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CIRCULAR
June 10, 2004

REQUEST FOR COMMENTS

LIMITATION OF THE LIABILITY OF THE BOURSE

AMENDMENTS TO ARTICLE 2510, DELETION OF ARTICLE 2510A AND ADDITION OF ARTICLES 2511 AND 2512 OF THE RULES OF BOURSE DE MONTRÉAL INC.

Summary

The Rules and Policies Committee of Bourse de Montréal Inc. (the “Bourse”) approved amendments to article 2510, deletion of article 2510A and adoption of articles 2511 and 2512 pertaining to the limitation of the liability of the Bourse. The analysis explaining the various changes is published with the proposed modifications for a public comment period of 30 days.

Process for Changes to the Rules

The Bourse is recognized as a self-regulatory organization (“SRO”) by the Autorité des marchés financiers (the “Autorité”). In accordance with this recognition, the Bourse carries on activities as an exchange and as a SRO in Québec. In its capacity as an exchange, the Bourse takes on responsibilities as a market regulator.

The Board of Directors of the Bourse has the power to approve the adoption or amendment of various Rules and Policies of the Bourse. The Board of Directors has delegated its powers of approval of Rules and Policies to the Rules and Policies Committee. The changes are submitted to the Autorité for approval.

Circular no : 086-2004

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Comments on the proposed amendments to article 2510, to the adoption of articles 2511 and 2512 and to the deletion of article 2510A of Rule Two must be submitted within 30 days following the date of publication of this notice in the bulletin of the Autorité. Please submit your comments to:

*Ms. Joëlle Saint-Arnault
Vice-President, Legal Affairs
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A copy of these comments shall also be forwarded to the Commission to :

*Ms. Anne-Marie Beaudoin
Director – Secretariat
Autorité des marchés financiers
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Appendices

For your information, you will find in appendices an analysis document of the proposed rule amendments as well as the proposed regulatory text. The implementation date of the proposed amendments will be determined following approval by the Autorité des marchés financiers.



LIMITATION OF THE LIABILITY OF THE BOURSE

AMENDMENT TO ARTICLES 2510 AND 2510A OF THE RULES OF BOURSE DE MONTRÉAL INC.

SUMMARY

A) Introduction

Under article 2510A as it now reads, the Bourse is exempted from all liability except for intentional or gross fault. This is the maximum extent of a liability exemption permitted under the Civil Code of Quebec. Prior to the 2002 revision of Rule Two, article 2510A excluded liability for “any negligent or reckless act or omission”, language which would likely have been “read down” by a court so as not to include intentional or gross fault. The broad pre-2002 exclusion was in the by-laws of the old Bourse de Montréal since as far back as can be traced.

B) Summary of the issues

In a review conducted in 2003, we found that all the major stock exchanges and derivatives exchanges, including those which have been demutualized, have liability waiver rules at least as broad as the current article 2510A. Exemption from liability appears to be an essential element of an organized market’s regulation. Without it, the stability of the market, and thus the public interest, remains exposed to the risk of catastrophic claims and costly litigation. Exemption from liability appears to be a standard regulatory requirement. For example, in the drafting of the CFTC no-action letter of February 27, 2002, the Bourse was advised to include a representation that its rules and contract terms provide that it and CDCC “will not be liable for any loss or damages as a result of the use of its trading systems”.

On the other hand, the demutualization of the Bourse and the fact that its approved participants are now inclined to view the Bourse at least in part as a service provider, suggest that its exemption from liability rules should encourage employee accountability and reflect the realities of electronic trading in a competitive global market.

C) Comparisons with other similar provisions

The survey of other exchanges confirmed, as mentioned above, that they all had general exclusion of liability rules. However, it was discovered that the NYSE, CBOE and CME had recently adopted limited discretionary claims payment programs for employee errors in processing trades on their electronic platforms. The Bourse team concluded that the new Bourse rule should include a similar program, with the cap scaled down to take into account the size of the Bourse compared to the three U.S. exchanges. The result of the international benchmarking is attached as Appendix I.

D) Summary of Bourse discussions

In December 2002, McCarthy Tétrault were retained by a group of approved participants to raise objections to the existing exemption from liability clauses, based on the language of article 2510A, as reproduced in the new approved participant application forms. The Bourse's in-house counsel and its external legal advisors from Ogilvy Renault conducted a series of meetings and conference calls with lawyers from McCarthy Tétrault in both 2003 and 2004. The proposed Rule amendments reflect a number of the suggestions put forward on behalf of the approved participant group by McCarthy Tétrault. However, the Bourse did not accept, and believes it cannot accept, the request that it effectively accept unlimited liability for claims resulting from circumstances not amounting to gross fault. The capped claims program was put forward in the discussions by the Bourse as a workable compromise between the *status quo* which was objected to by the approved participant group, and their insistence on an unlimited acceptance of liability for claims arising out of the failure to perform in accordance with a defined standard of care. The Bourse management team believes that acceptance of unlimited liability for ordinary fault would place the stability of its market at risk, and that increasing the proposed cap on voluntary indemnification for employee error would put the Bourse at a cost-of-doing-business disadvantage in competing with foreign derivatives exchanges.

E) Summary of proposed amendments

Article 2510 has been changed so as to deal only with the exclusion of the liability of directors, etc. to the Bourse. The wording relating to the liability of the Bourse has been deleted as being redundant and inconsistent with the new articles 2511 and 2512.

Article 2511 completely replaces article 2510A. Article 2510A was the cumulative product of various revisions over the years, and contains some rather convoluted language and redundancies borrowed from Common Law precedents. The new article 2511 uses simpler language inspired by the Civil Code of Québec. It retains the concept of an exemption of liability for ordinary negligence or fault, but introduces the limited claims payment program inspired by the CME example. The \$240,000 annual cap in Canadian dollars is 10% of the CME cap in U.S. dollars. This is more than what would be the case based solely on the relative trading volumes of the two exchanges. Claims are handled on

an annual basis, and share *pro rata* if the cap is exceeded in the aggregate. Unlike the CME system, there is no per claim, daily or monthly cap. (This is in response to a suggestion from the approved participant group mentioned in the previous section of this analysis). Eligible claims are limited to employee errors in regard to orders on the trading system of the Bourse. There are specific exclusions for system failure and regulatory activities. The new Rule does not reproduce the exclusion of recourse to the courts which is currently found in paragraph g) of article 2510A, and considered unenforceable.

The new article 2512 clarifies the approved participant's hold harmless obligations as being triggered by a failure to ensure that its client has agreed to be bound by the Bourse's limitation of liability rules. It clarifies the approved participant's liability to the Bourse for the cost of attending hearings, etc. involving a third party.

F) Public Interest

It is felt that the introduction of a capped indemnification program for employee errors will improve employee accountability and promote the exercise of care in the processing of trades on the systems of the Bourse. Similarly, the change should improve the confidence of users of those systems in the services provided by the Bourse. The amount of the cap compares favorably with similar arrangements at other exchanges, taking into account the differences in trading volumes and financial resources. Above the amount of the cap, the Bourse and its market retain protection, to the extent allowed by law, from claims in unpredictable amounts.

It is also felt that the existing limitation of liability and indemnification terms needed to be restated in clearer language consistent with the provisions of the Civil Code of Québec.

G) References

- Articles 2510 and 2510A of Rule Two of the Bourse
- The Bourse's international benchmarking analysis (Appendix I).

RULE TWO

LIABILITY AND RELATED MATTERS OF THE BOURSE

(Only articles 2510 and 2510A of By-Law Two of the Montreal Exchange (1874) were adopted, as of October 1st, 2000, as articles of Rule Two of Bourse de Montréal Inc.)

2510 Limitation of Liability to the Bourse

(03.02.77, 17.12.81, 09.03.99, 18.10.02, 00.00.04)

No director, member of any committee, officer or employee of the Bourse shall be liable to the Bourse ~~or an approved participant, approved person or restricted trading permit holder~~, for the acts, receipts, errors or omissions of any other director, member of any committee, officer or employee of the Bourse, or for joining in any receipt or other act for conformity, or for any loss, damage or expense occurring through the insufficiency or deficiency of title to any property acquired for or on behalf of the Bourse, or for the insufficiency or deficiency of any security in or upon which any of the moneys of the Bourse shall be invested or for any loss or damage arising from the bankruptcy, insolvency or wrongful act of any person with whom any of the moneys, securities or assets of the Bourse shall be deposited, or for any loss occasioned by any error of judgment or oversight on his part, or for any other loss or damage whatever which shall happen in the execution of the duties of his office or in relation thereto, unless the same are occasioned by his own willful neglect or default.

~~Neither the Bourse nor the clearing corporation shall be liable to any approved participant, approved person or restricted trading permit holder or any partner, shareholder, director, officer, agent or employee of an approved participant for damages arising out of the use of its services or facilities.~~

2510A Bourse Liability

(11.03.92, 18.10.02, abr. 00.00.04)

a) ~~For the purposes of this article:~~

- i) ~~the term "trading systems" includes all facilities and services provided by the Bourse to facilitate trading, including, but not limited to : data entry services; the Montréal Automated System (SAM); all other computer based trading systems and programs and price quotations and other market information services.~~
- ii) ~~the term "Bourse" includes the Bourse and its directors, officers, employees, committee members, affiliates and independent contractors.~~

b) ~~The Bourse shall not be liable to an approved participant, approved person, restricted trading permit holder, or partner, shareholder, director, officer, agent or employee of an approved participant for any loss, damage, cost, expense, or other liability or claim suffered by or made against them as a result of their use of the Bourse's trading systems. By making use of the Bourse's trading systems, such persons expressly agree to accept all liability arising from their use of such systems.~~

c) ~~The Bourse shall not be liable to an approved participant, approved person, restricted trading permit holder, or partner, shareholder, director, officer, agent or employee of an approved participant for any loss, damage, cost, expense, or other liability or claim arising from any failure of the Bourse's trading~~

~~systems or any negligent or reckless act or omission of the Bourse, with the exception of liability for material injury caused through an intentional or gross fault.~~

- ④ ~~In the event any legal proceeding is brought by a third party against the Bourse which arises directly or indirectly from the use by an approved participant, approved person, restricted trading permit holder, partner, shareholder, director, officer, agent or employee of an approved participant of the Bourse's trading systems, such approved participant, approved person, restricted trading permit holder, partner, shareholder, director, officer, agent or employee of an approved participant undertakes to hold the Bourse harmless in respect of, and to reimburse to the Bourse:~~
 - i) ~~all expenses, professional fees and judicial costs incurred by the Bourse in connection with the proceeding;~~
 - ii) ~~any recovery adjudged against the Bourse in the event it is found to be liable; and~~
 - iii) ~~any payment made by the Bourse, with the consent of the approved participant, approved person or restricted trading permit holder in settlement of any such proceeding.~~
- ⑤ ~~The Bourse shall not be liable to an approved participant, an approved person, a restricted trading permit holder, a partner, a shareholder, a director, an officer, an agent or an employee of an approved participant for any loss, damage, cost, expense or other liability or claim suffered by or made against such person as a result of the non availability of the Bourse's trading systems or a decision of the Bourse to suspend or terminate trading in whole or in part.~~
- ⑥ ~~The approved participant, the approved person, the restricted trading permit holder, the partner, the shareholder, the director, the officer, the agent or the employee of an approved participant shall indemnify and save the Bourse harmless from and against all costs, including amounts paid to settle an action or to satisfy a judgment, legal and professional fees, expenses for attending trials, hearings and meetings, that the Bourse incurs in any civil, criminal or administrative action, suit, proceeding, investigation, inquiry, hearing, appeal, or review that is threatened or brought against the Bourse, or in respect of which the Bourse is compelled or requested to participate, in respect of any act committed or permitted by the approved participant, the approved person, the restricted trading permit holder, the partner, the shareholder, the director, the officer, the agent or the employee of the approved participant.~~
- ⑦ ~~An approved participant, an approved person, a restricted trading permit holder, a partner, a shareholder, a director, an officer, an agent or an employee of an approved participant shall not be entitled to commence or carry on any proceeding against the Bourse in respect of any act, omission, penalty or remedy imposed on such persons pursuant to the Regulations of the Bourse. This section shall not restrict the right of such persons to apply for a review of a direction, order or decision of the Bourse by a competent regulatory authority.~~

2511 Liability of the Bourse

(00.00.04)

- 1) Any claim against the Bourse by an approved participant, an approved person, a restricted trading permit holder, or a partner, shareholder, director, officer, agent or employee of an approved participant shall be governed by the laws of Québec.

- 2) Except as expressly provided herein, the Bourse and its directors, officers, committee members and employees shall be exempt from all liability arising out of the acts or omissions of the Bourse, an affiliate of the Bourse, or the directors, officers, employees, agents, and independent contractors of the Bourse or of an affiliate of the Bourse.
- 3) The exemption from liability set out in paragraph 2 above shall not extend to, nor limit liability for damages caused through an intentional or gross fault as defined in Article 1474 of the Civil Code of Québec.
- 4) Notwithstanding paragraph 2 above, the Bourse undertakes to make payments in settlement of claims by approved participants for losses arising out of an error by an employee of the Bourse in regard to an order of the approved participant on the trading systems of the Bourse. Such payments shall be subject to the following conditions and limitations:

 - a) Any such payment may only be made as compensation for losses, except for loss of profit, sustained as an immediate, direct and foreseeable consequence of an error by an employee of the Bourse in regard to an order on the trading systems of the Bourse.
 - b) The Bourse's total liability in respect of all such claims by all approved participants of the Bourse in any calendar year shall be limited to \$240,000. All claims by approved participants shall be reviewed and evaluated by the Bourse on a yearly basis and shall share *pro rata* whenever the aggregate amount payable in respect of all such claims by all approved participants as determined by the Bourse exceeds the yearly limit.
 - c) Immediately upon becoming aware of an error for which it may make a claim, the approved participant must inform the Bourse of all the relevant details of which the approved participant is aware in order for the Bourse to trace the affected order in its systems (the "Advance Notice Requirement"). The Bourse will process a claim for payment only if (1) the approved participant has complied with the Advance Notice Requirement, (2) the approved participant has submitted a claim in writing to the Bourse within thirty days from the date the approved participant first knew of the loss, but in any event no later than thirty days from the end of the calendar year during which the approved participant's order relating to the loss occurred, and (3) the approved participant has provided to the Bourse, as soon as available but in any event no later than thirty days from the earlier of (a) the date the approved participant first knew of the loss and (b) the end of the calendar year during which the approved participant's order relating to the loss occurred, all documents and information reasonably required by the Bourse to enable it to evaluate the claim (the "Required Information"). The Bourse undertakes to review and evaluate such claims in a commercially reasonable manner and to advise the approved participant of its decision regarding payment of the claim within thirty days from the receipt of the Required Information. The Bourse undertakes to pay the amount which it determines is due in respect of each claim, subject to any pro rating required under paragraph 4) b) above, within sixty days from the end of the calendar year in which the loss occurred. Any disputed claim must be arbitrated in accordance with articles 5201 *et seq.* of Rule Five, which shall apply *mutatis mutandis*.
 - d) Without limiting the generality of paragraph 4) a), no loss shall be eligible for payment by the Bourse under paragraph 4):

- i) if it was the result of a failure or defect in the hardware or software used by the Bourse or an interruption in the supply of energy or communications services, except to the extent that the fault of an employee of the Bourse contributed to the loss;
 - ii) if it relates to the market surveillance or regulatory activities of the Bourse;
 - iii) to the extent that it was due to the failure of the approved participant or its client to take reasonable steps to mitigate the loss.
- e) No payment by the Bourse under this paragraph 4 shall be construed as an admission of liability by the Bourse.

2512 Indemnification

- 1) Every approved participant shall ensure that all of its clients on whose behalf the approved participant enters orders on the trading system of the Bourse have agreed to be bound by the Rules of the Bourse, including the provisions of the present Rule relating to limitation of the Bourse's liability. An approved participant shall hold harmless and indemnify the Bourse, its affiliates and the directors, officers, committee members and employees of the Bourse and of its affiliates in respect of any claim by a client of the approved participant which arises out of the approved participant's failure to fulfill this requirement.
- 2) An approved participant or an approved person shall reimburse the Bourse for the cost of attending or providing evidence in any proceedings against the approved participant or approved person by a third party.

Summary of Comparable Rules of Other Exchanges

Toronto

The TSX Rule 2307 excludes liability for the “negligent, reckless or wilful act or omission” of its employees, etc. This goes beyond the current Bourse exclusion, which does not exempt liability for intentional or gross fault (equivalent to “reckless or wilful act or omission”).

Eurex

Article 13.2, like the Bourse’s current Rules, accepts liability only for intentional misconduct or gross negligence. This includes accepting liability for typically foreseeable damage resulting from “a culpable breach by the Eurex Exchanges of its principal duties”. This notion of culpable breach of a principle duty appears to be a German civil law concept.

Liffe

Section 1.4.3 excludes all liability, including liability for negligence. It is preceded by Section 1.4.2, which is a warning to members and clients that business on the market can be interrupted, and that errors can occur in orders or contracts, for all kinds of reasons.

Chicago

With two exceptions, the CME (Rule 578) excludes liability for everything except wilful or wanton misconduct (i.e. similar to the Bourse’s current rule).

Paragraph D of Rule 578 states that the Exchange may make discretionary assumptions of liability in the event of the negligence of its staff. Such payments are restricted to direct, out-of-pocket loss, and subject to caps of \$100,000 per day, \$200,000 per month and \$2,400,000 per year.

Under changes to Rule 579, the Exchange may also make discretionary payments in the event of “incorrect order statusing information” resulting in Globex-related customer losses. Liability is subject to the same cumulative caps provided in Rule 578, and claims under \$1000 are excluded. Claims under either of these concessions are subject to binding arbitration.

New York

A very detailed, three-page Rule 16 provides for a procedure of trying to match uncompered “System Transactions”, binding arbitration, and limits of \$10,000 per claim and \$100,000 per

day on Exchange liability. Claims are shared pro-rata if the limits are reached. The limitation refers to “errors or omissions of an ITS clerk”, but does not mention negligence.

Rule 25 contains a hold-harmless undertaking by members in the event the Exchange is found secondarily liable for failing to have prevented or required action by the member. This appears to relate to the regulatory functions of the Exchange, and not to liability for trading errors.

There is also a requirement in Rule 25 that the member reimburse the Exchange for the cost of producing records in legal proceedings regarding the member.

Rule 813 provides an exemption from liability for errors, omissions and delays relevant to indexes and baskets.