Supreme Court of Canada denies authorization in first Quebec secondary market securities class action

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On April 17, 2015, the Supreme Court of Canada released its decision in ***Theratechnologies inc. v. 121851 Canada inc.***, the first case to consider the authorization of a secondary market class action under the provisions of the Quebec *Securities Act* that came into force in 2007. These provisions created a new statutory cause of action that enabled investors to bring claims against reporting issuers who breach their obligations to disclose material facts and changes; however, investors must obtain court authorization to commence such claims.

In a unanimous judgment, the Supreme Court held that the threshold for authorization to commence a secondary market action under the Quebec legislation requires showing "a reasonable or realistic chance that the action will succeed." The Court allowed the appeal, concluding that the evidence did not credibly point to any material change that could have triggered timely disclosure obligations for the reporting issuer; accordingly, there was no reasonable possibility that the action could succeed.

Background

Theratechnologies Inc. ("**Thera**"), a TSX-listed pharmaceutical company, filed a new drug application with the FDA in June 2009 for tesamorelin. Throughout the following year, Thera issued press releases updating investors on the status of the FDA approval process and announcing results from its Phase 3 clinical studies. In particular, since tesamorelin triggers a hormone associated with increased risk of diabetes, Thera announced results from clinical trials indicating that the possible effects of tesamorelin on blood sugar were not clinically significant.

As part of the usual FDA approval process, an Advisory Committee meeting was scheduled for May 27, 2010. Prior to the meeting, Thera provided the FDA with a briefing package that contained a summary of the clinical trial results already disclosed to investors. On May 11, 2010, the FDA sent Thera its own briefing package, which included a list of questions about tesamorelin's side effects for the Committee's consideration. Thera did not issue a press release at this point. In accordance with FDA policy, the FDA published all briefing materials on its website prior to the Advisory Committee meeting, on May 25, 2010.

Stock quotation agencies such as Dow Jones reacted immediately to the questions in the FDA briefing package and issued press releases suggesting that the FDA was concerned that tesamorelin could increase diabetes risk. Thera did not issue a press release at this point. The trading volume of Thera stock on May 25 was unusually high, and the share price fell 58%. Thera's stock was cease-traded on May 27. The same day, the Advisory Committee unanimously voted to approve Thera's new drug

application. Thera communicated this news to shareholders immediately, and its share price recovered on May 28.

The plaintiff, a holding company, sold its shares in Thera on May 25 following the Dow Jones press release at a loss of $271,752 relative to the previous trading day. The plaintiff sought authorization under s. 225.4 of the Quebec *Securities Act* ("**QSA**") to commence a secondary market class action. The plaintiff claimed that the FDA's May 11 questions about the potential side effects of tesamorelin amounted to a material change in Thera's business, operations or capital that should have been disclosed to investors.

The **Quebec Superior Court** held that the test under QSA s. 225.4 - whether the action has a "reasonable possibility of success" - is more stringent than the test for class action authorization. Even under this more stringent test, the Court granted authorization to commence a secondary market action.

The **Quebec Court of Appeal** upheld this decision. Justice Gascon, writing for the Court, held that the plaintiff had demonstrated a reasonable possibility of success because (i) it had identified a precise event that it alleged should have been disclosed, namely the questions posed by the FDA on May 11, and (ii) its theory of the case was supported by documentary evidence and explanations provided by the plaintiff on examination. Justice Gascon confirmed that the lower court was correct in not determining at the authorization stage whether the queries from the FDA could amount to a material change, as this determination should have been reserved for the trial on the merits.

The Supreme Court of Canada Decision

The Test for Authorization to Commence a Secondary Market Action

The Supreme Court of Canada agreed with the courts below that the test for authorization to commence a secondary market action is higher than the test for class action authorization, which in Quebec requires establishing only that "the facts alleged seem to justify the conclusions sought" or that the claim has "a good colour of right".

Justice Abella, writing for the Court, referred to the test for authorization to commence a secondary market action as "a meaningful screening mechanism" intended to prevent "costly strike suits and litigation with little chance of success". Accordingly, the test requires more than a mere possibility of success: it requires "a reasonable or realistic chance that the action will succeed". In turn, this requires the claimant to offer "both a plausible analysis of the applicable legislative provisions, and some credible evidence in support of the claim." The test should not be treated as a mini-trial, however, and "[a] full analysis of the evidence is unnecessary" at this stage. Ultimately, what is required is "sufficient evidence to persuade the court that there is a reasonable possibility that the action will be resolved in the claimant's favour."

In adopting this formulation of the test, Justice Abella relied on the legislative history of Ontario's statutory regime for secondary market liability, which served as the inspiration for similar legislation in other provinces including Quebec. Her Honour also endorsed Justice Belobaba's statement in ***Ironworkers Ontario Pension Fund (Trustee of) v. Manulife Financial Corp.*** that the threshold for leave to commence a secondary market action should be more than a "speed bump."

Application

While the Supreme Court set out the same general test as the courts below, it went on to apply that test in a more stringent fashion. The Court concluded that the plaintiff had failed to point to any evidence of a material change in Thera's operations, capital or business that could trigger the requirement for timely disclosure.

The Court noted that Thera had consistently disclosed to its shareholders that it was monitoring tesamorelin's side effects, including on patients' blood sugar levels, and that any reasonable investor reading Thera's news releases would have known that blood sugar issues and diabetes were potential side effects of the drug that Thera's clinical trials had found not to be clinically significant. There was no evidence to suggest that the questions in the FDA briefing package of May 11, 2010 were anything more than routine inquiries by the FDA, or reflected any new and undisclosed information about tesamorelin.

The Court allowed the appeal, denying authorization to commence the proposed secondary market claim.

Implications of the Theratechnologies Decision

In *Theratechnologies*, the Supreme Court of Canada has confirmed that the test for authorization to commence a secondary market action requires a preliminary assessment of the merit of the claim based on a critical review of the evidence. The Court did not merely determine that the plaintiff had stated a valid legal claim and provided some evidence in support of the basic facts, as the courts below had done. Rather, the Court subjected the plaintiff's evidence to some scrutiny to determine whether the claim that Thera failed to disclose a material change had a realistic chance of success.

In Quebec, this decision is a positive development for public companies. The "realistic chance of success" threshold for secondary market liability proceedings is more stringent than the general test for authorization of a class action under section 1003 of the *Code of Civil Procedure*, which requires showing only a "colour of right". The "realistic chance of success" test, as applied by the Supreme Court in *Theratechnologies*, should provide some comfort to public companies and their insurers that they will be shielded from undue securities class action exposure.

The *Theratechnologies* decision is also the latest word from the Supreme Court regarding the meaning of a "material change" for purposes of securities legislation. The Court reiterated the holding from its 2007 decision in ***Kerr v. Danier Leather Inc.*** that not every external development affecting a public company's share price is a material change to the business, operations or capital of the company that triggers timely disclosure obligations.