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Securities Class Actions: A higher threshold for leave and opportunities for a stronger defence

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Overview

Three decisions have made 2015 a notable year for securities class actions in Canada. This article examines how these decisions have affected the way courts will interpret and apply the leave mechanism found in the various provincial securities acts.

First, the Supreme Court of Canada in *Theratechnologies Inc. v. 121851 Canada Inc.*, 2015 SCC 18 ("**Theratech**") clarified the threshold that plaintiffs must meet to bring a secondary market class proceeding against public issuers for failure to make timely disclosures, or for misrepresentations, under the Quebec *Securities Act* ("**QSA**").[1]

Second, the Supreme Court of Canada in *Canadian Imperial Bank of Commerce v. Green*, 2015 SCC 60 ("**Green**"), reaffirmed that the leave threshold articulated in *Theratech* applies equally to the leave requirement in Ontario's *Securities Act* ("**OSA**").[2]

Third, the Ontario Superior Court of Justice in *Coffin v. Atlantic Power Corp*, 2015 ONSC 3686 ("**Atlantic Power**") applied the reasoning from *Theratech* in a motion for leave under the OSA, providing useful insight into the practical application of the Supreme Court's decision.

All three of these decisions clarify that statutory leave requirements are more than a simple "speed bump" on the way to certification.[3] In *Theratech* and *Atlantic Power*, leave to bring class action claims under the QSA and the OSA was denied.

The practical consequences of these decisions are twofold. First, more will be required of plaintiffs before leave to bring a class action under the OSA is granted. Second, public issuer defendants will be provided with the opportunity, at the early stage of potential class action proceedings, to provide evidence demonstrating that the plaintiffs do not have a reasonable possibility of success.

Both of these consequences favour public issuer defendants in that they militate against plaintiffs obtaining leave to commence class actions.

Obtaining Leave and Secondary Market Disclosure Claims under the OSA

Since December 31, 2005, Part XXIII.1 of the OSA creates statutory civil liability in Ontario for secondary market disclosures that contain misrepresentations or that fail to disclose a "material change" in a timely manner.

Statutory civil liability for misrepresentations made in take-over circulars, prospectuses or offering memoranda existed before 2005. However, Part XXIII.1, and specifically section 138.3, was added to give secondary market investors the right to sue public issuers, "or a person or company with

[1] *Securities Act*, CQLR c V-1.1.
[2] *Securities Act*, RSO 1990 c S-5.
[3] *Theratechnologies Inc. v. 121851 Canada Inc.*, 2015 SCC 18 at para 38; *Coffin v. Atlantic Power Corp*, 2015 ONSC 3686 at para 18. As of publication of this article, an appeal has been filed and perfected with the Ontario Court of Appeal, but a hearing date has not been set.

actual, implied or apparent authority to act" on behalf of an issuer, on grounds that encompass misrepresentations made in documents or in public statements, or where the issuer failed to disclose a "material change" in a timely manner. So long as the investors acquire and/or dispose of a security during the impugned period of time, they will have a right of action for damages.

Before Ontario introduced this regime, investor-plaintiffs had to rely on the common law tort of negligent misrepresentation, which requires plaintiffs to demonstrate actual reliance on the alleged misrepresentation. The statutory right of action carries with it no such requirement, as liability will be found regardless of whether the person actually relied on the misrepresentation.

In order to exercise this statutory right, section 138.8 of the OSA requires that leave must first be granted by the court. It states that "no action may be commenced" for secondary market disclosure, unless the court is satisfied that:

a) the action is being brought in good faith; and

b) there is a reasonable possibility that the action will be resolved at trial in favour of the plaintiff.[4]

The requirement found in section 138.8(1)(b) was the cause of concern for many practitioners and commentators. Without appellate interpretation of the provision, it was not clear whether the section was meant to denote a relatively low hurdle for the plaintiffs to pass (akin to the certification process found at section 5(1)(a) of the *Class Proceedings Act*,[5] for example), or if the legislature intended for the section to place a more onerous requirement on potential plaintiffs.

The recent decisions in *Theratech, Atlantic Power* and *Green* suggest it is the more stringent interpretation. And these cases offer clarity as to the threshold that now has to be met by plaintiffs seeking leave.

Theratech

While *Theratech*, an April 2015 decision, dealt with provisions from the QSA concerning secondary market liability, the Supreme Court's reasoning is nevertheless applicable to other provincial securities acts given the similarities between their respective leave mechanisms.[6]

Both the motions judge and the Court of Appeal held that the proposed class action should proceed given that the plaintiffs demonstrated that their claim had a reasonable possibility of success. In a unanimous decision written by Justice Abella, the Supreme Court allowed the appeal and reversed the granting of the proposed class action.

The facts of the case were that the appellant had applied for FDA approval of a drug aimed at reducing HIV patients' excess abdominal fat. The appellant regularly informed shareholders of its clinical trials, and noted that existing side-effects were minor. The FDA subsequently referred a number of questions to the appellant, which it made public, including questions regarding the drug's potential side effects. The appellant believed the briefing documents it had already provided to the FDA, and the clinical results shared with its investors, offered a comprehensive response to these questions. The FDA's questions, however, were publicized by stock quotation enterprises, interpreted as concerns by the public, and the company's shares thereafter plummeted. Ultimately, the drug was approved and the stock price rebounded.

The plaintiff/respondent, 121851 Canada Inc., sought leave to bring a class action for damages against the appellant under section 225.4 of the QSA. It was alleged that information about the potential side effects and the FDA's questions amounted to a material change, thereby triggering timely disclosure obligations.

In the Supreme Court's decision, Justice Abella emphasized that the legislative purpose behind the statutory secondary market civil liability regime was to strike a balance between preventing unmeritorious litigation and strike suits while, at the same time, ensuring that investors have a meaningful remedy when issuers breach disclosure obligations.[7] Justice Abella noted that if the "screening mechanism" was designed to prevent unmeritorious claims, it has to be applied as something more than a "speed bump," and the claimant must offer some credible evidence to support their claims.[8] Therefore, courts must undertake a reasoned consideration of the evidence (provided by both parties) to ensure that the action has some merit.[9]

Justice Abella warned, however, that this procedure is not intended to be a mini-trial with onerous evidentiary requirements and a need to conduct a full analysis of the evidence.[10] Nevertheless, Justice Abella held that this threshold requires sufficient evidence to persuade the court that there is a realistic chance of success.[11] In this instance, the Supreme Court held that there was no reasonable possibility of success, thereby denying to grant leave.

Atlantic Power: The Application of Theratech in Ontario

Coincidentally, the same judge (Justice Belobaba) cited by Justice Abella when referring to the fact that the statutory threshold is intended to be more than a "speed bump" was also the first judge to apply the Supreme Court's *Theratech*

[4] *OSA, supra note 2 at s.138.8(1)(a)(b).*
[5] *Class Proceedings Act, SO 1992, c 6.*
[6] Similar secondary market liability and leave requirements were adopted by Alberta in 2006, Manitoba in 2007, Quebec in 2007, Saskatchewan in 2008 and British Columbia in 2008.
[7] *Theratech, supra* note *3, at para 38.*
[8] *Ibid,* para *38.*
[9] *Ibid,* para *39.*
[10] *Ibid,* para *39*
[11] *Ibid,* para *39*

analysis in a proposed secondary market disclosure class action.[12]

In *AtlaIntic Power*, an August 2015 decision, Justice Belobaba denied the plaintiffs' motion for leave under the OSA for a proposed securities class action, and also for certification under section 5(1) of the *Class Proceedings Act*. Justice Belobaba did so after a thorough analysis of the evidence provided by both sides.

The facts of the case are straightforward. The plaintiffs alleged that the CEO and CFO of Atlantic Power Corporation, a publicly-traded power generation company, misrepresented the company's ability to maintain its dividend. The plaintiffs asserted that this caused certain shareholders and debenture-holders to sustain losses when the dividend was cut and the share price dropped. There was a further claim that a "material change" had arisen when facts surrounding the dividend cut were discovered, and that the defendants had failed to make timely disclosure of their decision to reduce the dividend.

Because there was no suggestion that the action was brought in bad faith, Justice Belobaba only considered whether the plaintiffs had demonstrated a reasonable possibility that the action will be resolved at trial in their favour (as required by section 138.8(1)(b) of the OSA cited above).

The question Justice Beloboba asked was whether, after considering all of the evidence presented by the parties, any part of the plaintiffs' case had a reasonable or realistic chance of success at trial or, alternatively, was the case so weak, or was it so successfully rebutted by the defendants, that it had no reasonable possibility of success?[13]

In contrast to *Theratech*, the defendants in *Atlantic Power* took the initiative and provided the court with "substantial" evidence to demonstrate that no misrepresentations were made and that no material changes had occurred that were not disclosed in a timely manner. In fact, the defendants provided more than 14,000 electronic records, and the evidence filed on the leave motion (mainly by the defendants) filled 10 banker boxes, contained fact affidavits, expert reports, cross-examination transcripts and numerous compendia with hundreds of corporate documents, emails and board meeting minutes.[14]

Justice Belobaba made a substantive overview of the evidence before him, and when dismissing the statutory claims, concluded that the evidence demonstrated no reasonable possibility that any of the allegations levelled at the defendants would succeed at trial.[15] Despite the fact that some Atlantic Power employees had discussed the possibility of dividend cuts, Justice Belobaba relied heavily on the evidence before him indicating that the board of directors did not make a decision to cut the dividend until the day of the actual announcement. Further, Justice Belobaba held that there had not been a "material change" in the company's "business, operations or capital" that warranted any earlier disclosure requirements.[16]

Atlantic Power: Additional Point Regarding Class Certification

After dismissing the plaintiffs' statutory claim, Justice Belobaba then considered, and dismissed, the plaintiffs' attempt to certify the proceeding under the *Class Proceedings Act* with a common law claim for negligent misrepresentation.

Justice Belobaba held that common law negligent misrepresentation claims in securities cases are generally not suitable for class certification since the tort is a reliance-based one, and requires individual issues of causation and damages to be assessed for each plaintiff.[17] The preferable procedure would be to bring the claim under the OSA rubric, as the plaintiffs had unsuccessfully attempted to do. Further, Justice Belobaba relied on the evidentiary findings he made when denying the statutory claim, since both claims would rely on the same evidentiary foundation, and neither claim had a reasonable prospect of success.[18]

Green: A Reaffirmation of the Theratech Threshold

On December 4, 2015, the Supreme Court released its decision in *Green*, where the Court jointly considered the appeal of three separate cases from Ontario's lower courts. The cases were heard together because each involved respondent plaintiffs claiming damages under the common law tort of negligent misrepresentation using the *Class Proceedings Act*. The plaintiffs also each pleaded an intention to claim damages under the statutory cause of action in section 138.3 of the OSA.

The main issue in *Green* was the applicability of limitation periods. In each of the three cases, none of the plaintiffs obtained leave to commence the statutory action before commencing their respective class proceeding based on the common law cause of action. The Supreme Court had to decide whether section 28 of the *Class Proceeding Act* suspends the limitation period for a statutory claim under section 138.3 of the OSA either (a) at the time when an intention to seek leave under section 138.8 OSA is pleaded or (b) at the time when leave is ultimately granted. In a split decision, a majority of the Court held that the limitation period is suspended upon leave being granted.

The Supreme Court also briefly discussed the leave requirement and the threshold test for statutory class actions for secondary market liability (this time under the

[12] Justice Abella cited Justice Belobaba's judgment in *Ironworkers Ontario Pension Fund (Trustee of) v. Manulife Financial Corp* (2013), CPC (7th) 80 (Ont SCJ) at para 39, where he made that statement.
[13] *Atlantic Power, supra* note 3, at para 25.
[14] *Ibid,* at para 24.
[15] *Ibid,* at para 73.
[16] *Ibid,* at para 110.
[17] *Ibid,* at para 134.
[18] See conversation at *Ibid*, paras 140-146.

Ontario legislation as opposed to Quebec's statute). The Court unanimously agreed that "the threshold test under section 225.4 QSA articulated in *Theratechnologies* applies in the context of section 138.8 OSA."[19]

The Court confirmed that plaintiffs must demonstrate a reasonable possibility that the action will be resolved in their favour to obtain leave. This standard requires a reasonable or realistic chance that the action will succeed, and the plaintiffs must offer both a plausible analysis of the applicable legislative provisions, and some credible evidence in support of the claim.[20]

While the Court did acknowledge that "there may be differences in the records that need to be produced in support of the leave applications in Quebec and Ontario," it concluded by stating that this "does not affect the threshold a plaintiff must meet."[21]

The Takeaways

Theratech, Atlantic Power and *Green* are positive decisions for public issuer defendants facing secondary market misrepresentation and/or failure to disclose material change claims.

In *Theratech*, the Supreme Court accepted that the leave mechanism found in Quebec's securities legislation, similar to that found in the OSA, was designed to weed out unmeritorious claims and would require an evidentiary basis to demonstrate that the plaintiffs' allegations had a reasonable possibility of success. The Supreme Court acknowledged that this is meant to be a "robust deterrent screening mechanism," as opposed to a mere formality.[22] In *Green*, the Supreme Court explicitly stated that the *Theratech* threshold test is applicable to the leave provision found in the OSA.

Atlantic Power is equally positive for public issuer defendants since it signals that courts will accept a substantial evidentiary record from defendants when considering the plaintiffs' potential for success at trial. Justice Belobaba noted that the defendants had "made a conscientious decision to do battle from the outset" as they filed competing expert reports and also submitted "a massive amount of non-public (indeed court-sealed) internal and corporate narrative evidence to fully rebut the plaintiff's allegations…."[23]

Public issuers can rely on *Atlantic Power* to vigorously defend unmeritorious actions at an earlier stage of secondary market claims. This strategy will have to be deployed with caution, bearing in mind the Supreme Court's additional guidance that the leave process is not intended to become a "mini-trial."[24] A balanced approach will be necessary. Public issuers now have ample jurisprudential support when, and if, they decide to "do battle from the outset."

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[19] *Canadian Imperial Bank of Commerce v. Green*, 2015 SCC 60 at para 122.
[20] *Ibid*, at para 121.
[21] *Ibid*, at para 123.
[22] *Theratech, supra* note 3, at para 38.
[23] *Atlantic Power, supra* note 3, at para 23.
[24] *Theratech, supra* note 3, at para 39.

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