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When Price Drops Prove Too Much: Rethinking Materiality in Secondary Market Misrepresentation Class Actions

In secondary market misrepresentation cases, materiality does an enormous amount of work. It is the gatekeeper: no material misrepresentation, no liability. Courts therefore look for proxies – ways of inferring whether an alleged misstatement was "reasonably expected to have a significant effect on the market price or value of the securities."

One increasingly common proxy is the market's reaction to a corrective disclosure. If the share price drops "materially" after the correction, the reasoning goes, that must mean the earlier misrepresentation was itself "material."

In *Dziedziejko v Canopy Growth Corporation*, the Ontario Superior Court of Justice leaned heavily on precisely that inference. While price drops in response to a corrective disclosure may be probative, over-reliance on price drops is problematic. A post-correction price drop can signal many things to the market, only some of which relate to the materiality of the original misstatement. Courts should be careful about relying exclusively or even primarily on the fact of a price drop after a corrective disclosure in order to assess whether a misrepresentation was material.

The Case and the Decision

The proposed class action arises out of Canopy Growth's acquisition and subsequent accounting for revenues at its BioSteel subsidiary. During the proposed class period, Canopy made both quantitative disclosures about BioSteel's revenues and qualitative statements about governance, disclosure controls, and internal controls over financial reporting.

In May and June 2023, Canopy issued a series of corrective disclosures. These included admissions that previously issued financial statements "should no longer be relied upon," that revenues had been materially overstated, and that Canopy's disclosure controls and internal controls over financial reporting were ineffective.

The market reaction was swift. As the Court noted:

> “The very next day, Canopy’s shares traded at an unusually high volume, and the share price dropped by 14% on the TSX and 15% on the NASDAQ.”
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> […]
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> “Some 6 weeks later … Canopy’s stock price dropped another 12% on the TSX and 14% on the NASDAQ, all on high trading volumes.”

Taken together, the Court observed:

> “The volume weighted average price of Canopy’s shares in the 10 trading days following the final Corrective Disclosures was 62% lower on the TSX and 60% lower on the NASDAQ than it was on May 10, 2023.”

At the leave stage under section 138.8 of the Ontario *Securities Act*, the central dispute was materiality. Canopy argued the alleged misstatements – particularly those relating to BioSteel – were quantitatively immaterial in the context of Canopy’s overall financials. By contrast, the plaintiff pointed to the market reaction. Both parties filed extensive expert evidence.

The Court accepted that the price decline following the corrective disclosures was powerful evidence of materiality:

> “[81] Having said that, I am of the view that the entire expert debate is an unnecessary part of the evidentiary record. The Supreme Court of Canada has held that the share price of a company immediately dropping upon disclosure of information “demonstrate[s] the “materiality” of this information: *Danier Leather*, at para. 18. Similarly, the Ontario Securities Commission has stated, “[c]learly, if disclosure when made actually has a significant effect on the market price of securities, that is strong evidence suggesting that the test for materiality may have been satisfied at an earlier time”: *Cornish v. Ontario Securities Commission*, 2013 ONSC 1310, at para. 69.
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> [82] What is clear to the Supreme Court and to the province’s securities regulator must be equally clear to the investing public: the market impact test for materiality is met where the market has been impacted by the disclosure of the misstatements. At this point, subsequent to the Corrective Disclosures, “the market impact can be objectively determined by an examination of the stock’s subsequent price movements, and the market, reflecting economically rational investor behaviour, becomes the determinant of what the reasonable investor might think”: *Gowanlock v. Auxly Cannabis Group Inc.*

> , 2021 ONSC 4205, at para. 39.
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> [83] Plaintiff’s counsel observe that, as detailed in part II above, on release of the Corrective Disclosures there was a significant negative market impact. The Ontario Securities Commission has observed that “events that would reasonably be expected to have had a significant effect on the market price or value of Coventree [or Canopy] shares would be of interest to the reasonable shareholder or investor”: *Cornish*, at para. 78. Canopy itself has admitted to material misstatements in its financial reporting; likewise, the record shows that market analysts at a number of financial institutions found BioSteel’s abnormal growth (compared to Canopy overall) to be material to Canopy, and after the release of the Corrective Disclosures found the disclosed information to be material and lowered their target prices for Canopy’s shares.
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> [84] Accordingly, this is an instance where the market speaks louder than the experts. Ms. Peterson qualifies her views by stating that it is possible that other unknown factors caused the drops in price of Canopy’s shares. And it is true that, theoretically, an external phenomenon such as a pandemic or sudden eruption of a trade war or a ‘Black Monday’ across the broader market could cause the share price to plummet on the very day following a Corrective Disclosure. But under the circumstances, that is a purely hypothetical possibility.”

Thus, while the Court acknowledged competing expert evidence on materiality, the sharp decline in share price loomed large in concluding that there was a reasonable possibility the misrepresentations were material.

Why This Reasoning Is Problematic

The difficulty with equating a post-correction price drop with the materiality of a prior misrepresentation is that it assumes, or at least privileges, a single causal story. Markets, however, rarely react to only one thing.

A corrective disclosure does not simply reveal the truth about a past statement. It sends a bundle of new signals to the market, many of which have nothing to do with whether the original statement was material when made. For example:

- **Increased Forward-Looking Risk** – A corrective disclosure often tells the market less about the magnitude of the error and more about the issuer’s management, operations, and controls. Investors may rationally discount the value of a company once they learn that management lacked effective disclosure controls, failed to supervise subsidiaries adequately, or permitted serious accounting breakdowns to persist. That discount may reflect future risks related to management, operations, or lack of reliability of future public disclosure, not about the extent to which a specific past representation would have mattered to a reasonable investor at the time.

- **Litigation Risk** – Corrective disclosures by public issuers invariably trigger expectations of securities class actions, regulatory investigations, or both. The market should be expected to take account of the risks of damages awards, fines, insurance premium increases, defence costs, management distraction, and reputational damage, independent of the magnitude or importance of the original misstatement.
- **Uncertainty Premiums** – Corrective disclosures often increase uncertainty rather than resolve it. Investors may sell not because they have fully priced the corrected information, but because they fear more bad news is coming. This is particularly true where the initial correction is incomplete, provisional, or accompanied by language such as “should no longer be relied upon.” Markets dislike (and price) uncertainty.
- **Mechanical and Algorithmic Trading Effects** – Modern markets are not composed solely of fundamental analysts calmly reassessing intrinsic value. Event-driven trading strategies, stop-loss triggers, and algorithmic reactions can amplify price movements that have little to do with the substantive importance of the original disclosure.

The Core Analytical Issue

The core problem is one of attribution. Observing a price drop after a corrective disclosure tells us that something about that disclosure mattered to the market at that moment. It does not tell us what that is. It certainly does not tell us whether what mattered was the earlier misrepresentation.

Materiality under securities law is an *ex ante* concept. It asks whether a reasonable investor would have expected the information to significantly affect price or value at the time the statement was made – not whether the market reacted strongly once a company publicly admitted error, weakness, or exposure.

When courts treat post-correction price movement as a sufficient proxy for materiality, they risk collapsing that distinction. The result is that price drops begin to “prove too much,” converting any large post-correction price drop into retroactive evidence of materiality without considering other likely causes.

Key Takeaways

While price changes after a corrective disclosure can be probative of materiality of the original representation, courts must be careful to not allow the price change to do too much work. The focus should be on the market at the time of the misrepresentation, not the period of the initial misrepresentation. Answering the materiality question will usually require substantially more analysis than merely observing a price drop – even a significant one – in response to a correction.