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Case & Project Experience

NERA Expert Provides Market Efficiency and Materiality Analysis for Class Action against Gold Mine Company

On 27 November 2009, a settlement was announced in a class action brought against a gold exploration and development company (the "Company"). The plaintiffs had sought $55 million in damages. The settlement was reached prior to the certification hearing and leave application under the *Securities Act* (Ontario). Under the terms of the settlement, the Company agreed (without any admission of wrongdoing) to pay $2.2 million to settle shareholders claims of common law misrepresentation and misrepresentation under the new provisions of the *Securities Act* (Ontario).

NERA Vice President Bradley A. Heys provided expert testimony on the efficiency of the market for the shares of the Company and on the materiality of the alleged misrepresentations.

Background

The class action was brought following the restatement of the Company's unaudited quarterly financial statements for the first three quarters of 2007.

The restatement was the result of a reclassification of certain gold forward contracts entered into by the Company from "executory contracts" to "financial instruments" under Canadian GAAP. Although this reclassification required the Company to recognize certain unrealized gains and losses on its income statements, those unrealized gains and losses were previously disclosed by the Company in the footnotes to its financial statements.

Allegations

The plaintiff class alleged that the Company's failure to account for its forward contracts as financial instruments was a material misrepresentation, which had the effect of inflating the market price of its shares. Plaintiffs further alleged that shareholders incurred losses as a result of the decline in the price of the shares following the restatement of the Company's financial statements. The stock traded on the Toronto Stock Exchange (TSX) and the Alternative Investment Market (AIM) in London.

NERA's Role

Counsel for the Company retained NERA to provide independent analysis of the efficiency of the market for the shares of the Company and to assess the impact on the stock price attributable to the alleged misrepresentations.

Materiality and Loss Causation

NERA assessed the impact of the alleged misrepresentations on the market price of its shares in the full economic context in which the financial statement restatements were made, and of the factors driving the market price of the stock during the proposed class period. The analysis demonstrated that:

(1) although there was a statistically significant stock price decline relative to the market and industry on the initial announcement by the Company that it would restate its financial statements, that decline was reversed several days later when the stock price increased by a statistically significant amount on the release of further details about the restatements; and

(2) the presence of economically meaningful information regarding the unrealized losses on the financial statements in the marketplace during the proposed class period suggested that the stock price was not affected by the accounting treatment of the forward contracts.

Analysis of the Company's business demonstrated that investors did not consider the information allegedly misrepresented to have been material. This was the result of the economically meaningful information already being known to the market, and having been already incorporated into the stock price. A more likely reason for the observed stock price movements was a contemporaneous announcement that the development of the Company's gold mine would be delayed—an announcement that was not the subject of any allegations.

Market Efficiency

NERA assessed the efficiency of the market for these particular shares.

Although the stock traded on the TSX (as well as the AIM), NERA's analysis found that this fact was insufficient to conclude that the market for the common stock was efficient. Rather, it was the characteristics specific to the market that were a more reliable indicator of whether the shares trade efficiently.

The securities in question were the common shares of the Company, which was in the business of exploring and developing gold mines, primarily in Kazakhstan.

Speculative trading activity in the market for the Company's shares was reflected in the volatility in the stock price in relation to general market factors, industry factors, and the release of company-specific news. Significant market- and industry-adjusted movements in the market price of the Company's stock were as likely to occur on days on which no company-specific news was released to the marketplace.

The trading records of the lead plaintiff in the case revealed a pattern of day-trading and momentum trading whereby trades were made in response to fluctuations in the price of the stock, rather than on the release of new information by the company. This type of trading suggested that the lead plaintiff did not trade based on the efficiency of the market or on the basis of company-specific news.

Thus, the presumption that investors could have relied on the integrity of the market price may not have been justified during the proposed class period.

The Result

On 27 November 2009, a settlement was announced in the case prior to the class certification hearing and leave application. Under the terms of the settlement, the Company agreed to pay $2.2 million to settle claims brought by shareholders of common law misrepresentation and misrepresentation under the new provisions of the *Securities Act* (Ontario), which provide for civil liability with respect to the continuous disclosure obligations of a reporting issuer. The court-approved settlement represents four percent of the $55 million in damages claimed by the plaintiffs ($50 million in compensatory damages and $5 million in punitive damages). The Company did not admit any wrong-doing under the terms of the settlement.

Expert Involved

Bradley A. Heys, Vice President

Mr. Heys' expertise is in the fields of economics, finance, and financial investigations. He performs economic analyses for securities litigations, antitrust class actions, and other complex commercial litigations, and has conducted financial investigations of public companies for both class action and criminal matters. Mr. Heys also conducts business and securities valuations for corporate and public sector clients. He is a CFA charterholder and a Certified Fraud Examiner, and teaches a graduate-level course in Economic Analysis of Law at the University of Toronto.

About NERA

NERA Economic Consulting (**www.nera.com**) is a global firm of experts dedicated to applying economic, finance, and quantitative principles to complex business and legal challenges. For over half a century, NERA's economists have been creating strategies, studies, reports, expert testimony, and policy recommendations for government authorities and the world's leading law firms and corporations. With its main office in New York City, NERA serves clients from more than 25 offices across North America, Europe, and Asia Pacific.

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