

WHITEPAPER

Securities Class Action Trends: Cannabis

There has been a rise in secondary market securities class actions in the Cannabis sector following the market fluctuations that began in July 2018 and continued throughout 2019. This is reflective of:

- A significant increase in securities class actions across industries since 2015;
- Market volatility within the Cannabis sector fueling event-based securities litigation;
- Short seller interest in cannabis companies;
- An engaged Plaintiff bar specializing in securities class actions; and
- Opportunities for betterment in market/securities compliance among companies in this industry.

Notable securities class actions include: Cronos Group Inc. (following short seller activity), CV Sciences (following short seller activity), Namaste Technologies Inc., Aphria Inc. (following short seller activity), Liberty Health Sciences, KushCo, FSD Pharma, Auxley, CannTrust, Curaleaf, India Globalization Capital, Inc., Sundial Growers Inc., Canopy Growth Corporation, Aurora Cannabis Inc., HEXO Corp., Trulieve Cannabis Corp. (following short seller activity) and Wayland Group Corp.

The vast majority of these actions are in their infancy. Time will tell whether they have enough substance to surmount the gatekeeping procedures in place to weed out unmeritorious actions. Nonetheless, in addition to any indemnity exposure, the proliferation of these actions has undoubtedly impacted loss ratios with ongoing and mounting defence costs for the insurers who have underwritten these companies.

Recent Class Action Developments:

We note that the class action naming Cronos Group Inc., which was launched following short seller activity and centered on allegations that Cronos misrepresented the size of its distribution agreements with Canadian provinces, was voluntarily dismissed in Q1 of 2019.

Namaste Technologies Inc. settled (subject to court approval) its US and Canadian class actions related to alleged misrepresentations concerning Namaste's selling off its US operations in December of 2017. Settlement amounts are \$2.15 million USD for the Canadian action and \$2.75 million USD for the US action, with no admission of liability.

Namaste's total contribution to the Canadian and US settlements is approximately \$500,000 USD, with the remainder being funded by Namaste's insurance.



Regulators Have Taken Notice

We have observed increased attention from regulators with respect to the cannabis industry. Health Canada, for instance, has engaged in several license infraction enforcement proceedings, focusing on unlicensed growing and storage facilities. The Canadian Securities Administrators released notice 51-359 in November of 2019 drawing attention to transparency and disclosure issues in a number of merger and acquisition transactions in the industry, as well as corporate disclosures relating to director independence.

Further, some provincial securities regulators, notably British Columbia and Ontario, announced several investigations into cannabis companies in 2019. As welcome as regulatory attention may be for market oversight, and aside from the direct impact arising from enforcement orders and penalties, regulator announcements and investigative findings are a spawning ground for securities class actions. Based on current trends, we expect a high level of regulatory scrutiny on the cannabis industry in 2020.

Final Notes

Currently, cannabis is a challenging industry segment from a securities litigation and regulatory perspective. The market for crucial coverage, such as Director and Officer liability policies, has tightened.

To help weather this storm and decrease underwriting hesitancy going forward, we suggest insureds focus on risk mitigation strategies, which could include:

- Stringent compliance with regulatory requirements;
- Designing and adhering to internal controls and oversight monitoring to deal with, among other things, regulatory and short seller scrutiny;
- Fostering a 'culture of compliance';
- The prompt release of any negative news; and
- A timely response to disclosure criticism.

The cannabis insurance market continues to evolve at a rapid pace. Insurance brokers keep on top of the latest developments and can help you address any coverage gaps in your insurance program and deliver options that align with the specific risks and exposures of your business.

HEIGHTENED RISK EQUATES TO A HARD INSURANCE MARKET

Insurers have signaled that they consider Cannabis to have a high-risk profile. It should be noted that dual-listed companies have increased risk, as they are exposed to parallel CAN/US actions, including parallel regulatory proceedings.

We anticipate that this risk profile will continue until markets stabilize, the frequency of claims diminishes, and limitation periods associated with large market fluctuations begin to expire.

Our Cannabis and D&O Specialists Provide Expert Guidance

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