

# Risk management strategies for your cannabis business during COVID-19 and beyond

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# What your budding business needs to know about the current cross border class action landscape

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# Meet our presenters



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# U.S. securities class action landscape



# U.S. securities class actions

- Increasing in number
- Against company, directors and officers
- Material misrepresentation or omission -- e.g., over-touted acquisition, business line, operations, finances/valuations/projections; omitted business activity or regulatory/legal issue -- with a decline in stock value
- Defenses: inappropriate lead plaintiff or class; pleadings lack specificity; facts adequately known, disclosed, or disclaimed; statements mere “puffery” or opinion; stock drop unrelated;
- Expensive, with risks of treble damages and run-away juries, so often brought by plaintiff lawyers for settlements

# Canada securities class action landscape

# Securities class actions – Canada (except Québec)

- **Secondary market exposure** – claims against company, directors and officers for misrepresentation or failure to make timely disclosure of material changes
- **Defences:** (1) Reasonable Investigation – before the release of the document the defendant conducted a reasonable investigation and the defendant had no reasonable grounds to believe that the document contained the misrepresentation; and (2) defendant can prove that decline in share price attributable to factors other than misrepresentation (e.g., decline in share prices for companies in that sector)
- **Liability limits:** Company - Greater of \$1 million and 5% of market cap; Director and Officer: Greater of \$25,000 and 50% of compensation from company and affiliates (do not apply for D&Os if conduct intentional)
- **Leave test:** Claim must be in good faith and have reasonable possibility of success

# Securities class actions - Canada (except Québec)

- **Claims for misrepresentation in public disclosure including:**
  - Operating in compliance with applicable law including licenses and permits, as well as complying with code of business conduct and ethics
  - Company's financial statements fairly presented company's financial position and prepared in accordance with IFRS
  - Company had adequate internal financial and disclosure controls and procedures
  - Inflating value of assets
  - Undisclosed related party transactions or benefits

# Québec class action landscape

# Securities class actions - Québec

- **Similar landscape to Ontario** – four class action applications filed in 2019 mirroring allegations from Canadian security class actions filed in Ontario. No authorization judgment yet.
- **Secondary market exposure under the *Québec Securities Act (QSA)***: claims against the company, directors and officers for misrepresentations or omissions (financial results and production forecasts, certainty of supply contracts, expected synergies from acquisitions, expansion of facilities, product quality, licenses and regulatory compliance)
- **Plaintiff's burden of proof:**
  - **Two rebuttable presumptions under the QSA:** (i) **reliance** on the false or misleading information, and (ii) the **loss of value** of security is due to the corrective disclosure of the misrepresentation.

# Securities class actions - Québec

- **Plaintiff's burden of proof:**
  - The plaintiff must prove that **the defendant knew**, at the time the document was released or the public oral statement was made, that the document or public oral statement contained a misrepresentation **or deliberately avoided acquiring such knowledge** at or before that time, **or committed a gross fault** in connection with the release of the document or the making of the public document.
- **Defences:**
  - Plaintiff's knowledge of the misrepresentation or material change;
  - Reasonable investigation by the Defendant and no reasonable grounds to believe that the document or public oral statement would contain a misrepresentation or that the failure to make timely disclosure would occur.
- **Limit of liability and Authorization test under the QSA:** same as ON

# Security class actions – Québec

- **Liability under the *Civil Code of Québec (CCQ)*:**
  - General duty of diligence or care under Article 1457 CCQ: the requisite elements for a civil claim in damages based on extra-contractual liability: (i) that the defendant committed a fault, (ii) that the plaintiff suffered an injury, and (iii) that there is a causal link between the fault and the injury.
  - The Plaintiff does not benefit from the same presumptions as under the QSA;
  - Causality without reliance;

# Product liability – U.S. class action landscape

# U.S. product liability risks

- Different states permit different products, but throughout the U.S. almost every kind of cannabis or CBD products sold
- Cases against cannabis companies slow to start
  - Mostly because (a) the cannabis isn't very dangerous, (b) products generally well tested; and (c) filing a complaint requires a felony admission
  - More about regulatory violations or recalls
- Hemp CBD class actions -- mislabeling or adulteration because product illegal under FDCA
- Current biggest risk: false claims, health claims, adulterations
- Likely see claims around edibles and dosing

# Product liability in Québec

# Product liability risks - Québec

- **Québec Cannabis Regulation Act:** sets standards for production quality and promotion of cannabis
- **Warranty of quality regime under the CCQ:** the seller guarantees to the buyer that the property is free of "latent defects". A latent defect refers to a defect that renders the good unfit for the use for which it is intended.
- A presumption of liability is attached to the existence of a latent defect when the good is sold by a professional seller. The burden of proof is reversed in product liability claims subject to Quebec law.
- **Extra-contractual liability of the manufacturer or seller:** obligation of safety and a duty to inform. A manufacturer is presumed to know the risks and dangers created by its product, as well as any manufacturing defects from which it may suffer. The plaintiff's burden ends with the demonstration that the product does not afford the security a person is entitled to expect.
- **Similarities to medical product class actions:** existing jurisprudence on medical product class actions will likely serve as reference in the analysis of the defendant's liability

# Consumer protection and privacy risk

# Canadian common law product liability risks

- ***Cannabis Act and cannabis regulations***

- Licensed Producers must comply with statutorily mandated good production practices and operating procedures to ensure product quality
- Prohibits promotion of cannabis in a false, misleading or deceptive manner
  - *Class members may rely on cannabis regulations to inform the alleged duties of care owed to the consumer class*

- **Consumer protection and sale of goods regulation**

- Provincial statutes generally address implied warranties regarding quality/fitness or implied condition of merchantable quality
- Regulates deceptive acts or practices including representations made by suppliers in a consumer transaction
  - *Class members must demonstrate a workable methodology at certification to establish alleged harm including negative health impacts*

# Canadian common law privacy risks

- **Cannabis businesses must comply with regulations regarding the collection, use and disclosure of personal information:**
  - Includes the collection of personal information about clients for business purposes such as customer relations, marketing and sales records
  - Increased security safeguards for “sensitive personal information”
  - Mandatory breach notification provisions if there is a real risk of significant harm to an individual
- **Increase in class actions related to alleged privacy breaches:**
  - External data breaches by malicious actors
  - Employment related privacy incidents including from rogue employees (using data for personal gain) and employee loss of data (lost or stolen storage devices)
  - Collection or disclosure of personal information without consent

# Top ten tips

1. Review existing disclosure and guidance in context of COVID for compliance with accounting standards and securities laws
2. If you think it may be necessary to restate any financial disclosure, carefully review the options with counsel and the auditor first – a restatement is an invitation to a securities class action
3. Review and refresh company disclosure, compliance and code of conduct policies for directors, officers and employees
4. Check insurance coverage – Does it cover securities and product claims? Does the company and its D&Os have sufficient coverage?
5. Directors and officers should ensure they have adequate indemnities in place with the company
6. Involve attorneys with specific knowledge of cannabis laws and the industry
7. Keep detailed records of all compliance efforts including privacy impact assessments
8. Review policies regarding security of sensitive personal information as employees return to work
9. Ensure compliance with applicable Health Canada regulations, including pesticide regulations, and implement vigilant testing of crops to ensure that all safety standards are met
10. Adopt proactive risk mitigation strategies after discovering a product issue

# Thank you

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