Cassels

Outlook 2020: A New Crop of Securities Class Actions and Amendments to the Class Proceedings Act

Robert B. Cohen, Kate Byers

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Following several years in which the number of class actions declined (as we reported in 2018 and 2019), 2019 saw the filing of the second-highest number of securities class actions in Canada since the introduction of the secondary market liability regime, largely in the cannabis space.[1] It remains to be seen whether amendments to Ontario's *Class Proceedings Act* ("CPA") that came into effect this fall, which are largely defendant-friendly, will have a chilling effect on this trend.[2]

Cannabis Securities Class Actions Growing Like Weeds

Since the enactment of Part XXIII.1 of the Ontario *Securities Act* in 2006 and the creation of a statutory cause of action for secondary market disclosure misrepresentations, proposed class actions that rely upon these legislative provisions have flourished. According to statistics gathered by NERA Economic Consulting,[3] there has been a fairly consistent number of new class action filings in Canada over the last decade in a variety of industries, with an average of seven or eight new secondary market class action claims being commenced each year. In 2019, fourteen new secondary market class actions were commenced, well above the 6 secondary market claims that had been issued in the previous year. So why the bump?

In the latter part of 2018, the Canadian government passed the *Cannabis Act*, S.C. 2018, c.16, which was designed to, among other things, regulate the production, distribution, marketing, and sale of recreational cannabis. The public markets seized upon the widespread optimism and the new opportunities that came with its legalization. Since that time, the industry has been subject to significant restrictions and oversight by securities regulators and licensing authorities. Consequently, the volatility of the market, along with the dashed dreams of many investors, has caught a number of industry players in a web of litigation.

At the time that the *Cannabis Act* was passed by Parliament in the latter part of 2018, CSA Staff Notice 51-357 was published.[4] In that Notice, Staff advised that the disclosure of 70 reporting issuers who had been operating in the cannabis industry in Alberta, British Columbia, Ontario, and Québec had been reviewed, and that Staff had identified industry specific disclosure deficiencies, including:

- Licensed cannabis producers had failed to provide sufficient information in their financial statements and their MD&A for an investor to understand their financial performance, especially insofar as

information that related to recording growing cannabis plants at their fair value;
- Some issuers had failed to consistently comply with securities requirements for forward looking information and in their guidance for providing balanced disclosure; and
- Almost 75% of the issuers with cannabis operations in the United States had failed to provide sufficient disclosure about the risks related to their US operations.

In November of 2019 and as a consequence of significant growth and activity in the cannabis sector, CSA Multilateral Staff Notice 51-359 was published to outline the regulators' additional areas of concern.[5] In that Notice, Staff of the securities regulatory authorities in each of Ontario, British Columbia, Québec, New Brunswick, Saskatchewan, Manitoba, and Nova Scotia highlighted deficiencies respecting the disclosure of conflicts of interest and inadequate transparency relating to the cross-ownership of financial interests, especially in connection with mergers, acquisitions, and other significant corporate transactions. The Notice also cited examples of deficient disclosure relating to corporate governance.

Not surprisingly, these Notices also prophesized (or recorded) the battleground for securities class actions in the cannabis industry, and in 2019 and 2020, several proposed class actions alleging secondary market liability against cannabis industry issuers (and, in some cases, against their officers, directors, auditors, and underwriters) were commenced, including:

- *Miller v. FSD Pharma, Inc*. (Ontario Superior Court), where the plaintiff alleged that FSD Pharma made misrepresentations in its MD&A with respect to the timing for completion of a construction project for its cannabis operations, as well as in a subsequent press release designed to correct the misrepresentation in the MD&A. The plaintiff obtained leave to proceed in 2020 and the case recently settled;[6]
- *Earle v. CannTrust Holdings Inc. et al* (Ontario Superior Court), where the plaintiffs claim that public statements made by CannTrust in relation to its compliance with cannabis licensing requirements were false, after it was reported that CannTrust was illegally producing and selling cannabis from unlicensed locations, which caused a massive drop in CannTrust's share price, an OSC cease trade order, and CannTrust's ultimate application for creditor protection pursuant to the *Companies' Creditors Arrangement Act* (Canada);[7]
- *Miller v. HEXO Corp.* (Quebec Superior Court), where the plaintiffs allege that HEXO made false representations in press releases and other disclosure documents about the expected revenues from a contract of cannabis supply with the Quebec government and the expected revenues to be generated in the acquisition of another cannabis producer;[8]
- *Dillon v. Wayland Group Corp.* (Quebec Superior Court), where the plaintiffs claim that there were misrepresentations pertaining to the timing and cost of Wayland's expansion of its cannabis growing facility in Langton, Ontario, including the funding of that expansion and the amount of cannabis production that Wayland could achieve in 2019;[9] and
- *Harpreet v. Cronos Group Inc.* (Ontario Superior Court), where the plaintiffs allege that Cronos inflated its revenues from cannabis products by improper accounting from bulk transactions, and

misrepresented those revenues in interim financial statements, in its MD&A, and in press releases.[10]

The cannabis sector must also still grapple with traditional product liability class actions, like *Organigram Holdings Inc. v. Downton* (Nova Scotia) in which the plaintiffs allege negligent design, development, and testing of cannabis products following the discovery that the defendant's products contained pesticides that had not been authorized for cannabis use, leading to a Health Canada recall.[11] And in Alberta, another proposed class action (*Langevin v. Aurora Cannabis Inc. et al*) was commenced in which the plaintiff alleges that a large number of cannabis manufacturers and distributors violated consumer protection laws by falsely labelling the THC and CBD content on their packaging.[12]

What's next for the cannabis industry? Our view is that the ongoing disclosure of issuers will continue to attract intense scrutiny from regulators and participants in the public markets, especially considering the volatility of this market and the negative publicity surrounding some of the large players in cannabis production and sales. We also expect to see a surge of securities class actions against cannabis companies in the US (including Canadian companies listed on US exchanges), which are similarly focused on disclosure deficiencies. In fact, NERA has reported that 8 out of the 12 US securities class actions commenced in 2019 against cross-listed Canadian companies carried on business in the cannabis industry.[13] This may continue until class counsel determine that this is not a fruitful avenue for potential claims, which may coincide with growing maturity and progress in the cannabis industry in respect of statutory and financial disclosure.

Whoa – What about the Recent Amendments to the Class Proceedings Act (Ontario)?

On September 17, 2020, Ontario's Attorney General announced that proposed amendments to the *Class Proceedings Act, 1992* pursuant to Bill 161 were proclaimed in force effective October 1, 2020 (these amendments only apply to claims commenced after that date and do not apply retroactively). The amendments are most notable for providing a more restrictive test for certification of a class proceeding, and in particular, that in order to be certified, a class action must propose common issues that *predominate* over individual ones, and the proposed action must also be *superior* to any other reasonably available means of resolving the claims of the plaintiff class or the conduct of the defendant (similar to certification rules in the United States). Other amendments suggest that it will be more difficult for plaintiffs to successfully prosecute class actions or related proceedings, including:

- Preliminary motions that may narrow or dispose of issues in a proceeding can be brought by defendants in advance of certification motions;
- Automatic dismissal of class actions after one year, unless certification materials have been filed by the plaintiffs or a timetable has been agreed to or fixed by the Court; and

- Tolling period for limitations periods has been amended to allow for limitation periods to run against class members once they are no longer actively involved in the class action.

On the other side of the coin, the amendments have clarified prior inconsistent case law relating to the three-year limitation period for proposed class actions that are commenced pursuant to Part XXIII.1 of the *Securities Act*. In particular, the amendments confirm that secondary market liability class actions will be considered to have been "commenced" upon the issuance of the originating process, and not at the time of the mandatory motion for leave to proceed pursuant to Part XXIII.1 of the *Securities Act* (to address previous cases where limitation period defences accrued after the issuance of the claim but before the motion for leave could be scheduled or heard).

What impact will all of these amendments have on Part XXIII.1 claims going forward? Time will tell, but considering the high stakes often involved with these class actions, it is unlikely that plaintiffs' counsel with significant, reasonable secondary market claims will be deterred. However, there may be an inclination by class counsel to proceed with their claims in provinces other than Ontario. That said, the additional procedural hurdles that have arisen by the amendments to the CPA should at least weed out some of the more dubious claims at earlier stages and allow targeted defendants to move forward with their business without the smoke of class action proceedings looming indefinitely.

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[1] *Trends in Canadian Securities Class Actions: 2019 Update*, NERA Economic Consulting, March 19, 2020, at p. 2, online: <https://www.nera.com/content/dam/nera/publications/2020/PUB_2019_Recent_Trends_Canada_0320.pdf> [NERA].

[2] The amendments to Ontario's *Class Proceedings Act* contain a transition provision wherein class proceedings commenced before October 1, 2020 (the date the amendments come into force) are governed by the previous CPA and any new class proceeding commenced after October 1, 2020 is subject to the amended CPA. As such, the increase in new class proceedings up to October 2020 may be an attempt by class counsel to ensure that their claims are governed by the former statutory regime.

[3] NERA at p. 3.

[4] CSA Staff Notice 51-357, "Staff Review of Reporting Issuers in the Cannabis Industry".

[5] CSA Multilateral Staff Notice 51-359, "Corporate Governance Related Disclosure Expectations for Reporting Issuers in the Cannabis Industry".

[6] *Miller v FSD Pharma, Inc.*, 2020 ONSC 2253 [*Miller*].

[7] *Earle v CannTrust Holdings Inc*., 2020 ONSC 579.

[8] *Miller v HEXO Corp*, Court File No. 500-06-001029-194.

[9] *Dillon v Wayland Group Corp*., Court File No. 500-06-001020-193.

[10] *Harpreet v Cronos Group Inc. et al*, Court File No. CV-20-00641990-00CP.

[11] *Organigram Holdings Inc. v Downton*, 2020 NSCA 38.

[12] *Langevin v. Aurora Cannabis Inc. et al*, Court of Queen's Bench of Alberta, Court File No. 2001-07541.

[13] NERA at p. 4.
