. Authorize is defined in part as to give official approval or permission, to give power or authority, to give justification for and permit is defined as to allow, consent to tolerate, to give permission, authorize permission especially in writing, a document granting permission, licence, warrant.
>
> (*R. v. Armaugh Corp.* (1993), 1 C.C.L.S. 87 (Ont. Ct. J.) at para. 20 ("***R. v. Armaugh***")

[767] Consistent with *R v. Armaugh*, in our view, the threshold for liability under section 129.2 of the Act is relatively low, in that merely acquiescing or passively consenting without protest will satisfy the requirements of that section (*R. v. Armaugh, supra,* at para. 19).

[768] Officers and directors of a reporting issuer are ultimately responsible for ensuring that timely and accurate information is disclosed by the issuer in accordance with the Act:

> The responsibility of companies to make timely and accurate financial disclosure ultimately rests with directors of those companies. In practice, the responsibility is shared by the directors, audit committees, chief executive officers, chief financial officers and other management. The company itself would also be responsible.
>
> (*Re Standard Trustco* (1992), 15 OSCB 4322 at 4364) ("***Re Standard Trustco***")

[769] More is expected of directors and officers who have superior qualifications, such as experienced business people, and more is expected of inside directors, such as Cornish and Tai, who have much greater involvement in corporate decision making and much greater direct access to corporate information (*Soper v. Canada* (1997) F.C.J. No. 881, at paras. 37 to 41; see also *Re YBM Magnex, supra,* at paras. 177, 183 and 184). The chief executive officer of a corporation plays a "pivotal" role in "co-ordinating, compiling and vetting material corporate disclosure" (*Re Biovail, supra,* at para. 387, referring to *Re Ironside,* 2006 ABASC 1930*,* at paras. 963 and 982; and *Re Workum and Hennig*, 2008 ABASC 363, at para. 713).

2. Analysis and Conclusions

[770] Both Cornish and Tai were leaders of Coventree and senior officers. Cornish was President and Tai was CEO of Coventree. They were both members of the Board and of Coventree's strategic council and disclosure committee. They had the knowledge, experience and access to information that their roles implied. Both Cornish and Tai were directly involved in deciding whether Coventree should make disclosure of the material changes in its business that we have found occurred on January 22, 2007 and by the close of business on August 1, 2007.

[771] We find that Cornish and Tai authorized, permitted or acquiesced in Coventree's contraventions of section 75 of the Act referred to in paragraphs 342 and 595 of these reasons. As a result, Cornish and Tai are deemed, pursuant to section 129.2 of the Act, also to have not complied with subsections 75(1) and (2) of the Act.

[772] We would add that there was no evidence before us that would lead us to conclude that either Cornish or Tai intentionally breached the Act or attempted to intentionally mislead public shareholders or investors.

[773] While no allegations were made in this matter against Allan, Child, Dalton or Paul, we have no reason to doubt that they testified truthfully and forthrightly and that they acted throughout the events that were the subject matter of this proceeding in good faith in what they considered to be the best interests of Coventree and its shareholders. Allan appeared to us to be attempting in good faith to fully inform the Board of developments in the ABCP market as they unfolded. Child appeared to us to be focused in good faith on attempting to ensure that Coventree complied with its disclosure obligations in the circumstances. No one should conclude otherwise based on these reasons.

[774] We would also add that there was no evidence that would lead us to conclude that Coventree, Cornish or Tai, or any other employee of Coventree who testified, did not co-operate fully in responding to Staff's investigation in this matter. We understand that Coventree voluntarily agreed that it would not make any distribution of dividends to shareholders in the course of its winding up until Staff's investigation had been completed and at least 45 days notice of any proposed distribution was given to Staff.

XIV. CONDUCT CONTRARY TO THE PUBLIC INTEREST

1. Staff Allegations

[775] Staff alleges that the conduct of Coventree, Cornish and Tai in contravening the Act as alleged by Staff is contrary to the public interest. No public interest order is sought by Staff as a result of any conduct of the Respondents that does not constitute a contravention of the Act. Accordingly, while our public interest jurisdiction may be exercised in circumstances where there has been no breach of the Act, in this case we will limit the exercise of that jurisdiction to circumstances in which we have concluded that there has been a contravention of the Act.

2. Coventree Submissions

[776] Coventree submits that there is no basis upon which the Commission can or should exercise its public interest jurisdiction against Coventree or the other Respondents in the absence of an established breach of the Act. Staff has conceded that point in this proceeding.

[777] In any event, Coventree submits that its conduct does not warrant the exercise of the Commission's public interest jurisdiction. It submits that there is no need for a preventative order against Coventree or any of the other Respondents in this case. Coventree further submits that it acted honestly, reasonably, diligently and fairly throughout the relevant period. There is no evidence that anyone at Coventree turned a blind eye to the company's disclosure obligations or set out to treat investors unfairly or improperly in any way. This case does not involve a scheme to mislead. To the contrary, Coventree submits that its management and Board considered their disclosure obligations carefully and took those obligations extremely seriously.

[778] Further, Coventree submits that there is no evidence that Coventree (or anyone associated with it) intended to mislead, conceal or withhold the truth from its shareholders or from anyone

else. To the contrary, the record is replete with evidence that Coventree sought to keep its public shareholders and investors in Coventree sponsored ABCP fully informed in respect of the matters that Staff alleges should have been publicly disclosed.

Prospectus Disclosure

[779] With respect to Staff's allegation regarding the disclosure in the Prospectus, Coventree submits that it engaged in a rigorous process guided by highly experienced experts with respect to the drafting, finalization, approval and issuance of the Prospectus. That process was intended to ensure that the Prospectus contained full, true and plain disclosure of all material facts. Moreover, Coventree submits that the undisputed evidence in this proceeding is that Coventree adopted the approach of disclosing in the Prospectus, in detail, every conceivable risk Coventree then faced, and attempted to dampen expectations regarding Coventree's future performance.

DBRS January Release

[780] With respect to Staff's allegation concerning the DBRS January Release, Coventree submits that when it became clear, Coventree disclosed the impact that the DBRS January Release would likely have in the Letter to Owners, Q1 MD&A and Q2 MD&A. Coventree submits that this was not the conduct of a company trying to mislead, conceal or hide the truth.

Disclosure of Subprime Exposure

[781] Coventree submits that to the extent it received enquiries concerning U.S. subprime exposure from investors or dealers, it responded to those enquiries in a helpful, accurate and timely manner. Coventree submits that the U.S. subprime disclosure that Coventree made in the April Investor Presentations was unprecedented at the time in the ABCP market in Canada and went beyond what other conduit sponsors and DBRS were providing to ABCP investors.

Events of Late July and Early August 2007

[782] Coventree submits that it had prepared, and was planning to disclose in its Q3 MD&A, a detailed and accurate summary of the prevailing market conditions and their impact on Coventree. That disclosure would have been made on August 13, 2007, but for the market disruption that occurred on that date. Again, Coventree submits that this is decidedly not the conduct of a company engaged in a scheme to mislead or conceal the truth.

[783] In late July and early August 2007, Coventree was struggling to understand the events and developments that were occurring in the ABCP market. The global economic crisis resulted from numerous factors that were beyond the control of Coventree. In this difficult, highly fluid and constantly changing environment, Coventree made its disclosure decisions based on the information then available to it. Coventree submits that those decisions should not be judged against a standard of perfection or with the benefit of hindsight.

[784] Coventree submits that it did not make its disclosure decisions arbitrarily or without careful deliberation. Coventree's management and Board included at least three former Bay Street lawyers with experience and training concerning the continuous disclosure obligations of public companies. The Board and members of senior management concluded reasonably and

prudently that it was not necessary to issue a news release or file a material change report in late July or early August prior to the market disruption that occurred on August 13, 2007.

[785] In addition, Coventree submits that it had well-founded concerns about making premature and unnecessary disclosure based on potentially misleading or inaccurate information. During this period, the ABCP market was characterized by speculation, misinformation, posturing and rumours. Issuing a premature or unnecessary news release or material change report based on this sort of information might well have misled the market and sparked panic, thereby precipitating the very market disruption that Coventree was trying to avoid.

[786] Coventree submits that there is no evidence to suggest that anyone associated with Coventree attempted to, or did, profit in any way from any of the alleged non-disclosure. When the market disruption occurred on August 13, 2007, it affected not only Coventree's public shareholders, but also Cornish, Tai and other members of the Board and management who owned shares in Coventree. Cornish and Tai were Coventree's largest shareholders and, as such, suffered the greatest losses in the period following the market disruption.

[787] Finally, in determining whether there is a need for a preventative order against Coventree and the other Respondents, Coventree submits that the Commission should have regard to Coventree's conduct following the market disruption. In particular, Coventree co-operated fully in the restructuring process as well as with Staff's investigation in this matter. Coventree produced every document Staff requested and every witness Staff sought to interview. Coventree answered all of Staff's questions fully and expeditiously, even in the highly difficult circumstances following the market disruption.

[788] Moreover, Coventree formed a special committee of independent directors to respond to Staff's investigation and to conduct its own investigation into the issues raised by Staff. The special committee spent hundreds of hours analyzing and considering the DBRS January Release, the events of late July and early August 2007 and Coventree's disclosure obligations in light of those events.

3. Cornish Submissions

[789] Cornish submits that he exercised good judgement and carried out his obligations as a senior officer and director of Coventree in a diligent and careful manner. He submits that he was attentive to and involved in all of Coventree's deliberations and discussions about its disclosure obligations under the Act.

[790] Cornish submits that his actions indicate his intention to "get in front of" the subprime issue by taking the lead in disclosing the U.S. subprime exposure of Coventree-sponsored conduits. Cornish submits that this evidences his proactive attitude and approach to disclosure.

[791] Cornish submits that he continuously assessed and re-assessed Coventree's disclosure obligations at each critical interval from Coventree's evolution into a public company in November 2006 through to the market disruption on August 13, 2007.

[792] Cornish submits that Staff can point to no instance when he did not personally review or consider Coventree's disclosure obligations in response to market events or developments

involving DBRS or the dealer syndicate. Cornish submits that nothing in the evidence provides a basis to conclude that he would, in the future, be a risk to or would prejudice the fair and efficient operation of Ontario's capital markets.

[793] Cornish submits that evidence of his good character is relevant to the issue of his credibility as a witness and to the substantive issue of whether he is a person who should be the subject of an order made by the Commission in the public interest.

[794] Cornish submits that his conduct and analysis of Coventree's disclosure obligations throughout the period under review were consistent with and reflected the attributes of an intelligent, diligent, thoughtful and experienced business person.

[795] Cornish submits that the Commission must examine the nature of his conduct in the larger context of market events that occurred in 2007. Cornish submits that it appears that no other similarly situated individual or company has been the subject of enforcement proceedings arising from the global credit crisis of 2007 and 2008. The strong inference to be drawn from the absence of a response from other regulators is that there is no valid basis for Staff's decision to seek to punish Coventree for alleged failures to disclose events that were driven by external events and that were uncertain in the circumstances.

[796] Cornish submits that, contrary to Staff's allegations, there is no evidence that he controlled or dictated the disclosure decisions of Coventree. The disclosure decisions were made on a collective basis, through a process of consultation and discussion among Coventree's management team and the Board, and were reasonable in the circumstances. Staff's allegations against Cornish are inconsistent with the uncontradicted evidence of all the witnesses, other than the Staff witnesses.

[797] Cornish also adopts the submissions of Coventree and Tai on this issue.

[798] Accordingly, Cornish submits that there is no basis for the Commission to make an order against him in the public interest.

4. Tai Submissions

[799] Tai also submits that the alleged breaches of securities law, and the alleged conduct contrary to the public interest, are not pleaded by Staff as alternative bases of liability; rather, they are pleaded conjunctively. Accordingly, Tai submits that in order to succeed, Staff must prove both elements of the allegation that it has made: that Tai breached securities law *and* that Tai acted in a manner contrary to the public interest.

[800] Tai submits that he had an honest belief that none of the facts relied upon by Staff were material changes to the business or operations of Coventree. Tai submits that his belief was reasonable for the following reasons:

> (a) there is no evidence that Tai delegated tasks inappropriately or shirked his responsibilities as Coventree's CEO. Rather, he discharged his duties and played a pivotal role in coordinating, compiling and vetting material corporate disclosure;

(b) Tai sought out, considered and relied upon input from Cornish, who was a securities lawyer with at least 15 years' experience in securities regulation and a fellow member of Coventree's disclosure committee. Allan, who was also a member of the strategic council from January 22, 2007 onwards, was a lawyer with experience in advising public companies with respect to their disclosure obligations;

(c) Tai relied on input from independent Board members, including those with significant public company disclosure experience, to advise of any concerns they had with respect to Coventree's public disclosure;

(d) Tai relied on Child, as Coventree's CFO, to make financial calculations and projections with respect to the materiality of certain events and developments;

(e) Tai relied on an extensive, seasoned team of underwriters and counsel to advise of any concerns they had with respect to the disclosure in the Prospectus; and

(f) Tai relied on reports he received from Allan and others that the Caisse and other entities (such as the Office of the Superintendent of Financial Institutions) would intervene to ensure the Canadian ABCP market remained stable.

[801] Tai submits that the evidence of the robust disclosure made to the owners of Coventree when it was a private company as well as the evidence of Tai's expansive attitude toward risk disclosure during the drafting of the Prospectus are additional reasons why an order in the public interest against him is not appropriate in this case.

[802] Tai also adopts Coventree's and Cornish's submissions with respect to this issue.

[803] Accordingly, Tai submits that there is no basis for the Commission to make an order against him in the public interest.

5. Analysis and Conclusions

[804] The purpose of the Commission's public interest jurisdiction is protective and preventive. It is intended to be exercised to prevent likely future harm to Ontario capital markets.

[805] The Commission is entitled to make various sanction orders under section 127 of the Act if it is of the opinion that doing so would be in the public interest. In considering the Commission's power to make such orders in the public interest, the Supreme Court of Canada has observed that "[t]he OSC has the jurisdiction and a broad discretion to intervene in Ontario capital markets if it is in the public interest to do so" (*Committee for the Equal Treatment of Asbestos Minority Shareholders v. Ontario (Securities Commission)*, [2001] 2 S.C.R. 132 ("***Asbestos***"), at para. 45).

[806] The Supreme Court of Canada has indicated that the Commission's public interest discretion is subject to two constraints:

> In exercising its discretion, the OSC should consider the protection of investors and the efficiency of, and public confidence in, capital markets generally. In addition, s. 127(1) is a regulatory provision. The sanctions under the section are preventive in nature and prospective in orientation. Therefore, s. 127 cannot be used merely to remedy Securities Act misconduct alleged to have caused harm or damages to private parties or individuals.
>
> (*Asbestos*, *supra,* at para. 45)

[807] Further, the Supreme Court of Canada has recognized general deterrence as an additional factor that the Commission may consider when imposing sanctions. In *Cartaway Resources Corp.*, [2004] 1 S.C.R. 672 at para. 60, the Supreme Court stated that "… it is reasonable to view general deterrence as an appropriate and perhaps necessary consideration in making orders that are both protective and preventative".

[808] The Commission has exercised its public interest jurisdiction in a number of circumstances that involved the failure to make timely disclosure or the making of misleading disclosure (See, for instance, *Re Cineplex Corporation*, *Drabinsky and Gottlieb* (1983), 6 OSCB 3845, *Re Standard Trustco*, *supra, Re YBM Magnex, supra, Re Rex Diamond*, *supra,* and *Re Biovail, supra*). It is clear that the Commission considers the failure to make timely disclosure in accordance with section 75 of the Act, and the making of inaccurate, misleading or untrue disclosure, to be contrary to the public interest.

[809] In our view, the conduct of Coventree, Cornish and Tai in contravening the Act was contrary to the public interest.

[810] The question of what orders against Coventree, Cornish or Tai should be made in the public interest is a matter for consideration at the sanctions hearing.

XV. CCAA RELEASE

1. Coventree's Submission

[811] On March 17, 2008, the Ontario Superior Court of Justice (Commercial List) issued an Initial Order under the CCAA (*ATB Financial Metcalfe and Mansfield Investments II Corp.* (2008), 42 CBR (5th) 90 (Ont. S.C.J. (Comm. List)) imposing a stay of proceedings in order to allow creditors to vote on a plan of arrangement (the "**Plan**") that resulted in a restructuring of ABCP in Canada.

[812] Coventree submits that participants in the Plan, including Coventree, Cornish and Tai, were released under the terms of the Plan from various claims. Coventree submits that the release contained in the Plan is a complete bar to Staff commencing this proceeding and on the Commission making any order against Coventree, Cornish or Tai.

2. Background

[813] The Plan contains a comprehensive release of what are defined as "ABCP Market Claims". Section 10.2 of the Plan provides as follows:

> [E]very Person … hereby fully, finally, irrevocably and unconditionally releases and forever discharges each of the Released Parties of and from any and all past, present and future claims, rights, interests, actions, rights of indemnity, liabilities, demands, duties, injuries, damages, expenses, fees (including attorney fees and liens), costs, compensation, or causes of action of whatsoever kind or nature whether foreseen or unforeseen, known or unknown, asserted or unasserted, contingent or actual, liquidated or unliquidated, whether in tort or contract, whether statutory or at common law or in equity, based on, in connection with, arising out of, or in any way related to, in whole or in part, directly or indirectly, any act, inaction or omission existing or taking place on or prior to the Plan Implementation Date relating to or otherwise in connection with the Third Party ABCP market in Canada, the ABCP Conduits, the Affected ABCP, the business and affairs of any of the Released Parties relating to or otherwise in connection with the Affected ABCP … (collectively, the 'ABCP Market Claims').

[814] Both Staff and the Commission are "Persons" for purposes of the release. "Person" is defined in the Plan to include any "government, agency, regulatory body or instrumentality thereof".

[815] There is a "carve-out" provided for in section 10.3 of the Plan which allows the Commission to conduct certain types of regulatory proceedings related to ABCP Market Claims notwithstanding the terms of the release. The carve-out reads as follows:

> Notwithstanding sections 10.1 and 10.2, nothing in this Plan shall: (i) release, enjoin or compromise claims against Directors of the Respondents that are described in Section 5.1(2) of the CCAA; or (ii) stay, release, discharge, bar, enjoin or otherwise interfere with any powers or remedies of, or proceedings or investigations by, *any regulatory or self-regulatory body having jurisdiction* (pursuant to any applicable statute, regulation, rule or, in the case of the Investment Industry Regulatory Organization of Canada, contract) over any Released Party *concerning such Released Party's involvement in the creation, issue, sale or rating of any Affected ABCP*, provided that sections 10.1 and 10.2 would be effective to release and enjoin the making of any order or award to compensate or make restitution to an aggrieved person or company or to pay general or punitive damages to any other person or company. [emphasis added]

[816] Coventree, Cornish and Tai submit that the allegations made by Staff in this matter, other than the allegation with respect to the subprime statement, do not concern "the creation, issue, sale or rating" of any affected ABCP. The Respondents submit that those allegations relate primarily to Coventree's compliance with its disclosure obligations under the Act and do not concern "the creation, issue, sale or rating" of affected ABCP.

3. Analysis and Conclusion

[817] In our view, the submissions made by Coventree in this respect should have been brought as a motion at the commencement of the hearing. In our view, Coventree should not be permitted to take the position referred to in paragraph 812 of these reasons after having participated in a 45-day hearing on the merits without objection.

[818] In any event, we take a different view of the proper interpretation of the provisions of the Plan.

[819] There is no question that the language of the release contained in the Plan is extremely broad and would, as a threshold matter, apply to the Commission. However, in our view, the exception to the release referred to in paragraph 815 of these reasons is sufficiently broad to apply to this proceeding. This proceeding relates to compliance by Coventree with its disclosure obligations under the Act arising out of the creation, issue and sale of ABCP. It is regulatory in nature and is not for the purpose of compensating any market participant for any damages or claims arising out of events in the ABCP market or for paying any restitution.

[820] We agree with Staff that the Plan provides that the release does not apply to any regulatory body that has jurisdiction over an otherwise released party who was involved in the "creation, issue, sale or rating of any Affected ABCP". In our view, the Respondents fit within that language. They are persons who were involved in the "creation, issue, sale or rating" of ABCP and over whom the Commission has jurisdiction. The regulatory carve-out is directed at the Commission's jurisdiction in the public interest over certain released parties and not, as suggested by the Respondents, at the scope of the regulatory proceedings that may be brought against them. This proceeding relates to the Respondents' involvement and activities in the ABCP market in connection with the creation, issue and sale of ABCP and is regulatory in nature. This proceeding therefore falls within the terms of the exception to the release referred to in paragraph 815 of these reasons.

[821] Accordingly, we reject the submission that the terms of the Plan bar this proceeding or the making of any order against the Respondents.

XVI. SALES OF ABCP TO INVESTORS

[822] While the background facts, events and developments in this matter involve the Canadian commercial paper market and the issuance and "rolling" of ABCP, it does not, with the exception of the allegation with respect to the subprime statement (set out in paragraph 18(c) of these reasons), relate to whether misleading statements were made to investors in connection with the sale of Coventree sponsored ABCP to them. In 2010, settlements were reached by securities regulators with a number of the Canadian dealers who distributed and sold ABCP to the public in Canada (see, for instance, *Re Canadian Imperial Bank of Commerce* (2010), 33 OSCB 73 and *Re HSBC Bank of Canada* (2010), 33 OSCB 62). Each of those banks admitted in a settlement agreement that it "engaged in conduct contrary to the public interest by failing to adequately respond to emerging issues in the third-party ABCP market insofar as it continued to sell third-party ABCP without engaging compliance and appropriate processes for the assessment of such information and concerns".

[823] As noted in paragraph 21 of these reasons, with the exception of the allegation with respect to the subprime statement, this proceeding does not address the question whether any of the facts, events and developments referred to in these reasons were material to purchasers of ABCP or would reasonably be expected to have had a significant effect on the market price or value of Coventree sponsored ABCP. Those questions are not the subject of this proceeding.

[824] We would be remiss, however, if we did not make one additional comment in connection with the issue and sale of ABCP in the period leading up to the market disruption that occurred on August 13, 2007. It is clear to us having considered and reviewed the extensive evidence submitted to us over 45 hearing days, that Coventree and a number of the dealers distributing Coventree sponsored ABCP from August 1, 2007 to August 13, 2007, had knowledge of liquidity related events and developments in the ABCP market that were important to investors considering the purchase of ABCP. It is unlikely that any investor would have purchased Coventree sponsored ABCP, or any other ABCP, if they had been aware of those market events and developments.

XVII. CONCLUSIONS

[825] For the reasons discussed above, we have concluded that:

(a) Coventree contravened subsection 75(1) of the Act by failing to forthwith issue and file a news release disclosing the material change that occurred as a result of the DBRS January Release. Coventree contravened subsection 75(2) of the Act by failing to file a material change report in respect of that material change in accordance with that subsection. (see paragraph 342 of these reasons)

(b) Coventree contravened subsection 75(1) of the Act by failing to forthwith issue and file a news release disclosing the material changes that occurred by the close of business on August 1, 2007. Coventree contravened subsection 75(2) of the Act by failing to file a material change report in respect of those material changes in accordance with that subsection. (see paragraph 595 of these reasons)

(c) Each of Cornish and Tai authorized, permitted or acquiesced in Coventree's non-compliance with Ontario securities law referred to in sub-paragraphs (a) and (b) above and are deemed also to have not complied with Ontario securities law in accordance with section 129.2 of the Act. (see paragraph 771 of these reasons)

(d) The conduct of Coventree in contravening Ontario securities law as provided in sub-paragraphs (a) and (b) above, and the conduct of each of Cornish and Tai in contravening Ontario securities law as provided in sub-paragraph (c) above, was contrary to the public interest. (see paragraph 809 of these reasons)

[826] The allegations of Staff that Coventree breached section 56 and subsection 126.2(1) of the Act are dismissed (see paragraphs 215 and 402 of these reasons).

[827] The Respondents should contact the Office of the Secretary of the Commission within 30 days of these reasons to schedule a sanctions hearing.

DATED at Toronto this 28th day of September, 2011.

"James E. A. Turner"

James E. A. Turner

"Mary G. Condon"

Mary G. Condon

"Paulette L. Kennedy"

Paulette L. Kennedy

SCHEDULE A

GLOSSARY OF TERMS AND LIST OF INDIVIDUALS REFERRED TO IN THESE REASONS

Acronym	Term	Description
AcG-15		CICA Accounting Guideline 15, Consolidation of Variable Interest Entities.
	Act	*Securities Act*, R.S.O. 1990, c. S.5, as amended.
	A notes	Series of ABCP issued by Coventree or Nereus sponsored conduits typically backed by liquidity arrangements.
	April Investor Presentations	Presentations on April 25 and 26, 2007 by Coventree to ABCP investors that included a statement as to the total subprime exposure of Coventree sponsored conduits. See the "subprime statement".
ABCP	Asset-backed commercial paper	Asset-backed debt securities distributed in Canada with a term to maturity of less than one year.
	asset originator/seller	Person that "originates" or sells to a conduit the assets that back ABCP in a traditional securitization transaction.
	Attachment Point	The point at which there is exposure of a holder of ABCP to losses in a CDO structure. It is dependent on the level of credit enhancement.
	August Board Meeting	Meeting of the Coventree Board on August 1, 2007.
BA	bankers' acceptance	Form of short-term borrowing by a Canadian bank, typically for less than 365 days.
	bank-sponsored ABCP	ABCP sponsored by a Canadian bank or other large financial institution.
	basis point	One basis point equals 1/100th of one percent. The interest rate on ABCP was expressed as the basis point spread over the CDOR rate.
	BGI Deal	Coventree and Nereus sponsored transaction that did not proceed as a result of DBRS withdrawing its grandfathered status under the DBRS January Release.
BIMCOR		Bell Investment Management Corporation, manager of Bell Canada's pension fund. An ABCP investor.

Acronym	Term	Description
	bids	An ABCP investor wishing to sell ABCP prior to maturity requests a "bid" or purchase offer for the ABCP from dealers in the secondary market.
BNP		BNP Paribas (Canada), a member of Coventree's dealer syndicate.
	Board	The Coventree board of directors.
	Caisse	Caisse de dépôt et placement du Québec, the Quebec pension fund that in 2007 held approximately one-third to one-half of ABCP issued by Coventree sponsored conduits. An ABCP investor and a minority shareholder in Coventree.
CDOR	Canadian Deposit Offering Rate	Daily average of the interest rates for Canadian bankers' acceptances.
	Canadian style liquidity (also known as general market disruption liquidity)	Liquidity arrangements generally backing A notes; liquidity would be provided only if: (i) new ABCP could not be issued due to a general market disruption, and (ii) DBRS confirmed that the credit quality of the underlying assets had not been impaired. A general market disruption may be defined differently in different liquidity arrangements but it generally means a disruption to the overall ABCP market and not just to certain conduits or note series.
	cash or dry powder	Cash held by a conduit; created by overfunding, selling assets or amortization of assets.
	cash CDO	A CDO structure that owns the underlying securities directly.
CIBC		CIBC World Markets Inc., a member of Coventree's dealer syndicate.
	Citibank	Citibank Canada, an ABCP investor.
	collateral	Short-term high quality assets that may be available to eventually repay ABCP investors on maturity.
	collateral call	A request that a conduit post additional cash collateral for the benefit of a counter party in an LSS transaction.
	collateral call trigger	The occurrence of an event that would require the posting of additional collateral by a conduit to a counter party in an LSS transaction.

Acronym	Term	Description
CDO	collateralized debt obligation	A form of credit arbitrage transaction where diversified debt instruments are owned by a special purpose entity referred to as a CDO trust. The CDO Trust issues different tranches of securities, backed by the debt instruments. The different tranches have different risk profiles. Coventree sponsored conduits generally invested in AAA tranches of CDOs. CDOs may be cash CDOs or synthetic CDOs.
CCAA	*Companies' Creditors Arrangement Act*	Canadian statute under which an insolvent issuer may be reorganized.
	CDO related SFA transaction	An SFA transaction involving a CDO.
	CDO trust	A special purpose vehicle that purchases assets from originators in the form of bonds or other securities that are repackaged for sale to a conduit. See also "synthetic CDO".
	conduit	The issuer of ABCP. A special purpose vehicle.
	contingent funding risk	The risk that a conduit would have to raise additional funding in order to meet collateral calls. Contingent funding risk arises only in LSS transactions.
	Coventree sponsored ABCP	ABCP issued by Coventree sponsored conduits
	Coventree sponsored conduits	Coventree sponsored eight conduits: Apollo Trust, Aurora Trust, Comet Trust, Gemini Trust, Planet Trust, Rocket Trust, Slate Trust and Venus Trust.
	credit arbitrage transaction	Type of ABCP asset securitization transaction that includes collateralized debt obligations and LSS transactions. Revenue to the sponsor is based on the spread between the return on the underlying assets and the conduit's cost of funds. The term is generally used interchangeably with structured financial asset transactions or "SFA transactions". Cornish testified that SFA transactions include all credit arbitrage transactions, but not all SFA transactions are credit arbitrage transactions.
	credit default swaps	Derivative contract used as part of certain credit arbitrage securitizations to hedge the risk of default in a reference portfolio. In economic effect, similar to insurance for the protection buyer.
	credit enhancement	Credit protection within an ABCP structure; a buffer between the default rate and the exposure to risk.
	Davies	Davies Ward Phillips & Vineberg

Acronym	Term	Description
	dealer	Investment dealer that sells ABCP to investors.
	dealer lines	See "market-making lines"
	dealer syndicate	Coventree sponsored conduits sold ABCP through a syndicate of dealers that included NBF, CIBC, Scotia, RBC, Deutsche Bank, HSBC, Laurentian Bank and BNP.
	Deutsche Bank	Deutsche Bank Securities Limited, a member of Coventree's dealer syndicate.
DBRS	Dominion Bond Rating Service Limited	Only Canadian domiciled credit rating agency; only credit rating agency that rated ABCP with Canadian style liquidity.
	DBRS January Release	News release issued by DBRS on January 19, 2007 announcing new criteria for CDO related SFA transactions including a requirement for global style liquidity (attached as Schedule D to these reasons).
	DBRS November Letter	Letter sent by DBRS to market participants on November 10, 2006 indicating a more restrictive approach to rating SFA transactions (attached as Schedule C to these reasons).
	Draft Q3 MD&A	Coventree's draft third quarter Management's Discussion and Analysis for the period ending June 30, 2007.
	Draft Press Release	Draft news release prepared by Cornish following the August Board Meeting that was distributed to directors on August 2, 2007.
	E notes	Extendible ABCP. No liquidity protection was provided because the conduit had the option, in certain events, of extending the maturity date of the ABCP for a period of up to 364 days from the original date of issue.
	extension risk	The risk that the term of extendible ABCP may be extended by the conduit; E notes were offered at a higher interest rate spread because the conduit had the option, in certain events, of extending the maturity date of the ABCP for a period of up to 364 days from the original date of issue.
	February Subprime Data	Data set out in an e-mail from Dalton to NBF on March 15, 2007 disclosing the subprime exposure of Coventree sponsored conduits, by conduit, as of February 28, 2007.

Acronym	Term	Description
FRNs	floating rate notes	Floating rate notes; generally notes with terms that exceed one year and that are not backed by liquidity arrangements.
	general market disruption liquidity	Used interchangeably with the term “Canadian style liquidity”.
	global style liquidity	Type of liquidity facility that can be accessed by a conduit where the ABCP fails to roll essentially for any reason.
HSBC		HSBC Bank Canada, a member of Coventree’s dealer syndicate.
IPO	initial public offering	The initial public offering by Coventree of shares pursuant to the Prospectus.
	July 24 e-mail	E-mail sent by Dalton to the dealer syndicate on July 24, 2007 disclosing subprime exposure of Coventree sponsored conduits, by conduit and note series, as of June 28, 2007.
	July 30 Conference Call	Conference call on July 30, 2007 among representatives of Coventree and its three largest dealers.
	June Subprime Data	Data set out in an e-mail from Paul to NBF on July 11, 2007, disclosing the subprime exposure of Coventree sponsored conduits, by conduit and note series, as of June 29, 2007.
	Laurentian Bank	Laurentian Bank Securities Inc., a member of Coventree’s dealer syndicate.
	Letter to Owners	Letter to Owners contained in Coventree’s 2006 Annual Report filed on SEDAR on February 14, 2007.
LSS Transactions	leveraged super senior transactions	A type of synthetic CDO credit arbitrage transaction. A low yield on a perceived very safe investment is leveraged to provide a higher return.
	liquidity provider	A person who commits in certain circumstances to purchase or otherwise provide liquidity for A notes that mature.
MD&A		Management’s Discussion and Analysis under Ontario securities law.
	market-making lines	Funds available to dealers to acquire maturing ABCP that does not roll on a particular day. Dealers may, at their discretion, purchase the ABCP into inventory. The ABCP is then sold as soon as market conditions permit.

Acronym	Term	Description
	material or materiality	Whether a fact or change in an issuer's business, operations or capital would reasonably be expected to have a significant effect on the market price or value of the issuer's securities (see the definition of "material fact" and "material change" in the Act and subsection 126.2(1) of the Act).
	maturity date	The date when ABCP becomes due and payable to the holder.
	Mavrix	Mavrix Fund Management Inc., a mutual fund management company. An ABCP investor.
NBF		National Bank Financial, lead dealer of Coventree's dealer syndicate. As lead dealer, NBF would set the daily spread on Coventree sponsored ABCP after consultation with Coventree.
	NI 45-106	National Instrument 45-106 – *Prospectus and Registration Exemptions*
	NP 51-201	National Policy 51-201 – *Disclosure Standards*
	Nereus	Wholly-owned subsidiary of Coventree as of May 10, 2007 that focused principally on credit arbitrage transactions. Prior to that date, Coventree owned 75.5% of Nereus.
	Nereus sponsored conduits	Nereus sponsored two conduits: Structured Investment Trust III (SIT III) and Structured Asset Trust (SAT).
	non-CDO related SFA transaction	A type of credit arbitrage transaction where ABCP funds are used to purchase a bond structure. Cornish testified that non-CDO related SFA transactions comprised approximately 20% of Coventree sponsored conduit assets.
	notional portfolio	In an LSS transaction, the conduit has exposure to a notional portfolio of securities that is some multiple of the size of the reference portfolio (see "reference portfolio").
	NorthBrook	NorthBrook Capital Corp., a traditional asset provider.
	overfunding	Another term for cash held by a conduit. Assets in a conduit mature or are sold and the proceeds of the maturity/sale are held in cash by the conduit pending redemption of ABCP. Overfunding is typically invested in safer, short-term assets such as BAs.
	Plan	The plan of arrangement under the CCAA that resulted in a restructuring of ABCP in Canada.

Acronym	Term	Description
	pre-funding	Another term for cash held by a conduit. Pre-funding means that a conduit issues ABCP before actually purchasing underlying assets. The pre-funding is typically invested in safer, short-term assets such as BAs.
	Prospectus	Coventree's final prospectus dated November 15, 2006, filed with the Commission on November 16, 2006.
	Prospectus Form	Form 41-101F – *Information Required in a Prospectus*
	protection buyer	A person, usually a bank or financial institution, that purchases protection from a conduit in respect of the loss of value of CDOs or other assets. The protection buyer pays a protection premium to the conduit. The protection buyer is paid protection payments by the conduit in specified circumstances.
	protection payments	The amounts payable by a conduit to a protection buyer. The protection payment for a specific CDO tranche is triggered when losses reach a specified level.
	Q1 MD&A	Coventree's publicly filed first quarter Management's Discussion and Analysis for the period ending December 31, 2006.
	Q2 MD&A	Coventree's publicly filed second quarter Management's Discussion and Analysis for the period ending March 31, 2007.
	rebalancing	Transfer of assets between conduits or note series in order to reduce the subprime exposure of a particular conduit or note series.
	R-1(high)	The highest DBRS credit rating for ABCP, comparable to an AAA bond rating. Almost all Coventree sponsored ABCP was rated R-1(high).
	reference portfolio	The portfolio of securities referenced by a credit default swap.
	Respondents	Coventree, Cornish and Tai
	revenue backlog	The present value of Coventree's total estimated future revenues from completed funding transactions; as of February 14, 2007, Coventree revenue backlog for the 2007 fiscal year was approximately $34.4 million.
	Roadshow Presentation	Coventree's roadshow presentation in connection with the IPO.

Acronym	Term	Description
	rolled or rolling ABCP	An investor re-investing the proceeds from maturing ABCP in newly issued ABCP for another term; also refers generally to the purchase of maturing ABCP by another investor or by a dealer.
	rollover risk	The risk that a conduit does not have the funds to meet its obligations to repay maturing ABCP.
RBC		RBC Dominion Securities Inc., a member of Coventree's dealer syndicate until July 27, 2007.
	Scotia	Scotia Capital Inc., the lead dealer for Nereus. As lead dealer, Scotia would set the daily spread on Nereus sponsored ABCP after consultation with Nereus.
	securitization transactions	There are two basic types of securitization transactions: traditional securitizations and credit arbitrage transactions. The former involve the purchase of traditional revenue generating assets. The latter include CDO related SFA transactions. See "SFA transactions".
	shares	Coventree common shares.
S&P		Standard & Poor's Financial Services LLC, a U.S. rating agency.
	sponsor	The person who sponsors a conduit by managing its activities as securitization agent, including making all of the arrangements for securitization transactions and the issue and repayment of ABCP.
SPPA		*Statutory Powers Procedure Act*, R.S.O. 1990, c. s.22
	Spread on ABCP	Interest rate payable on ABCP, expressed as a number of basis points above CDOR.
	Sprott	Sprott Securities Inc., co-lead underwriter of Coventree's IPO.
	Staff	Staff of the Ontario Securities Commission.
	Statement of Allegations	The statement of allegations in this matter issued by Staff on December 7, 2009.
SFA transactions	structured financial asset transactions	Term typically used by DBRS to refer to credit arbitrage transactions. Cornish testified that SFA transactions include all credit arbitrage transactions, but not all SFA transactions are credit arbitrage transactions.
	subprime exposure	Exposure of a conduit to assets that constitute U.S. subprime mortgages from less creditworthy borrowers.

Acronym	Term	Description
	subprime statement	The statement made by Coventree at the April Investor Presentations that the total U.S. subprime mortgage exposure of its sponsored conduits was 7.4%.
	super senior tranches	The most senior tranches of a CDO trust (tranches typically are (a) super senior tranches, (b) mezzanine tranches, and (c) equity tranches). Credit enhancement is higher than for other tranches, so the possibility of default on a super senior tranche is generally viewed as very low.
	synthetic CDO	A CDO that replicates a bond portfolio through credit default swaps. Cash from ABCP investors is invested in liquid collateral such as BAs that is pledged to the protection buyer and is intended to be used in the event of losses.
	third-party sponsor	A conduit sponsor such as Coventree that is not a Canadian bank or large financial institution. Also referred to as a non-bank sponsor of ABCP.
	traditional assets	Income producing assets acquired by a conduit in a traditional securitization transaction (for example, mortgages or credit card receivables).
	traditional securitization	Proceeds from the sale of ABCP are used to fund the direct purchase by the conduit of traditional assets. The assets are owned directly by the conduit.
	tranches	Different classes of debt securities with different credit ratings issued by a CDO Trust.
	Xceed	Xceed Mortgage Corporation, an asset originator or seller of mortgages to Coventree sponsored conduits.

Individuals Referred to in these Reasons
(and their affiliation or role at the relevant time)

Name as Defined	Name and Affiliation or Role
Allan	David Allan joined Coventree on January 22, 2007 as head of Coventree's Capital Markets Group.
Allardyce	Craig Allardyce, Associate Portfolio Manager at Mavrix.
Child	Bridget Child, Coventree's Chief Financial Officer during 2006 and 2007. Member of Coventree's credit committee, strategic council and disclosure committee.
Cornish	Geoffrey Cornish, President and a director of Coventree during 2006 and 2007. One of the three founders of Coventree. Member of Coventree's strategic council and disclosure committee.
Courchesne	Bob Courchesne, of NBF.
Dalton	Judi Dalton, group leader of Coventree's funding group.
Davidson	Natalie Davidson, of CIBC.
Dymott	Peter Dymott, head of the Canadian fixed income and currency business at RBC during 2006 and 2007.
Gaucher	Christian Gaucher, of NBF.
George	Christine George, Senior Forensic Accountant in the Enforcement Branch of the Commission.
Homer	Per Homer, Vice-President and Senior Trader at Citibank during 2007.
Hudec	Al Hudec, a lawyer at Davis & Co.
Jones	Michael Jones, President and Chief Executive Officer of Xceed.
Loke	Huston Loke, Group Managing Director and Head of Global Structured Finance at DBRS in 2006 and 2007. A member of DBRS's rating committee and executive committee.
McCloskey	Michael McCloskey, Partner and Director, Investment Banking at Sprott. Lead participant at Sprott during the IPO process.
Miller	Patrick Miller, junior money market trader at BIMCOR.
Mowat	Clara Jane Mowat, a director of Coventree and Chair of Coventree's Audit Committee.
Paul	Doug Paul, member of Coventree's funding group.

Name as Defined	Name and Affiliation or Role
Smith	Greg Smith, of Scotia.
Tai	Dean Tai, CEO and a director of Coventree during 2006 and 2007. One of the three founders of Coventree. Member of Coventree’s strategic council and disclosure committee.
Tillie	Marcel Tillie, Senior Forensic Accountant in the Enforcement Branch of the Commission.
Toten	Ken Toten, a Coventree employee.
Verville	Luc Verville of the Caisse, responsible for ABCP purchases.

SCHEDULE B

STAFF'S DETAILED ALLEGATIONS FROM THE STATEMENT OF ALLEGATIONS

Staff's detailed allegations in this matter are reproduced from the Statement of Allegations as follows:

…

IV. Allegations

A. Prospectus Disclosure

42. Coventree had an obligation under section 56 of the Act to provide full, true and plain disclosure in its prospectus of all material facts relating to the Coventree securities that it proposed to distribute.

43. In addition, Coventree's CEO, CFO and any two of its directors, on behalf of the board of directors were required under section 58 of the Act to certify that the prospectus contained full, true and plain disclosure.

44. Coventree filed its preliminary prospectus with the Commission on October 18, 2006 and filed its final prospectus (dated November 15, 2006) with the Commission on November 17, 2006. Its initial public offering consisted of a secondary offering of 22.81 percent of the then-issued and outstanding common shares held by certain shareholders of the company.

45. Cornish and Tai certified the prospectus as a director and CEO, respectively.

46. Coventree's final prospectus identified material risk factors relating to the business of Coventree, including that:

    (a) if a disruption in the ABCP market occurred and there was a cessation or fundamental adverse shift in the liquidity of the ABCP market, Coventree sponsored conduits would be exposed to a demand for payment well in excess of Coventree's cash reserves. In its prospectus, Coventree acknowledged that "[a]lthough Coventree has no legal obligation to fund the conduits to buy back ABCP from investors in the event of a disruption, Coventree's reputation in the industry and ongoing ability to access the capital markets could be severely adversely impacted if it did not or could not do so.";

(b) Coventree was heavily dependent on a sole supplier, DBRS, to provide credit rating services for the ABCP issued by Coventree-sponsored conduits;

(c) Coventree relied on a small number of investors to purchase a relatively high percentage of the ABCP issued by its conduits. In particular, a substantial minority percentage of the ABCP issued by Coventree-sponsored conduits was purchased by the Caisse de depot et placement du Quebec ("CDPQ") which also held a minority interest in Coventree's equity;

(d) ABCP investors relied on Coventree because they were not provided with financial information about the assets underlying the conduits;

(e) Coventree was exposed to basis risk, being the difference (or spread) between the CDOR rate and Coventree's ABCP interest rates;

(f) the assets underlying the ABCP could perform at less than expected levels, such that cash flow generated by the assets would be insufficient to meet the conduit's outstanding obligations, including to its ABCP investors;

(g) a default could occur by any counterparty to the Coventree-sponsored conduits' liquidity agreements, swaps, or other credit-related derivatives;

(h) the supply of ABCP could exceed demand from investors in Canada, given the substantial growth in the ABCP market and given the possibility of investors moving their money to other money market investments;

(i) there was a high degree of competition in the markets for Coventree's services; and

(j) negative press or rumours regarding any ABCP industry participant could adversely affect the market and prevent the Coventree-sponsored conduits from re-issuing or rolling their commercial paper (ABCP).

47. Coventree did not disclose in its final prospectus that on, November 10, 2006, DBRS had advised Coventree that, effective immediately, DBRS was taking a more restrictive approach to approving new structured financial asset-backed ("SFA") transactions (which Coventree described as credit arbitrage transactions) for ABCP conduits. DBRS had advised Coventree of this fact by email five days before Coventree filed its final prospectus with the OSC.

48. Coventree's final prospectus contained the same language about DBRS as the preliminary prospectus.

49. As discussed above, the ABCP issued by the conduits had to have an approved credit rating from an approved credit rating organization to qualify for the prospectus exemption contained in section 2.35(2) of NI 45-106.

50. All Coventree-sponsored ABCP had approved credit ratings from DBRS. No other credit rating organization was willing to provide those services. Coventree was therefore wholly dependent on DBRS as its sole supplier of credit rating services, a fact which was disclosed in Coventree's prospectus.

51. The final prospectus did not disclose that approximately 80 percent of Coventree's revenues were derived from credit arbitrage transactions.

52. Coventree's revenues were 'substantially derived from establishing, operating and administering securitization conduits. In the prospectus, Coventree described itself as "a niche investment bank specializing in structured finance using securitization based financing technology". Coventree stated that it was also beginning to focus on an expanded vision of becoming "a financial services company focused on niches". This expanded corporate objective was in the early planning stage and the prospectus stated that there "is no assurance that all, or any, of current Coventree's growth experiments will be successful". The growth experiments had not yielded revenue when the final prospectus was filed, nor did they generate revenue subsequently.

53. The November 10, 2006 notification from DBRS was a material change for Coventree and, in any event, a material fact to Coventree.

54. Each of Cornish and Tai knew, or ought to have known, of the November 10, 2006 notice from DBRS when they certified that the final prospectus contained full, true and plain disclosure of all material facts.

55. Contrary to section 56 of the Act, Coventree failed to provide full, true and plain disclosure of all material facts relating to the Coventree securities that it proposed to distribute. In particular, the fact that on November 10, 2006, DBRS had advised Coventree that, effective immediately, DBRS was taking a more restrictive approach to approving new SFA transactions for ABCP conduits.

56. Each of Cornish and Tai being directors and officers of Coventree authorized, permitted or acquiesced in Coventree's failure to provide full, true and plain disclosure of all material facts in its prospectus contrary to section 129.2 of the Act.

B. Impact of the DBRS Change in Rating Criteria

57. As a reporting issuer, Coventree had continuous disclosure obligations and, in particular, where a material change occurred in Coventree's business, operations or capital it was required under section 75 of the Act to issue a press release forthwith.

58. When Coventree went public, it formed a disclosure committee that included Cornish and Tai. The disclosure committee was responsible for ensuring that all securities regulatory disclosure requirements were met and for overseeing the company's disclosure practices. Coventree's disclosure policy required the disclosure committee to meet "as conditions dictate, and at least quarterly" and to keep minutes of its meetings.

59. Coventree also had a strategic council that included Cornish and Tai. The strategic council was formed in the spring of 2007 and was Coventree's senior decision making team. The members of the disclosure committee were represented on the strategic council.

60. On January 19, 2007, DBRS issued a press release announcing changes to its rating methodology for arbitrage-type transactions entered into by commercial paper issuers and funded by ABCP. The press release detailed specific new rating criteria, including that SFA transactions were required to be supported by Global-style liquidity.

61. The assets in the Coventree-sponsored conduits were not supported by Global-style liquidity, and Global-style liquidity was not available to Coventree. Consequently, Coventree experienced a change in its business or operations as it was no longer able to purchase credit arbitrage assets for its conduits because a credit rating from DBRS was required in order to continue to qualify for prospectus exemptions for the ABCP under section 2.35 of NI 45-106. DBRS was the sole supplier of essential credit rating services to Coventree.

62. As previously stated, Coventree's only business was related to securitization conduits. Approximately 80 percent of Coventree's revenues were derived from credit arbitrage transactions and its ongoing operations were substantially funded from this revenue source. Coventree had not disclosed this in either its prospectus or subsequently filed financial statements.

63. Since Coventree had not disclosed the fact that a substantial majority of its revenues were derived from credit arbitrage transactions, the market could not appreciate the change in DBRS rating criteria resulted in a change to Coventree's business or operations without elaboration by Coventree.

64. Each of Cornish and Tai knew, or ought to have known, that the change in DBRS rating criteria resulted in a change to Coventree's business or operations, but refused or failed to make disclosure.

65. On each day between January 19, 2007 and August 13, 2007, Coventree failed to comply with its continuous disclosure obligations contained in section 75(1) of the Act by failing to issue and file a news release disclosing the nature and substance of the material change namely, that the change in DBRS rating criteria resulted in a change to Coventree's business or operations.

66. On each day between January 19, 2007 and August 13, 2007, each of Cornish and Tai, being directors and officers of Coventree, authorized, permitted or acquiesced in Coventree's failures to comply with its continuous disclosure obligations contrary to section 129.2 of the Act.

67. On each day between January 19, 2007 and August 13, 2007, Coventree failed to file a report of a material change, namely that the change in DBRS rating criteria resulted in a change to Coventree's business or operations, contrary to section 75(2) of the Act.

68. On each day between January 19, 2007 and August 13, 2007, each of Cornish and Tai, being directors and officers of Coventree, failed to file a report of a material change, namely that the change in DBRS rating criteria resulted in a change to Coventree's business or operations, contrary to section 75(2) of the Act.

69. On each day between January 19, 2007 and August 13, 2007, each of Cornish and Tai, being directors and officers of Coventree, authorized, permitted or acquiesced in Coventree's failures to file a report of a material change, contrary to section 129.2 of the Act.

C. Misleading Statement

70. In early 2007, market participants became increasingly concerned about assets with US subprime exposure, including those underlying the ABCP. In this environment, Coventree gave a presentation "Coventree Investor Update" to a number of ABCP dealers and investors on April 25, 2007 in Toronto and gave the same presentation on April 26, 2007 in Montreal. In the portion of the presentation called "Demystifying the Subprime Market", Coventree told dealers and investors that the total US subprime exposure in its conduits was 7.4 percent but failed to provide a detailed breakdown by conduit and note series.

71. The US subprime exposure varied by conduit and note series and exceeded 15 percent in three conduits, and 40 percent in one note series. Coventree knew or ought to have known that the US

subprime exposure in three of its ABCP note series was significantly higher than 7.4 percent.

72. By advising investors that there was 7.4 percent exposure to US subprime in its conduits, while failing to tell those same investors that the US subprime exposure was significantly higher than 7.4 percent in three ABCP note series, Coventree made a misleading statement to investors and dealers.

73. On each of April 25, 2007 and April 26, 2007, Coventree made a statement contrary to section 126.2(1) of the Act that it knew or reasonably ought to have known, was in a material respect and at the time and in light of the circumstances under which it was made, misleading (namely that Coventree's total US subprime exposure was 7.4 percent), and did not state a fact that was required to be stated or necessary to make the statement not misleading (namely that the US subprime was significantly higher than 7.4 percent in three of its ABCP note series). This misleading statement would reasonably be expected to have a significant effect on the market price or value of at least three Coventree-sponsored ABCP note series.

74. On July 24, 2007, Coventree advised the dealer syndicate of the US subprime exposure per conduit and note series as of June 28, 2007 but did not generally disclose the facts required to be stated or necessary to make its April statements not misleading.

D. Liquidity and Liquidity-Related Issues Prior to August 13, 2007

75. As a reporting issuer, Coventree had continuous disclosure obligations and, in particular, where a material change occurred in Coventree's business, operations or capital it was required under section 75 of the Act to issue a press release forthwith.

76. In January 2007, Coventree put its US subprime transactions on its internal watchlist.

77. Beginning in February 2007, Coventree began making disclosure to some dealers and ABCP investors about the US subprime exposure in Coventree's sponsored conduits. Coventree's dealer syndicate members and a few ABCP investors began making increasingly detailed inquiries about the assets underlying Coventree's ABCP, and by July 2007, Coventree's disclosure to some dealers and ABCP investors became more frequent and detailed.

78. Two of these disclosures by Coventree were: (a) a July 11, 2007 email from Coventree to it a member of the dealer syndicate attaching a breakdown of the US subprime exposure in its conduits, and (b) a July 24, 2007 email from Coventree to its dealer syndicate attaching a similar breakdown.

79. The dealer sent the July 11, 2007 email to CDPQ on July 20, 2007. In the first half of 2007, CDPQ held up to 50 percent of Coventree-sponsored ABCP. In response to the facts disclosed in the July 11 email, on July 23, 2007 CDPQ began substantially reducing its holdings of Coventree ABCP with US subprime exposure. CDPQ's reduction of ABCP with US subprime exposure was of such a concern to Coventree that Coventree took steps to reallocate US subprime assets among its conduits to satisfy CDPQ. In doing so, Coventree did not take into account the interests of other ABCP investors.

80. On July 24, 2007, Coventree sent an email to the dealer syndicate with the following table summarizing the Coventree-sponsored conduits' US subprime exposure per conduit and note series as of June 28, 2007.

Conduit	Series A	Series E	Total ABCP	FRNs	Total ABCP and FRNs
Aurora Trust	0%	8%	3%	2%	3%
Comet Trust	0%	**42%**	16%	12%	16%
Planet Trust	**26%**	3%	17%	0%	15%
Slate Trust	0%	**16%**	13%	0%	13%
Apollo Trust Gemini Trust Rocket Trust Venus Trust	0%	0%	0%	0%	0%
SAT	0%	0%	0%	0%	0%
SIT III	1%	0%	1%	0%	1%
TOTAL	**3%**	**6%**	**5%**	**2%**	**4%**

81. After Coventree sent the July 24, 2007 email to its dealer syndicate, certain dealers reduced or temporarily eliminated their market-making lines and adjusted their inventory holdings of Coventree-sponsored ABCP, in order to minimize their exposure to losses in the third-party ABCP market.

82. On July 25, 2007, DBRS advised Coventree that it was getting daily calls on US subprime exposure in Canadian conduits and stated that Coventree's funding capacity might be affected.

83. By early August 2007, a number of material risks that Coventree had identified in its prospectus (see paragraph 46 above) had occurred:

(a) Coventree was experiencing a sharp and substantial loss of demand for its ABCP products, which Coventree expected to continue. The loss of demand manifested itself in several ways, including that:

- by July 23, 2007, Coventree's dealers were reporting difficulty selling Coventree ABCP, especially ABCP with US subprime exposure;
- beginning on July 26, 2007 other members of Coventree's dealer syndicate

had substantially reduced their participation in the market for Coventree-sponsored ABCP (by turning back unsold newly issued ABCP to the lead dealer, by declining to bid on Coventree's ABCP in the secondary market and by reducing their market making lines);

- on July 27, 2007, one of the dealers had resigned from Coventree's dealer syndicate;
- by July 27, 2007, Coventree was aware that CDPQ was reducing its holdings in Coventree-sponsored conduits with US subprime exposure and if it continued to do so it would cause a market disruption; and
- by August 1, 2007, spreads on Coventree-sponsored E notes were widening above 25 basis points over CDOR, which was well beyond historical levels, and the market conditions were adversely affecting Coventree's revenue. The spreads on A notes had also widened above 10 bps.

(b) by July 31, 2007, Coventree had sold assets in its conduits to accumulate funds so that it would be able to honour anticipated collateral calls. Coventree was doing daily calculations to determine whether a collateral call would occur.

(c) by August 7, 2007, Coventree was unable to purchase new assets from its asset suppliers and ultimately advised its asset suppliers that it did not know when it would be able to resume offering financing in the ordinary course. At that time, Coventree acknowledged that "the spread widening in the Canadian market [is] beginning to adversely affect Coventree's revenues and will adversely affect future revenues of Coventree if those conditions persist."

The events described in subparagraphs (a) to (c) above, individually and collectively, constituted a material change in Coventree's business or operations.

84. Coventree's management convened an emergency board of directors meeting on August 1, 2007 to discuss deteriorating market conditions. After being briefed, the Board instructed Coventree's management to draft a press release about liquidity issues in the third-party ABCP market.

85. On August 2, 2007, Coventree management circulated a draft press release to the Coventree Board, together with a recommendation by Coventree management that the press release not be issued, but that it be held for future release. Cornish stated in the August 1, 2007 draft press release that "this spread widening has decreased the current revenues of Coventree and, if it were to continue, will result in a material decrease in the future revenues of the Company and therefore its profitability".

86. The decision by Coventree not to disclose the material change was substantially influenced by its perception that disclosure would have an adverse market impact.

87. On July 25, 2007, Coventree had an internal meeting to discuss market disruption procedures. By July 26, 2007, dealers had been asking Coventree for details of liquidity agreements and the liquidity drawdown protocols relating to the ABCP.

88. After August 1, 2007, the liquidity in the market for Coventree's ABCP continued to deteriorate, a clear indication that demand for Coventree's ABCP was disappearing, but a press release was not issued until after the third-party ABCP market froze on August 13, 2007.

89. On August 6, 2007, Coventree took comprehensive steps to prepare for a market disruption, including meeting with their counsel to prepare the necessary notices and notifying DBRS. The risk of a market disruption was also a material change requiring disclosure.

90. Cornish and Tai were aware of the liquidity and liquidity-related issues and the risk of a market disruption and, notwithstanding their roles as members of the disclosure committee, the strategic council and directors and officers of Coventree, refused or failed to make disclosure.

91. On each day between August 1, 2007 and August 13, 2007, Coventree failed to comply with its continuous disclosure obligations contained in section 75(1) of the Act by failing to issue and file a news release disclosing the nature and substance of the material change, namely the liquidity and liquidity-related issues and the risk of a market disruption.

92. On each day between August 1, 2007 and August 13, 2007, each of Cornish and Tai, being directors and officers of Coventree, authorized, permitted or acquiesced in Coventree's failures to comply with its continuous disclosure obligations contrary to section 129.2 of the Act.

93. On each day between August 1, 2007 and August 13, 2007, contrary to section 75(2) of the Act, Coventree failed to file a report of a material change, namely the liquidity and liquidity-related issues and the risk of a market disruption.

94. On each day between August 1, 2007 and August 13, 2607, each of Cornish and Tai, being directors and officers of Coventree, authorized, permitted or acquiesced in Coventree' s failure to file a report of a material change, contrary to section 129.2 of the Act.

V. Conduct Contrary to Ontario Securities Law and the Public Interest

95. Based on the foregoing, Coventree, Cornish and Tai breached the Act and acted in a manner that is contrary to the public interest.

96. Such further and other allegations as Staff may advise and the Commission may permit.

December 7, 2009

SCHEDULE C

DBRS NOVEMBER LETTER

dbrs

Dominion Bond Rating Service Limited

200 King Street West, Suite 1304
Sun Lire Centre, West Tower, P.O. Box 34
Toronto, Ontario, Canada M5H 3T4

Telephone 416-593·5577
Fax 416-593-5904
Website www dbrs.corn

November 10, 2006

Sent by e-mail

To: various market participants,

<u>Re: Canadian ABCF-funded Structured Financial Asset-backed transactions</u>

As part of ongoing credit reviews of Canadian ABCP-funded transactions, DBRS has made the following observations:

1. The Canadian asset backed commercial paper ("ABU") market has experienced extraordinary growth (in excess of 50%) over the past two years. This growth has largely been attributed to the contemporaneous growth of Structured Financial Asset-backed ("SEA") transactions funded by ABCP. These types of transactions now comprise approximately 28% of all ABCP outstandings and approximately 20% of total ABS outstandings in the Canadian market;

2. Leveraged Super Senior ("LSS") CDO structures have been the most popular type of transaction selected for inclusion into Canadian ABCP conduits and the portion of LSS transactions funded by ABCP is now approximately 70%; and

3. Current conditions in the structured credit market provide for less attractive returns for credit protection sellers than before. Consequently, greater scrutiny has been required in reviewing newer transactions to ensure that no additional risks are incorporated into SFA transactions.

After considerable contemplation of the above points, together will a detailed review of existing SFA transactions, DBRS has concluded that:

1. Although the current volume of SEA transactions is sizable in relation to the overall ABS market, DBRS views the quality of current assets in its rated universe as very high and anticipates that future performance of these assets to be strong.

2. Should growth rates in SPA backed transactions continue at the pace previously experienced, DBRS believes that certain concerns will arise with respect to:

    a. The continued and near exclusive use of LSS technology resulting in contingent funding obligations embedded in an increasingly larger portion of the market; and

b. SFA transactions structured in the current environment potentially may incorporate economic and risk characteristics that are quite different from previously structured transactions.

Pursuant to the views expressed above, DBRS believes that a measured approach should be taken with respect to managing the future growth of SFA-backed transactions funded in the Canadian ABCP market. Consistent with past practice, market participants should only expect transactions that clear the minimum rating requirements by an ample margin to be approved by DBRS. However, consistent with DBRS's new approach to SFA transactions, market participants should also expect that the types of SFA transactions that will be approved going forward will be more restrictive than those approved in the past.

This mandate will be effective immediately. It is DBRS's expectation that no existing Canadian ABCP ratings will be affected, as all rated SFA transactions are currently enhanced beyond minimum thresholds for each rating category.

With regard to transactions currently: under review by DBRS, such transactions will be reviewed on a case by case basis to determine whether the transaction in question can be approved.

All inquiries regarding this matter should be directed to Huston Loke.

Yours truly,

DOMINION BOND RATING SERVICE LIMITED

Huston Loke
Assistant Group Managing Director 416-597-3627

SCHEDULE D

DBRS JANUARY RELEASE

DBRS® As It Happens JANUARY 19, 2007 03:34 PM

Press Releases

DBRS Revises CDO Criteria for Canadian ABCP Issuers

Dominion Bond Rating Service (DBRS) has today announced changes to its methodology for arbitrage-type transactions entered into by Canadian commercial paper issuers (CP Issuers) and funded by DBRS-rated Canadian asset-backed commercial paper (ABCP)(l).

The Canadian ABCP market has grown rapidly over the past two years with growth largely being attributed to the contemporaneous growth of arbitrage-type transactions (also known as Structured Financial Asset or SFA Transactions). The most common type of SFA Transaction funded by ABCP involves collateralized debt obligations (CDOs) that reference corporate obligations. Recently, Leveraged Super Senior (LSS) structures have been the most prevalent type of CDO transaction executed by Canadian CP Issuers. SFA Transactions currently represent approximately 30% of Canadian ABCP market outstandings and LSS technology is used in transactions that account for approximately 22% of ABCP outstandings.

Although growth in ABCP outstandings has been rapid, DBRS views the quality of existing SFA Transactions as very high and consistent with the ratings assigned. In its evaluation of transactions funded by CP Issuers, DBRS has followed traditional conservative Canadian structuring practices, which in many instances have resulted in transaction credit enhancement significantly exceeding the AAA threshold required to qualify for funding with R-1 (high)-rated ABCP. These conservative practices have increased ABCP investors' confidence in the ABCP market and assisted in maintaining a track record of zero downgrades or defaults of ABCP rated by DBRS. The proposed criteria revisions are intended to ensure that transactions continue to be conservatively structured and ratings stability continues to be a key requirement of all DBRS-rated ABCP transactions.

Within the structured credit market, complexity is increasing while transparency for ABCP investors is still quite limited. More recent proposals by CP Issuers have incorporated structural and risk characteristics that are quite different from previously completed SFA Transactions. While these proposals can be readily structured to AAA attachment levels using the DBRS CDO Toolbox, other risk characteristics relating to leverage, mark-to-market, hedging and collateral are more challenging to mitigate in today's environment.

DBRS has recently declined to approve many of the SFA Transactions proposed by CP Issuers and at this time believes it is appropriate to outline to market participants the basis on which DBRS would find new SFA Transactions acceptable for funding by ABCP. DBRS would welcome the opportunity to consider CDO-related SFA Transactions that:

(1) Provide for resilient credit characteristics that surpass the DBRS CDO Toolbox minimum 'AAA' attachment point;

(2) Contain limited exposures to any one particular industry and to non-investment grade entities;
(3) Are supported by liquidity facilities from DBRS-approved liquidity providers that contain conditions to draw that are not limited to market disruption and are not dependent on a confirmation of the then-current ratings; and

(4) Are proposed by CP Issuers that maintain a superior level of information disclosure to ABCP investors, which in particular relate to the type of SFA Transactions executed, the nature of the collateral and hedging transactions employed by the CP Issuer, and whether or not the CP Issuer is exposed to contingent funding obligations.

In addition to the criteria listed above and consistent with past practice, DBRS will also review other risk characteristics associated with each CDO transaction such as leverage, mark-to-market, hedging, collateral quality and liquidity in order to confirm that the proposed SFA Transaction is appropriate for a CP Issuer to fund with ABCP.

The changes to DBRS's methodology will be effective immediately and apply to all SFA Transactions including both public and private transactions that may involve a single or series of re-packaged notes. For non-CDO related SFA Transactions that involve publicly traded instruments that are deemed to have robust credit and liquidity characteristics, alternative mechanisms may be available to mitigate the risks described above. It is DBRS's expectation that no existing Canadian ABCP ratings will be affected as all rated SFA Transactions are currently enhanced beyond minimum thresholds for the applicable rating category.

Note:

(1) The term ABCP in this press release refers to all forms of notes issued by a CP Issuer including extendible commercial paper, fixed or floating rate notes and medium term notes.

Click here for the full document.

Michael Buzanis
Managing Director - Canadian Structured Finance 416-597-3620
mbuzanis@dbrs.com

Huston Loke, CFA
Group Managing Director - Global Head Structured Finance 416-597-3627
hloke@dbrs.com

You can reach DBRS at:

E-Mail: info@dbrs.com
Phone: 416-593-5577 ext. 2333 Fax: 416-593-8432
Website: www.dbrs.com

...

SCHEDULE E

CHRONOLOGY OF SIGNIFICANT EVENTS

Date	Event
October 18, 2006	Coventree's preliminary prospectus is filed with the Commission.
November 10, 2006	DBRS November Letter is sent to market participants by e-mail indicating DBRS's more restrictive approach to rating SFA transactions (see Schedule C to these reasons).
November 3 to 15, 2006	Roadshow Presentations in Toronto and Montreal. Final due diligence session for Coventree's final Prospectus.
November 16, 2006	Coventree's final prospectus is filed with the Commission.
January 9, 2007	Coventree news release announcing the hiring of David Allan.
January 19, 2007	DBRS January Release announcing revised credit rating criteria for CDO related SFA transactions (see Schedule D to these reasons).
January 22, 2007	Coventree confirms with DBRS that global style liquidity is being required by the DBRS January Release in connection with CDO related SFA transactions. David Allan joins Coventree as head of Coventree's Capital Markets Group.
February 9, 2007	DBRS ABCP Investor Conference addressing its revised credit rating criteria for CDO related SFA transactions.
February 14, 2007	Coventree 2006 Annual Report and Letter to Owners is filed on SEDAR. Coventree First Quarter MD&A for the three months ended December 31, 2006 is filed on SEDAR.
March 13, 2007	Citibank is sent subprime information for Coventree sponsored conduits by NBF; information is not provided by note series.
March 15, 2007	Coventree e-mail to NBF disclosing the subprime exposure of its conduits as of February 28, 2007 (defined as the February Subprime Data).
March 27, 2007	Date by which Citibank had sold all of its Planet E notes.
April 25 and 26, 2007	Coventree April Investor Presentations; statement made that total subprime exposure of Coventree sponsored conduits is 7.4%.
May 10, 2007	Nereus becomes a wholly-owned subsidiary of Coventree.
May 14, 2007	Coventree Second Quarter MD&A for the three months ended March 31, 2007 is filed on SEDAR.
June 12, 2007	Bloomberg Business Week article on "Bear Stearns Subprime Bath".
July 6, 2007	Coventree e-mail to Mavrix disclosing subprime exposure by conduit and note series.

Date	Event
July 10, 2007	S&P issues a news release announcing the downgrade of billions of dollars of U.S. asset-backed securities because of subprime exposure. Moody's issues a similar news release.
July 11, 2007	Coventree e-mail to NBF disclosing subprime exposure by conduit and note series. Cornish attends S&P conference in the United States and learns of hundreds of downgrades of U.S. asset-backed securities because of subprime exposure.
July 12, 2007	Coventree e-mail to Citibank disclosing subprime exposure by conduit and note series.
July 13, 2007	Citibank sells Comet E notes.
July 20, 2007	NBF e-mail to the Caisse disclosing subprime exposure of Coventree sponsored conduits by conduit and note series. Significant downgrades in the U.S. of ABCP backed by subprime mortgages. Coventree sponsored conduits sell assets generating cash of approximately $173 million.
July 23, 2007	Caisse reduces its holdings of Coventree sponsored ABCP with subprime exposure.
July 24, 2007	Coventree e-mail (the July 24 e-mail) sent to all members of the dealer syndicate disclosing subprime exposure by conduit and note series. Coventree advised by dealers that the Caisse is reducing its holdings of Coventree sponsored ABCP. Date by which Citibank had sold all of its holdings of Comet and Slate notes. Dealers begin requesting information with respect to conduit assets as part of credit reviews.
July 25, 2007	Internal Coventree meeting to discuss and review market disruption procedures; some dealers have been asking for details as to those procedures. Increasing information requests from dealers for credit review of conduit assets. Scotia returns a relatively small amount of unsold Coventree sponsored ABCP to NBF. Caisse switches from some Coventree sponsored ABCP to bank sponsored ABCP.

Date	Event
July 27, 2007	RBC resigns from Coventree dealer syndicate. Dealers are “no bid” for secondary market purchases of Coventree sponsored ABCP in the previous week. Scotia reassures Allan that Scotia will continue to make its market-making lines available for Coventree sponsored ABCP.
July 28, 2007	Paul proposes that Coventree set up a data room to address the high level of dealer requests for credit review of conduit assets.
Monday, July 30, 2007	Coventree conference call with members of the dealer syndicate (including NBF, CIBC and Scotia) discussing market events and conditions (the July 30 Conference Call). Coventree advises Xceed that it is postponing a scheduled mortgage purchase due to turbulent market conditions. Citibank makes two collateral calls that are withdrawn the next day. Coventree transfers assets of approximately $58 million between conduits to reduce the subprime exposure of Comet E notes. Courchesne indicates that Coventree sponsored conduits cannot issue new ABCP. Toten states in an e-mail that Coventree is struggling to roll ABCP and has no new issue capacity. Allan is aware that all of the dealers “have issues” with the availability of their market-making lines. July 24 e-mail forwarded by RBC to its clients. RBC advises its clients of its resignation from the dealer syndicate.
Wednesday, August 1, 2007	Coventree convenes emergency board meeting on short notice. Spreads on Coventree sponsored A notes widen to approximately 12.8 basis points over CDOR and on E notes to approximately 26.8 basis points over CDOR. Coventree calculations indicate that one transaction has crossed the collateral call trigger; counterparty advises it will not make a collateral call that day. Child prepares a schedule assessing financial impact of spread widening. Cornish prepares draft press release addressing only spread widening. Coventree and Nereus sponsored conduits hold cash from asset sales of approximately $188 million.

Date	Event
Thursday, August 2, 2007	Disclosure committee meeting to discuss draft press release. Coventree draft press release e-mailed to Board, but Cornish and Tai recommend that it not be issued. E-mail from Paul indicating that over the past week, spreads on third-party sponsored ABCP have increased approximately 12 basis points relative to bank sponsored ABCP.
Friday, August 3, 2007	Syndicate members advise Coventree of $3 billion new bank sponsored ABCP transaction led by RBC and TD Bank. Approximately $60 million of overfunding is used by a Nereus conduit to purchase Planet A notes. Approximately $160 million of cash overfunding has been accumulated in Coventree sponsored conduits according to Tai's e-mail to the Board. Coventree calculations show that collateral calls have been triggered on two transactions and two transactions are close to the triggers.
Saturday, August 4, 2007	Tai indicates that cash overfunding should be used only to meet collateral calls.
Sunday, August 5, 2007	Coventree prepares with assistance of legal counsel for the possibility of a liquidity event on Tuesday, August 7, 2007.
Monday, August 6, 2007 (holiday in Ontario)	Allan requests that the Caisse support Coventree sponsored ABCP during the week commencing August 7, 2007; the Caisse confirms its support. Child consults Davis & Co. by telephone as to Coventree's disclosure obligations. Strategic council meeting to discuss market developments. Coventree determines not to proceed with rebalancing of conduits to reduce subprime exposure.
Tuesday, August 7, 2007	Caisse and other Quebec purchasers "back-stop" the market for Coventree sponsored ABCP. Spreads on Coventree sponsored A notes widen to approximately 25 basis points over CDOR and on E notes to approximately 40 basis points over CDOR. Disclosure committee meeting to discuss whether a disclosure obligation was triggered. Coventree calculations indicate that four transactions are close to or have crossed collateral call triggers.
Wednesday, August 8, 2007	Coventree voluntarily posts $25 million of cash collateral for each of two Citibank transactions. Coventree advises NorthBrook, a traditional asset provider, that it is unable to fund a purchase of assets.

Date	Event
Thursday, August 9, 2007	BNP freezes US$2.2 billion of funds associated with US subprime. Bank of Canada announces it will provide liquidity to support financial markets. Allan circulates draft powerpoint presentation to other Coventree officers entitled: “What the Hell is Going On?”.
Friday, August 10, 2007	Meeting of ABCP market participants in Montreal to discuss restructuring of ABCP market (the “soft landing”). United States Federal Reserve announces it will provide liquidity to support financial markets.
Sunday, August 12, 2007	Allan concludes that the Caisse may not support Coventree sponsored ABCP on the following Monday.
Monday, August 13, 2007	An ABCP market disruption occurs: • Coventree substantially widens spreads on ABCP • Some Coventree sponsored ABCP fails to roll • Coventree begins notifying liquidity providers of market disruption, extending extendible ABCP • Bank sponsored ABCP continues to roll Coventree requests TSX trading halt and issues news release announcing that Coventree sponsored conduits are unable to fund some ABCP maturing that day. Regularly scheduled Coventree Board meeting to approve Q3 MD&A; no approval of MD&A as a result of market disruption.
August 16, 2007	Montreal agreement reached in which market participants agree to a temporary ABCP market freeze.
February, 2008	First downgrade of credit rating for Coventree sponsored notes.
March 17, 2008	Ontario Court of Justice issues an initial order staying proceedings to allow a vote on the Plan restructuring ABCP in Canada.