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The Superior Court of Québec denies certification of a proposed worldwide securities class action

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On July 29, 2022, in *Levy* v. *Loop Industries Inc. et al.*[1], the Superior Court of Québec dismissed the authorization of a securities class action in misrepresentations against a public issuer pursuant to both the *Code of Civil Procedure* (the CCP) and the Québec *Securities Act* (the QSA).

In a detailed decision, the Court concluded that the QSA requirements to authorize a statutory action in secondary market misrepresentations were not met. The only evidence offered by the plaintiff in support of the alleged misrepresentations was a short seller report. The report was prepared by a short seller with an overt interest in seeing the issuer's stock price fall, contained hearsay and did not offer any scientific evidence. The Court held that, without more evidence, the plaintiff had not shown a reasonable possibility of proving the alleged misrepresentations at trial, as required under the QSA.

With respect to the claim under Article 1457 of the *Civil Code of Québec* (the CCQ), the Court found that the plaintiff had failed to demonstrate, even *prima facie*, all the requisite elements of a civil liability claim. Namely, the plaintiff had failed to demonstrate the issuer's fault and the resulting damages.

Background

On October 13, 2020, a short-seller posted negative information on the Internet regarding Loop Industries Inc. (Loop), a publicly-traded company on the NASDAQ Global Market. Within the next few hours following dissemination of this report, multiple class actions were filed, both in the United States and Canada. Both the release of the short-seller report and the filing of proposed class actions precipitated a significant decline in Loop's stock price.

On the same day, the plaintiff filed an application to authorize a class action before the Superior Court of Québec, seeking the authorization to institute a class action pursuant to the extra-contractual civil liability regime under article 1457 of the CCQ and primary market claim under the QSA, as well as authorization to bring a secondary market action pursuant to section 225.4 of the QSA. The plaintiff was seeking to represent a class comprised of all persons and entities worldwide who had ever acquired Loop's securities in any market.

The plaintiff essentially alleged that Loop misrepresented material facts through affirmative false and/or misleading statements and through its failure to disclose the allegations

contained in the short-seller report. More specifically, the plaintiff argued that the public documents filed by Loop contain false information when it stated that the technology used by the company was revolutionary and patented.

Reasons and conclusions

The claim under the QSA

The primary market claim was withdrawn at the authorization hearing. With respect to the secondary market claim, the Court had to answer the question of whether there was a reasonable possibility that the action would be resolved in the plaintiff's favour.

At the outset, the Court emphasized that under the QSA, a misrepresentation is material when it constitutes "a fact that may reasonably be expected to have a significant effect on the market price or value of securities issued". The Court also pointed out that materiality is not presumed and must be considered at the time the representation was made.

The Court noted that the alleged misrepresentations must be assessed in the context in which they were made and that the burden is and remains on the plaintiff to show a reasonable possibility that the technology was not revolutionary and patented. It was not the defendants' burden to show that their technology was revolutionary and patented.

Applying these principles to the facts at hand, the Court essentially concluded that:

- A short seller report, in securities litigation, must be looked at in light of the goal of the "more than a speed-bump" test of the QSA, in order to prevent strike suits.
- The only evidence offered by the plaintiff was a report in which there were claims prepared by a short seller with an interest in seeing the stock price fall and did not offer any scientific evidence. Moreover, the report was solely based on hearsay.
- Without any further evidence, there was no reasonable chance, in the context of a start-up technology company, that the alleged misrepresentations were material at the time they were made.
- At the time these alleged misrepresentations were made by the public issuer, its technology was not yet commercialized, and profitability was not assured. According to the Court, a reasonable investor would have been aware that the technology was still being developed for commercial purposes and that such technology might never be successful or profitable. As acknowledged by the Court, "some revolutionary technologies are never commercialized".
- The economic viability of the technology was always presented in the most cautionary language by the public issuer in its public filings.
- The plaintiff failed to provide cogent evidence of the falsity of the alleged misrepresentations, while the defendants filed expert evidence confirming that the technology does appear to work.
- The short-seller report was not a public correction.

Therefore, the Court concluded that the secondary market claim had no reasonable chance of success and dismissed the secondary market claim under the QSA.

The Claim under Article 1457 of the CCQ

Summarizing the applicable legal principles for a class action to be authorized in Québec, the Court reiterated that the authorization stage is a filtering process to assess whether the application presents an arguable case. This being said, it is not sufficient to simply allege a misrepresentation; there must be a minimum of proof to substantiate the factual allegations of the alleged fault.

In the case at hand, referring to its conclusions under the QSA claim, the Court concluded that the authorization application did not provide sufficient factual elements to establish an arguable case. The documents filed by the plaintiff did not contain any material misrepresentation. Therefore, it was not necessary for the Court to consider the effect of the alleged public correction on the share price, as there was nothing to correct.

The Court further noted that, although the creation of the QSA statutory regime removed the burden of proving reliance, this is not the case for a claim made under the CCQ. Notwithstanding the foregoing, the present matter did not turn on the reliance of the plaintiff, as there was no arguable case that there was a material misrepresentation for him to rely upon.

Furthermore, the Court recalled that the mechanism to determine the damages under the QSA does not apply to a regular damage action under article 1457 of the CCQ. Therefore, the plaintiff still needed to demonstrate that a fault has caused damages. In this case, the plaintiff still held his shares at the authorization hearing, and therefore, the Court asked how the plaintiff could establish he had suffered damages when he could still sell his shares with a profit? Since he had decided to keep his shares, more than two years after the dissemination of the short seller report, "it seem[ed] next to impossible to relate the current share price to what happened then". In addition, the Court emphasized that the plaintiff still had a duty to mitigate his damages under the CCQ and, given the lack of information about the share price's evolution, the Court had no information about whether the plaintiff would have mitigated the damages he alleged having suffered.

The Court concluded that the plaintiff was asking it to recognize his personal cause of action, where his damages were purely speculative, and to authorize a class action which the Court refused to do.

Having concluded that the second criterion of article 575 of the CCP was not met[2], the Court also concluded that the plaintiff was not an adequate representative because he failed to demonstrate that he had a personal cause of action against the defendants.

The proposed action against the officers and directors

The Court's view was that no document was alleged to support the claim that the directors and officers made material misrepresentations.

The jurisdiction argument

The Court discussed the issue of jurisdiction, even if the proposed class action was dismissed in the end. According to the Court, the dispute was only linked to Québec residents and there was no factual allegation that would allow the Court to assume jurisdiction over the claims of residents of other Canadian provinces or other countries. Were the Court to authorize the class action, it would limit the class to Québec residents.

Comments

The present case had all the appearances of a strike suit. It began with an anonymous short seller publishing an inflammatory report accusing Loop of lying about its technological capabilities. Then, the plaintiff hastened to file a lawsuit lacking both sufficient allegations and credible evidence. The result was a statutory action for secondary market misrepresentations that had no reasonable possibility of success.

To our knowledge, this was the first time in Canada that a proposed securities class action was solely based on a short seller report. The “more than a speed-bump” test of the QSA exists to prevent strike suits filed by opportunistic parties. A short seller is, by its very nature, an opportunistic third party. The Court made it clear that it is not sufficient to solely rely on such a report, considering the very purpose of a short seller, which is to cause a significant decrease in the share price, allowing for a generous profit in return.

Moreover, it was the first time in the context of a proposed securities class action that a Québec court discussed the question of mitigation of damages at the authorization stage of a securities class action. Indeed, contrary to the QSA, the CCQ does not provide any formula to calculate damages.

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[1] The authors were counsel for the defendants in the case at hand.

[2] The first and third criterion of article 575 C.C.P. were not contested by the defendants.