OSLER

# Materiality in insider trading: recent insights from the Québec Financial Markets Administrative Tribunal

**AUG 30, 2024 8 MIN READ**

## Related Expertise

- Capital Markets
- Capital Markets Regulatory Enforcement
- Corporate and Commercial Disputes
- Corporate and Securities Disputes
- Corporate Governance

Authors: Fabrice Benoît, Sophie Courville, Anaïs Nguyen

What threshold must a proposed transaction meet to be classified as material non-public information? Pursuant to Québec's *Securities Act*, privileged information is information that is both undisclosed to the public (i.e., confidential) and susceptible of affecting the decision of a reasonable investor (i.e., material).[1] In *Autorité des marchés financiers v. Gauthier* (*Gauthier*),[2] the Financial Markets Administrative Tribunal (the Tribunal) was required to assess the confidentiality and materiality of information in the context of insider trading. As part of this assessment, the Tribunal emphasized that a proposed acquisition must have reached a certain level of transactional certainty to be considered material.

## Background

The *Gauthier* decision concerned allegations of insider trading involving the prohibited use of privileged information in the context of the proposed acquisition of Napec Inc. (Napec), a reporting issuer, by Oaktree Capital Management L.P. (Oaktree) (the Transaction). The Transaction was intended to prevent Napec from defaulting under a syndicated credit agreement.

The Financial Market Authority (the AMF) alleged that respondents Gauthier and Racine had committed insider trading by using and disclosing privileged information in violation of sections 187 to 189 of the *Securities Act.* On November 3, 2017, Gauthier participated in a conference call regarding the privatization of Napec in his capacity as an employee of a lending bank of Napec and was required to sign a confidentiality agreement. This agreement was to remain in effect until the Transaction's public announcement on December 4, 2017, and it allowed Gauthier to access information about the Transaction in the context of approving modifications to a syndicated loan agreement.

In the hour following the conference call, Gauthier reached out to a friend to endorse the buying of Napec shares. He also recommended the purchase of Napec shares at gatherings with friends, including one attended by respondent Racine, who is described as a very close friend of Gauthier. Racine subsequently bought an important number of shares in Napec. Gauthier remained engaged with the matter pertaining to amending the syndicated loan agreement and continued to obtain updates concerning the advancement of the Transaction until it was officially announced to the public.

The Tribunal found that Gauthier had disclosed privileged information about Napec to multiple persons and had provided advice on transactions using this privileged information. Racine was also found to have been involved in using and disseminating such privileged information to trade Napec securities while being aware that it originated from an insider disclosure.

Consequently, the Tribunal levied administrative penalties totalling $350,000 against Gauthier and $250,000 against Racine. It also ordered Racine to remit to the AMF the profits gained from insider trading activities in the amount of $88,398. In addition, the Tribunal imposed a five-year ban on both Gauthier and Racine, restricting their ability to engage in securities trading, except for transactions in their personal accounts under certain conditions, as well as prohibiting them from serving as directors or officers of public companies and from working as consultants or managing investment funds.

## The Tribunal's analysis on what constitutes privileged information

### Confidential nature of information

As mentioned above, privileged information in insider trading is defined as being information that is unknown to the public (confidential) and that could affect the decision-making of a reasonable investor (material).[3] In the present case, Gauthier invoked his ignorance of the Transaction on November 3, 2017, and Racine argued that the information was already public and thus not confidential, citing rumours of a potential transaction.

The Tribunal did not agree and drew a clear distinction between rumours of a potential transaction and an actual future merger or acquisition. Rumours surrounding an acquisition are merely speculative and are not considered to be publicly disclosed information, since information is only deemed "publicly known" when it is widely disseminated for the purpose of informing the market. In *Gauthier,* the information in question had only become public when the press release and material change report were filed on December 4, 2017, and was considered confidential prior to that event.

### Notion of 'transactional certainty' and the probability/magnitude test

The analysis of materiality involves determining whether the knowledge of a particular transaction would likely affect a reasonable investor's decision, and it is well established that any substantial change in a reporting issuer's status is the type of information likely to influence the judgment of a prudent investor.[3]

In *Gauthier*, the Tribunal recognized that negotiations concerning a potential or future transaction could have an impact on an investor's decision-making, but only where there is a reasonable probability that such negotiations would materialize and affect the company's share price.[4] On this basis, the Tribunal observed that, to be considered privileged, an acquisition must have reached "a certain level of transactional certainty."[5] This notion, while being a new terminology, is not novel. Indeed, it seems to reflect the "probability/magnitude test" established by the U.S. Supreme Court in *Basic Inc. v. Levinson* (*Basic*).[6]

The *Basic* case concerned the merger of two companies, including the appellant, Basic Inc. (Basic). In previous years, although representatives of the companies had held various

meetings concerning the possibility of a merger, Basic had issued public statements denying that merger negotiations had taken place. The respondents, former Basic shareholders accused of insider trading, had sold their shares between Basic's first public denial of the merger and the suspension of trading in Basic shares prior to the merger announcement.

The U.S. Supreme Court concluded that the standard for materiality should depend on whether a reasonable investor would find the disclosure of the omitted fact significant.[7] The Court rejected the "agreement-in-principle" test, according to which preliminary merger discussions would not become material until the merger partners had reached agreement on the price and structure of the transaction. Rather, the Court opted for a case-by-case approach to assessing the probability of a merger and its importance to the company. The Court thus recognized and endorsed the probability/magnitude test, which had first appeared in *SEC v. Texas Gulf Sulphur Co*., and set out a number of elements to be taken into consideration when applying such a test:

- indication of the importance of the transaction at the highest corporate levels, such as board resolutions, instructions to investment bankers, etc.
- ongoing negotiations between the parties or their intermediaries, as indicators of the transaction's potential
- various other factors, such as the size of the companies involved and the expected market value premiums

However, the Court found that no single event or factor, other than the completion of the transaction, could conclusively determine the materiality of the merger discussions.

The probability/magnitude test subsequently gained acceptance in jurisdictions across Canada, notably in Ontario, Alberta and Québec. Indeed, both the Ontario Securities Commission and the Alberta Securities Commission have incorporated this test into their assessment of materiality in insider trading cases.[8] Thus, in accordance with the test, the seriousness of acquisition negotiations has since been considered by these regulators as a key factor in determining materiality.[9]

In Québec, the Tribunal applied the probability/magnitude test in *Autorité des marchés financiers v. Bertrand* and noted the wide acceptance of the U.S. test in Canadian securities law.[10] It was then mentioned in several other decisions[11] and, finally, the application of the test was summarized in *Autorité des marchés financiers v. Baazov*. In this decision, the Tribunal ruled that, in analyzing the privileged nature of information, it should notably consider the circumstances surrounding this information, the nature and size of the issuer, and the market in which it operates. The Tribunal also found that, when analyzing the impact on the reasonable investor's decision of a contingent event, it can base its analysis "on a test of probability of the event and its impact, namely the 'probability/magnitude test'."[12]

## Potential impact of the notion of transactional certainty

The *Gauthier* decision reaffirms the principle that the threshold for the application of insider trading restrictions is not the formal approval of a transaction, but rather the moment when the transaction is considered sufficiently likely to be concluded, even if certain formalities have not yet been resolved between the parties.

It remains to be seen whether the notion of a necessary level of transactional certainty

discussed by the Tribunal could lead to a slightly modified approach by Québec regulators and courts when determining the materiality of undisclosed information and its impact on investors and the market.

---

[1] See the definition of "privileged information" at section 5 of the *Securities Act*, RLRQ, c. V-1.1.

[2] *Autorité des marchés financiers v. Gauthier*, 2024 QCTMF 26.

[3] Section 5 of the *Securities Act*, RLRQ, c. V-1.1.

[4] *Autorité des marchés financiers v. Gauthier*, supra note 1, para. 70.

[5] *Autorité des marchés financiers v. Gauthier*, supra note 1, para. 72, citing *Autorité des marchés financiers v. Roy*, 2014 QCBDR 142, para. 140.

[6] In original French : "[t]outefois, le projet d'acquisition doit avoir atteint un certain degré de certitude transactionnelle.", para. 71.

[7] *Basic Inc. v. Levinson*, 485 U.S. 224 (1988), citing *SEC v. Texas Gulf Sulphur Co.*, 401 F.2d 833 (2d Cir. 1968).

[8] The U.S. Court referenced the precedent *TSC Industries, Inc. v. Northway, Inc.*, 426 U. S. 438.

[9] *See Re Sheridan (1993)*, 16 O.S.C.B. 6345, *Donnini (Re)*, supra note 10, paras. 130 à 138, and *Holtby, Re*, 2013 ABASC 45, paras. 510–515.

[10] *Holtby, Re*, 2013 ABASC 45, paras. 510–515.

[11] *Autorité des marchés financiers v. Bertrand*, 2012 QCBDR 97 citing *Donnini (Re)*, 2002 LNONOSC 570, paras. 130 à 134; *YBM Magnex International inc. (Re)*, 2003 LNONOSC 337, para. 525; *Donald (Re)*, 2012 LNONOSC 546, paras. 205 à 207.

[12] *Autorité des marchés financiers v. Lamarre*, 2014 QCBDR 29, para. 121; *Autorité des marchés financiers v. Roy*, supra note 6, paras. 140–141; *Autorité des marchés financiers v. Pharand*, 2014 QCBDR 112, paras. 161, 409.