Supreme Court raises bar for leave to bring secondary market securities class actions

Contributed by **Dentons**

July 14 2015

Authors

Michael D Schafler

Matthew Fleming

Thomas Wilson

Introduction

In *Theratechnologies Inc v 12185 Canada Inc*,(1) the Supreme Court of Canada ruled that Section 225 (4) of the Quebec Securities Act(2) – which, as a condition precedent, requires plaintiffs to show that their claims have been brought in good faith and have a reasonable chance of success – is no mere speed bump on the way to obtaining court authorisation to bring an action against reporting issuers, directors, officers or experts for damages resulting from the acquisition or disposition of securities in the secondary market.

The decision directs courts in all Canadian provinces to more rigorously apply securities law requirements that oblige plaintiffs to obtain judicial authorisation before proceeding with secondary market securities class actions. In the wake of *Theratechnologies*, plaintiffs in such actions must present sufficient evidence to demonstrate a reasonable chance of success, lest their claim be denied at the outset.

Facts

In 2010, Theratechnologies Inc – a pharmaceutical research and development company based in Montreal and listed on the Toronto Stock Exchange – was awaiting approval from the Food and Drug Administration (FDA) for a HIV drug then under development. Theratechnologies regularly updated its shareholders and Quebec's securities regulator with developments regarding the FDA approval process and had earlier disclosed clinical trial results indicating that the drug's negative side effects were clinically insignificant.

As part of its approval process, the FDA referred a number of questions about the drug – including questions about potential side effects – to an expert advisory committee. These questions were posted to a public FDA website and Theratechnologies elected to make no related disclosure to investors. Upon learning about the questions, certain third-party stock quotation companies issued press releases stating that Theratechnologies' drug could cause unwanted side effects. The market reacted negatively to these reports and shares in the company lost 58% of their value in just two days. The plaintiff, 121851 Canada Inc, sold shares in Theratechnologies during this period, suffering a loss of C$271,752.(3) The value of Theratechnologies' shares ultimately recovered and the drug received FDA approval.

121851 Canada took the position that the FDA's questions represented a material change in Theratechnologies' business, operations or capital which, pursuant to Section 73 of the Quebec Securities Act, should have been disclosed by the company. 121851 Canada sought judicial authorisation – required under Section 225(4) of the act – to bring a class action against Theratechnologies for damages. Section 225(4) of the act states, in part, that an action for damages with respect to secondary market securities may proceed only if the court "deems that the action is in good faith and there is a reasonable possibility that it will be resolved in favour of the plaintiff".

At first instance, the motions judge noted that Section 225(4) is more stringent than Article 1003 of the Code of Civil Procedure, which requires a court to find that "the facts alleged seem to justify the conclusions sought" before certifying a class action proceeding.(4) Despite this higher authorisation threshold for secondary market securities claims, the motions judge held that there was sufficient evidence to conclude that the plaintiff's action had a reasonable chance of success. The Quebec Court of Appeal agreed.

Decision

The issue before the Supreme Court of Canada was whether 121851 Canada's claim had a

'reasonable possibility' of succeeding within the meaning of Section 225(4) of the Securities Act. In a unanimous decision, the court allowed Theratechnologies' appeal and held that the action should not be authorised.

The court agreed with both lower courts that Section 225(4) contains a more stringent authorisation requirement than Article 1003 of the Code of Civil Procedure. According to the court, this higher threshold reflects the legislature's desire to meaningfully screen claims in the securities context and avoid the strike suits common in the United States.(5)

Justice Abella highlighted that Section 225(4) is part of a relatively new securities regime designed to address breaches of continuous disclosure obligations in the secondary market.(6) In the early 2000s, the Canadian Securities Administrators recommended a statutory cause of action to assist injured investors that face considerable challenges in proving that they relied on misinformation or the omission of information. The new regime, first implemented by Ontario in 2002, features a presumption in favour of investors that fluctuations in the value of a security are attributable to false declarations or failures to disclose.(7) Balancing against this presumption, all Canadian provinces have adopted a screening mechanism to ensure that only those claims with a reasonable chance of success are permitted to proceed – Section 225(4) of the Securities Act is an example of one such screening mechanism.(8)

The Supreme Court clarified that in order to establish that it has a realistic chance of success, a claimant must offer "some credible evidence in support of its claim".(9) A full analysis of the evidence is not required. Instead, a plaintiff must adduce "sufficient evidence to persuade the court that there is a reasonable possibility that the action will be resolved in the claimant's favour".(10)

Applying these principles, the Supreme Court focused on whether Theratechnologies had failed to disclose a material change within the meaning of Section 5(3) of the Securities Act.(11) The court held that there was no evidence to suggest that by electing not to disclose the FDA's questions, Theratechnologies had failed to disclose a material change that had affected its business, operations or capital. The information that the company had elected not to disclose contained no new information about the drug or its side effects. There was no evidence to suggest that the FDA's questions departed in any way from its routine drug approval procedure.(12) Because the evidence did not credibly suggest that there had been a material change that required disclosure under Quebec's securities laws, the Supreme Court held that there was no reasonable possibility of success and, accordingly, 121851 Canada's action was not authorised.

Comment

Securities legislation in all Canadian provinces contains threshold requirements similar to Section 225(4) of the Securities Act – a claimant must establish that its action is brought in good faith and has a reasonable chance of success.(13) Accordingly, *Theratechnologies* will have a far-reaching impact and, given the Supreme Court's decision, will likely result in courts approaching 'reasonable chance for success' requirements with increased analytical rigour. The message to plaintiffs is clear: evidence that illustrates the fundamental merits of a claim must be adduced before a court will authorise an action for damages in secondary market securities disputes.

The Supreme Court provides general guidance regarding the evidence that will establish that a given claim has a reasonable chance of success. Although the authorisation stage for secondary market liability actions "should not be treated as a 'mini-trial'",(14) plaintiff's counsel should view *Theratechnologies* as a call for increased evidentiary diligence. According to the court, "a case with a reasonable possibility of success requires the claimant to offer both a plausible analysis of the applicable legislative provisions, and some credible evidence in support of the claim."(15) Only time and subsequent consideration and application by lower courts will bear out exactly how provincial authorisation threshold requirements have been affected by *Theratechnologies*.

Finally, the Supreme Court emphasised that the timely disclosure obligations in Canadian securities legislation are designed to:

- "increase fairness in the secondary market";
- support capital market efficiency "by helping investors target the most deserving securities"; and
- enhance the accountability of corporate management.(16)

Theratechnologies further demonstrates that the Supreme Court is engaged in balancing the rights of investors to bring secondary market claims against the rights of issuers to ensure that such claims are not baseless.

For further information on this topic please contact Michael Schafler, Matthew Fleming *or* Thomas Wilson *at Dentons Canada LLP by telephone (+1 416 863 4511) or email (michael.schafler@dentons.com, matthew.fleming@dentons.com or thomas.wilson@dentons.com). The Dentons website can be accessed at www.dentons.com.*

Endnotes

(1) 2015 SCC 18.

(2) CQLR, c V-1(1).

(3) *Theratechnologies*, *supra* note 1 at para 16.

(4) CQLR, c C-25 (CCP).

(5) *Theratechnologies*, *supra* note 1 at paras 30 and 36.

(6) *Ibid*, at para 21.

(7) *Ibid*, at paras 31 and 33.

(8) *Ibid*, at para 30.

(9) *Ibid*, at para 39.

(10) *Ibid*.

(11) A 'material change' is defined as:

> "*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 a decision to implement such a change made by the directors or by senior management of the issuer who believe that confirmation of the decision by the directors is probable*."

(12) *Theratechnologies*, *supra* note 1 at paras 48 and 51.

(13) British Columbia (Securities Act, RSBC 1996 c 418, s 140(8)(2)); Alberta (Securities Act, RSA 2000 c S-4, s 211(08)(2)); Saskatchewan (Securities Act, 1988, SS 1988-89 c S-42(2), s 136(4)(1)); Manitoba(Securities Act, CCSM c S-50, s 191(2)); Ontario (Securities Act, RSO 1990 c S-5, s 138(8)(1)); New Brunswick (Securities Act, SNB 2004 c S-5(5), s 161(41)(1)); Nova Scotia (Securities Act, RSNS 1989 c 418, s 146H(1)); PEI (Securities Act, RSPEI 1988 c S-3, s 129(2)); Newfoundland and Labrador (Securities Act, RSNL 1990 c S-13, s 138(8)(2)).

(14) *Theratechnologies*, *supra* note 1 at para 39.

(15) *Ibid*.

(16) *Ibid*, at paras 25 and 26.