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Secondary Market Liability: Supreme Court of Canada Clarifies the Screening Mechanism for Class Actions

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In *Theratechnologies inc v. 121851 Canada inc.,*[1] the Supreme Court of Canada ruled for the first time on a case involving the new secondary securities market liability regimes. These regimes, which have been adopted in most Canadian provinces, facilitate actions by investors when reporting issuers breach their disclosure obligations, including when they fail to report a material change.

Theratechnologies, a pharmaceutical company whose common shares are listed on the Toronto Stock Exchange, applied to the U.S. Food and Drug Administration (FDA) for a new drug. As part of its approval process, the FDA referred questions about the drug, including its possible side effects, to an expert advisory committee. The FDA also published the questions in documents posted on its website. When some analysts then published reports addressing the issues raised by the FDA, including the possible side effects, the share price of Theratechnologies dropped by more than 50%. Theratechnologies did not react publicly to these statements. Two days later, the advisory committee unanimously voted in favour of approving the new drug application. The share price recovered soon thereafter.

A class action was then brought under the Québec *Securities Act*. The plaintiffs principally claimed that the possible side effects of the medication and the FDA's questions regarding those effects constituted a material change in the business, operations or capital of Theratechnologies and that it had failed to disclose that change.

Article 225.4 of the *Securities Act* provides that such recourse is subject to prior approval of the court, which it must give "if it deems ... there is a reasonable possibility that it will be resolved in favour of the plaintiff". The Supreme Court concluded that this test is more demanding than the general authorization criteria applicable to class actions in Québec, in which the court only examines whether "the facts alleged seem to justify the conclusions sought".

The Supreme Court also held that the gatekeeping role of the courts under article 225.4 requires that the courts "undertake a reasoned consideration of the evidence to ensure that the action has some merit". In addition, it "requires the claimant to offer both a plausible analysis of the applicable legislative provisions, and some credible evidence in support of the claim" so as to establish a reasonable possibility of success. While the authorization required by the Québec *Securities Act* should not be treated as a mini-trial, sufficient evidence is nevertheless required to convince the court that there is a reasonable possibility that the action will be resolved in the plaintiff's favour.

In this case, the Supreme Court concluded that the plaintiffs had not satisfied the test. Citing its decision in the *Kerr*[2] case, the Court reiterated that the obligation of timely disclosure is limited to "material changes"– that is, a material change in the operations, business or capital of the issuer. In *Theratechnologies*, the Supreme Court found that the plaintiffs had not demonstrated that the FDA's questions related to new information that had not been disclosed. The Court further concluded that it was difficult to characterize the questions as any kind of change to the business, operations or capital of Theratechnologies requiring any reassuring public response. This was particularly the case because Theratechnologies would have been put in a very difficult position had it tried to reassure investors while the FDA's decision was still pending.

The Court therefore concluded that the plaintiffs' action had no reasonable chance of success and refused to authorize the class action.

The Ontario *Securities Act* also provides for a screening method requiring that for an action in the secondary market to be authorized, there must be "a reasonable possibility that the action will be resolved at trial in favour of the plaintiff", a test very similar to that found in the Québec *Securities Act*. The finding in *Theratechnologies* is therefore likely to have an impact beyond the borders of Québec.

[1] 2015 SCC 18.

[2] *Kerr v. Danier Leather Inc.*, [2007] 3 S.C.R. 331, 2007 SCC 44.

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