

CANNABIS SECURITIES LITIGATION

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I. INTRODUCTION

This Article examines the rise of securities litigation related to the cannabis industry. Cannabis securities class action litigation commenced in 2014, and by June 2022 there had been at least thirty-four such filings.¹ Twenty-three of the filings occurred during the years 2019–2021.² This development is expected to continue, driven by multiple factors.

The rise of cannabis securities litigation reflects two broader litigation trends. The first is the rise of event-driven securities litigation (“EDSL”). In a standard event-driven case, the defendant company’s stock price drops following the disclosure or occurrence of a negative event that plaintiffs link to prior soft statements by the company that it was in regulatory compliance, its internal controls were effective, or it adhered to its corporate code of conduct or ethics.³ The underlying theory in most of these actions is that the occurrence or event upon which the case is based was the materialization of an undisclosed or under-disclosed risk that caused a stock price drop.⁴ This differs from traditional accounting or financial fraud cases, which historically dominated

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¹ *Current Trends in Securities Class Action Filings, Cannabis*, STANFORD L. SCH., SEC. CLASS ACTION CLEARINGHOUSE, <https://securities.stanford.edu/current-trends.html> (last visited June 15, 2022); Robert Becher & Colin Gillespie, *Quinn Emanuel Cannabis Litigation Practice Alert: Recent Stock Drop Securities Actions in the Cannabis Industry*, QUINN EMMANUEL URQUHART & SULLIVAN, LLP (Dec. 3, 2019), <https://www.quinnemanuel.com/media/0gkbyflg/cannabis-securities-action.pdf>.

² *Current Trends in Securities Class Action Filings, Cannabis*, STANFORD L. SCH., SEC. CLASS ACTION CLEARINGHOUSE, <https://securities.stanford.edu/current-trends.html> (last visited June 15, 2022).

³ See, e.g., *In re Eletrobras Sec. Litig.*, 245 F. Supp. 3d 450, 463–64 (S.D.N.Y. 2017) (EDSL involving foreign bribery); *In re Petrobras Sec. Litig.*, 116 F. Supp. 3d 368, 381 (S.D.N.Y. 2015) (same).

⁴ Jeffrey Lubitz & Elisa Mendoza, *Event Driven Securities Litigation: The New Driver in Class Action Growth* 4, INSTITUTIONAL S’HOLDER SERVS. (Dec. 1, 2020), <https://www.issgovernance.com/library/event-driven-securities-litigation-the-new-driver-in-class-action-growth/> [hereinafter *New Driver*] (“The main theory in the event-driven cases is that the occurrence or event upon which the case is based was the materialization of an under-disclosed or downplayed risk.”).

the securities class action domain.⁵ Plaintiffs usually initiate standard accounting fraud cases following a corrective disclosure—in which a company corrects a false or misleading statement or omission—that is alleged to have caused a price drop.⁶ EDSL and the subset of cannabis securities litigation have recently become major drivers of securities litigation and concurrently have generated substantial controversy.⁷

The second trend reflected by the spike of cannabis securities cases is the rise of litigation stemming from the common use of special purpose acquisition companies (“SPACs”). A SPAC is a modified version of a “blank check” company⁸ and has no operating history or assets.⁹ A SPAC is formed for the purpose of raising capital in an initial public offering (“IPO”) and using that capital to acquire a target¹⁰—such as a cannabis-related business (“CRB”). The target is usually private and then taken public by the SPAC.¹¹ Although SPACs have existed since the early 1990s,

⁵ See John C. Coffee, Jr., *Securities Litigation in 2019: Predictions and Speculations*, N.Y. L.J., at 5 (Jan. 17, 2019)

[T]he character of securities litigation has recently changed. Once, securities class actions were largely about financial disclosures. . . . In this world, the biggest disaster was an accounting restatement. Now the biggest disaster may be a literal disaster. . . . The best characterization for this new type of securities litigation is that it is ‘event-driven’ litigation.

⁶ See *Ark. Teachers Ret. Sys. v. Goldman Sachs Grp., Inc.*, 879 F.3d 474, 480 n.3 (2d Cir. 2018) (“A ‘corrective disclosure’ is an announcement or series of announcements that reveals to the market the falsity of a prior statement.”).

⁷ See *New Driver*, *supra* note 4, at 2 (“[T]he trend of event-driven litigation is rising each year, while the more traditional accounting-based allegations are on the decline.”).

⁸ The Securities and Exchange Commission (“SEC”) defines a blank check company as “a development stage company that has no specific business plan or purpose or has indicated its business plan is to engage in a merger or acquisition with an unidentified company or companies, other entity, or person.” *Blank Check Company*, U.S. SEC. AND EXCH. COMM’N, <https://www.investor.gov/introduction-investing/investing-basics/glossary/blank-check-company> (last visited June 15, 2022).

⁹ Daniel S. Riemer, Note, *Special Purpose Acquisition Companies: SPAC and Span, or Blank Check Redux?*, 85 WASH. U. L. REV. 931, 933 (2007).

¹⁰ Michael Klausner, Michael Ohlrogge & Emily Ruan, *A Sober Look at SPACs*, HARV. L. SCH. F. ON CORP. GOV. (Nov. 19, 2020), <https://corpgov.law.harvard.edu/2020/11/19/a-sober-look-at-spacs/>.

¹¹ Usha Rodrigues & Mike Stegemoller, *Exit, Voice, and Reputation: The Evolution of SPACs*, 37 DEL. J. CORP. L. 849, 870 (2013).

their use did not explode until recently.¹² In 2020, the use of SPACs became the dominant method for companies to go public in the United States,¹³ and billions of dollars have been raised in cannabis-focused SPACs.¹⁴ The ubiquity of SPACs has attracted the attention of the plaintiffs' class action bar. More than sixty SPAC-related securities class actions were filed during the period of January 2019 to June 2022.¹⁵

This Article proceeds in four parts. Part II examines the rise of EDSL. Part III analyzes cannabis securities litigation as an aspect of EDSL. Part IV examines the exponential growth of SPACs, their use in the cannabis industry, and the proliferation of SPAC-related litigation. Part V sets forth specific recommendations for cannabis industry players seeking to minimize their risk of confronting securities class action and shareholder derivative litigation. The Article then concludes.

¹² See Max H. Bazerman & Paresh Patel, *SPACs: What You Need to Know*, HARV. BUS. REV. (July-Aug. 2021), <https://hbr.org/2021/07/spacs-what-you-need-to-know>.

¹³ See *id.* ("In 2020, SPACs accounted for more than 50% of new publicly listed U.S. companies."); Stefania Palma & Nikou Asgari, *SEC Chair Orders Staff to Recommend New Investor Protections for SPACs*, FIN. TIMES (Dec. 9, 2021), <https://www.ft.com/content/22dcc2fe-f902-40cb-88cb-bcd1cb5ebfa0> (reporting that SPACs have "become Wall Street's hottest investment product over the past year").

¹⁴ See, e.g., Charlie Innis, *Rimon, Schiff Hardin Steer Cannabis SPAC's \$200M IPO*, LAW360 (Nov. 30, 2021), <https://www.law360.com/articles/1444302/rimon-schiff-hardin-steer-cannabis-spac-s-200m-ipo> (reporting IPO of cannabis SPAC Canna-Global Acquisition Corp.).

¹⁵ *Current Trends in Securities Class Action Filings, SPACs*, STANFORD L. SCH., SEC. CLASS ACTION CLEARINGHOUSE, <https://securities.stanford.edu/current-trends.html> (last visited June 15, 2022).

II. EVENT-DRIVEN SECURITIES LITIGATION

Securities class action litigation has transformed in recent years to increasingly encompass event-driven cases.¹⁶ Complaints filed in securities class actions asserting violations of Section 10 of the Securities Exchange Act of 1934 (“Exchange Act”) and companion Rule 10b-5, Section 11 of the Securities Act of 1933 (“Securities Act”), and/or Section 12 of the Securities Act are commonly referred to as core or standard filings.¹⁷ From 2009 to 2014, fifty-one to sixty-eight percent of the core filings alleged (a) false statements in the defendant company’s financial statements and/or (b) false projections of defendant’s future earnings.¹⁸ During these years and earlier, plaintiffs made many of the filings after defendant companies announced restatements of their financial statements.¹⁹ Major event-driven filings also occurred, and while they date back at least as early as 2010, they were uncommon.²⁰

¹⁶ See, e.g., Adam Hakki, et al., *Civil Litigation Update: Major Civil Cases*, SIFMA Compliance & Legal Society 2020 Annual Seminar 3 (Mar. 10, 2020), <https://www.sifma.org/wp-content/uploads/2020/03/TA1-Civil-Litigation-Update-Securities-Class-Actions-and-other-Major-Civil-Cases.pdf> (“The biggest change in the realm of securities litigation has been the rise of the event-driven securities fraud lawsuit.”); Client Memorandum, *Mitigating Securities Litigation Risks Related to the Coronavirus*, PAUL, WEISS, RIFKIND, WHARTON & GARRISON LLP (Mar. 5, 2020), <https://www.paulweiss.com/practices/litigation/securities-litigation/publications/mitigating-securities-litigation-risks-related-to-the-coronavirus?id=30788> (“The last few years have seen a dramatic increase in ‘event-driven’ litigation.”).

¹⁷ 15 U.S.C. § 78j(b); 15 U.S.C. § 77(k); 15 U.S.C. § 77(l); Employment of Manipulative and Deceptive Devices, 17 C.F.R. § 240.10b-5(b) (2022).

¹⁸ See Stefan Boettrich & Svetlana Starykh, *Recent Trends in Securities Class Action Litigation: 2018 Full-Year Review* 17, NERA ECONOMIC CONSULTING (Jan. 29, 2019), https://www.nera.com/content/dam/nera/publications/2019/PUB_Year_End_Trends_012819_Final.pdf [hereinafter *2018 Full-Year Review*].

¹⁹ See Matthew C. Moehlman, *The Ascendancy of “Event-Driven” Securities Cases*, POMERANTZ MONITOR (May/June 2018), <http://pomerantzlawfirm.com/publications/2018/6/4/the-ascendancy-of-event-driven-securities-cases> (“Fifteen years ago, securities fraud often came to light when a company restated its past financial results.”).

²⁰ See Reynolds Holding, *Breakingviews—Holding: Investors Ignore Law of “Stuff Happens,”* REUTERS (Apr. 11, 2019, 10:43 AM), <https://www.reuters.com/article/us-usa-fraud-breakingviews/breakingviews-holding-investors-ignore-law-of-stuff-happens-idUSKCN1RN210> [hereinafter *Stuff Happens*] (noting that EDSL was “relatively rare before 2017”). An early example of EDSL is the litigation begun in 2010 against Massey Energy Co., following an explosion at its Upper Big Branch mine in West Virginia that killed twenty-nine miners. See *In re Massey Energy Co.*

The landscape has evolved since then. From 2015 to 2018, the share of core filings that alleged (a) false statements in the defendant company's financial statements and/or (b) false projections of defendant's future earnings never reached fifty percent.²¹ By 2016, only ten percent of class action filings included allegations related to false projections of future earnings, and that downward slope has continued.²² Simultaneously, both financial statement restatements and the fraction of core filings alleging a restatement sharply declined. The number of restatements spiked in the years immediately following the enactment of the Sarbanes-Oxley Act of 2002 and has plunged since then.²³ Since peaking in 2006, the number of annual financial restatements has declined by more than eighty percent.²⁴ In 2020, only eighty companies issued restatements, as compared with more than three hundred companies in 2011, and a mere five percent of core securities class action filings alleged a restatement, as compared with nineteen percent in 2014.²⁵

Sec. Litig., 883 F. Supp. 2d 597 (S.D. W.Va. 2012) (denying motions to dismiss consolidated amended class action complaint). This case settled for \$265 million in 2014. *See The Top 100 U.S. Class Action Settlements of All-Time*, Institutional Investor Services 1, 9 (2022), <https://www.issgovernance.com/library/the-top-100-us-class-action-settlements-of-all-time-as-of-december-2021/>.

²¹ *2018 Full-Year Review*, *supra* note 18, at 17.

²² Stefan Boettrich & Svetlana Starykh, *Recent Trends in Securities Class Action Litigation: 2016 Full-Year Review* 1, 15, NERA ECONOMIC CONSULTING (Jan. 23, 2017), https://www.nera.com/content/dam/nera/publications/2017/PUB_2016_Securities_Year-End_Trends_Report_0117.pdf.

²³ Sarbanes-Oxley Act of 2002, Pub. L. No. 107-204, 116 Stat. 745 (2002).

²⁴ *2020 Financial Restatements: A Twenty-Year Review* 1, 4 AUDIT ANALYTICS (Nov. 2021), https://www.auditanalytics.com/doc/2020_Financial_Restatements_A_Twenty-Year_Review.pdf.

²⁵ Nicola M. White, *Pervasive SPAC Accounting Error Prompts Mass Restatements*, BLOOMBERG TAX (July 26, 2021, 4:46 AM), <https://news.bloombergtax.com/financial-accounting/pervasive-spac-accounting-error-prompts-mass-restatements>; *Securities Class Action Filings: 2020 Year in Review* 1, 11, CORNERSTONE RESEARCH (2021), <https://www.cornerstone.com/Publications/Reports/Securities-Class-Action-Filings-2020-Year-in-Review> [hereinafter *2020 Year in Review*]; *Securities Class Action Filings: 2018 Year in Review* 1, 10, CORNERSTONE RESEARCH (2019), <https://securities.stanford.edu/research-reports/1996-2018/Cornerstone-Research-Securities-Class-Action-Filings-2018-YIR.pdf>.

Notwithstanding the diminishing share of cases alleging financial fraud and the simultaneous sharp reduction in the number of companies listed on the Nasdaq and the New York Stock Exchange (“NYSE”), the overall number of securities class action filings reached historically high levels from 2015 to 2020.²⁶ In 2020, the ratio of new filings to listed companies declined to 5.7 percent, but this measure was still higher than the annual ratios during the first twenty years following the enactment of the Private Securities Litigation Reform Act (“PSLRA”)²⁷ in 1995.²⁸ New securities class action filings declined again in 2021, to 218, but even this number exceeded the mean number of filings during the period of 2012 to 2016.²⁹

Two primary factors explain the expansion of securities class action litigation in an era in which financial fraud cases have declined and there are significantly fewer publicly listed companies. First, beginning in 2016, cases in which plaintiffs objected to mergers and acquisitions (“M&A”) migrated from the Delaware Court of Chancery to federal district courts in Delaware or other states. The federal filings commonly allege a violation of Section 14(a) of the Exchange Act, which prohibits material misrepresentations and omissions in proxy solicitations associated with registered securities.³⁰ In 2020, M&A objection filings

²⁶ From 1996–2020, the number of U.S.-listed companies plunged by thirty-five percent, from 8,783 to 5,720. Janeen Mcintosh & Svetlana Starykh, *Recent Trends in Securities Class Action Litigation: 2020 Full-Year Review* 1, 2, NERA ECONOMIC CONSULTING (Jan. 25, 2021), https://www.nera.com/content/dam/nera/publications/2021/PUB_2020_Full-Year_Trends_012221.pdf [hereinafter *2020 Full-Year Review*]. The number of U.S.-listed companies increased to 5,956 as of September 2021. Janeen McIntosh & Svetlana Starykh, *Recent Trends in Securities Class Action Litigation: 2021 Full-Year Review* 1, 3, NERA ECONOMIC CONSULTING (Jan. 25, 2022), https://www.nera.com/content/dam/nera/publications/2022/PUB_2021_Full-Year_Trends_012022.pdf.

²⁷ Private Securities Litigation Reform Act, Pub. L. No. 104-67, 109 Stat. 737 (1995) (codified as amended in scattered sections of 15 and 18 U.S.C.).

²⁸ See *2020 Full-Year Review*, *supra* note 26, at 2.

²⁹ *Securities Class Action Filings: 2021 Year in Review*, CORNERSTONE RESEARCH 1, 4 (2022), <https://securities.stanford.edu/research-reports/1996-2021/Securities-Class-Action-Filings-2021-Year-in-Review.pdf> [hereinafter *2021 Year in Review*].

³⁰ Section 14(a) prohibits proxy solicitations that violate SEC rules and SEC Rule 14a-9 prohibits false or misleading statements made in any proxy statement, form of proxy, notice of meeting, or other communication. See *False or Misleading Statements*, 17 C.F.R. § 240.14a-9(a) (2022). Liability is generally subject to a negligence standard. *Beck v. Dobrowski*, 559 F.3d 680, 682 (7th Cir. 2009).

accounted for thirty-three percent of the aggregate 326 federal securities class action filings, whereas the share was thirty-one percent in 2016.³¹ By comparison, from 2009 to 2015, M&A objection cases accounted for just twenty-two percent of the annual number of securities class action filings.³² The migration to federal court was prompted by a 2016 decision by the Court of Chancery which underscored that M&A disclosure settlements—which merely seek enhanced proxy disclosures—are strongly disfavored and generally will not be judicially approved.³³

Second, complaints alleging securities fraud linked to specific negative events have proliferated. Historically, EDSL had been uncommon, but by 2018, such suits accounted for more than one-quarter of all securities class actions filings,³⁴ as well as an expanding portion of aggregate Investor Losses³⁵ in core cases.³⁶ The rise of EDSL has since continued. One report concluded that the number of new event-driven filings increased from thirty-four in 2018 to forty-seven in 2020.³⁷ But even this is a significant undercount, insofar as it excludes, *inter alia*, most filings in the life sciences sector and antitrust-driven securities litigation.³⁸ Litigation against foreign companies whose shares are traded on U.S.-based exchanges—including Canadian CRBs—has been a prime component of EDSL, consistent with the recent overall increase in securities litigation involving such companies.³⁹

³¹ See *2020 Full-Year Review*, *supra* note 26, at 3, 13.

³² See *2018 Full-Year Review*, *supra* note 18, at 6.

³³ *In re Trulia S'holder Sec. Litig.*, 129 A.3d 884, 898 (Del. Ch. 2016).

³⁴ See *Stuff Happens*, *supra* note 20.

³⁵ NERA Economic Consulting uses the term “Investor Losses” as a proxy for the aggregate amount that investors lost from buying defendant’s stock, rather than investing in the broader market during the alleged class period. Historically, Investor Losses “have been a powerful predictor of settlement size.” *2018 Full-Year Review*, *supra* note 18, at 11.

³⁶ *Id.* at 12 (“Over the past couple of years, growth in aggregate Investor Losses was concentrated in filings alleging regulatory violations, a substantial number of which were also *event-driven* securities cases”).

³⁷ See *New Driver*, *supra* note 4.

³⁸ See Samuel Groner & Andrew Cashmore, *Trends in Securities Cases Based on Antitrust Allegations*, LAW360 (July 5, 2018, 1:19 PM EDT), <https://www.law360.com/articles/1060044/trends-in-securities-cases-based-on-antitrust-allegations> (observing that antitrust-based securities litigation is an example of EDSL and such litigation has “become commonplace”).

³⁹ Colby Hamilton, *Skadden Securities Team Sees ‘Event-Driven’ Class Actions*

Event-driven securities litigation comprises numerous discrete subject areas, including cannabis, #MeToo, cybersecurity, opioid, and Covid-19 securities litigation.⁴⁰ Notwithstanding its ubiquity, or perhaps because of it, EDSL has been controversial, for multiple reasons. Maybe the most common criticism is that whereas many of the events that drive the litigation merely constitute corporate mismanagement, it is settled law that neither the Exchange Act nor the Securities Act is designed to regulate such conduct.⁴¹ For the reasons explained below, this criticism is mostly misplaced.

It is undeniable that mismanagement is not the subject of federal securities laws. In 1977, the Supreme Court declared in *Santa Fe Industries, Inc. v. Green*⁴² that “[w]e thus adhere to the position that ‘Congress by [Section] 10(b) did not seek to regulate transactions which constitute no more than internal corporate mismanagement.’”⁴³ Likewise, in 2019, when the Second Circuit affirmed the dismissal of a putative class action complaint in *Singh v. Cigna Corp.*,⁴⁴ the court highlighted plaintiffs’ “creative attempt to recast corporate mismanagement as securities fraud.”⁴⁵ Other federal courts agree with this conclusion.⁴⁶ To be sure, some

as *Continuing Trend for 2019*, N.Y. L.J. (Jan. 4, 2019), <https://www.law.com/newyorklawjournal/2019/01/04/skadden-securities-team-sees-event-driven-class-actions-as-continuing-trend-for-2019/>.

⁴⁰ See, e.g., Kevin LaCroix, *COVID-19-Related Securities Suit Filed Against Pharma Company*, D&O DIARY (Jan. 19, 2022), <https://www.dandodiary.com/2022/01/articles/coronavirus/covid-19-related-securities-suit-filed-against-pharma-company/#> (reporting that 45 COVID-19-related securities class action suits had been filed since the pandemic began in the United States in March 2020).

⁴¹ See, e.g., Richard Zelichov, *Guest Post: Corporate Mismanagement Becomes Event-Driven Securities Litigation*, D&O DIARY (Oct. 21, 2018), <https://www.dandodiary.com/2018/10/articles/securities-litigation/guest-post-corporate-mismanagement-becomes-event-driven-securities-litigation/> (arguing that event-driven cases undermine established law that “Section 10(b) [of the Exchange Act] does not create a federal private right of action for corporate mismanagement”).

⁴² *Santa Fe Indus., Inc. v. Green*, 430 U.S. 462 (1977).

⁴³ *Id.* at 479 (citing *Superintendent of Ins. v. Bankers Life & Cas. Co.*, 404 U.S. 6, 12 (1971)).

⁴⁴ *Singh v. Cigna Corp.*, 918 F.3d 57 (2d Cir. 2019).

⁴⁵ *Id.* at 59–60. The Second Circuit added: “The attempt relies on a simple equation: first, point to banal and vague corporate statements affirming the importance of regulatory compliance; next, point to significant regulatory violations; and *voilà*, you have alleged a prima facie case of securities fraud.” *Id.*

⁴⁶ See, e.g., *In re Hertz Global Holdings, Inc.*, 905 F.3d 106, 117 (3d Cir. 2018)

complaints filed in EDSL merely allege non-actionable corporate mismanagement and are properly dismissed. However, many other cases—some of them in cannabis litigation—do not concern internal corporate mismanagement and thus are not subject to the *Santa Fe* limitation.⁴⁷

Moreover, other complaints that might encompass mismanagement fit within recognized fraud categories. To state a claim for securities fraud under Section 10(b), a plaintiff must plead that defendant acted with scienter.⁴⁸ The PSLRA further requires that a plaintiff “plead ‘with particularity facts giving rise to a strong inference that the defendant acted with the required state of mind.’”⁴⁹ In the context of Section 10(b), scienter “refers to a mental state embracing intent to deceive, manipulate, or defraud.”⁵⁰ Pursuant to the Supreme Court’s decision in *Tellabs, Inc. v. Makor Issues & Rights, Ltd.*,⁵¹ a complaint adequately pleads scienter “only if a reasonable person would deem the inference of scienter cogent and at least as compelling as any opposing inference one could draw from the facts alleged.”⁵² Corporations are defendants in virtually all Section 10(b) cases.⁵³ Where a defendant is a corporation, *Tellabs* mandates pleading facts that give rise to a strong inference that an individual whose intent could be imputed to the corporation acted with the requisite scienter.⁵⁴

(“[W]e have long held ‘that an allegation of mismanagement on the part of a defendant will not alone support’ a securities fraud claim.”); *City of Dearborn Heights Act 345 Police & Fire Ret. Sys. v. Waters Corp.*, 632 F.3d 751, 760 (1st Cir. 2011) (“Allegations of corporate mismanagement are not actionable under Rule 10b-5.”); *Acito v. IMCERA Grp., Inc.*, 47 F.3d 47, 53 (2d Cir. 1995) (“It is well settled ‘that section 10(b) was not designed to regulate corporate mismanagement.’”).

⁴⁷ *Santa Fe Indus.*, 430 U.S. at 479 (1977).

⁴⁸ *Lehmann v. Ohr Pharm., Inc.*, 830 F. App’x 349, 352 (2d Cir. 2020).

⁴⁹ *Id.*

⁵⁰ *Ernst & Ernst v. Hochfelder*, 425 U.S. 185, 193 n.12 (1976); *accord* *Tellabs, Inc. v. Makor Issues & Rts., Ltd.*, 551 U.S. 308, 313 (2007) (noting that “[t]he PSLRA requires plaintiffs to state with particularity both the facts constituting the alleged violation, and the facts evidencing scienter, *i.e.*, the defendant’s intention ‘to deceive, manipulate, or defraud.’”).

⁵¹ *Tellabs, Inc. v. Makor Issues & Rights, Ltd.*, 551 U.S. 308 (2007).

⁵² *Id.* at 324.

⁵³ Daniel A. McLaughlin & Mark Taticchi, *Corporate Scienter Under Section 10(b) and Rule 10b-5*, 46 BLOOMBERG BNA SEC. REG. & LAW REP. 875 (2014).

⁵⁴ *See* *Jackson v. Abernathy*, 960 F.3d 94, 98 (2d Cir. 2020) (*per curiam*).

One caveat to the general proposition that corporate mismanagement does not constitute fraud is that lying to investors about the mismanagement is actionable. The Ninth Circuit observed in 2019 that “*Santa Fe* does not protect defendants who mismanage their company and lie to investors about that mismanagement.”⁵⁵ Similarly, the Third Circuit explained in 2018 that allegations of mismanagement can support the requisite inference of scienter in a Section 10(b) action if facts are alleged that defendant was aware that mismanagement had occurred “and lied about the existence of that mismanagement.”⁵⁶ But lying is not required, insofar as both materially misleading statements about mismanagement⁵⁷ and material omissions about mismanagement may also be actionable.⁵⁸ Rule 10b-5 has always specified that it is unlawful to “omit to state a material fact necessary in order to make the statements made, in light of the circumstances in which they were made, not misleading.”⁵⁹ Accordingly, if a nondisclosure about corporate mismanagement renders other statements by defendants misleading, a viable securities fraud claim may be stated.⁶⁰ Overall, because corporate mismanagement violates Section 10(b) if the conduct at issue is fraudulent, the most frequent critique of EDSL is flawed.⁶¹

⁵⁵ *Okla. Police Pension and Ret. Sys. v. LifeLock, Inc.*, 780 F. App’x 480, 484 n.4 (9th Cir. 2019).

⁵⁶ *In re Hertz Global Holdings, Inc.*, 905 F.3d 106, 117–18 (3d Cir. 2018); see also Richard A. Booth, *Loss Causation and the Materialization of Risk Doctrine in Securities Fraud Class Actions*, 75 BUS. LAW. 1791, 1800 (2020) (noting that claims of mismanagement may be actionable “if covered up by an affirmative misrepresentation”).

⁵⁷ See, e.g., *In re Vivendi S.A. Sec. Litig.*, 838 F.3d 223, 250 (2d Cir. 2016); *Chapman v. Mueller Water Prods., Inc.*, 466 F. Supp. 3d 382, 396 (S.D.N.Y. 2020) (quoting *Vivendi*, 838 F.3d at 250)).

⁵⁸ *In re Ebix Sec. Litig.*, 898 F. Supp. 2d 1325, 1340 (N.D. Ga. 2012).

⁵⁹ See 17 C.F.R. § 240.10b-5(b) (2022).

⁶⁰ *Menora Mivtachim Ins. Ltd. v. Int’l. Flavors & Fragrances Inc.*, No. 19 Civ. 7536 (NRB), 2021 WL 1199035, at *15 (S.D.N.Y. Mar. 30, 2021); *Fries v. N. Oil & Gas, Inc.*, 285 F. Supp. 3d 706, 718–19 (S.D.N.Y. 2018).

⁶¹ See THOMAS LEE HAZEN, 4 TREATISE ON THE LAW OF SECURITIES REGULATION § 12.191 (May 2021 Update) (“[T]he fact that mismanagement is involved does not preclude a Rule 10b-5 claim for material misrepresentation.”).

III. DEVELOPMENTS IN CANNABIS SECURITIES LITIGATION

A major source of EDSL has been cannabis securities litigation, which has proliferated since 2018. CRBs historically lacked access to conventional capital sources,⁶² primarily because marijuana has been classified since 1970 as a Schedule I drug under the federal Controlled Substances Act.⁶³ The legal environment shifted in 2018 when Congress enacted the Agriculture Improvement Act (which decriminalized the cultivation of hemp),⁶⁴ Canada legalized adult-use recreational cannabis,⁶⁵ and numerous states legalized or decriminalized medical and recreational cannabis products. By early 2021, approximately one-third of Americans resided in a state that had legalized recreational marijuana.⁶⁶ Later that year, new markets were created in five additional states (Alabama, Connecticut, New Mexico, New York, and Virginia), which collectively are projected to generate more than \$5 billion in annual sales by their fourth year of operation.⁶⁷ In February 2022 Mississippi became the thirty-seventh state to legalize medicinal marijuana,⁶⁸ and in May

⁶² Chris Gismondi & Wendy Michael, *Feeling the Burn? The Plaintiffs' Securities Bar Has Set Its Sights on the Cannabis Industry*, N.Y. L.J. (May 15, 2020, 2:30 PM EST), <https://www.law.com/newyorklawjournal/2020/05/15/feeling-the-burn-the-plaintiffs-securities-bar-has-set-its-sights-on-the-cannabis-industry/>; CHRISTOPHER GISMONDI ET AL., FINANCIAL SERVICES IN THE CANNABIS INDUSTRY: A COMPLIANCE GUIDE 1, 2 (2021) (noting that “[f]inancial institutions have been unable or unwilling to provide services to many cannabis-related businesses”).

⁶³ Controlled Substances Act, Pub. L. No. 91-513, 84 Stat. 1236 (1970); see also Marc Hauser, *Looking Forward to the Coming Year in the Cannabis Industry*, REED SMITH LLP (Jan. 7, 2022), <https://viewpoints.reedsmith.com/post/102hftd/looking-forward-to-the-coming-year-in-the-cannabis-industry> (predicting no federal legalization of cannabis in 2022).

⁶⁴ Agriculture Improvement Act of 2018, Pub. L. No. 115-334 § 10113, 132 Stat. 4490 (2018).

⁶⁵ See generally Peter Bowal et al., *Regulating Cannabis: A Comparative Exploration of Canadian Legalization*, 57 AM. BUS. L.J. 677 (2020) (discussing cannabis legalization in Canada) [hereinafter *Regulating Cannabis*].

⁶⁶ Stephanie Zimmerman, *A Green Wave: Successful Ballot Measures for Marijuana and Other Substances Create Opportunities for Lawyers*, A.B.A. J. (Feb. 1, 2021, 1:30 AM CST), <https://www.abajournal.com/magazine/article/successful-ballot-measures-for-marijuana-and-other-substances-create-opportunities-for-lawyers>.

⁶⁷ Lawrence Carrel, *Cannabis Sales Fell In 2021, But Debt Capital Raises Grew 806%*, FORBES (Dec. 30, 2021, 5:49 PM EST), <https://www.forbes.com/sites/lcarrel/2021/12/30/cannabis-sales-fell-in-2021-but-debt-capital-raises-grew-806/?sh=5c568a591d9f>.

⁶⁸ Jennifer Fisher, Kelsey Middleton & Brett Schuman, *Mississippi Becomes the*

2022 Rhode Island became the nineteenth state to legalize adult-use recreational marijuana.⁶⁹ Total U.S. CRB revenue reached \$20 billion in 2020 and is expected to double to a minimum of \$40 billion by 2025.⁷⁰ Moreover, the total economic impact of cannabis sales in the United States is projected to spike to \$160 billion in 2025, compared with \$92 billion in 2021.⁷¹

The combined effect of the foregoing developments has spurred multiple CRBs to list their shares on the NYSE and the Nasdaq.⁷² Still, until recently, most listings in the North American cannabis industry transpired only on Canadian exchanges—primarily the junior Canadian Securities Exchange (“CSE,” located in Toronto) and TSX Venture Exchange (headquartered in Calgary), rather than the senior Toronto Stock Exchange

37th State to Legalize Medical Cannabis, GOODWIN PROCTER LLP (Feb. 4, 2022), <https://www.jdsupra.com/legalnews/mississippi-becomes-37th-state-to-3270410/>.

⁶⁹ Sam Reisman, *Rhode Island Becomes 19th State to Legalize Marijuana*, LAW360 (May 25, 2022, 5:54 PM EDT), <https://www.law360.com/tax/articles/1496660/rhode-island-becomes-19th-state-to-legalize-marijuana?about=tax>.

⁷⁰ See Paul Demko, *Investors Sour on Cannabis after Democrats Fail to Help Industry*, POLITICO (Nov. 6, 2021, 7:00 AM EDT), [https://www.politico.com/news/2021/11/06/cannabis-industry-investors-sour-519742#:~:text=Stock%20prices%20have%20plummeted%20roughly,popular%20gauge%20of%20the%20sector%20\(reporting%20revenue%20data\)](https://www.politico.com/news/2021/11/06/cannabis-industry-investors-sour-519742#:~:text=Stock%20prices%20have%20plummeted%20roughly,popular%20gauge%20of%20the%20sector%20(reporting%20revenue%20data)). Accord Iris Dorian, *Legal Cannabis Market Projected to Rack Up \$43 Billion by 2025*, FORBES (June 18, 2021, 8:20 AM EDT), <https://www.forbes.com/sites/irisdorian/2021/06/18/legal-cannabis-market-projected-to-rack-up-43-billion-by-2025-says-new-study/?sh=4b07e8fe36b4>.

⁷¹ Andrew Long, *Marijuana Industry Expected to Add \$92 Billion to U.S. Economy in 2021*, MARIJUANA BUS. DAILY (May 11, 2021), <https://mjbizdaily.com/marijuana-industry-expected-to-add-92-billion-to-us-economy-in-2021/?cn-reloaded=1>.

⁷² See, e.g., Kevin LaCroix, *A Rash of Cannabis-Related Securities Class Action Lawsuits*, D&O DIARY (Nov. 25, 2019), <https://www.dandodiary.com/2019/11/articles/securities-litigation/a-rash-of-cannabis-related-securities-class-action-lawsuits/> (noting that numerous Canadian CRBs listed their shares on U.S. securities exchanges “both in the lead up to and in the wake of the October 2018 legalization of cannabis-based products in Canada”). Additionally, in August 2020, the SEC approved a proposal by NYSE Arca to list shares of an exchange-traded fund (“ETF”) invested in the cannabis industry. Caitlin Reilly, *NYSE Arca Wins Approval to List Cannabis-Based Exchange-Traded Fund*, CQ ROLL CALL (Aug. 21, 2020). NYSE Arca is the top U.S. exchange for the listing and trading of ETFs. *NYSE Arca Equities*, NEW YORK STOCK EXCHANGE, <https://www.nyse.com/markets/nyse-arca> (last visited June 14, 2022). By June 2022, at least seven cannabis ETFs traded in the United States. The largest of these held total assets of almost \$700 million. See *Marijuana ETF List*, ETF DATABASE, <https://etfdb.com/themes/marijuana-etfs/> (last visited June 14, 2022).

(“TSE”).⁷³ Listings were exclusive to Canada, given the refusal of senior U.S. exchanges to list U.S. holders of state cannabis licenses while the distribution and consumption of cannabis remain illegal under federal law.⁷⁴

Some cross-listing has occurred in Toronto and New York. Cross-listing takes place when a company can satisfy the requirements of multiple exchanges and lists its securities on each of them in order to buy access to more investors, greater liquidity, a higher share price, and a lower cost of capital.⁷⁵ Canadian CRBs have been able to list both in Canada and on senior U.S. exchanges primarily by restricting their U.S. activity to ancillary, non-plant-touching operations, such as research and development.⁷⁶ By comparison, a plant-touching company might be a cultivator, processor, or dispensary.⁷⁷

⁷³ See David George-Cosh, *U.S. Pot Companies to Uplist on Major Exchanges Soon: Curaleaf*, BNN BLOOMBERG (Mar. 10, 2021), <https://www.bnnbloomberg.ca/curaleaf-exec-chair-expects-u-s-pot-companies-to-soon-uplist-on-major-exchanges-1.1575058> (reporting that TSE does not permit listings by U.S.-based marijuana companies); Jenel Stelton-Holtmeier, *What Cannabis Companies Should Know Before Going Public*, MARIJUANA BUS. DAILY (updated Dec. 17, 2021), <https://mjbizdaily.com/what-cannabis-companies-should-know-before-doing-public/> (reporting that “many U.S. cannabis companies have turned to the Canadian Securities Exchange for their ventures into public trading”); cf. Charles Aloviseti & Ilya Ross, *What Is a Cannabis SPAC?*, CANNABIS LAW & POLICY INSIGHTS, VICENTE SEDERBERG LLP (Mar. 15, 2021), <https://www.jdsupra.com/legalnews/what-is-a-cannabis-spac-1041159/> (“More recently, cannabis entities have been listed directly on the more extensive Toronto Stock Exchange and the NEO Exchange.”).

⁷⁴ *SPAC Activity in Cannabis 2021*, HIGHWAY 33 CAPITAL ADVISORY (Sept. 3, 2021), <https://highway33.com/spac-activity-in-cannabis-2021/>.

⁷⁵ See, e.g., Nicola Cetorelli & Stavros Peristiani, Federal Reserve Bank of New York, Staff Report No. 474, *Firm Value and Cross-Listings: The Impact of Stock Market Prestige* 1 (Sept. 2010), https://www.newyorkfed.org/medialibrary/media/research/staff_reports/sr474.pdf (identifying advantages of cross-listing).

⁷⁶ Vince Sliwoski, *Psychedelics, Cannabis and the Stock Exchanges*, CANNA LAW BLOG (Oct. 29, 2021), <https://harrisbricken.com/cannalawblog/psychedelics-cannabis-and-the-stock-exchanges/>; see *Regulating Cannabis*, *supra* note 65, at 709–10 (describing listing difficulties encountered by Canadian CRBs); Julie Weed, *Businesses That ‘Don’t Touch the Plant’ Grow Up Alongside Marijuana Industry*, FORBES (Jan. 23, 2018, 8:12 AM), <https://www.forbes.com/sites/julieweed/2018/01/23/businesses-that-dont-touch-the-plant-grow-up-alongside-marijuana-industry/?sh=66a3d9a57e16> (describing cannabis-related products and services that “don’t touch the plant”).

⁷⁷ Daniel Hughes, *Risk & Reward: A Primer on Plant-Touching Cannabis Companies*, JDSUPRA (May 22, 2018), <https://www.jdsupra.com/legalnews/risk-reward-a-primer-on-plant-touching-19714/>.

More recently, the senior exchanges in New York have become marginally more relaxed. In June 2021, Canadian CRB High Tide became “the first major publicly traded cannabis retailer . . . to trade on the Nasdaq.”⁷⁸ Multiple other CRBs trade on the Nasdaq, including Tilray, Inc. (headquartered in Toronto), and Canopy Growth (headquartered in Ontario).⁷⁹ Such trading reflects the fact that non-U.S. CRBs in full compliance with applicable laws in their home jurisdiction have been subject to less scrutiny by the Nasdaq.⁸⁰

⁷⁸ See *Nasdaq Approves High Tide’s Application to List*, PR NEWSWIRE (May 28, 2021, 6:00 AM ET), <https://www.prnewswire.com/news-releases/nasdaq-approves-high-tides-application-to-list-301301434.html>. High Tide also lists on Canada’s TSX Venture Exchange. *Id.*

⁷⁹ See *A Complete List of NYSE and NASDAQ-Listed Cannabis Companies (Updated)*, BENZINGA CANNABIS (July 2, 2021, 10:35 AM), <https://www.benzinga.com/markets/cannabis/21/07/12591805/a-complete-list-of-nyse-and-nasdaq-listed-cannabis-companies-updated>. If a CRB is listed on a Canadian exchange such as CSE and trades in the United States on an over-the-counter market (“OTC”) such as OTCQX, these trades may not qualify as the requisite domestic trading activity for a U.S. court to entertain a securities fraud suit under *Morrison v. National Australia Bank Ltd.*, 561 U.S. 247 (2010). *Morrison* limits application of § 10(b) to transactions listed on domestic exchanges and domestic transactions in other securities. *Id.* at 267. The CSE is not a domestic exchange, OTC markets are not national securities exchanges within the scope of *Morrison*, and no domestic transaction may have occurred. See *United States v. Georgiou*, 777 F.3d 125, 134-35 (3d Cir. 2015) (holding that OTC markets are not national securities exchanges); *iAnthus Capital Holdings, Inc. Sec. Litig.*, Nos. 20-cv-03135 (LAK), 20-cv-03898, 2021 WL 3863372 (S.D.N.Y. Aug. 30, 2021) (granting motions to dismiss in consolidated securities class action litigation involving Canadian CRB iAnthus Capital Holdings, the shares of which are listed on the CSE and trade on the OTCQX). Amended complaints alleging domestic transactions were filed in *iAnthus* in November 2021. See Sarah Jarvis, *iAnthus Investors Revise Pot Co. Suits to Beat Legal Hurdles*, LAW360 (Nov. 4, 2021, 9:39 PM EDT), <https://www.law360.com/articles/1437650/ianthus-investors-revise-pot-co-suits-to-beat-legal-hurdles> (reporting filing of amended complaints). New motions to dismiss were filed in *iAnthus* in December 2021, while a parallel shareholder class action was pending in Canada. Sarah Jarvis, *iAnthus, Gotham Green Want Investors’ Latest Pot Suits Axed*, LAW360 (Dec. 21, 2021, 7:53 PM EST), <https://www.law360.com/articles/1450655/ianthus-gotham-green-want-investors-latest-pot-suits-axed>.

⁸⁰ Aloviseti & Ross, *supra* note 73. See also Michael Jones & Adanna Uwazurike, *Update on Securities Litigation Against Cannabis Companies*, GOODWIN PROCTER LLP 1, 5 (Apr. 23, 2020), <https://www.goodwinlaw.com/files/PracticeReports/Cannabis-2020-YIR/flipbook/index.html?page=1> (observing that U.S. exchanges “generally will register and list Canadian cannabis firms on the theory that those companies are operating in compliance with their domestic laws”). U.S. exchanges have become more receptive to other drugs as well. By October 2021 more than fifty psychedelics companies were listed in the United States, nine of them

The advent of publicly traded CRBs has attracted the attention of the plaintiffs' class action bar in the United States, which has filed numerous cases alleging violations of the federal securities laws following stock price dips experienced by the companies. As noted *supra*, cannabis securities class action litigation commenced in 2014,⁸¹ by June 2022 there had been at least thirty-four such filings,⁸² and twenty-three of the filings occurred during the period 2019 to 2021.⁸³ This trend is expected to continue, driven by industry growth,⁸⁴ stock price volatility,⁸⁵ regulatory uncertainty,⁸⁶ and the increasing number of public offerings in the cannabis sector. Many of the target companies in

on the NYSE or the Nasdaq and the remainder on the decentralized OTC exchanges. Sean McClintock, *Why Investors are Turning Toward Psychedelic Health Care Companies*, FORTUNE (Sept. 4, 2021, 1:00 PM EDT), <https://fortune.com/2021/09/04/psychedelic-industry-investment-growth-stocks-companies/>; Nathan Ponieman, *There Are Now 50 Psychedelics Companies Listed in the U.S.—Here They Are*, YAHOO! (Oct. 14, 2021), <https://www.yahoo.com/now/now-50-psychedelics-companies-listed-202501099.html>. The psychedelic industry appears to be following the same trajectory as the cannabis industry, with the market for psychedelic health care projected to reach \$10.75 billion by 2027. Sean McClintock, *Why Investors are Turning Toward Psychedelic Health Care Companies*, FORTUNE.COM (Sept. 4, 2021, 1:00 PM EDT), <https://fortune.com/2021/09/04/psychedelic-industry-investment-growth-stocks-companies/>. Expanding investment in psychedelics has been attributed to three factors: “the global need for effective mental health treatments, evolving legislation and regulation, and widely supportive public opinion.” *Id.*

⁸¹ See Quinn Emanuel Cannabis Litigation Practice Alert: *Recent Stock Drop Securities Actions in the Cannabis Industry*, QUINN EMANUEL URQUHART & SULLIVAN, LLP (2019), <https://www.quinnemanuel.com/media/0gkbyflg/cannabis-securities-action.pdf>.

⁸² *Current Trends in Securities Class Action Filings, Cannabis*, STANFORD L. SCH., SEC. CLASS ACTION CLEARINGHOUSE, <https://securities.stanford.edu/current-trends.html> (last visited June 15, 2022).

⁸³ *Id.*

⁸⁴ Julie Hussey et al., *Class Actions Increasingly Targeting Cannabis Companies*, CANNABIS BUS. EXEC. (July 12, 2021), <https://www.cannabisbusinessexecutive.com/2021/07/class-actions-increasingly-targeting-cannabis-companies/> (predicting that dynamic market will result in expansion of class action activity targeting cannabis and cannabidiol companies).

⁸⁵ Stephen Lenn, *Is There a Pot-Com Bubble on the Horizon?*, 34 WESTLAW J. CORP. OFFICERS & DIRECTORS LIAB. (Mar. 18, 2019) (“Public cannabis stocks have been and will likely continue to be volatile.”).

⁸⁶ Gismondi & Michael, *supra* note 62; Jeff Smith, *As Marijuana Class Action Lawsuits Surge, Experts Stress Accurate, Forthright Disclosures*, MARIJUANA BUS. DAILY (updated Dec. 17, 2021), <https://mjbizdaily.com/how-marijuana-companies-can-avoid-class-action-lawsuits/>.

the securities litigation have been Canadian.⁸⁷

The cannabis/hemp industry has also generated multiple shareholder derivative actions⁸⁸ and consumer class actions.⁸⁹ In 2019 and 2020 alone, more than 100 class action complaints were filed in the United States against CRBs, involving cannabis labeling, marketing, and securities-related disclosures.⁹⁰ The industry likewise has been the subject of increasing enforcement activity by the SEC,⁹¹ the Department of Justice (“DOJ”),⁹² and state regulators.⁹³

⁸⁷ See Kevin LaCroix, *A Closer Look at Securities Suits Against Cannabis Companies*, D&O DIARY (Apr. 27, 2020), <https://www.dandodiary.com/2020/04/articles/securities-litigation/a-closer-look-at-securities-suits-against-cannabis-companies/> (noting that more than half of the nineteen CRBs sued in securities class actions from 2018–19 were Canadian companies).

⁸⁸ See, e.g., First Amended Complaint at 22, *Janis v. Earle*, No. 4:20-cv-00193 (N.D. Okla. 2020) (alleging, *inter alia*, that CEO of CRB Upper Street Marketing mismanaged the company and attempted to transfer its assets into another entity that he owned).

⁸⁹ See Smith, *supra* note 86.

⁹⁰ Hussey et al., *supra* note 84.

⁹¹ See, e.g., Katryna Perera, *SEC Accuses Cannabis Co. CEO of Self-Dealing, Fraud*, LAW360 (June 1, 2022, 8:01 PM EDT), <https://www.law360.com/articles/1498634/sec-accuses-cannabis-co-ceo-of-self-dealing-fraud> (reporting SEC enforcement action against North Carolina CRB); Madeline Lyskawa, *SEC Nabs \$1.1M from Cannabis Developer in Fraud Suit*, LAW360 (Nov. 4, 2021, 5:53 PM EDT), <https://www.law360.com/articles/1437736> (reporting settlement in alleged scheme to defraud more than 400 CRB investors out of \$25.5 million); Rachel Scharf, *More Cannabis Developers Ink \$3.4M Deal in SEC Fraud Suit*, LAW360 (Jan. 28, 2021, 7:11 PM EST), <https://www.law360.com/articles/1349542/more-cannabis-developers-ink-3-4m-deal-in-sec-fraud-suit> (reporting prior settlement in same alleged scheme).

⁹² See J. Edward Moreno, *Feds Accuse Hemp Co. Executives of \$15M Investment Scam*, LAW360 (Oct. 5, 2021, 8:01 PM EDT), <https://www.law360.com/articles/1428477/feds-accuse-hemp-co-executives-of-15m-investment-scam> (reporting parallel enforcement actions by SEC and federal prosecutors in New York against CanaFarma Hemp Products Corp., a Canadian CRB that trades on the CSE). These parallel actions were followed by private securities litigation. See Katryna Perera, *CanaFarma Investor Hits Embattled Execs with Civil Suit*, LAW360 (Nov. 9, 2021, 3:00 PM EST), <https://www.law360.com/articles/1439016/canafarma-investor-hits-embattled-execs-with-civil-suit> (reporting filing of complaint against CanaFarma and two of its executives).

⁹³ See, e.g., Chris Villani, *Pot Biz Investors Win \$2.1M over Failed Mass. Venture*, LAW360 (Nov. 30, 2021, 1:26 PM EST), <https://www.law360.com/articles/1444057/pot-biz-investors-win-2-1m-over-failed-mass-venture> (reporting both results of state court bench trial in Massachusetts and pending securities enforcement action by Massachusetts involving medical marijuana business).

A significant share of cannabis EDSL has followed the publication of negative reports by short seller investors.⁹⁴ A short sale is the common practice of selling borrowed stock with the hope that the stock price will decline, resulting in a profit when the short seller later buys the shares back in the open market at a lower price to replace the borrowed shares.⁹⁵ Columbia University Professor Joshua Mitts has characterized the relationship between short sellers and plaintiffs' class action law firms as "a kind of *de facto* symbiosis" insofar as stock price drops accompanied by fraud allegations are mutually profitable—short sellers gain because they hold short stock positions and plaintiffs' firms can sue based upon the issuance of the reports.⁹⁶ Mitts observed that "short seller reports are often followed by plaintiffs' firms rushing to file a complaint which quotes the short report at great length as revealing of the truth."⁹⁷ An analysis of securities class action filings in 2021 found that approximately nineteen percent of such filings against U.S. issuers relied on short seller research to support their Rule 10b-5 claims.⁹⁸

Short selling is both legal and often beneficial to the market.⁹⁹ The activity can generate enhanced market efficiency, improved liquidity, and exposure of misconduct that regulators overlook.¹⁰⁰ However, various scholars regard short selling as predatory.¹⁰¹

⁹⁴ See Smith, *supra* note 86.

⁹⁵ Joanna Lee, *Activist Short Sellers: Market Manipulators or Market Protectors?*, 32 REV. BANKING & FIN. L. 274, 274 (2013).

⁹⁶ Joshua Mitts, *Short Sellers and Plaintiffs' Firms: A Symbiotic Ecosystem*, COLUM. L. SCH., CLS BLUE SKY BLOG (Oct. 14, 2020), <https://clsbluesky.law.columbia.edu/2020/10/14/short-sellers-and-plaintiffs-firms-a-symbiotic-ecosystem/>.

⁹⁷ *Id.*

⁹⁸ Messim Mezrahi et al., *More Securities Class Actions May Rely on Short-Seller Data*, LAW360 (Jan. 10, 2022, 7:07 PM EST), <https://www.law360.com/articles/1453499/more-securities-class-actions-may-rely-on-short-seller-data>.

⁹⁹ Charles F. Walker & Colin D. Forbes, *SEC Enforcement Actions and Issuer Litigation in the Context of a "Short Attack,"* 68 BUS. LAW. 687, 688 (2013).

¹⁰⁰ Avi Weitzman et al., *What to Know About Short-Seller Risks During Pandemic*, LAW360 (June 3, 2020, 4:24 PM EDT), <https://www.law360.com/articles/1278319>. See also Marco Pagano, *Should We Ban Short Sales in a Stock Market Crash?*, COLUM. L. SCH., CLS BLUE SKY BLOG (Mar. 17, 2020), <https://clsbluesky.law.columbia.edu/2020/03/17/should-we-ban-short-sales-in-a-stock-market-crash/> (arguing that short sale bans "have significant negative side effects").

¹⁰¹ See John C. Coffee, Jr., *Activist Short Selling Today: The Two Sides of the Coin*, COLUM. L. SCH., CLS BLUE SKY BLOG (July 7, 2020),

Short sellers are subject to regulatory prohibitions against manipulative conduct—including those set forth in Section 10(b) and Rule 10b-5—but there “are no public disclosure requirements for individual short sellers comparable to those for certain investors holding long positions.”¹⁰² Short seller activity has attracted federal attention. In February 2022 the DOJ was investigating possible trading abuses by short selling hedge funds and research firms¹⁰³ and that same month the SEC issued a new proposed Rule 13f-2 requiring certain institutional investment managers to report short sale-related information to the SEC.¹⁰⁴

Cannabis short selling has been profitable. CRB stock short sellers netted almost \$1 billion in 2019 as cannabis stocks plunged by approximately two-thirds from March to December 2019.¹⁰⁵ Moreover, the symbiosis between short sellers and plaintiffs’ class action firms has been reflected in cannabis EDSL. Five of the nineteen cannabis securities class actions commenced in 2018 and 2019 followed the issuance of “purported exposés by short sellers and activists”¹⁰⁶ and additional actions commenced in later years involved similar scenarios.¹⁰⁷ The targeted CRBs were accused of

<https://clsbluesky.law.columbia.edu/2020/07/07/activist-short-selling-today-the-two-sides-of-the-coin/>.

¹⁰² Weitzman et al., *supra* note 100.

¹⁰³ Laurence Fletcher et al., *US Investigates Potential Short Selling Abuses*, FIN. TIMES (Feb. 4, 2022), <https://www.ft.com/content/08899017-2994-4990-84e8-4a6efb7c57c6>.

¹⁰⁴ Brian Breheny, Raquel Fox & James Rapp, *SEC Proposes Short Sale Disclosure Rules*, HARV. L. SCH. F. ON CORP. GOV. (Apr. 6, 2022), <https://corpgov.law.harvard.edu/2022/04/06/sec-proposes-short-sale-disclosure-rules/>.

¹⁰⁵ Kristine Owram, *Pot Stock Short-Sellers Net Almost \$1 Billion in 2019*, BLOOMBERG (Dec. 18, 2019, 12:28 PM EST), <https://www.bloombergquint.com/onweb/pot-stock-wipeout-nets-short-sellers-almost-1-billion-in-2019>.

¹⁰⁶ Jack Queen, *Pot Investor Class Actions Doubled in Past Year*, LAW360 (Apr. 24, 2020, 4:15 PM EDT), <https://www.law360.com/articles/1266979/pot-investor-class-actions-doubled-in-past-year>.

¹⁰⁷ *See, e.g., In re PharmaCielo Ltd. Sec. Litig.*, No. 2:20-cv-02182 (C.D. Cal. 2020) (filed after critical short seller report issued by Hindenburg Research); Jack Queen, *Pomerantz to Lead Investor Suit Against Pot Co. PharmaCielo*, LAW360 (June 23, 2020, 6:12 PM EDT), <https://www.law360.com/articles/1285610/pomerantz-to-lead-investor-suit-against-pot-co-pharmacielo> (noting that the complaint “leans heavily” on the March 2020 report published by Hindenburg, which held a short position in PharmaCielo).

covering up regulatory lapses and operational failures.¹⁰⁸

The significant liability exposure for CRB management has been largely uninsured or underinsured.¹⁰⁹ Many insurers have declined to offer directors' and officers' ("D&O") insurance to CRBs in the United States given the industry's risk profile, banking hurdles, and the continued illegality of cannabis under federal law.¹¹⁰ When D&O insurance is offered, it typically includes low policy limits, multiple regulatory exclusions, and high premiums.¹¹¹ The absence of adequate insurance has hampered the growth of the U.S. cannabis industry.¹¹²

The cannabis EDSL trend noted above reflects the broader phenomenon of expanding securities class action litigation against life sciences companies. Such companies are attractive targets for securities class action plaintiffs and their counsel for multiple reasons, including their high degree of regulation by the Food and Drug Administration ("FDA").¹¹³ EDSL against CRBs shares some aspects of litigation against other businesses in the life sciences sector, insofar as the cases often focus on defendants' communications with, and responses to actions by, the FDA.¹¹⁴ In 2017 and 2018, approximately twenty percent of securities class action suits were filed against life sciences companies, and by 2019 this share had increased to approximately twenty-five percent.¹¹⁵

¹⁰⁸ Queen, *supra* note 106.

¹⁰⁹ Kimberly E. Blair et al., *Cannabis Directors and Officers Liability: Cause for Optimism?* (July 7, 2021), <https://www.mondaq.com/unitedstates/cannabis-hemp/1088586/cannabis-directors-and-officers-liability-cause-for-optimism>.

¹¹⁰ Matthew M. Ferguson & Matthew Guarnero, *Cannabis and SPACs: The Potential Convergence of Growing Industries and Opportunities for D&O Underwriters to Assess Risk*, KENNEDYS (Nov. 10, 2021), <https://kennedylaw.com/thought-leadership/article/cannabis-and-spacs-the-potential-convergence-of-growing-industries-and-opportunities-for-do-underwriters-to-assess-risk/>.

¹¹¹ Peter A. Halprin, et al., *The Legalization of Cannabis in New York and the Need for D&O Insurance Coverage*, N.Y. L.J. (May 21, 2021), <https://www.law.com/newyorklawjournal/2021/05/21/the-legalization-of-cannabis-in-new-york-and-the-need-for-do-insurance-coverage/>.

¹¹² See *id.* (arguing that "D&O insurance could be a crucial, and essential, component of a cannabis company's success and growth").

¹¹³ Nicki Locker & Laurie B. Smilan, *2019 Life Sciences Securities Litigation Roundup*, WILSON SONSINI GOODRICH & ROSATI (Apr. 28, 2020), <https://www.wsgr.com/en/insights/2019-life-sciences-securities-litigation-roundup.html>.

¹¹⁴ Queen, *supra* note 106.

¹¹⁵ David H. Kistenbroker, et al., *Insight: Life Sciences Companies Targeted for*

In 2019 the number of such actions filed against life sciences companies reached historic levels. Plaintiffs filed ninety-seven securities class action lawsuits against life sciences companies that year¹¹⁶ and nine percent of the actions were commenced against CRBs.¹¹⁷ Filings against life sciences companies declined to eighty in 2020, and fifty-nine in 2021, consistent with the overall pandemic-induced reductions those years, but still accounted for approximately twenty-eight percent of all securities class action filings in 2021.¹¹⁸

Most of the cannabis EDSL has been filed pursuant to Section 10(b) and Rule 10b-5, but other actions have included Section 11 and Section 12 claims when the alleged misstatements or omissions were made in connection with a securities offering.¹¹⁹ The complaints usually focus on disclosures related to operations, transactions, financial guidance, financial restatements, and internal controls.¹²⁰ Plaintiffs often allege that the CRB made affirmative misrepresentations about earnings prospects or knowingly failed to disclose the minimal demand for its products,¹²¹ the full risk of regulatory hurdles,¹²² and reductions in revenue.¹²³

Securities Class Actions, BLOOMBERG LAW (Mar. 13, 2020, 4:00 AM), <https://news.bloomberglaw.com/us-law-week/insight-life-sciences-companies-targeted-for-securities-class-actions-1>.

¹¹⁶ *Id.*

¹¹⁷ *Id.*

¹¹⁸ See David H. Kistenbroker et al., *Dechert Survey: Developments in Securities Fraud Class Actions Against Life Sciences Companies* 3–4, DECHERT LLP, (Mar. 28, 2022), <https://www.dechert.com/knowledge/publication/2022/3/dechert-survey--developments-in-securities-fraud-class-actions-a.html>.

¹¹⁹ Gideon Mark & Laurie A. Lucas, *Symposium, Cannabis—Legal, Ethical, and Compliance Issues: Introduction*, 57 AM. BUS. L.J. 651, 664 (2020).

¹²⁰ Jones & Uwazurike, *supra* note 80, at 5.

¹²¹ See, e.g., Jack Queen, *Investors Press Canopy on Alleged Lies about Pot Demand*, LAW360 (Jan. 8, 2021, 9:17 PM EST), <https://www.law360.com/classaction/articles/1342825>.

¹²² See, e.g., Complaint, *In re Curaleaf Holdings Inc. Sec. Litig.*, No. 1:19-cv-04486 (E.D.N.Y. 2019) (alleging that defendant Curaleaf, a CRB trading on the OTC market, failed to disclose that its products had not received regulatory approval).

¹²³ See, e.g., Complaint, *Ganovsky v. Tilray*, No. 20-cv-01240 (E.D.N.Y. 2020) (alleging that defendant misled investors by overstating the value of an agreement with a third-party vendor). This action was voluntarily dismissed in 2020.

Motions to dismiss are standard practice in cannabis EDSL, just as they are in other categories of securities litigation. A motion to dismiss was filed in ninety-four percent of all securities class actions commenced and resolved during the period of 2000 to 2017,¹²⁴ and this share increased to ninety-six percent for all securities class actions commenced and resolved during the period of 2012 to 2021.¹²⁵ Motions involving Section 10(b) claims frequently target plaintiffs' thin scienter allegations.¹²⁶ Plaintiffs in cannabis cases often attempt to satisfy the scienter requirement by alleging that CRB officers had access to the truth by virtue of their executive positions within the companies, but intentionally or recklessly failed to disclose this information to CRB shareholders.¹²⁷ This is an arduous pleading path. Analogous allegations in numerous non-cannabis cases were found insufficient unless plaintiffs specifically identified the reports or statements setting forth the allegedly true information.¹²⁸

Thus, in EDSL involving CRB Tilray, Inc., the court granted a motion to dismiss in 2021 after observing that "scienter cannot simply be presumed from a defendant's organizational role or professional expertise"¹²⁹ and completely discounting allegations

¹²⁴ Gideon Mark, *Confidential Witness Interviews in Securities Litigation*, 96 N.C. L. REV. 789, 794 (2018).

¹²⁵ Janeen McIntosh & Svetlana Starykh, *Recent Trends in Securities Class Action Litigation: 2021 Full-Year Review* 1, 14, NERA Economic Consulting (Jan. 25, 2022), <https://www.nera.com/publications/archive/2022/recent-trends-in-securities-class-action-full-year.html#:~:text=For%20the%20first%20time%20since,merger%20objection%20suits%20in%202021.>

¹²⁶ Gismondi & Michael, *supra* note 62; *see also* Acerra v. Trulieve Cannabis Corp., Consolidated Case No. 4:20cv186, 2021 WL 6197088 (N.D. Fla. Dec. 30, 2021) (dismissing second amended complaint with prejudice in cannabis EDSL for failure to adequately allege scienter).

¹²⁷ Gideon Mark & Laurie A. Lucas, *Symposium, Cannabis—Legal, Ethical, and Compliance Issues: Introduction*, 57 AM. BUS. L.J. 651, 672 (2020).

¹²⁸ *See, e.g.*, *Teamsters Local 445 Freight Div. Pension Fund v. Dynex Capital, Inc.*, 531 F.3d 190, 196 (2d Cir. 2008); *Industriens Pensionsforsikring A/S v. Becton, Dickinson & Co.*, No. 2:20-cv-02155-SRC-CLW, 2021 WL 4191467, at *19 (D.N.J. Sept. 15, 2021) ("Courts routinely reject allegations that a defendant's 'position' within a company, even an important position, creates an inference of scienter."); *Set Capital LLC v. Credit Suisse Group AG*, No. 18 Civ. 2268, No. 18 Civ. 4045, No. 18 Civ. 4045, 2019 WL 4673433, at *6 (S.D.N.Y. Sept. 25, 2019), *aff'd in part and vacated in part*, 996 F.3d 64 (2d Cir. 2021).

¹²⁹ *Kasilingam v. Tilray, Inc.*, No. 1:20-cv-03459, 2021 WL 4429788, at *9 (S.D.N.Y. Sept. 27, 2021).

from a confidential witness (“CW”).¹³⁰ CWs are usually current or former employees of the defendant company who provide information to plaintiffs for use in their complaints,¹³¹ typically in an effort to buttress scienter or falsity allegations, or both.¹³² This information is furnished anonymously, insofar as the CWs—commonly located by private investigators hired by plaintiffs’ counsel—are not named in the pleadings.¹³³ Anonymity is provided because the witnesses fear retaliation by the defendant companies against which they provide information.¹³⁴ Federal courts have accepted this pleading practice, in recognition of the risk of retaliation.¹³⁵ There are some inconsistencies between courts, but at least in the Second, Third, and Ninth Circuits, the use of CWs is allowed if they have certain indicia of reliability and personal knowledge.¹³⁶ At a minimum, the CW must be described with sufficient particularity to support the probability that a person in a position occupied by the witness would possess the information alleged.¹³⁷ Courts generally expect to see job descriptions and responsibilities, and often dates of employment and reporting lines.¹³⁸

¹³⁰ *Id.* at *10.

¹³¹ *In re Bofi Holding, Inc.*, Sec. Litig., No. 3:15-CV-02324-GPC-KSC, 2016 WL 5390533, at *16 (S.D. Cal. Sept. 27, 2016); Mark, *supra* note 124, at 554–55.

¹³² *See, e.g.*, *Kendall v. Odonate Therapeutics, Inc.*, No. 3:30-cv-01828-H-LL, 2021 WL 3406271, at *7–8 (S.D. Cal. Aug. 4, 2021) (denying motion to dismiss in life sciences EDSL after crediting information from five CWs in scienter analysis).

¹³³ Gideon Mark, *Confidential Witness Interviews in Securities Litigation*, 96 N.C. L. REV. 789, 790 (2018).

¹³⁴ *See* Gideon Mark, *Recanting Confidential Witnesses in Securities Litigation*, 45 LOY. U. CHI. L.J. 575, 596–98 (2014) (discussing multiple forms of retaliation).

¹³⁵ *See, e.g.*, *In re Cabletron Sys., Inc.*, 311 F.3d 11, 30 (1st Cir. 2002) (observing that requiring plaintiffs to name their confidential internal corporate sources would “have a chilling effect on employees who provide information about corporate malfeasance”).

¹³⁶ *See, e.g.*, *Davoli v. Costco Wholesale Corp.*, 854 F. App’x 116 (9th Cir. 2021) (affirming dismissal of second consolidated amended complaint after rejecting allegations by CWs).

¹³⁷ *See id.*; *Novak v. Kasaks*, 216 F.3d 300, 314 (2d Cir. 2000); *Hershewe v. JOYY Inc.*, No. 2:20-cv-10611-SB-AFM, 2022 WL 1123208, at *3 (C.D. Cal. Mar. 9, 2022) (dismissing second amended complaint with prejudice after holding that CWs were not described with sufficient particularity to support probability that persons in the positions occupied by the witnesses would possess the information alleged).

¹³⁸ *See, e.g.*, *Brendon v. Allegiant Travel Co.*, 412 F. Supp. 3d 1244, 1260 (D. Nev. 2019).

Plaintiffs' use of CWs has become a staple of EDSL,¹³⁹ but these efforts frequently stall because many courts remain skeptical of such witnesses and often discount—sometimes sharply—the information furnished by them.¹⁴⁰ Discounting occurred in *Tilray*, mentioned above.¹⁴¹ Similarly, in litigation against Canopy Growth—the largest Canadian CRB—the federal district court dismissed without prejudice plaintiffs' second amended complaint in May 2021 after discounting information provided by a CW and concluding that plaintiffs failed to adequately allege scienter.¹⁴² This case subsequently settled for \$13 million.¹⁴³

Adequately alleging a material misrepresentation or omission is another steep hurdle for plaintiffs in cannabis EDSL, whether under Section 10(b) or Section 11. In July 2021, the New Jersey federal district court dismissed without prejudice the first amended complaint against Canadian CRB Aurora—which alleged a Section 10(b) claim following a twelve percent stock price drop—in large part because the company had adequately disclosed the risks associated with an oversupplied market, the lack of sufficient retail stores, and a robust black market.¹⁴⁴

¹³⁹ See Mark, *supra* note 124, at 796 (noting the “almost universal reliance by plaintiffs in securities class action complaints on information provided by CWs”).

¹⁴⁰ See, e.g., *Ind. Elec. Workers' Pension Trust Fund IBEW v. Shaw Grp., Inc.*, 537 F.3d 527, 535 (5th Cir. 2008) (“[C]ourts must discount allegations from confidential sources.”); J. Robert Brown, Jr., *The “Tellabs Excuse” and Confidential Witnesses*, HARV. L. SCH. F. ON CORP. GOV. (Sept. 28, 2007), <https://corpgov.law.harvard.edu/2007/09/28/the-tellabs-excuse-and-confidential-witnesses/> (arguing that automatic discounting is unjustified). Plaintiffs' use of CWs also falters because such witnesses often recant, often under pressure from defense counsel. See Alison Frankel, *After Confidential Witness Recants, Judge in Chemours Class Action Wants Answers*, REUTERS (May 23, 2022, 7:32 PM EDT), <https://www.reuters.com/legal/government/after-confidential-witness-recants-judge-chemours-class-action-wants-answers-2022-05-23/> (“Plaintiffs lawyers will tell you, in fact, that corporations and their defense lawyers use intimidation tactics—like threatening to rescind severance agreements—to get confidential witnesses to change their stories.”).

¹⁴¹ *Kasilingam v. Tilray, Inc.*, No. 1:20-cv-03459, 2021 WL 4429788, at *10 (S.D.N.Y. Sept. 27, 2021).

¹⁴² *Ortiz v. Canopy Growth Corp.*, 537 F. Supp. 3d 621 (D.N.J. 2021).

¹⁴³ See Katryna Perera, *\$4.3M in Atty Fees Awarded in Pot Co. Canopy's \$13M Deal* (June 9, 2022, 6:02 PM EDT), <https://www.law360.com/articles/1501333> (reporting judicial approval of *Canopy* settlement).

¹⁴⁴ *In re Aurora Cannabis, Inc. Sec. Litig.*, No. 19-20588, 2021 WL 2821167, at *11-13 (D.N.J. July 6, 2021). A motion to dismiss the second amended complaint against Aurora and some of its former and current executives was pending in

Similarly, a New York trial court, relying on federal precedent, dismissed Section 11 litigation against Canadian CRB Sundial Growers in large part because Sundial had included a robust thirty-five-page risk disclosure section in its prospectus.¹⁴⁵ The court concluded that in connection with its August 2019 IPO Sundial had disclosed the precise type of risk underpinning plaintiffs' complaint—specifically, that risks are inherent in the agricultural sector and even when cultivating cannabis indoors, crops are vulnerable to the elements.¹⁴⁶

The decision in *Sundial Growers* highlights another obstacle—common in post-IPO securities suits¹⁴⁷—confronted by cannabis plaintiffs in adequately alleging a material misrepresentation or omission. The decision concluded that the statements by defendant Sundial identified by plaintiff as false or misleading were corporate puffery, mere expressions of corporate optimism, or statements of opinion.¹⁴⁸ Puffery encompasses statements that are too inexact to cause reasonable investors to rely upon them and therefore cannot have misled them.¹⁴⁹ In general, federal appellate courts to have considered the issue have held that puffery, puffing, or statements of corporate optimism are not actionable as a matter of law and securities claims based on such statements are subject to dismissal on a motion to dismiss.¹⁵⁰ However, if puffery is both factual and material, it may be actionable.¹⁵¹ Opinion statements, likewise, rarely are actionable.¹⁵²

December 2021. See Sarah Jarvis, *Pot Co. Aurora Looks to Dodge New Sham Sale Class Action*, LAW360 (Dec. 7, 2021, 4:38 PM EST), <https://www.law360.com/articles/1446342/pot-co-aurora-looks-to-dodge-new-sham-sale-class-action> (reporting motion to dismiss).

¹⁴⁵ *In re Sundial Growers Inc. Sec. Litig.*, 127 N.Y.S.3d 699, at *6–7 (N.Y. Cnty. 2020).

¹⁴⁶ *Id.*

¹⁴⁷ See Robert N. Kravitz, *Room for Optimism: The “Puffery” Defense under the Federal Securities Laws (Part 1 of 2)*, 19 SEC. LITIG. J. (2009), https://www.paulweiss.com/media/104380/PW_KravABAFeb09.pdf.

¹⁴⁸ *In re Sundial Growers Inc. Sec. Litig.*, 127 N.Y.S.3d 699, at *4 (N.Y. Cnty. 2020).

¹⁴⁹ *In re Vivendi, S.A. Sec. Litig.*, 838 F.3d 223, 245 (2d Cir. 2016).

¹⁵⁰ See Kravitz, *supra* note 147.

¹⁵¹ *Longman v. Food Lion, Inc.*, 197 F.3d 675, 682 (4th Cir. 1999); *Emp. Ret. Sys of Baton Rouge & Parish of E. Baton Rouge v. Macrogenics, Inc.*, No. GJH-19-2713, 2021 WL 4459218, at *11 (D. Md. Sept. 29, 2021).

¹⁵² In 2015 the Supreme Court resolved a circuit split and unanimously held in

In *Sundial Growers* the state trial court concluded that such references in Sundial’s offering documents as “high quality” and “premium” cannabis were non-actionable puffery or opinions,¹⁵³ and this decision was affirmed on appeal in 2021.¹⁵⁴ However, in September 2020, a few months before the *Sundial* appellate decision was issued, securities litigation involving Canadian CRB Aphria produced a different result. Here the federal district court rejected an argument that references to an Aphria asset as “world class” or “established and successful” were non-actionable puffery or expressions of corporate optimism. According to the court, a reasonable investor could rely on such statements, when viewed in context, because they indicate that an asset is operational.¹⁵⁵ Shortly thereafter, Aphria announced that it was merging with Tilray to form the largest cannabis company in the world,¹⁵⁶ and in June 2022 a motion to grant class certification was pending in the *Aphria* litigation.¹⁵⁷

Omnicare, Inc. v. Laborers Dist. Council Constr. Indus. Pension Fund, 575 U.S. 175 (2015), that pure statements of opinion are not untrue statements of material fact actionable as securities fraud, regardless of whether an investor can ultimately prove the belief wrong. *Omnicare*, 575 U.S. at 186. Pursuant to that holding, opinion statements give rise to liability in only three circumstances: (1) when the speaker does not actually hold the stated belief; (2) when the statement incorporates an underlying untrue statement of fact; and (3) when the statement omits a material fact and thus is misleading to a reasonable investor. *Id.* at 183–90. *Omnicare* was a § 11 action, but the majority view appears to be that the holding applies to § 10(b) cases as well. *Ortiz v. Canopy Growth Corp.*, 537 F. Supp. 3d 621, 666 (D.N.J. 2021).

¹⁵³ *In re Sundial Growers Inc. Sec. Litig.*, 127 N.Y.S.3d, at *5.

¹⁵⁴ *In re Sundial Growers Inc. Sec. Litig.*, 138 N.Y.S.3d 330 (N.Y. App. Div. 2021).

¹⁵⁵ *In re Aphria, Inc. Sec. Litig.*, No. 18 Civ. 11376 (GBD), 2020 WL 5819548, at *9 (S.D.N.Y. Sept. 30, 2020). *See also* *Acerra v. Trulieve Cannabis Corp.*, Consolidated Case No. 4:20cv186-RH-MJF, 2021 WL 6197088, at *2 (N.D. Fla. 2021) (concluding in cannabis EDSL that statement on defendant’s website that its marijuana was grown in a climate-controlled environment was “barely more than puffery”).

¹⁵⁶ Emily Ruscoe, *Tilray Investor Sues over \$3.8B Pot Industry Megamerger*, LAW360 (Mar. 16, 2021, 7:43 PM EST), <https://www.law360.com/articles/1365341/tilray-investor-sues-over-3-8b-pot-industry-megamerger>.

¹⁵⁷ An initial order granting certification in May 2022 was vacated without prejudice less than one week later. Order, *In re Aphria, Inc. Sec. Litig.*, No. 18 Civ. 11376, at 9 (S.D.N.Y. May 10, 2022); Katryna, Perera, *Pot Co. Aphria Urges Judge to Deny Investors’ Class Cert. Bid*, LAW360 (June 1, 2022, 5:34 PM EDT), <https://www.law360.com/articles/1498529/pot-co-aphria-urges-judge-to-deny-investors-class-cert-bid>.

Other potential obstacles for cannabis plaintiffs include the PSLRA's safe harbor for forward-looking statements and the bespeaks caution doctrine. The PSLRA introduced into both the Exchange Act and the Securities Act safe harbors for certain forward-looking statements that protect issuers and those acting on their behalf, subject to some exceptions.¹⁵⁸ The PSLRA broadly defines "forward-looking statement" to encompass projections of future performance, plans and objectives for future operations, and assumptions underlying these statements.¹⁵⁹ The statute immunizes from liability any forward-looking statement provided that: (1) the statement is identified as such and is accompanied by meaningful cautionary language identifying important factors that could cause actual results to differ materially from those in the statement; or (2) the statement is immaterial; or (3) plaintiff fails to show that defendant had actual knowledge that the statements were false or misleading when made.¹⁶⁰ The immunizing language is disjunctive, so there is no liability with respect to statements covered by any of the three categories.¹⁶¹ Because the safe harbor incorporates an actual knowledge standard, a complaint may allege scienter as to a forward-looking statement only by alleging knowing falsity.¹⁶² Plaintiffs often seek to establish actual knowledge using information provided by CWs.¹⁶³

The statutory harbor continues to complement the similar and sometimes overlapping common law "bespeaks caution" doctrine. Under the doctrine, alleged misrepresentations are deemed immaterial as a matter of law if no reasonable investor could consider them important in light of adequate cautionary language, and thus, if a statement is puffery, the doctrine likely applies.¹⁶⁴ Forward-looking statements often are aspirational and,

¹⁵⁸ See, e.g., *Weston Family P'Ship LLLP v. Twitter, Inc.*, 29 F.4th 611, 620 (9th Cir. 2022) (discussing PSLRA's safe harbor provisions).

¹⁵⁹ See 15 U.S.C. §§ 77z-2(i)(1), 78u-5(i)(1).

¹⁶⁰ See 15 U.S.C. §§ 77z-2(c)(1), 78u-5(c)(1).

¹⁶¹ *Wochos v. Tesla, Inc.*, 985 F.3d 1180, 1190 (9th Cir. 2021).

¹⁶² *Slayton v. Am. Exp. Co.*, 604 F.3d 758, 773 (2d Cir. 2010).

¹⁶³ Richard A. Rosen & Jessica S. Carey, *The Safe Harbor for Forward-Looking Statements after Twenty Years*, 30 INSIGHTS (May 2016), https://www.paulweiss.com/media/3592238/insights_0516_rosen.pdf.

¹⁶⁴ See *In re Bemis Co. Sec. Litig.*, 512 F. Supp. 3d 518, 537 n.6 (S.D.N.Y. 2021) (explaining the doctrine).

if they are deemed to be puffery, they will be regarded as immaterial and likewise will be protected under the statutory harbor.¹⁶⁵ The PSLRA safe harbor and bespeaks caution doctrine have particular importance in EDSL because in such litigation “what is being challenged is often a forward-looking risk assessment.”¹⁶⁶

In litigation involving the collapse of Quebec-based CRB HEXO Corporation, the federal district court dismissed plaintiffs’ first amended class action complaint in March 2021, in part because defendants’ statements were protected by the PSLRA’s safe harbor (as to the Rule 10b-5 claim) and bespeaks caution doctrine (as to the Section 11 claim).¹⁶⁷ As to the latter, the court noted that HEXO’s cautionary language directly addressed the relevant risk that the company was operating within a newly legalized industry in Canada.¹⁶⁸ A few months later, in June 2021, a New York state court judge also dismissed a proposed securities class action alleging a Section 11 claim against HEXO, again in major part on the basis of the bespeaks caution doctrine. The court observed that “the offering documents contained ample cautionary statements.”¹⁶⁹ The court in *Canopy Growth* also concluded that most of the challenged statements by defendants were protected by the safe harbor.¹⁷⁰ Similarly, in September 2021 a federal court dismissed with prejudice claims under Sections 10(b) and 11 against Sundial Growers, in large part on the basis of the safe harbor.¹⁷¹ However, another federal securities class action involving Sundial Growers settled for \$7 million in December 2021 after the court mostly denied a motion to dismiss earlier that

¹⁶⁵ See *SEC v. Revolutions Med. Corp.*, No. 1:12-cv-3298-LMM, 2015 WL 11190068, at *4 (N.D. Ga. 2015) (observing that statements classified as puffery frequently are forward-looking).

¹⁶⁶ Donald C. Langevoort, *Disasters and Disclosures: Securities Fraud Liability in the Shadow of a Corporate Catastrophe*, 107 *GEO. L.J.* 967, 995 (2019).

¹⁶⁷ *In re* HEXO Corp. Sec. Litig., 524 F. Supp. 3d 283, 290, 303-04, 307 (S.D.N.Y. 2021).

¹⁶⁸ *Id.* at 303.

¹⁶⁹ Decision and Order on Motion, *Leung v. HEXO Corp.*, No. 150444/2020, at 2 (N.Y. Cnty. June 3, 2021).

¹⁷⁰ *Ortiz v. Canopy Growth Corp.*, 537 F. Supp. 3d 621, 641 (D.N.J. 2021).

¹⁷¹ *Sun, A Series of E Squared Investment Fund, LLC v. Sundial Growers, Inc.*, No. 1:20-CV-03579 (ALC), 2021 WL 4482276, at *7-8 (S.D.N.Y. 2021).

year.¹⁷²

Overall, the decisions to date in cannabis EDSL suggest that motions to dismiss may turn in large part on the puffery issue, and those cases in which the subject statements are not merely general and aspirational and are unprotected by the safe harbor and bespeaks caution doctrine are more likely to proceed to discovery.¹⁷³ In addition, adequately alleging scienter will remain a common obstacle for plaintiffs, even when CWs are available.¹⁷⁴ Of course, not all cannabis EDSL proceeds to resolution of dismissal motions. Some cases have settled prior to that juncture.¹⁷⁵

¹⁷² See Sarah Jarvis, *Cannabis Co. Investors Want \$7M Deal to End IPO Suit*, LAW 360 (Dec. 6, 2021, 4:57 PM EST), <https://www.law360.com/articles/1445719/cannabis-co-investors-want-7m-deal-to-end-ipo-suit> (reporting *Sundial* settlement following mediation). When securities class action litigation settles, it often does so following mediation. Barry M. Kaplan, *New Trends in Securities and Shareholder Class Actions*, ASPATORE, 2015 WL 4967440, at *6 (July 2015) (“In attempting to settle a securities class action, a mediation using a well-respected former judge or mediator is almost always employed.”). Unsurprisingly, then, *Sundial* is not the only cannabis litigation to settle following mediation. See Sarah Jarvis, *\$66.4M CannTrust Shareholder Deal Gets Initial OK*, LAW360 (Sept. 3, 2021, 3:19 PM EST), <https://www.law360.com/articles/1418625> (reporting settlement following mediation of cannabis EDSL involving Canadian CRB CannTrust Holdings). In January 2022 CannTrust was mulling an operations wind-down following judicial approval of the settlement and a cash flow crisis. Sam Reisman, *Canadian Pot Co. CannTrust Mulling Potential Wind-Down*, LAW360 (Jan. 6, 2022, 6:39 PM EST), <https://www.law360.com/articles/1453107/canadian-pot-co-canntrust-mulling-potential-wind-down>.

¹⁷³ See, e.g., Civil Minutes, *In re PharmaCielo Ltd. Sec. Litig.*, No. CV 20-2182 (C.D. Cal. Apr. 16, 2021), at 6 (granting motion to dismiss in cannabis EDSL in part based on puffery defense). A motion to dismiss the second amended complaint in *PharmaCielo* was granted in December 2021. See Civil Minutes, *In re PharmaCielo Ltd. Sec. Litig.*, No. CV 20-2182 (C.D. Cal. Dec. 7, 2021) (dismissing action with prejudice); see also Katryna Perera, *Canadian Pot Co. Permanently Dodges ‘Vague’ Investor Suit*, LAW360 (Dec. 8, 2021, 4:28 PM EST), <https://www.law360.com/articles/1446549> (reporting dismissal in *PharmaCielo*).

¹⁷⁴ See Matthew Solum, *Courts Continue to Express Skepticism over Confidential Witnesses*, SEC. REG. DAILY (June 10, 2021), <https://www.kirkland.com/publications/article/2021/06/courts-continue-to-express-skepticism-over-confide> (“Courts across the country continue to pressure-test vague or exaggerated claims attributed to confidential sources, often resulting in case dismissal at the pleading stage.”).

¹⁷⁵ See, e.g., Sam Reisman, *Pot Co. Liberty Health Agrees to Settle \$1.8M Securities Row*, LAW360 (Nov. 20, 2020, 8:20 PM EST), <https://www.law360.com/articles/1330906/pot-co-liberty-health-agrees-to-settle-1-8m-securities-row> (reporting settlement of cannabis securities class action on eve of oral argument of

One other point merits discussion at this juncture. As noted above, Canadian CRBs Sundial Growers and HEXO both faced Section 11 litigation in state court and parallel securities litigation in federal court. Additional CRBs will likely confront future parallel EDSL. Such proceedings can be linked to the Supreme Court's 2018 decision in *Cyan, Inc. v. Beaver County Employees' Retirement Fund*.¹⁷⁶ In *Cyan* the Court unanimously held that state courts have concurrent subject-matter jurisdiction over putative class actions that exclusively allege claims under the Securities Act and that these suits cannot be removed to federal court.¹⁷⁷ *Cyan* resolved a split among state and federal courts over the effect of the Securities Litigation Uniform Standards Act of 1998, which amended portions of the Securities Act and Exchange Act.¹⁷⁸

Section 11 of the Securities Act provides the primary basis for alleging a securities violation in connection with an IPO.¹⁷⁹ It gives shareholders virtually no-fault claims against public companies for materially misleading statements or omissions in registration statements filed with the SEC, in addition to claims that are nearly as powerful against the companies' directors and the underwriters of the offerings.¹⁸⁰ Individual defendants "can escape liability only by proving their good faith—a factual inquiry rarely resolved at the pleading stage."¹⁸¹

multiple motions to dismiss).

¹⁷⁶ 138 S. Ct. 1061 (2018).

¹⁷⁷ *Id.* at 1078.

¹⁷⁸ Securities Litigation Uniform Standards Act of 1998, Pub. L. No. 105-353, 112 Stat. 3227 (1998).

¹⁷⁹ Andrew J. Pincus, *Containing the Contagion: Proposals to Reform the Broken Securities Class Action System 1*, 12, U.S. CHAMBER INST. FOR LEGAL REFORM (Feb. 2019), <https://instituteforlegalreform.com/wp-content/uploads/2020/10/Securities-Class-Action-Reform-Proposals.pdf>.

¹⁸⁰ Boris Feldman, *The Forum Wars of Section 11*, HARV. L. SCH. F. ON CORP. GOVERNANCE (Dec. 10, 2020), <https://corpgov.law.harvard.edu/2020/12/10/the-forum-wars-of-section-11/>.

¹⁸¹ Laurie Smilan & Nicki Locker, *Courts Cut Shareholders Slack on Section 11 Claims*, HARV. L. SCH. F. ON CORP. GOV. (May 17, 2020), <https://corpgov.law.harvard.edu/2020/05/17/courts-cut-shareholders-slack-on-section-11-claims/>.

Newly public companies have always been vulnerable to Section 11 litigation, and the rise of EDSL has multiplied that risk. During the years 2010 to 2019, more than eighty percent of all securities class actions asserting only Securities Act claims involved IPOs,¹⁸² probably as a function of the shorter operating histories and more entrepreneurial nature of such companies. In the aftermath of *Cyan*, many commentators predicted that recent IPO companies would face a significant risk of parallel Section 11 suits in federal and state court, or even in multiple state courts,¹⁸³ because the Supreme Court recognized concurrent jurisdiction and disallowed removal.

Cyan has aided plaintiffs. As predicted, there was a dramatic spike in Securities Act state court filings, which were often accompanied by parallel federal actions. The total number of Securities Act state court filings increased from thirteen in 2017 to thirty-five in 2018 to fifty-two in 2019.¹⁸⁴ In 2019 more Securities Act claims were filed in state court than in federal court,¹⁸⁵ and approximately forty-five percent of state court Securities Act cases were accompanied by parallel federal proceedings.¹⁸⁶ The parallel federal actions often asserted, on behalf of the same putative classes, claims identical to those filed in state court.¹⁸⁷ The parallel actions in the cannabis litigation in both *Sundial Growers* and *HEXO* reflected these trends.¹⁸⁸

¹⁸² *Securities Class Action Settlements: 2019 Review and Analysis*, Cornerstone Research 1, 8 (2020), <https://www.cornerstone.com/Publications/Reports/Securities-Class-Action-Settlements-2019-Review-and-Analysis>.

¹⁸³ See, e.g., Kevin LaCroix, *Scrutinizing Event-Driven Securities Litigation*, D&O DIARY (Mar. 27, 2018), <https://www.dandodiary.com/2018/03/articles/securities-litigation/scrutinizing-event-driven-securities-litigation/> (arguing that the impact of EDSL on IPO companies will be amplified by *Cyan*).

¹⁸⁴ *2020 Year in Review*, *supra* note 25, at 19.

¹⁸⁵ *Securities Class Action Filings: 2019 Year in Review* 1, 4, Cornerstone Research (2020), <https://www.cornerstone.com/Publications/Reports/Securities-Class-Action-Filings-2019-Year-in-Review> [hereinafter *2019 Year in Review*].

¹⁸⁶ *Id.*

¹⁸⁷ Israel Dahan & Alexander Noble, *NY Rulings Show State Court Aversion to Securities Act Suits*, LAW360 (Mar. 3, 2021, 5:39 PM EST), <https://www.law360.com/articles/1359293/ny-rulings-show-state-court-aversion-to-securities-act-suits>.

¹⁸⁸ See Gregory A. Markel et al., *Recent New York Appellate Decision Highlights That Cannabis Companies Going Public are Subject to Typical Securities Litigation Risks—and Defenses*, SEYFARTH SHAW LLP (Mar. 16, 2021), <https://www.seyfarth.com/news-insights/recent-new-york-appellate-decision->

The post-*Cyan* increase in state and parallel state and federal Securities Act filings had multiple negative ramifications for defendants. First, D&O insurance premiums for newly public companies soared.¹⁸⁹ Second, once sued, defendants were more likely to remain in the litigation than if they had been sued in federal court pre-*Cyan* because state courts are much less likely than federal courts to dismiss Section 11 claims. During the years 2010 to 2019, motions to dismiss claims brought under Section 11 were granted in only twenty-six percent of cases in state court, as opposed to forty-three percent of cases in federal court.¹⁹⁰ The contrasting dismissal rates are explained in large part by the fact that, at least in cases not involving fraud, many states utilize a more lenient pleading standard than the *Twombly*¹⁹¹-*Iqbal*¹⁹² pleading standard applied in federal courts.¹⁹³ To survive a motion to dismiss in federal court, a complaint must allege “enough facts to state a claim to relief that is plausible on its face”¹⁹⁴ in light of “judicial experience and common sense.”¹⁹⁵ In contrast, in California, where Section 11 cases are frequently litigated in Superior Court,¹⁹⁶ a plaintiff seeking to survive a demurrer—California’s equivalent of a motion to dismiss—is merely required to plead a “statement of the facts constituting the cause of action, in ordinary and concise language.”¹⁹⁷

highlights-that-cannabis-companies-going-public-are-subject-to-typical-securities-litigation-risks-and-defenses.html (“Like much of the Securities Act litigation following the *Cyan* decision, Sundial Growers faced parallel suits in federal and state courts.”).

¹⁸⁹ Feldman, *supra* note 180.

¹⁹⁰ *2019 Year in Review*, *supra* note 185, at 26.

¹⁹¹ Bell Atl. Corp. v. Twombly, 550 U.S. 544, 570 (2007).

¹⁹² Ashcroft v. Iqbal, 556 U.S. 662, 678 (2009).

¹⁹³ Michael Klausner, et al., *State Section 11 Litigation in the Post-Cyan Environment* 1, 4-5 (2019), https://www-cdn.law.stanford.edu/wp-content/uploads/2019/04/State-Section-11-White-Paper_FINAL.pdf.

¹⁹⁴ *Twombly*, 550 U.S. at 570.

¹⁹⁵ *Iqbal*, 556 U.S. at 679.

¹⁹⁶ See Joseph Grundfest et al., *After Cyan: Potential Trends in Section 11 Litigation*, LAW360 (Mar. 27, 2018, 5:07 PM EST), <https://www.cornerstone.com/Publications/Articles/After-Cyan-Potential-Trends-In-Section-11-Litigation>

(“California courts have been the most active jurisdiction for these lawsuits, in part because California courts have historically rejected efforts to remove claims filed in state court to federal court.”). *Cyan Inc.*, lead defendant in the *Cyan* litigation, had been sued in California Superior Court for alleged § 11 violations. 138 S. Ct. at 1069.

¹⁹⁷ Cal. Code Civ. Proc. § 425.10(a)(1).

Third, defendants in post-*Cyan* Securities Act litigation faced an increasingly complex and expensive battle because state courts—unlike federal courts—have virtually no tools they can employ to streamline pretrial proceedings in related cases filed in multiple jurisdictions.¹⁹⁸ Likewise, the cases cannot be consolidated in a single federal or state forum because they cannot be removed, there is no mechanism to consolidate lawsuits pending in separate state court systems, and there is no certainty that courts will apply the doctrine of *forum non conveniens* to relieve defendants of the burden of litigating in multiple states.¹⁹⁹ Requiring defendants to defend in multiple jurisdictions adds complexity, expense, uncertainty, and the risk of conflicting or inconsistent procedures and outcomes.²⁰⁰ Such a requirement also helps coerce settlements.²⁰¹

Post-*Cyan*, some corporations adopted forum selection provisions requiring that all Section 11 claims be adjudicated in federal court,²⁰² but their validity was unsettled. In March 2020, the Delaware Supreme Court reversed the Court of Chancery and held in *Sciabacucchi v. Salzberg*²⁰³ that charter provisions requiring

¹⁹⁸ James Goldfarb & Gaurav Talwar, *The Post-Cyan Spike in State Securities Act Filings*, LAW360 (Mar. 19, 2019, 1:54 PM EST), <https://www.law360.com/articles/1140225/the-post-cyan-spike-in-state-securities-act-filings>.

¹⁹⁹ See Kevin LaCroix, *Guest Post: The State of Securities Litigation After Cyan*, D&O DIARY (Apr. 23, 2018), <https://www.dandodiary.com/2018/04/articles/securities-litigation/guest-post-state-securities-litigation-cyan/>

There is no ability to consolidate these multiple state court and related federal court filings. The only way to coordinate them is to file motions to stay, *forum non conveniens*, or to coordinate. But these types of motions are always unpredictable and often unsuccessful. And where the forum is the plaintiff's residence, we believe it will be very difficult to move the case, and more difficult still when the plaintiff is a significant local institutional investor.

²⁰⁰ Kevin LaCroix, *Multiplied and Parallel Litigation: The Mess that Cyan Has Wrought*, D&O DIARY (Nov. 18, 2019), <https://www.dandodiary.com/2019/11/articles/securities-litigation/multiplied-and-parallel-litigation-the-mess-that-cyan-has-wrought/>.

²⁰¹ Andrew Pincus & Avi Kupfer, *Courting Confusion: Federal Securities Class Actions Don't Belong in State Courts*, U.S. CHAMBER INST. FOR LEGAL REFORM (Aug. 30, 2021), <https://institutelegalreform.com/research/ilr-briefly-courting-confusion-federal-securities-class-actions-dont-belong-in-state-courts/>.

²⁰² Joseph Grundfest et al., *After Cyan: Potential Trends in Section 11 Litigation*, LAW360 (Mar. 27, 2018, 5:07 PM EST), <https://www.cornerstone.com/Publications/Articles/After-Cyan-Potential-Trends-In-Section-11-Litigation>.

²⁰³ *Salzberg v. Sciabacucchi*, 227 A.3d 102, 109 (Del. 2020).

Securities Act claims to be brought exclusively in federal court are facially valid under Delaware law.²⁰⁴ The Delaware Supreme Court's decision marked a major defense victory because it essentially allows a Delaware defendant corporation to compel plaintiffs to litigate Securities Act claims in federal court, where dismissals are more common and defendants have a brawnier hand in negotiating settlements.²⁰⁵

Corporations quickly took advantage of this good fortune. A November 2020 survey found that of forty-nine companies that completed post-*Salzberg* IPOs, eighty-four percent included federal forum provisions ("FFPs") in their governing documents (most frequently in their charters).²⁰⁶ The same survey revealed that post-*Salzberg*, 126 existing companies had adopted FFPs, and overall, eight percent of the Russell 3000 now include such provisions in their charters and/or bylaws.²⁰⁷ This trend is likely to accelerate, in part because FFPs have been endorsed by at least one of the leading proxy advisory firms. Pursuant to its revised benchmark policies, effective for shareholder meetings on or after February 1, 2021, Institutional Shareholder Services will generally recommend a vote for FFPs for federal securities law matters, in the absence of serious concerns about corporate governance or board responsiveness to shareholders, assuming the provisions do not select a particular federal district court as the exclusive forum.²⁰⁸

FFPs are having their intended effect. In 2020 the total number of state court Securities Act filings plunged sixty-five percent to eighteen, following a record high of fifty-two in 2019.²⁰⁹ State court filings in jurisdictions outside of New York and

²⁰⁴ *Id.*

²⁰⁵ Joseph A. Grundfest, *The Limits of Delaware Corporate Law: Internal Affairs, Federal Forum Provisions, and* Sciabacucchi, 75 BUS. LAW. 1319, 1322 (2020).

²⁰⁶ John Laide, *Companies' Response to Delaware Supreme Court Upholding Federal Forum Provisions*, HARV. L. SCH. F. ON CORP. GOV. (Nov. 11, 2020), <https://corpgov.law.harvard.edu/2020/11/11/companies-response-to-delaware-supreme-court-upholding-federal-forum-provisions/>.

²⁰⁷ *Id.*

²⁰⁸ Cydney Posner, *ISS Releases New Benchmark Policies for 2021*, HARV. L. SCH. F. ON CORP. GOV. (Nov. 23, 2020), <https://corpgov.law.harvard.edu/2020/11/23/iss-releases-new-benchmark-policies-for-2021/>.

²⁰⁹ *2020 Year in Review*, *supra* note 25, at 19.

California declined to their lowest level since 2015.²¹⁰ And in 2021, total state court Securities Act filings declined to thirteen.²¹¹ Nevertheless, *Salzberg* left unanswered at least nine key questions as to whether courts will enforce FFP provisions: (a) adopted after an IPO, (b) adopted after litigation commenced, (c) for Delaware corporations sued outside of Delaware, (d) included in corporate bylaws rather than in charters, (e) for Securities Act claims against non-issuer defendants, (f) for non-Delaware corporations, (g) for Rule 10b-5 or other non-Section 11 claims, (h) if the FFP designates a specific federal court in which suit must be brought, whether in Delaware or elsewhere, or (i) if the corporation seeks to compel arbitration of securities claims.²¹²

Some of the foregoing issues were addressed in a quartet of non-precedential 2020 California state trial court decisions that enforced FFPs for Delaware companies, at least one of which had included the provision in its bylaws.²¹³ Three of the four decisions were issued in plaintiff-friendly San Mateo County—which includes a portion of Silicon Valley and had become a cauldron of Section 11 litigation—and the fourth was issued in nearby San Francisco.²¹⁴

²¹⁰ *2020 Year in Review*, *supra* note 25, at 19; *see also* Gregory A. Markel et al., *Recent New York Appellate Decision Highlights That Cannabis Companies Are Subject to Typical Securities Litigation Risks—and Defenses*, SEYFARTH SHAW LLP (Mar. 16, 2021), <https://www.seyfarth.com/news-insights/recent-new-york-appellate-decision-highlights-that-cannabis-companies-going-public-are-subject-to-typical-securities-litigation-risks-and-defenses.html> (advising CRBs “to adopt federal forum selection provisions to prevent exposure to duplicative state and federal court litigation”).

²¹¹ *2021 Year in Review*, *supra* note 29, at 19.

²¹² *See, e.g.*, Allon Kedem, *5 Securities Litigation Questions Raised by Del. Forum Ruling*, LAW360 (May 5, 2020, 5:15 PM EST), <https://www.law360.com/articles/1265730/5-securities-litigation-questions-raised-by-del-forum-ruling> (raising some of the foregoing issues).

²¹³ *See* William B. Chandler III et al., *Frequently Asked Questions About Federal Forum Provisions*, 2021 COLUM. BUS. L. REV. 569, 595 (2021) (“Whether the FFP is adopted as a charter provision or a bylaw should not affect its enforceability because courts have applied the same law to both.”).

²¹⁴ *See In re Sonim Tech., Inc. Sec. Litig.*, Lead Case No. 19-CIV-05564 (Cal. Super. Ct. San Mateo Dec. 7, 2020); *In re Dropbox, Inc. Sec. Litig.*, No. 19-CIV-05089 (Cal. Super. Ct. 2020); *In re Uber Tech. Sec. Litig.*, No. CGC-19-579544 (Cal. Super. Ct. 2020); *Wong v. Restoration Robotics, Inc.*, No. 18-CIV-02609 (Cal. Super. Ct. 2020).

However, multiple issues remain unresolved. The four California decisions split as to whether FFPs can be enforced against defendant underwriters, and none of them addressed the validity and enforceability of FFPs for companies incorporated under non-Delaware law.²¹⁵ The latter point is key because many technology companies are incorporated in Nevada, many financial services companies are incorporated in New York, and numerous other companies are incorporated elsewhere.²¹⁶ Indeed, as noted *supra*, many of the CRBs subject to securities litigation in the United States are Canadian companies with shares listed on U.S. exchanges. Moreover, the California decisions may motivate shareholders to assert separate constitutional challenges to FFPs,²¹⁷ possibly under the Commerce Clause²¹⁸ or the Supremacy Clause²¹⁹ of the United States Constitution.

In April 2021, a Utah trial court enforced a bylaws FFP on grounds substantially similar to those identified by the four California trial courts.²²⁰ Subsequently, in August 2021, a New York state trial court provided additional clarity when it dismissed Securities Act claims because the defendant-issuer's charter included an FFP requiring such claims to be litigated in federal court.²²¹ The decision was important for three reasons. First, the vast majority of state court Securities Act class actions have been filed in California or New York,²²² and this was the first decision

²¹⁵ See Kevin LaCroix, *New York State Court Enforces Federal Forum Provision*, D&O DIARY (Sept. 12, 2021), <https://www.dandodiary.com/2021/09/articles/securities-litigation/new-york-state-court-enforces-federal-forum-provision/#> (“We also don’t know how the issue of the validity of FFPs will play out for companies that are incorporated under the laws of jurisdictions other than Delaware.”).

²¹⁶ Kevin LeCroix, *Third California State Court Upholds Enforceability of Federal Forum Provisions*, D&O DIARY (Dec. 10, 2020), <https://www.dandodiary.com/2020/12/articles/securities-litigation/third-california-state-court-upholds-enforceability-of-federal-forum-provision/>.

²¹⁷ See Israel David & Justin Santolli, *Calif. Federal Forum Clause Rulings are Good News for Cos.*, LAW360 (Jan. 4, 2021, 4:05 PM EST), <https://www.law360.com/articles/1339986>.

²¹⁸ U.S. CONST. art. I, § 8, cl. 3.

²¹⁹ U.S. CONST. art. VI, cl. 2.

²²⁰ *Volonte v. Domo, Inc.*, No. 190401778, 2021 WL 1960296 (D. Utah Apr. 13, 2021).

²²¹ *Hook v. Casa Sys., Inc.*, No. 654548/2019, 2021 WL 3884063 (N.Y. Cnty. 2021).

²²² See Andrew J. Ehrlich et al., *New York Court on the Enforcement of Federal*

from the latter. Second, the New York court dismissed the Securities Act claims of all defendants, including the IPO underwriters who were not parties to the charter containing the FFP.²²³ Third, the court rejected plaintiff's arguments that enforcement of the FFP violated the Commerce Clause and the Supremacy Clause.²²⁴

Further clarity was provided in April 2022 when one of the four California trial court decisions was affirmed. In the first appellate decision issued outside of Delaware, the California Court of Appeal enforced a forum-selection clause in a corporate charter requiring that all Securities Act claims be brought in federal court.²²⁵ The Court of Appeal rejected all of plaintiff's challenges to the FFP under the Securities Act, dormant Commerce Clause, Supremacy Clause, and California law.²²⁶

Cyan has had at least one other significant effect. In its aftermath, lower federal and state courts disagree concerning a primary feature of the PSLRA. That statute imposes an automatic stay of discovery and other proceedings during the pendency of a motion to dismiss, absent application of one of two exceptions—when particularized discovery is necessary to preserve evidence or to prevent undue prejudice to the party seeking relief.²²⁷ Congress created the stay to prevent fishing expeditions and extortive discovery.²²⁸ Federal courts have an expansive view of the scope of the provision, and “most courts have rejected attempts to lift the stay on the ground that a defendant has already produced the documents in a government investigation, an internal

Forum Provisions, HARV. L. SCH. F. ON CORP. GOV. (Oct. 9, 2021), <https://corpgov.law.harvard.edu/2021/10/09/new-york-court-on-the-enforcement-of-federal-forum-provision/> (noting that 80 percent of such cases filed in 2020 were filed in California or New York).

²²³ *Hook v. Casa Sys., Inc.*, No. 654548/2019, 2021 WL 3884063, at *4 (N.Y. Cnty. 2021).

²²⁴ *Id.*

²²⁵ *Wong v. Restoration Robotics, Inc.*, 78 Cal. App. 5th 48, at *16 (Cal. App. 2022).

²²⁶ *Id.* at *4–16.

²²⁷ 15 U.S.C. § 78u-4(b)(3)(B).

²²⁸ Wendy Gerwick Couture, *The PSLRA Discovery Stay in Complex Litigation*, COLUM. L. SCH., CLS BLUE SKY BLOG (July 7, 2014), <https://clsbluesky.law.columbia.edu/2014/07/07/the-pslra-discovery-stay-in-complex-litigation/>.

investigation, a bankruptcy proceeding, or another action not governed by the PSLRA.”²²⁹

The PSLRA stay has great practical significance. The parties in securities class actions rarely file motions for summary judgment,²³⁰ and during the years 1997 to 2020, only 0.4 percent of core federal securities filings (nineteen cases) proceeded to trial.²³¹ Accordingly, the ultimate outcome of the litigation is primarily dependent on the resolution of motions to dismiss. If plaintiffs survive the motion, the likelihood of a major settlement—often following mediation and class certification—increases exponentially.²³² Not surprisingly, then, as noted *supra*, motions to dismiss were filed in ninety-six percent of all securities class actions filed and resolved during the period of 2012 to 2021. These motions are almost always resolved absent discovery because plaintiffs generally fail to have the automatic stay lifted under either of the two statutory exceptions.²³³ The stay—in combination with the PSLRA’s strict pleading requirements—explains the almost universal reliance on CWs by plaintiffs and their counsel in drafting their complaints in securities litigation. In the absence of publicly available information from the SEC or DOJ, information

²²⁹ David M.J. Rein et al., *Securities Litigation Involving the Private Securities Litigation Reform Act*, PRACTICAL L. 39, 42 (Nov. 2017).

²³⁰ See *2018 Full-Year Review*, *supra* note 18, at 19 (“Motions for summary judgment were filed by defendants in 7.1%, and by plaintiffs in only 1.9%, of the securities class actions filed and resolved over the 2000-2018 period, among those we tracked.”).

²³¹ *2020 Year in Review*, *supra* note 25, at 19.

²³² William S. Freeman & Catherine T. Zeng, *The Trouble with ‘Confidential Witness’ Allegations*, LAW360 (Feb. 3, 2012, 2:12 PM EST), <https://www.law360.com/articles/303826/the-trouble-with-confidential-witness-allegations>. Cf. Andrew Pincus, *Containing the Contagion: Proposals to Reform the Broken Securities Class Action System*, U.S. Chamber Institute for Legal Reform 1, 19 (Feb. 2019), <https://instituteforlegalreform.com/wp-content/uploads/2020/10/Securities-Class-Action-Reform-Proposals.pdf> (“The district court’s decision on the motion to dismiss is the critical event in securities class actions: if the motion to dismiss is denied, class certification and settlement virtually always follow.”). The foregoing statement is somewhat hyperbolic. A motion for class certification was filed in less than twenty percent of the securities class actions filed and resolved during the period 2012–2021, in part because so many cases settle or are dismissed before the parties reach the certification stage of the litigation. Janeen McIntosh & Svetlana Starykh, *Recent Trends in Securities Class Action Litigation: 2021 Full-Year Review* 1, 15, NERA Economic Consulting (Jan. 25, 2022), https://www.nera.com/content/dam/nera/publications/2022/PUB_2021_Full-Year_Trends_01222.pdf.

²³³ Mark, *supra* note 124, at 795.

provided by CWs often is the only support for allegations of scienter or falsity.²³⁴

Post-*Cyan*, trial courts both across and within states have disagreed as to whether the PSLRA's discovery stay applies in state court Securities Act litigation. State court judges in New York—which experienced one of the largest post-*Cyan* spikes in Securities Act cases—have split on the issue,²³⁵ and courts in other states are similarly divided. One 2020 review found that, post-*Cyan*, there have been fifteen rulings in state courts on motions to stay discovery in Securities Act cases, ten of which were in New York.²³⁶ Four of the New York motions “were granted, four were denied, and two were granted pursuant to the parties’ stipulations.”²³⁷ A compelling argument offered by Professor Wendy Gerwick Couture is that the PSLRA discovery stay should not apply in state court because the statute does not expressly or impliedly preempt states’ permissive discovery rules.²³⁸ Courts rejecting that argument and choosing to impose a stay can effectively prevent plaintiffs from obtaining discovery to bolster amended complaints in cannabis EDSL and other categories of securities litigation.²³⁹ The Supreme Court was poised to resolve the conflict, but the Court removed a potentially dispositive case from its November 2021 argument calendar after the parties advised that a settlement was imminent.²⁴⁰

²³⁴ *Id.* at 796.

²³⁵ See Rachel Graf, *NY Judges Split on Post-Cyan Discovery Stays*, LAW360 (Aug. 7, 2019, 8:17 PM EST), <https://www.law360.com/articles/1185924/ny-judges-split-on-post-cyan-discovery-stays>.

²³⁶ Michael Klausner & Jason Hegland, *State Section 11 Litigation in the Post-Cyan Environment (Despite Sciabacucchi)*, 75 BUS. LAW. 1769, 1780 (2020).

²³⁷ *Id.*

²³⁸ See Wendy Gerwick Couture, *Cyan, Reverse Erie, and the PSLRA Discovery Stay in State Court*, 47 SEC. REG. L.J. 21 (2019).

²³⁹ Bruce G. Vanya et al., *Guest Post: Section 11 Cases in State Court Post-Cyan—Is the Tide Turning?*, D&O DIARY (May 18, 2020), <https://www.dandodiary.com/2020/05/articles/securities-litigation/guest-post-section-11-cases-in-state-court-post-cyan-is-the-tide-turning/>.

²⁴⁰ See *Pivotal Software, Inc. v. Superior Court of Cal.*, No. 20-1541, 2021 WL 2742794 (U.S. 2021) (granting petition for writ of certiorari); Dean Seal, *Justices Shelve Securities Discovery Case as Sides Near Deal*, LAW360 (Sept. 2, 2021, 9:45 PM EDT), <https://www.law360.com/articles/1418647/justices-shelve-securities-discovery-case-as-sides-near-deal> (reporting settlement).

IV. CANNABIS SPACs

The next Part of this Article examines two intertwined trends: the rise of cannabis SPACs and the flood of securities class action litigation stemming from de-SPAC transactions. This Part also discusses both direct and derivative claims in SPAC litigation for alleged breaches of fiduciary duty.

A. *The Rise of Cannabis SPACs*

As noted *supra*, a SPAC is a shell company with no operating history and no assets. SPACs are formed for the purpose of raising capital in an IPO and using that capital to acquire one or more existing private companies—such as a CRB—and take those companies public.²⁴¹ Investors in a SPAC IPO generally receive a unit consisting of one share of redeemable voting common stock in the SPAC (typically denominated as Class A), as well as a fraction of a warrant to purchase additional common stock at a fixed price in the public company that survives the acquisition.²⁴² SPACs temporarily invest IPO proceeds in U.S. treasury securities and escrow proceeds in an interest-bearing trust account until they are used to acquire a target.²⁴³ The acquisition by the SPAC of a private company is commonly referred to as a de-SPAC transaction and less frequently referred to as an initial business combination.²⁴⁴ In a typical de-SPAC, a target company combines with the SPAC (often by merging into a SPAC's subsidiary), and the target's stock is canceled and exchanged for the right to receive SPAC shares.²⁴⁵ Prior to the de-SPAC, "the SPAC is considered a shell company under Rule 405 of the Securities Act."²⁴⁶

²⁴¹ Harold S. Bloomenthal & Samuel Wolff, *Structure and Related Considerations*, 3A SEC. & FED. CORP. LAW § 8:166 (Jan. 2022).

²⁴² *Id.*

²⁴³ *Id.*

²⁴⁴ See, e.g., U.S. Sec. and Exch. Comm'n, *What You Need to Know About SPACs—Updated Investor Bulletin* (May 21, 2021), <https://www.sec.gov/oiea/investor-alerts-and-bulletins/what-you-need-know-about-spacs-investor-bulletin> (using latter terminology).

²⁴⁵ Bloomenthal & Wolf, *supra* note 241.

²⁴⁶ *Id.*

If no de-SPAC occurs within the time frame specified in the SPAC's charter, typically by eighteen to twenty-four months after the effective date of the IPO and never in excess of thirty-six months,²⁴⁷ the SPAC liquidates and returns its IPO funds to the public shareholders with nominal interest.²⁴⁸ Extensions, which prevent failure and the return of funds, are common. A 2021 study found that fifty-nine percent of SPACs were unable to fulfill the timetable for acquiring a company set forth in their IPO prospectus,²⁴⁹ but less than ten percent of SPACs have liquidated since 2009.²⁵⁰

De-SPAC transactions generally require approval of the shareholders of both the SPAC and the acquired company,²⁵¹ but the vote typically is a mere formality. SPAC founders—often referred to as sponsors—pay “a nominal amount (usually \$25,000) for a number of founder shares that equal twenty-five percent of the number of shares being registered for offer to the public,”²⁵² and sponsors commit their shares at signing through a voting agreement to vote in favor of the de-SPAC.²⁵³ “[T]he expertise and

²⁴⁷ Rodrigues & Stegemoller, *supra* note 11, at 899. The thirty-six-month ceiling was established by the NYSE and the Nasdaq when the exchanges began listing SPACs in 2008. *Id.* In late 2021 multiple SPACs committed to completing mergers in fifteen months or less, but such a compression remains atypical. Tom Zanki, *3 Hurdles That Could Slow the Pace of SPACs in 2022*, LAW360 (Jan. 3, 2022, 12:03 PM EST), <https://www.law360.com/articles/1447642> (“Most SPACs historically have set time frames of 18 to 24 months to complete a deal or return investors their money. But many SPACs went public in late 2021 with shorter timelines of 15 months or less.”).

²⁴⁸ Christopher S. Auguste et al., *A SPAC Primer*, M&A MONITOR, KRAMER LEVIN NAFTALIS & FRANKEL LLP (Mar. 1, 2021), <https://www.kramerlevin.com/en/perspectives-search/a-spac-primer.html>.

²⁴⁹ See Usha R. Rodrigues, *SPACs: Insider IPOs*, HARV. L. SCH. F. ON CORP. GOV. (Sept. 21, 2021), <https://corpgov.law.harvard.edu/2021/09/21/spacs-insider-ipos/> (describing study of all SPACs that filed an initial prospectus during the period 2010–2018).

²⁵⁰ Bloomenthal & Wolff, *supra* note 241.

²⁵¹ Derek Zaba et al., *SPACs: A New Frontier for Shareholder Activism*, HARV. L. SCH. F. ON CORP. GOV. (Oct. 5, 2021), <https://corpgov.law.harvard.edu/2021/10/05/spacs-a-new-frontier-for-shareholder-activism/> (stating that de-SPAC requires shareholder approval from both SPAC and target).

²⁵² Ramey Layne & Brenda Lenahan, *Special Purpose Acquisition Companies: An Introduction*, HARV. L. SCH. F. ON CORP. GOV. (July 6, 2018), <https://corpgov.law.harvard.edu/2018/07/06/special-purpose-acquisition-companies-an-introduction/>.

²⁵³ Igor Kirman & Alon B. Harish, *Understanding De-SPAC Transactions*,

reputation of the sponsor[s],” who frequently work in the private equity or venture capital sectors, are often critical to the SPAC’s success, and serial sponsors are not uncommon.²⁵⁴ The sponsors’ shares—often referred to as the “promote”—typically equal twenty percent of the total outstanding shares after completion of the IPO, thus requiring less than forty percent of the public shares to achieve a majority vote and approve the de-SPAC transaction.²⁵⁵

In addition, in connection with the de-SPAC vote, shareholders can typically redeem their shares at closing for the initial investment value (usually \$10 per share), plus interest earned, even if they vote for the business combination. While “[s]tock exchange listing rules require that redemption rights be offered only to shareholders who vote against the” transaction, SPACs’ organizational documents generally extend this right “regardless of how or whether they vote.”²⁵⁶ During the period July–November 2021, “mean and median SPAC redemptions were fifty-seven percent and sixty-eight percent, respectively,”²⁵⁷ and the mean spiked to approximately eighty percent in January 2022.²⁵⁸ Such elevated rates reflect historical SPAC norms—more than one-third of SPACs that merged between January 2019 and June 2020 had redemptions in excess of ninety percent.²⁵⁹ High redemptions, however, generally have not derailed de-SPAC votes. In 2021, a record 199 de-SPACs closed, up from the prior record of sixty-four in 2020,²⁶⁰ and during the years 2019 to 2021, a mere eight SPACs

THOMSON REUTERS PRACTICAL L., [https://content.next.westlaw.com/practical-law/document/I97a1a6b8cd1611ebbea4f0dc9fb69570/The-Mechanics-of-De-SPAC-Deals?viewType=FullText&transitionType=Default&contextData=\(sc.Default\)&firstPage=true](https://content.next.westlaw.com/practical-law/document/I97a1a6b8cd1611ebbea4f0dc9fb69570/The-Mechanics-of-De-SPAC-Deals?viewType=FullText&transitionType=Default&contextData=(sc.Default)&firstPage=true) (last visited Mar. 16, 2022).

²⁵⁴ Jerry K C Koh & Victoria Leong, *Spotlight on SPACs: Key Trends and Issues*, 22 BUS. L. INT’L 279, 289, 302 (2021).

²⁵⁵ Layne & Lenahan, *supra* note 252.

²⁵⁶ Kirman & Harish, *supra* note 253.

²⁵⁷ Michael Klausner et al., *A Second Look at SPACs: Is This Time Different?*, HARV. L. SCH. F. ON CORP. GOV. (Jan. 24, 2022), <https://corpgov.law.harvard.edu/2022/01/24/a-second-look-at-spacs-is-this-time-different/>.

²⁵⁸ Benjamin Horney, *De-SPACs Still Popular but Becoming Harder to Close*, LAW360 (Feb. 16, 2022, 4:02 PM EST), <https://www.law360.com/articles/1464716/de-spacs-still-popular-but-becoming-harder-to-close>.

²⁵⁹ Michael Klausner et al., *A Sober Look at SPACs*, HARV. L. SCH. F. ON CORP. GOV. (Nov. 19, 2020), <https://corpgov.law.harvard.edu/2020/11/19/a-sober-look-at-spacs/>.

²⁶⁰ Horney, *supra* note 258.

liquidated.²⁶¹

SPACs provide an alternative to traditional IPOs and direct listings for companies that seek to go public.²⁶² SPACs of the 2020s are descendants of two prior much-derided vehicles: the blank check companies of the 1980s²⁶³ and the reverse shell mergers of the early 2000s.²⁶⁴ While SPACs have existed in some form in the United States since 1993, for decades they were regarded as a niche segment of the capital markets landscape.²⁶⁵ As described below, SPACs did not explode until 2020, when the modern SPAC ecosystem arose. Catalysts for this development likely include the onset of the COVID-19 pandemic, pent-up investor demand, and a substantial number of potential target private companies.

²⁶¹ Jocelyn Arel et al., *SPAC 2021 Year-End Review and 2022 Preview: Tailwinds, Headwinds, and Regulatory Landscape*, GOODWIN PROCTER LLP (Jan. 6, 2022), <https://www.goodwinlaw.com/-/media/files/publications/spac2021.pdf>.

²⁶² A direct listing offers a company a path to list its shares on an exchange without an underwritten offering. Andrew J. Pitts et al., *Direct Listings: Going Public Without an IPO*, 53 REV. OF SEC. & COMM. REG. 139, 139 (2020); Benjamin J. Nickerson, Comment, *The Underlying Underwriter: An Analysis of the Spotify Direct Listing*, 86 U. CHI. L. REV. 985, 986 (2019). While direct listings by such companies as Spotify and Slack have generated considerable publicity, by October 2021 only twelve companies had used this option in the United States. Hester M. Peirce, *Speech by Commissioner Peirce on the Future of the SPAC Market*, HARV. L. SCH. F. ON CORP. GOV. (Nov. 1, 2021), <https://corpgov.law.harvard.edu/2021/11/01/speech-by-commissioner-peirce-on-the-future-of-the-spac-market/>. In May 2022 the CRB Bright Green Corporation went public via a direct listing and began trading on the Nasdaq. Tom Zanki, *Dentons-Led Cannabis Producer Soars After Direct Listing*, LAW360 (May 17, 2022, 9:40 PM EDT), <https://www.law360.com/articles/1494110/dentons-led-cannabis-producer-soars-after-direct-listing>.

²⁶³ See Bazerman & Patel, *supra* note 12 (noting that blank check companies of the 1980s were plagued by penny-stock fraud). The terminology can be confusing because the SEC sometimes describes SPACs as blank check companies. Layne & Lenahan, *supra* note 252, at n.10. This description is somewhat misleading because SPACs do not issue penny stock, whereas blank check companies do. *Id.*

²⁶⁴ See Perrie Weiner et al., *How SPACs Can Avoid Failed China Reverse Mergers 2.0*, LAW360 (Apr. 27, 2021, 5:21 PM EDT), <https://www.law360.com/articles/1379137/how-spacs-can-avoid-failed-china-reverse-mergers-2-0> (describing demise of Chinese reverse merger boom).

²⁶⁵ Peirce, *supra* note 262.

In 2020, the use of SPACs became the dominant method for companies to go public in the United States,²⁶⁶ and by December 2021, SPACs accounted for more than sixty percent of annual U.S. IPO volume.²⁶⁷ In 2021, more than six hundred SPACs went public in the United States²⁶⁸ (raising more than \$123 billion),²⁶⁹ and more than 180 de-SPAC transactions took place, with an aggregate deal value of at least \$370 billion.²⁷⁰ By comparison, there were only 226 total SPAC IPOs in the United States during the years 2009 to 2019,²⁷¹ and only twenty-six de-SPAC transactions took place in 2019.²⁷² The number of announced de-SPACs in the United States increased over 200 percent from 2019 to 2021.²⁷³ Subsequently, however, the SPAC market cooled in 2022.²⁷⁴

Nasdaq and the NYSE first allowed SPAC listings in 2008.²⁷⁵ In the United States, SPACs typically form as Delaware corporations and list on the Nasdaq Capital Markets (the Nasdaq market tier for early-stage companies with lower market

²⁶⁶ See Michael Damba et al., *Should SPAC Forecasts Be Sacked?*, HARV. L. SCH. F. ON CORP. GOV. (Oct. 11, 2021), <https://corpgov.law.harvard.edu/2021/10/11/should-spac-forecasts-be-sacked/> (observing that since 2020 the number of IPOs by SPACs has outpaced the number of traditional IPOs).

²⁶⁷ U.S. Sec. & Exch. Comm'n, Gary Gensler, Remarks Before the Healthy Markets Association Conference (Dec. 9, 2021), <https://www.sec.gov/news/speech/gensler-healthy-markets-association-conference-120921> [hereinafter Gensler Remarks].

²⁶⁸ Arel, *supra* note 261.

²⁶⁹ Brian A. Herman et al., *The Future of SPACs: Increasing Litigation and Regulation*, MORGAN, LEWIS & BOCKIUS LLP (Dec. 1, 2021), <https://www.morganlewis.com/pubs/2021/12/the-future-of-spacs-increasing-litigation-and-regulation>.

²⁷⁰ Gensler Remarks, *supra* note 267.

²⁷¹ Kevin LaCroix, *Post-SPAC-Merger Fintech Company Hit with Securities Suit*, D&O DIARY (Dec. 12, 2021), <https://www.dandodiary.com/2021/12/articles/securities-litigation/post-spac-merger-fintech-company-hit-with-securities-suit/>.

²⁷² Gensler Remarks, *supra* note 267.

²⁷³ Christopher Barlow et al., *Strong IPO Demand Offered One Route to Public Markets—Other Companies Opted for de-SPACs or Direct Listings*, SKADDEN, ARPS, SLATE, MEAGHER & FLOM LLP (Feb. 1, 2022), <https://www.skadden.com/insights/publications/2022/02/strong-ipo-demand-offered-one-route-to-public-markets>.

²⁷⁴ See, e.g., Tom Zanki, *Forbes, SeatGeek Cancel SPAC Mergers Amid Market Woes*, LAW360 (June 1, 2022, 3:01 PM EDT), <https://www.law360.com/articles/1498557/forbes-seatgeek-cancel-spac-mergers-amid-market-woes> (noting “latest sign of chilling market conditions for the once-scorching SPAC sector”).

²⁷⁵ Koh & Leong, *supra* note 254, at 289.

capitalizations), but some list on the NYSE.²⁷⁶ Most SPACs seek domestic targets, and those SPACs seeking offshore targets are organized primarily in the Cayman Islands.²⁷⁷ SPAC formation also is increasingly common in Canada, Europe, and Asia.²⁷⁸ Indeed, foreign capital markets have taken numerous steps to facilitate SPAC activity, in an effort to compete with the United States.²⁷⁹

Life sciences companies have become frequent SPAC merger targets and CRBs constitute a significant fraction of that pool because they are especially attractive.²⁸⁰ This is partly because the cannabis industry, still in its relative infancy, has substantial growth potential that generates a more favorable risk/reward profile than other industries.²⁸¹ SPAC transactions are likewise appealing to cannabis companies seeking to go public. The industry is cash-starved²⁸² and SPACs provide access to capital that has previously

²⁷⁶ Christopher S. Auguste et al., *A SPAC Primer*, M&A MONITOR, KRAMER LEVIN NAFTALIS & FRANKEL LLP (Mar. 1, 2021), <https://www.kramerlevin.com/en/perspectives-search/a-spac-primer.html>.

²⁷⁷ *Id.*; cf. Robert Malionek et al., *SPAC-Related Litigation Risks and Mitigation Strategies*, HARV. L. SCH. F. ON CORP. GOV. (Aug. 9, 2021), <https://corpgov.law.harvard.edu/2021/08/09/spac-related-litigation-risks-and-mitigation-strategies/> (“[M]any US SPACs are increasingly looking to Asia for targets.”).

²⁷⁸ See, e.g., Michael Levitt et al., *SPAC Momentum Continues in Europe*, HARV. L. SCH. F. ON CORP. GOV. (Oct. 3, 2021), <https://corpgov.law.harvard.edu/2021/10/03/spac-momentum-continues-in-europe/> (noting that nearly thirty SPACs listed in Europe from January–September 2021); Mark Geday et al., *How Global Markets Are Preparing for Potential SPAC Growth*, LAW360 (June 17, 2021, 04:52 PM EST), <https://www.law360.com/articles/1392490/how-global-markets-are-preparing-for-potential-spac-growth> (discussing SPAC markets in the United Kingdom, Europe, and Asia).

²⁷⁹ See, e.g., Tom Zanki, *Hong Kong’s New SPAC Regulations to Go Live in January*, LAW360 (Dec. 17, 2021, 5:20 PM EST), <https://www.law360.com/articles/1449813/hong-kong-s-new-spac-regulations-to-go-live-in-january> (reporting that new rules governing SPACs in Hong Kong will become effective in January 2022).

²⁸⁰ See Robert A. Freedman & Amanda L. Rose, *Life Sciences IPOs, SPACs on the Upswing in H1 2021*, FENWICK & WEST LLP (Sept. 14, 2021), <https://www.fenwick.com/life-sciences/life-sciences-ipos-spacs-on-the-upswing-in-h1-2021> (reporting that sixteen life sciences de-SPACs took place in the first half of 2021, compared with only four in the second half of 2020).

²⁸¹ *SPAC Activity in Cannabis 2021*, HIGHWAY 33 CAPITAL ADVISORY (Sept. 3, 2021), <https://highway33.com/spac-activity-in-cannabis-2021/>.

²⁸² Matthew M. Ferguson & Matthew Guarnero, *Cannabis and SPACs: The Potential Convergence of Growing Industries and Opportunities for D&O*

been unavailable from banks²⁸³ or in a traditional IPO.²⁸⁴ Cannabis companies seek market share to ensure economies of scale and market dominance, and a de-SPAC transaction can help achieve those goals.²⁸⁵

Underwriters to Assess Risk, KENNEDYS (Nov. 10, 2021), <https://kennedyslaw.com/thought-leadership/article/cannabis-and-spacs-the-potential-convergence-of-growing-industries-and-opportunities-for-do-underwriters-to-assess-risk/>; see also Christopher Jones, *The Market for Cannabis SPACs*, MG MAGAZINE (Nov. 17, 2021), <https://mgretailer.com/business/finance-acquisitions/the-market-for-cannabis-spacs/> (noting on-going equity capital shortage in cannabis market).

²⁸³ See Aloviseti & Ross, *supra* note 73 (noting minimal number of FDIC-insured banks willing to lend to CRBs); Colleen M. Baker, *Entrepreneurial Regulatory Legal Strategy: The Case of Cannabis*, 57 AM. BUS. L.J. 913, 917 (2020) (“CRBs currently have limited (if any) access to the banking system because cannabis remains illegal under federal law.”). The circumscribed access of CRBs to banking services in the United States has compelled them to become significant cash businesses, which elevates their susceptibility to fraud. Nicole Hallas, *Cannabis Market Audit Firm Landscape*, AUDIT ANALYTICS (May 9, 2022), <https://blog.auditanalytics.com/cannabis-market-audit-firm-landscape/>. Legislation prohibiting financial institutions from being penalized by federal banking regulators for doing business with CRBs has repeatedly stalled in Congress, most recently in December 2021. See Jonathan Gallo, *SAFE Banking Act Removed from Defense Spending Bill*, JDSUPRA (Dec. 10, 2021), <https://www.jdsupra.com/legalnews/safe-banking-act-removed-from-defense-2397461/> (reporting failure of cannabis banking reform bill). Indeed, the CRB-focused Secure and Fair Enforcement Banking Act has passed the House of Representatives six times but has never advanced in the Senate. Sam Reisman, *Rep. Perlmutter Says He Has a ‘Plan B’ for Pot Banking Bill*, LAW360 (June 9, 2022, 7:40 PM EDT), <https://www.law360.com/articles/1501315/rep-perlmutter-says-he-has-a-plan-b-for-pot-banking-bill>. In another CRB banking development, in November 2021, JPMorgan Chase & Co. advised its prime brokerage clients that it would no longer permit new purchases or short positions in stocks of plant-touching CRBs that are not listed on the Nasdaq, the NYSE, or the TSE. A.J. Herrington, *JPMorgan Chase to Restrict Trading in Some U.S. Cannabis Stocks*, FORBES (Nov. 5, 2021, 4:25 PM EST), <https://www.forbes.com/sites/ajherrington/2021/11/05/jpmorgan-to-restrict-trading-in-some-us-cannabis-stocks/?sh=20f31f031a3f>.

²⁸⁴ *Once Taboo, SPACs Are Now the Main Driver of Fundraising and New Growth in Cannabis*, PRNEWswire (Nov. 1, 2021, 7:28 PM EST), <https://www.prnewswire.com/news-releases/once-taboo-spacs-are-now-the-main-driver-of-fundraising-and-new-growth-in-cannabis-301413460.html>.

²⁸⁵ Matthew Rizzo & Marco Eadie, *Cannabis SPACs are Piquing Investor Interest*, LAW360 (June 16, 2021, 3:45 PM EST), <https://www.law360.com/articles/1394350/cannabis-spacs-are-piquing-investor-interest>.

Not surprisingly, then, a wave of cannabis-focused SPACs began to build, beginning in 2019 and continuing thereafter.²⁸⁶ The SPAC wave gained momentum in 2020 when cannabis sales were deemed essential services by most governors in legal cannabis states during the coronavirus pandemic,²⁸⁷ and cannabis SPACs held more than \$2 billion in assets that year.²⁸⁸ The trend continued as the pandemic persisted—between mid-2020 and mid-2021 most cannabis financing deals were conducted through SPACs.²⁸⁹ During the period January–August 2021 nine cannabis de-SPAC transactions totaling approximately \$5 billion were completed.²⁹⁰ One August 2021 transaction was described as “combin[ing] two of the hottest trends in public markets over the last few years: SPACs and cannabis.”²⁹¹ By October 2021 there were at least twenty-two cannabis SPACs.²⁹² Additional cannabis (and psychedelic) SPAC activity occurred in 2022.²⁹³ For example, in

²⁸⁶ Tom Zanki, *3 Trends Underlying the Boom in Blank-Check IPOs*, LAW360 (June 19, 2020, 10:08 AM EST), <https://www.law360.com/articles/1284146>; Yelena Dunaevsky, *Cannabis SPACs: A Promising Trend?*, AM. BAR ASS'N BUS. L. SEC. (Mar. 2020), <https://businesslawtoday.org/month-in-brief/march-brief-mergers-acquisitions-2020/> (reporting that five cannabis-focused SPACs went public in 2019).

²⁸⁷ Siri Bulusu, *Cannabis SPACs' Cross-Border Push Threatens Tax Hit on Investors*, BLOOMBERG TAX (Apr. 9, 2021, 4:46 AM EST), <https://news.bloombergtax.com/daily-tax-report-international/cannabis-spacs-cross-border-push-threatens-tax-hit-on-investors>; Lawrence Carrel, *Cannabis Sales Fell in 2021, but Debt Capital Raises Grew 806%*, FORBES (Dec. 30, 2021, 5:49 PM EST), <https://www.forbes.com/sites/lcarrel/2021/12/30/cannabis-sales-fell-in-2021-but-debt-capital-raises-grew-806/?sh=5c568a591d9f> (stating that marijuana sales surged 39.2 percent in 2020 in California, Colorado, Nevada, Oregon, and Washington after cannabis retailers were deemed essential businesses during pandemic-induced lockdowns).

²⁸⁸ Eric Sandy, *SPACs Infused a Tough Capital Market for Cannabis Businesses This Year*, CANNABIS BUS. TIMES (Dec. 21, 2020), <https://www.cannabisbusinesstimes.com/article/spac-investment-reverse-merger-trends-cannabis/>.

²⁸⁹ *Could SPACs Rescue the Cannabis Industry?*, DEFIANCE ETFs (June 23, 2021), <https://www.defianceetfs.com/could-spacs-rescue-the-cannabis-industry/>.

²⁹⁰ *Once Taboo, SPACs Are Now the Main Driver of Fundraising and New Growth in Cannabis*, *supra* note 284.

²⁹¹ *SPAC Deal Brings Greek Cannabis Company to London*, 420 INTEL (Aug. 2, 2021), <https://420intel.com/articles/2021/08/02/spac-deal-brings-greek-cannabis-company-london>.

²⁹² Christopher Jones, *The Market for Cannabis SPACs*, MG MAGAZINE (Nov. 17, 2021), <https://mgretailer.com/business/finance-acquisitions/the-market-for-cannabis-spacs/>.

²⁹³ See Kurt Schlosser, *Cannabis Marketplace Leafly Closes SPAC Merger Deal*

February 2022, Safe Harbor Financial—one of the first commercial cannabis lending platforms in the United States—announced plans to go public in a de-SPAC.²⁹⁴ Safe Harbor launched seven years earlier to provide legally compliant access to banking and financial services for the U.S. cannabis industry.²⁹⁵

Potential cannabis deals have not always closed. Multiple SPACs that originally targeted the cannabis sector were ultimately forced to merge with companies unrelated to marijuana,²⁹⁶ given a scarcity of cannabis targets of sufficient size to meet deal requirements imposed by the NYSE and the Nasdaq.²⁹⁷ The exchanges require target businesses or assets to have an aggregate fair market value of at least eighty percent of the assets held in the SPAC's trust account.²⁹⁸

and Will Go Public on Monday, GEEKWIRE (Feb. 4, 2022, 2:27 PM EST), <https://www.geekwire.com/2022/cannabis-marketplace-leafly-closes-spac-merger-deal-and-will-go-public-on-monday/> (reporting that CRB Leafly will trade on the Nasdaq following de-SPAC); *see also* Katryna Perera, *Latham, Davis Polk Guide Psychedelic Co.'s SPAC Merger*, LAW360 (Jan. 20, 2022, 5:25 PM EST), <https://www.law360.com/securities/articles/1457220/latham-davis-polk-guide-psychedelic-co-s-spac-merger> (reporting SPAC involving life science company Eleusis, which primarily works with psilocybin and LSD, and will list on the Nasdaq).

²⁹⁴ Jeff Smith, *Pioneering Cannabis Banking Company Safe Harbor to Trade on Nasdaq via \$185 Million Deal*, MARIJUANA BUS. DAILY (Feb. 14, 2022), <https://mjbizdaily.com/cannabis-banking-company-safe-harbor-to-trade-on-nasdaq-via-185-million-deal/>.

²⁹⁵ *Id.*

²⁹⁶ Christopher Jones, *The Market for Cannabis SPACs*, MG MAGAZINE (Nov. 17, 2021), <https://mgretailer.com/business/finance-acquisitions/the-market-for-cannabis-spacs/> (noting SPACs are prohibited from identifying specific target operating companies prior to their IPOs, but they are allowed to identify target industry sectors).

²⁹⁷ *See* Shariq Khan, *Cannabis SPAC Deals Hit Nadir After Investors Snub Sector*, REUTERS (Sept. 23, 2021, 1:42 PM EST), <https://money.usnews.com/investing/news/articles/2021-09-23/cannabis-spac-deals-hit-nadir-after-investors-snub-sector>; *see also* *Could SPACs Rescue the Cannabis Industry?*, DEFIANCE ETFs (June 23, 2021), <https://www.defianceetfs.com/could-spacs-rescue-the-cannabis-industry/> (suggesting that there are too many SPAC IPOs chasing too few suitable CRB targets).

²⁹⁸ Layne & Lenahan, *supra* note 252.

Cannabis SPACs share the same listing obstacle confronted by CRBs going public through a traditional IPO or a direct listing²⁹⁹—senior exchanges in the United States generally decline to list plant-touching companies, given the illegality of marijuana under the federal CSA.³⁰⁰ The result is that many cannabis SPACs have formed in Canada, rather than in the United States,³⁰¹ and multiple Canadian SPACs have pursued U.S. CRBs.³⁰² Still, other SPACs have formed in the United States and targeted hemp³⁰³ or non-plant-touching cannabis companies,³⁰⁴ in recognition that the Nasdaq has been more receptive to listing ancillary CRBs.³⁰⁵ Some SPACs have been required to de-list their securities from U.S. exchanges following the acquisition of a plant-touching business and relist elsewhere, such as Toronto.³⁰⁶ This is generally

²⁹⁹ See John Rebchok, *A Marijuana SPAC Can Expedite Going Public, But Research on the Partner is Key*, MARIJUANA BUS. DAILY (Feb. 21, 2021), <https://mjbizdaily.com/an-acquisition-company-can-expedite-going-public-but-research-on-the-partner-is-key/> (reporting that cannabis technology company MJ Freeway considered both traditional IPO and direct listing before selecting SPAC structure to go public in 2019 and trade on the Nasdaq).

³⁰⁰ Aloviseti & Ross, *supra* note 73 (“Nasdaq and the NYSE have made it clear that they will not accept listings of plant-touching entities, despite state law compliance.”).

³⁰¹ Ashley Thurman, *SPAC Transactions in Cannabis: What’s a SPAC*, CANNABIS L. REP. (Apr. 19, 2021), <https://cannabislaw.report/spac-transactions-in-cannabis-whats-a-spac/>.

³⁰² Bulusu, *supra* note 287.

³⁰³ *Could SPACs Rescue the Cannabis Industry?*, DEFIANCE ETFs (June 23, 2021), <https://www.defianceetfs.com/could-spacs-rescue-the-cannabis-industry/> (noting that companies trading in hemp are generally welcome on the Nasdaq).

³⁰⁴ See, e.g., Charlie Innis, *Cannabis-Focused SPAC Files for \$100M IPO*, LAW360 (Aug. 5, 2021, 6:35 PM EST), <https://www.law360.com/articles/1410163/cannabis-focused-spac-files-for-100m-ipo> (reporting that the new SPAC Achari Ventures Holdings Corporation I may target “non-plant touching businesses that support the functioning of cannabis activity but are not directly related to cultivation, manufacturing, processing, branding, transportation, distribution, storage or sale of cannabis and cannabis-based products”).

³⁰⁵ See John Rebchok, *SPACs Offer Marijuana Companies a Source of Funding—And a Way to Go Public*, MARIJUANA BUS. DAILY (updated Mar. 15, 2021), <https://mjbizdaily.com/special-purpose-acquisition-companies-offer-marijuana-companies-funding-source-way-to-go-public/>; Aloviseti & Ross, *supra* note 73 (observing that U.S. exchanges are becoming increasingly comfortable listing ancillary cannabis SPACs, with the comfort level linked to the details of the target CRB’s operations).

³⁰⁶ Ashley Thurman, *SPAC Transactions in Cannabis: What’s a SPAC*, CANNABIS L. REP. (Apr. 19, 2021), <https://cannabislaw.report/spac-transactions-in-cannabis-whats-a-spac/>; see also Sarah Jarvis, *Pot-Focused Co. Greenrose Closes Theraplant*

undesirable from the CRBs' perspective because the trading volume in Canada is a fraction of the volume in the United States³⁰⁷ and the Canadian legal cannabis market is narrower.³⁰⁸

How have cannabis SPACs performed as publicly traded reporting companies? In general, SPAC performance has been unfavorable for most investors and the results are even worse for the subset of cannabis SPACs. A September 2021 analysis found that all but one CRB listed in the United States through a de-SPAC since 2020 was trading below its \$10 per share IPO price, whereas 46.5 percent of SPACs overall were trading higher since their mergers.³⁰⁹ A November 2021 analysis found that sixty-five percent of de-SPACs completed in 2021 at a valuation above \$1 billion were trading below their \$10 IPO price.³¹⁰ And a different November 2021 analysis of more than 190 de-SPACs completed since early 2019 found that such transactions “tend to significantly underperform typical IPOs.”³¹¹

Acquisition, Law360 (Nov. 29, 2021, 8:17 PM EST), <https://www.law360.com/articles/1443882/pot-focused-co-greenrose-closes-theraplant-acquisition> (reporting that former cannabis-focused SPAC Greenrose Acquisition Corporation delisted its shares from the Nasdaq in anticipation of becoming a plant touching business); John Rebchook, *SPACs Offer Marijuana Companies a Source of Funding—And a Way to Go Public*, MJBIZDAILY (updated Mar. 15, 2021), <https://mjbizdaily.com/special-purpose-acquisition-companies-offer-marijuana-companies-funding-source-way-to-go-public/> (citing Reed Smith LLP partner Marc Hauser for the proposition that if a SPAC buys a plant touching company, it would likely be required to delist from a U.S. exchange and relist on a Canadian exchange).

³⁰⁷ Khan, *supra* note 297.

³⁰⁸ See Keith Speights, *Why Canopy Growth, Cronos, Hexo, Sundial, and Tilray Stocks Are Plunging This Week*, MOTLEY FOOL (Nov. 18, 2021, 4:59 PM EST), <https://www.fool.com/investing/2021/11/18/why-canopy-growth-cronos-hexo-sundial-and-tilray-s/> (noting relatively small size of Canadian legal cannabis market).

³⁰⁹ Khan, *supra* note 297; *but see* Matthew Rizzo & Marco Eadie, *Cannabis SPACs are Piquing Investor Interest*, LAW360 (June 16, 2021, 3:45 PM EST), <https://www.law360.com/articles/1394350/cannabis-spacs-are-piquing-investor-interest> (reporting that most cannabis SPACs are “trading at a premium over their redemption value”).

³¹⁰ Ortenca Aliaj & Miles Kruppa, *The SPAC Machine Sputters Back to Life after Dramatic Meltdown*, FIN. TIMES (Nov. 21, 2021), <https://www.ft.com/content/d1723a8e-c146-4d48-8475-01cc9947a5d6>.

³¹¹ Noah Buhayar et al., *Wall Street is Churning Out SPACs at Investors' Peril*, BLOOMBERG.COM (Nov. 16, 2021), <https://www.bloomberg.com/graphics/2021-what-is-a-spac-wall-street-investor-risk/?terminal=1>.

B. SPAC Securities Class Action Litigation

SPACs have generated a significant volume of securities class action litigation, the filing trend is accelerating, and the underperformance noted above likely constitutes one major factor driving the litigation.³¹² By 2007 there had been no litigation involving SPACs.³¹³ Such litigation remained quite rare for the next decade, particularly in comparison to litigation involving traditional IPOs and public-to-public M&A transactions. In 2015 a New York state court denied motions to dismiss claims for alleged breaches of fiduciary duty by SPAC directors,³¹⁴ and in 2014 a federal SPAC securities class action settled following the denial of motions to dismiss.³¹⁵ In sharp contrast, at least sixty-two SPAC-related securities class actions were commenced during the period of January 2019 to June 2022.³¹⁶ According to one reliable tally, at least thirty-one such suits were filed in 2021 alone,³¹⁷ representing approximately fifteen percent of the securities class actions filed that year.³¹⁸

More than forty percent of the forty-eight SPAC-related securities class actions filed during the period of January 2021 to May 2022 followed the publication of a short seller report, and a disproportionate number of these cases arose in the electric

³¹² See *Litigation Risk in the SPAC World*, QUINN EMANUEL URQUHART & SULLIVAN, LLP, <https://www.quinnemanuel.com/the-firm/publications/litigation-risk-in-the-spac-world/#:~:text=The%20massive%20amount%20of%20SPAC,%2C%20investors%2C%20and%20targets%20alike> (last visited Apr. 26, 2022) (“Most SPAC litigation, historically, and most likely going forward, occurs after the SPAC merger has been completed, and the new company has performed poorly.”).

³¹³ Riemer, *supra* note 9, at 965.

³¹⁴ AP Servs., LLP v. Lobell, No. 651613/12, 2015 WL 3858818 (N.Y. Cnty. 2015).

³¹⁵ See *In re Heckmann Corp. Sec. Litig.*, 869 F. Supp. 2d 519 (D. Del. 2012) (denying motions to dismiss); *In re Heckmann Corp. Sec. Litig.*, No. 1:10-cv-00378-LPS-MPT, 2014 WL 12957418 (D. Del. June 26, 2014) (awarding attorneys’ fees and expenses in connection with settlement).

³¹⁶ *Current Trends in Securities Class Action Filings, SPACs*, STANFORD L. SCH., SEC. CLASS ACTION CLEARINGHOUSE, <https://securities.stanford.edu/current-trends.html> (last visited June 15, 2022).

³¹⁷ Kevin LaCroix, *And Again: Another Post-SPAC Merger EV Company Hit with Securities Suit*, D&O DIARY (Dec. 27, 2021), <https://www.dandodiary.com/2021/12/articles/securities-litigation/and-again-another-post-spac-merger-ev-company-hit-with-securities-suit/#>.

³¹⁸ *Id.*

vehicle and autonomous vehicle sector.³¹⁹ In a decision issued in January 2022 in a SPAC-related securities class action, a federal district court in California rejected defendants' argument that a short seller report could not be relied upon to establish the Rule 10b-5 elements of falsity or loss causation because it was inherently unreliable, and then mostly denied defendants' motion to dismiss.³²⁰ This case was somewhat anomalous, insofar as (1) none of the SPAC's former officers or directors were named as defendants³²¹ and (2) all of the alleged misrepresentations occurred after the de-SPAC. Nevertheless, the decision is significant insofar as it unequivocally rejected the argument that short seller reports are inherently unreliable,³²² and much SPAC litigation is premised upon such reports.

SPAC securities class action filings are widely expected to multiply in 2022 and 2023.³²³ Cannabis SPACs will likely be the subjects of some of these class actions, as well as other securities litigation commenced by individual investors.³²⁴ SPACs also have generated enforcement activity by the SEC and the U.S. Attorney's

³¹⁹ Kevin LaCroix, *Quantum Computing Company Hit with SPAC-Related Securities Suit After Short-Seller Report*, D&O DIARY (June 5, 2022), <https://www.dandodiary.com/2022/06/articles/securities-litigation/quantum-computing-company-hit-with-spac-related-securities-suit-after-short-seller-report/#>; *Client Alert No. 2938: SPAC-Related Enforcement and Litigation: What to Expect in 2022*, LATHAM & WATKINS LLP (Mar. 28, 2022), <https://www.lw.com/thoughtLeadership/SPAC-Related-Enforcement-and-Litigation-What-to-Expect-in-2022>.

³²⁰ *In re QuantumScape Sec. Class Action Litig.*, No. 3:21-cv-00058-WHO, 2022 WL 137729, at *9-10 (N.D. Cal. Jan. 14, 2022).

³²¹ *Cf. Camelot Event-Driven Fund v. Alta Mesa Resources, Inc.*, No. 4:19-CV-957, 2021 WL 1416025 (S.D. Tex. Apr. 14, 2021) (denying motions to dismiss as to all defendants in SPAC securities litigation, including SPAC's former officers).

³²² Kevin LaCroix, *SPAC-Related Securities Suit Dismissal Motion Substantially Denied*, D&O DIARY (Jan. 18, 2022), <https://www.dandodiary.com/2022/01/articles/uncategorized/spac-related-securities-suit-dismissal-motion-substantially-denied/>.

³²³ *See, e.g.*, Kevin LaCroix, *First SPAC-Related Securities Suit of the New Year Filed*, D&O DIARY (Jan. 12, 2022), <https://www.dandodiary.com/2022/01/articles/securities-litigation/first-spac-related-securities-suit-of-the-new-year-filed/> (“[W]e are for sure going to be seeing a lot more SPAC-related securities litigation in 2022.”).

³²⁴ *See, e.g.*, Sarah Jarvis, *Investors Accuse Wrigley Heir of Fraud over Cannabis SPAC*, LAW360 (Mar. 11, 2022, 6:42 PM EST), <https://www.law360.com/articles/1472760/investors-accuse-wrigley-heir-of-fraud-over-cannabis-spac> (reporting filing of complaint alleging securities fraud in connection with failed cannabis SPAC affiliated with music executive Scooter Braun).

Office for the Southern District of New York.³²⁵ This type of activity is likely to expand.³²⁶

Like any IPO, a SPAC requires filing a registration statement with the SEC, and some de-SPACs require both proxy and registration statements.³²⁷ Complaints in SPAC securities class action cases often focus on deficient disclosures in these statements.³²⁸ Indeed, because de-SPACs typically require shareholder approval, plaintiffs in early SPAC litigation often paired Section 10(b) securities fraud claims with Section 14(a) claims for misleading proxies.³²⁹ However, in 2021, only one SPAC

³²⁵ See, e.g., Dean Seal, *Electric Truck Co. Nikola to Pay \$125M to End SEC Probe*, LAW360 (Dec. 21, 2021, 11:28 AM EST), <https://www.law360.com/articles/1450654/electric-truck-co-nikola-to-pay-125m-to-end-sec-probe> (reporting \$125 million settlement between SEC and electric vehicle SPAC in December 2021). A different 2021 SEC enforcement action involved Stable Road Acquisition Corporation, a SPAC that initially focused on the cannabis industry and then pivoted to space transportation. See U.S. Sec. and Exch. Comm'n, Press Release No. 2021-124, *SEC Charges SPAC, Sponsor, Merger Target, and CEOs for Misleading Disclosures Ahead of Proposed Business Combination* (July 13, 2021), <https://www.sec.gov/news/press-release/2021-124> (announcing charges in connection with de-SPAC). The Stable Road de-SPAC also generated securities litigation. See Sarah Jarvis, *SPAC, Space Co. Say Investor Claims Not Ready for Launch*, LAW360 (Feb. 15, 2022, 6:25 PM EST), <https://www.law360.com/articles/1465190/spac-space-co-say-investor-claims-not-ready-for-launch> (reporting motions to dismiss in the litigation). Stable Road's de-SPAC pivot from cannabis or hemp is not unique. Another example is Collective Growth Corporation, a SPAC that initially targeted the international hemp industry in 2020 but ultimately merged with an Israeli company that produces lidar sensors and perception software for autonomous driving vehicles. Christopher Jones, *The Market for Cannabis SPACs*, MG MAGAZINE (Nov. 17, 2021), <https://mgretailer.com/business/finance-acquisitions/the-market-for-cannabis-spacs/>.

³²⁶ Bloomenthal & Wolff, *supra* note 241.

³²⁷ Bruce A. Ericson et al., *The SPAC Explosion: Beware the Litigation and Enforcement Risk*, HARV. L. SCH. F. ON CORP. GOV. (Jan. 14, 2021), <https://corpgov.law.harvard.edu/2021/01/14/the-spac-explosion-beware-the-litigation-and-enforcement-risk/>.

³²⁸ See Perrie M. Weiner & Desiree Hunter-Reay, *SPAC Litigation and Enforcement*, Westlaw Practical Law, THE JOURNAL/LITIGATION 22, 27 (Spring 2022), https://www.bakermckenzie.com/-/media/lit_spring22_coverfeature.pdf?sc_lang=en&hash=65DEB1ED368AD75FE24FF1EFE14FE669 (observing that commonly asserted claims in SPAC-related private litigation include material omissions or misstatements in the proxy statement).

³²⁹ *The SPAC Litigation Boom: What SPAC Sponsors, Directors and Officers Can Do to Mitigate Their Exposure*, PAUL, WEISS, RIFKIND, WHARTON & GARRISON LLP 1, 5 (Mar. 17, 2021), https://www.paulweiss.com/media/3980948/what_spac_sponsors_directors_and_officers_can_do_to_mitigate_their_litigation_exposure.pdf [hereinafter *SPAC Litigation Boom*].

securities class action filing included a Section 14 claim, while all of the remaining actions included Section 10(b) claims.³³⁰

Multiple SPAC suits have alleged deficient disclosure of financial projections. In traditional IPOs, companies do not disclose projections partly because underwriters are concerned about the liability risk under Section 11.³³¹ This concern is justified because the PSLRA's statutory safe harbor "contains a hodgepodge of exclusions," including one for IPOs.³³² In contrast, market participants have often assumed that because de-SPACs are mergers (or reverse mergers) the PSLRA's IPO safe harbor exclusion is inapplicable.³³³ As a result, financial projections, which look as many as five or more years into the future, have been a key aspect of marketing de-SPACs and investors have often been targeting those projections in SPAC litigation.³³⁴ A 2021 study found that over ninety percent of SPAC targets provide at least one financial forecast, with revenue being the most frequently projected metric.³³⁵ A different 2021 study found that the average SPAC projection extended nearly four years into the future and only thirty-five percent of firms had met their revenue projections.³³⁶

³³⁰ 2021 Year in Review, *supra* note 29, at 8.

³³¹ Gail Weinstein et al., *How SPACs Are Evolving, and What to Expect Next*, LAW360 (Aug. 10, 2021, 11:27 AM EST), <https://www.law360.com/articles/1410741/how-spacs-are-evolving-and-what-to-expect-next>.

³³² Amanda Rose, *SPAC Mergers, IPOs, and the PSLRA's Safe Harbor: Unpacking Claims of Regulatory Arbitrage*, HARV. L. SCH. F. ON CORP. GOV. (Dec. 2, 2021), <https://corpgov.law.harvard.edu/2021/12/02/spac-mergers-ipos-and-the-pslras-safe-harbor-unpacking-claims-of-regulatory-arbitrage/>.

³³³ Harold S. Bloomenthal & Samuel Wolff, *Special Purpose Acquisition Companies (SPACs)—Projections and the PSLRA Safe Harbor for Forward-Looking Statements*, 3A SEC. & FED. CORP. LAW § 8:158 (Jan. 2022).

³³⁴ Weinstein, *supra* note 331; Christopher Kercher et al., *SPAC Litigation Risks—What Happens if the SPAC Bubble Bursts*, QUINN EMANUEL URQUHART & SULLIVAN LLP, <https://www.quinnemanuel.com/the-firm/publications/spac-litigation-risks-what-happens-if-the-spac-bubble-bursts/> (last visited Feb. 20, 2022) ("[L]awsuits alleging SPAC investors were provided false and misleading projections are on the rise; disgruntled investors have filed nearly 10 cases that include such allegations in just the last three months.").

³³⁵ Michael Dambra et al., *Should SPAC Forecasts Be Sacked?*, HARV. L. SCH. F. ON CORP. GOV. (Oct. 11, 2021), <https://corpgov.law.harvard.edu/2021/10/11/should-spac-forecasts-be-sacked/> (reporting study results).

³³⁶ See Elizabeth Blankespoor et al., *A Hard Look at SPAC Projections*, HARV. L. SCH. F. ON CORP. GOV. (Jan. 20, 2022), <https://corpgov.law.harvard.edu/2022/01/20/a>

In March 2022 the SEC proposed new rules to align SPACs more closely with IPOs, and the proposal amended the existing definition of “blank check company” to clarify that SPACs cannot rely on the PSLRA’s safe harbor for projections and other forward-looking statements when marketing de-SPAC transactions.³³⁷ The SEC’s proposed new rules do not address the common law bespeaks caution doctrine, which provides that alleged misrepresentations are deemed immaterial as a matter of law if no reasonable investor could consider them important in light of adequate cautionary language.³³⁸ Accordingly, the doctrine may continue to provide an effective defense to plaintiffs’ claims concerning projections even if the new rules are adopted. Another potential defense may be the Supreme Court’s 2015 decision in *Omnicare*,³³⁹ which circumscribed securities claims based on opinion statements.

By June 2022 there had been rulings on motions to dismiss complaints in at least six SPAC-related securities class actions. Two of the motions were granted and four were substantially denied. In the most recent decision, in June 2022, a federal district court in New York substantially denied motions to dismiss claims against a de-SPACed company (Romeo Power) and two of its top executives but did dismiss claims against seven former members of the SPAC’s board of directors.³⁴⁰ As part of its ruling, the court rejected the application of the PSLRA’s safe harbor because the subject statements neither contained projections nor constituted statements of assumptions underlying projections.³⁴¹

hard-look-at-spac-projections/ (reporting study results).

³³⁷ *SEC Proposes Rules to Align SPACs More Closely with IPOs*, GIBSON DUNN & CRUTCHER LLP (Apr. 6, 2022), <https://www.gibsondunn.com/sec-proposes-rules-to-align-spacs-more-closely-with-ipos/>.

³³⁸ *See In re Bemis Co. Sec. Litig.*, 512 F. Supp. 3d 518, 537 n.6 (S.D.N.Y. 2021) (explaining the doctrine).

³³⁹ *Omnicare, Inc. v. Laborers Dist. Council Constr. Indus. Pension Fund*, 575 U.S. 175 (2015). *See also* *Ortiz v. Canopy Growth Corp.*, 537 F. Supp. 3d 621 (D.N.J. 2021) (explaining *Omnicare* decision).

³⁴⁰ *In re Romeo Power Inc. Sec. Litig.*, No. 21 Civ. 3362 (LGS), 2022 WL 1806303 (S.D.N.Y. June 2, 2022).

³⁴¹ *Id.* at *4.

In the five prior decisions, issued between April 2021 and January 2022, the courts twice granted motions to dismiss and three times substantially denied them.³⁴² In one of the decisions denying dismissal, involving QuantumScape Corporation and discussed above, a federal district court in California rejected defendants' argument that a negative short seller report issued by Scorpion Capital could not be relied upon to establish the Rule 10b-5 elements of falsity or loss causation because it was inherently unreliable.³⁴³ The court rejected defendants' motion to dismiss with respect to twenty-six of twenty-seven alleged misstatements, with the sole exception being a statement involving non-actionable puffery.³⁴⁴ In another victory for plaintiffs, a federal district court in Texas rejected defendants' puffery defense and denied eight separate motions to dismiss. The eighteen defendants in the case included the de-SPACed company (Alta Mesa Resources), its executives and board of directors, two executives from the SPAC, the SPAC sponsor, and three associated entities.³⁴⁵ This decision, while light on legal analysis, illustrates, *inter alia*, the broad range of potential targets in SPAC securities litigation. Finally, another federal district court in Texas denied a motion to dismiss plaintiffs' second amended complaint in *Shen v. Exela Technologies, Inc.* after concluding that the subject alleged misstatements were protected neither by the PSLRA's safe harbor nor by the bespeaks caution doctrine.³⁴⁶

In contrast, motions to dismiss were granted in two SPAC-related securities cases during the period April 2021 to January 2022. One of these cases was *Shen*, where the court dismissed plaintiffs' first amended class action complaint, without prejudice.³⁴⁷ Defendants in *Shen* were the de-SPACed company

³⁴² Andrew Hammond, et al., *How to Manage the Risks of SPAC Securities Fraud Actions in 2022*, WHITE & CASE LLP (Mar. 3, 2022), <https://www.whitecase.com/publications/alert/how-manage-the-risks-spac-securities-fraud-actions-2022>.

³⁴³ *In re QuantumScape Sec. Class Action Litig.*, No. 3:21-cv-00058-WHO, 2022 WL 137729, at *9–10 (N.D. Cal. Jan. 14, 2022).

³⁴⁴ *Id.* at *17.

³⁴⁵ *Camelot Event-Driven Fund v. Alta Mesa Resources, Inc.*, No. 4:19-CV-957, 2021 WL 1416025 (S.D. Tex. Apr. 14, 2021).

³⁴⁶ No. 3:20-CV-0691-D, 2022 WL 198402, at *2 n.3, *9 (N.D. Tex. Jan. 21, 2022).

³⁴⁷ *Shen v. Exela Tech., Inc.*, No. 3:20-CV-0691-D, 2021 WL 2589584 (N.D. Tex. June 24, 2021).

(Exela Technologies), its chief executive officer, its chief financial officer, and the chairman of its board of directors.³⁴⁸ As noted *supra*, the second amended complaint survived. The other case in which defendants prevailed involved an amended complaint based heavily on a short seller report by Hindenburg Research. A federal district court in California granted defendants' motion to dismiss, without prejudice, based on plaintiffs' failure to adequately plead falsity and scienter under their Section 10(b) claim and failure to adequately plead falsity and the requisite level of culpability under their Section 14(a) claim.³⁴⁹

C. SPAC Shareholder Derivative Litigation

SPACs have also generated direct and derivative claims for alleged breaches of fiduciary duty.³⁵⁰ More than fifty percent of the SPACs that went public in 2020 and 2021 are incorporated in Delaware, which renders SPAC litigation in that jurisdiction especially important.³⁵¹ A fundamental aspect of Delaware corporate law is that a board of directors owes fiduciary duties to the company and its shareholders.³⁵² Complaints in multiple SPAC cases have asserted claims for breach of fiduciary duty by directors and/or officers, often based on potential or actual undisclosed conflicts stemming from the SPAC structure.³⁵³ CRBs have been

³⁴⁸ *Id.* at *2.

³⁴⁹ *Mendoza v. HF Foods Group Inc.*, No. 2:20-CV-02929-ODW (JPRx), 2021 WL 3772950 (C.D. Cal. Aug. 25, 2021).

³⁵⁰ See Julia L. Bensusan & James Heyworth, *SPAC Litigation Accelerates in Delaware Courts*, SIDLEY AUSTIN LLP (Apr. 8, 2021), <https://ma-litigation.sidley.com/2021/04/spac-litigation-accelerates-in-delaware-courts/> (discussing SPAC litigation in Delaware). SPAC derivative litigation often follows SPAC securities class action litigation involving the same set of underlying facts. Yelena Dunaevsky, *Six Types of SPAC Lawsuits and Counting*, JDSUPRA (Dec. 16, 2021), <https://www.jdsupra.com/legalnews/six-types-of-spac-lawsuits-and-counting-6056491/>.

³⁵¹ *Delaware Finds Stockholder Claims Against SPAC Fiduciaries Subject to Entire Fairness Review*, COOLEY LLP (Jan. 10, 2022), <https://sle.cooley.com/2022/01/10/delaware-finds-stockholder-claims-against-spac-fiduciaries-subject-to-entire-fairness-review/>.

³⁵² See, e.g., *Aronson v. Lewis*, 473 A.2d 805, 810-11 (Del. 1984) (underscoring fiduciary duties owed by boards of directors to corporations and their shareholders).

³⁵³ See, e.g., *Complaint, Delman v. GigAcquisitions3, LLC*, No. 2021-0679 (Del. Ch. 2021) (alleging that SPAC structure created strong incentives to complete any merger, rather than return funds to investors).

the subject of a subset of these Delaware SPAC suits based on alleged breaches of fiduciary duty, at least one of which has proceeded as a direct, rather than derivative, action.³⁵⁴

Since January 2020 more than 850 SPACs completed IPOs and close to six hundred of them were still seeking targets in February 2022.³⁵⁵ All of those SPACs faced a ticking clock in the journey to merge with a private company, and—as discussed above—the clock is generally no more than eighteen to twenty-four months.³⁵⁶ These compressed deadlines, combined with a limited pool of suitable targets, likely motivate some SPAC founders and directors to consummate deals that may be disadvantageous for public shareholders—before the clock winds down, liquidation must occur, and the founders' shares become essentially worthless. As noted *supra*, SPACs typically provide for sponsors to pay a nominal sum for a twenty percent post-IPO equity stake in the target company.³⁵⁷ Sponsors “pay a fraction of market value for these promotes,”³⁵⁸ but they become essentially nugatory if no deal closes. In short, “the economic structure of a SPAC creates an inherent conflict between a SPAC’s sponsor and its public shareholders. That conflict centers on the only decision a SPAC’s management must make—to merge or to liquidate.”³⁵⁹

³⁵⁴ See, e.g., *Blue v. Fireman*, C.A. No. 2021-0268-MTZ, 2022 WL 593899 (Del. Ch. Feb. 28, 2022) (denying motions to dismiss claims for breach of fiduciary duties in proposed shareholder class action involving cannabis SPAC that touted rapper Jay-Z as its chief visionary officer); see also Leslie A. Pappas, *Electric Car Co. Investor Sues in Del. Over Disclosure Failures*, LAW360 (June 14, 2022, 11:19 PM), <https://www.law360.com/articles/1502865/electric-car-co-investor-sues-in-del-over-disclosure-failures> (reporting filing of proposed SPAC class action in Delaware’s Court of Chancery for alleged breaches of fiduciary duty).

³⁵⁵ Yun Li, *The SPAC Market Starts 2022 with Abysmal Losses, Abandoned Deals*, CNBC (Feb. 2, 2022, 11:50 AM EST), <https://www.cnbc.com/2022/02/02/the-spac-market-starts-2022-with-abysmal-losses-abandoned-deals.html>; Nicholas Megaw & Nikou Asgari, *Rising Number of Blank-Cheque Companies Call It Quits Before Listing*, FIN. TIMES (Jan. 21, 2022), <https://www.ft.com/content/1c3eb215-b029-4c65-b660-6022113e3d54>.

³⁵⁶ See *supra* text accompanying n.247.

³⁵⁷ See *supra* text accompanying n.255.

³⁵⁸ *The SPAC Hack: How SPACs Tilt the Playing Field and Enrich Wall Street Insiders 7* (May 2022), Prepared by the Office of Sen. Elizabeth Warren, <https://www.warren.senate.gov/imo/media/doc/SPACS.pdf>.

³⁵⁹ Michael Klausner & Michael Ohlrogge, *SPAC Governance: In Need of Judicial Review*, HARV. L. SCH. F. ON CORP. GOV. (Dec. 7, 2021), <https://corpgov.law.harvard.edu/2021/12/07/spac-governance-in-need-of-judicial->

To date, there is very little caselaw concerning SPACs and fiduciary duties. One of the primary unresolved questions in such litigation is which standard of review should be employed by courts. In Delaware, where some of the major state court litigation was unfolding in 2022,³⁶⁰ the default standard in cases involving alleged breaches of fiduciary duty by directors is the deferential business judgment rule (“BJR”).³⁶¹ Delaware courts will apply an elevated standard in lieu of the BJR in multiple circumstances.³⁶² In SPAC litigation, plaintiffs have urged application of entire fairness review,³⁶³ which applies in cases involving a material conflict of interest.³⁶⁴ This standard—Delaware’s most onerous

review; see also Ortenca Aliaj & Miles Kruppa, *The SPAC Machine Sputters Back to Life After Dramatic Meltdown*, FIN. TIMES (Nov. 21, 2021), <https://www.ft.com/content/d1723a8e-c146-4d48-8475-01cc9947a5d6> (noting that relatively small investments can create large windfalls for SPAC sponsors, incentivizing their pursuit “of any viable deal”).

³⁶⁰ Delaware is not the sole jurisdiction for SPAC state court litigation. By May 2021, more than sixty SPAC-related lawsuits had been filed in New York state courts. Kevin LaCroix, *SPAC-Related State Court Merger Objection Litigation*, D&O DIARY (May 9, 2021), <https://www.dandodiary.com/2021/05/articles/merger-litigation/spac-related-state-court-merger-objection-litigation/>. This litigation is a variant of the M&A objection litigation described in Part II of this Article. The complaints often track disclosure guidance issued by the SEC in 2020 and generally allege that SPAC directors breached their fiduciary duties to shareholders by providing inadequate disclosures of conflicts of interest. Douglas A. Rappaport et al., *Recent SPAC Shareholder Suits in New York State Courts: The Beginning Wave of SPAC Litigation*, HARV. L. SCH. F. ON CORP. GOV. (Apr. 23, 2021), <https://corpgov.law.harvard.edu/2021/04/23/recent-spac-shareholder-suits-in-new-york-state-courts-the-beginning-wave-of-spac-litigation/>. Some of the complaints also assert claims against the SPAC itself, as well as the target company and its directors or officers—for aiding and abetting the SPAC directors’ breaches. *Id.* For a discussion of the SEC guidance on SPACs, see Bloomenthal & Wolff, *supra* note 333.

³⁶¹ *Directors’ Fiduciary Duties: Back to Delaware Law Basics 2*, SKADDEN, ARPS, SLATE, MEAGHER & FLOM LLP (Feb. 19, 2020), <https://www.skadden.com/insights/publications/2020/02/directors-fiduciary-duties> (noting that “[i]n general, courts applying Delaware law and evaluating board decisions, will, in the first instance,” apply the BJR).

³⁶² See *id.* at 2 n.2 (identifying circumstances).

³⁶³ See, e.g., *In re MultiPlan Corp. S’holders Litig.*, 268 A.3d 784 (Del. Ch. 2022) (agreeing with plaintiffs and applying entire fairness).

³⁶⁴ Amir Licht, *Farewell to Fairness: Towards Retiring Delaware’s Entire Fairness Review*, HARV. L. SCH. F. ON CORP. GOV. (Mar. 14, 2019), <https://corpgov.law.harvard.edu/2019/03/14/farewell-to-fairness-towards-retiring-delawares-entire-fairness-review/> (“Entire fairness, after all, is Delaware’s gold standard for fiduciary loyalty in the corporation. It is the touchstone for examining corporate fiduciaries’ behavior in the face of conflict of interest.”).

one—allocates the burden to defendants to prove that the price and the process of the challenged transaction were entirely fair to the company’s stockholders,³⁶⁵ and its use simultaneously increases the likelihood of liability and decreases the likelihood that defendants will prevail on a motion to dismiss.³⁶⁶ The use of entire fairness review has a “near-preclusive impact” on motions to dismiss, largely because the inquiry is so fact-intensive.³⁶⁷

In 2015 a New York state court applied entire fairness review and denied a motion to dismiss claims for breach of fiduciary duty against a SPAC and its directors.³⁶⁸ The parties settled a few months later.³⁶⁹ No other court appears to have addressed the issue until January 2022, when the Delaware Chancery Court decided *In re MultiPlan Corp. Stockholders Litigation*,³⁷⁰ a case of first impression. *MultiPlan* was the first major test of how Delaware corporate law will be applied to SPACs. The court applied entire fairness review and denied motions to dismiss the complaint,³⁷¹ which relied heavily on a short seller report.³⁷² Entire fairness applied because (1) the case involved a conflicted

³⁶⁵ *SPACs and Entire Fairness: What Standard of Review Applies to the de-SPACing Transaction*, VINSON & ELKINS LLP (Dec. 11, 2020), <https://www.velaw.com/insights/spacs-entire-fairness-what-standard-of-review-applies-to-the-de-spacing-transaction/>.

³⁶⁶ *Id.*

³⁶⁷ Cydney Posner, *Fiduciary Duty Claims Against SPAC Sponsor Survive Dismissal in Delaware Under Entire Fairness Standard*, COOLEY LLP (Jan. 10, 2022), <https://www.jdsupra.com/legalnews/fiduciary-duty-claims-against-spac-1095428/>.

³⁶⁸ AP Servs., LLP v. Lobell, No. 651613/12, 2015 WL 3858818 (N.Y. Cnty. 2015). *See also* Klauser & Ohlrogge, *supra* note 359 (“[T]he inherent conflict of interest requires entire fairness review.”).

³⁶⁹ Brian A. Herman, et al., *The Future of SPACs: Increasing Litigation and Regulation*, MORGAN, LEWIS & BOCKIUS LLP (Dec. 1, 2021), <https://www.morganlewis.com/pubs/2021/12/the-future-of-spacs-increasing-litigation-and-regulation>.

³⁷⁰ *In re MultiPlan Corp. S'holders Litig.*, 268 A.3d 784, 809 (Del. Ch. 2022).

³⁷¹ *Id.* at 809, 818.

³⁷² Jeff Montgomery, *Short Seller's Allegations Slammed in MultiPlan SPAC Suit*, LAW360 (Feb. 17, 2022, 9:52 PM EST), <https://www.law360.com/articles/1466372/short-seller-s-allegations-slammed-in-MultiPlan-spac-suit>. De-SPAC litigation based on short seller reports appears to be even more common than is overall securities class action litigation based on such reports. Kevin LaCroix, *Post-Merger Commercial Space Launch Company Hit with SPAC-Related Securities Suit*, D&O DIARY (Feb. 9, 2022), <https://www.dandodiary.com/2022/02/articles/securities-litigation/post-merger-commercial-space-launch-company-hit-with-spac-related-securities-suit/>.

controller transaction and (2) a majority of the SPAC's directors were interested and not independent.³⁷³ Entire fairness review is the default standard in both situations under Delaware law.³⁷⁴ The court's application of entire fairness in *MultiPlan* was largely "premised on the divergent economic interests of the sponsor and the public investors."³⁷⁵

MultiPlan is significant in the realm of de-SPAC litigation. The decision increased litigation risks for Delaware SPAC sponsors and directors, and probably target companies as well.³⁷⁶ Claims against targets for aiding and abetting disclosure violations may be difficult to dismiss if entire fairness is applied to the underlying claims against SPAC fiduciaries.³⁷⁷ *MultiPlan* left multiple key issues unresolved, including whether Delaware courts will apply the entire fairness standard in all de-SPAC cases or only those (like *MultiPlan*) with a viable disclosure claim.³⁷⁸ However, the decision is well-reasoned and likely to be persuasive to other courts—at least with regard to the standard of review to be employed in other SPAC fiduciary duty cases presenting similar facts.³⁷⁹ *MultiPlan*

³⁷³ *In re MultiPlan Corp.*, 268 A.3d at 809.

³⁷⁴ *M&A Report—Determining the Likely Standard of Review Applicable to Board Decisions in Delaware M&A Transactions*, GIBSON DUNN & CRUTCHER LLP (May 4, 2020), <https://www.gibsondunn.com/ma-report-determining-the-likely-standard-of-review-applicable-to-board-decisions-in-delaware-ma-transactions/>.

³⁷⁵ *Delaware Court Holds de-SPAC Transaction Subject to Entire Fairness*, DEBEVOISE & PLIMPTON LLP (Jan. 14, 2022), <https://www.debevoise.com/insights/publications/2022/01/delaware-court-holds-despac-transaction>.

³⁷⁶ Stephen Fraidin et al., *Delaware Chancery Court Signals Heightened Scrutiny of SPAC Boards and Sponsors*, NAT'L L. REV. (Jan. 13, 2022), https://www.natlawreview.com/article/delaware-chancery-court-signals-heightened-scrutiny-spac-boards-and-sponsors#google_vignette.

³⁷⁷ *Delaware Finds Stockholder Claims Against SPAC Fiduciaries Subject to Entire Fairness Review*, COOLEY LLP (Jan. 10, 2022), <https://sle.cooley.com/2022/01/10/delaware-finds-stockholder-claims-against-spac-fiduciaries-subject-to-entire-fairness-review/>.

³⁷⁸ See *Client Alert No. 2922: Delaware Court Applies Entire Fairness Standard to MultiPlan de-SPAC*, LATHAM & WATKINS LLP (Jan. 19, 2022), <https://www.lw.com/thoughtLeadership/Delaware-Court-Applies-Entire-Fairness-Standard-to-MultiPlan-de-SPAC> (identifying unresolved issues). Plaintiffs in *MultiPlan* asserted that defendants failed to disclose that the de-SPAC target was likely to lose one of its largest customers, thereby impairing stockholders' decisions to redeem their shares instead of participating in the de-SPAC. *In re MultiPlan Corp.*, 268 A.3d at 816–17.

³⁷⁹ See Tom Zanki, *Delaware Suit Means SPACs Will Face Tougher Legal Scrutiny*, LAW360 (Jan. 14, 2022, 4:57 PM EST), <https://www.law360.com/articles/1454546/delaware-suit-means-spacs-will-face-tougher-legal-scrutiny>

suggests that given the standard SPAC structure, sponsors and public stockholders are in a conflicted position “in almost any de-SPAC transaction,” and therefore all such transactions are potentially subject to entire fairness review.³⁸⁰

MultiPlan may motivate additional SPACs to organize outside of Delaware. In 2021, thirty-four percent of the 199 de-SPACs that closed involved a SPAC that was incorporated in the Cayman Islands and one percent were incorporated in the British Virgin Islands (“BVI”).³⁸¹ These percentages may increase post-*MultiPlan*.³⁸² If a SPAC is incorporated in the Cayman Islands or BVI, and the directors are sued for breach of fiduciary duty by shareholders in the United States, then the law of that foreign jurisdiction may apply, rather than Delaware law.³⁸³ Both foreign jurisdictions have SPAC-suitable company law frameworks and limited additional regulatory compliance requirements,³⁸⁴ and

(suggesting that the decision in *MultiPlan* could be influential because many elements of the transaction in that case, including 20 percent founder shares, are common in other SPAC deals).

³⁸⁰ *Delaware Court Holds de-SPAC Transaction is Subject to Entire Fairness, supra* note 375; *but cf.* James Heyworth et al., *New School SPAC Subject to Old School Rules: Court of Chancery Rejects SPAC Sponsor’s Motion to Dismiss*, SIDLEY AUSTIN LLP (Jan. 6, 2022), <https://ma-litigation.sidley.com/2022/01/new-school-spac-subject-to-old-school-rules-court-of-chancery-rejects-spac-sponsors-motion-to-dismiss/> (arguing that the decision in *MultiPlan* is unlikely to be bellwether of future SPAC cases, given allegations in the case of extreme conflicts and substantial disclosure failures). In any event, while multiple suits have asserted *MultiPlan*-style claims, other theories of liability also have been asserted in Delaware SPAC litigation. *See Trending Liability Theories in Delaware SPAC-Related Litigation*, VINSON & ELKINS LLP (June 15, 2022), <https://www.velaw.com/insights/trending-liability-theories-in-delaware-spac-related-litigation/> (discussing at least five non-mutually exclusive theories).

³⁸¹ *2021 De-SPAC Debrief* 5, FRESHFIELDS BRUCKHAUS DERINGER US LLP (Jan. 2022), <https://www.freshfields.com/48fe4e/globalassets/noindex/documents/de-spac-debrief-2021.pdf>.

³⁸² *Delaware Chancery Court Allows SPAC Merger Challenge to Proceed*, CLEARY GOTTlieb STEEN & HAMILTON LLP (Jan. 5, 2022), <https://www.clearygottlieb.com/news-and-insights/publication-listing/delaware-chancery-court-allows-spac-merger-challenge-to-proceed> (“Many recent SPACs have been organized in jurisdictions outside of Delaware. The *MultiPlan* decision may reinforce that trend.”).

³⁸³ *See, e.g.*, Erik Bodden & Jonathon Milne, *SPAC Litigation: What Happens if the “Blank Check” Bounces?*, CONYERS (May 17, 2021), <https://www.jdsupra.com/legalnews/spac-litigation-what-happens-if-the-1939735/> (observing that in litigation involving Cayman-domiciled SPACs, Cayman law will apply).

³⁸⁴ Anton Goldstein et al., *Offshore SPACs*, CONYERS (June 2021),

both are tax-neutral.³⁸⁵ Moreover, Cayman law “may be more deferential to directors than Delaware law.”³⁸⁶ Finally, *MultiPlan* may also make it more difficult for SPACs to obtain affordable D&O insurance in the United States.³⁸⁷ This hurdle is of particular concern for CRBs, which, as noted *supra*, are already underinsured.

V. MINIMIZING THE RISK OF CANNABIS SECURITIES CLASS ACTION AND DERIVATIVE LITIGATION

Cannabis-related businesses can take multiple steps to reduce the risk of encountering securities class action and derivative litigation, including litigation stemming from the use of SPACs. With respect to SPACs, the following steps should be taken. First, the SPAC board of directors should have a strong majority of directors who are truly independent of the sponsor. At a minimum, the Nasdaq and NYSE require the combined company to have a majority of independent directors.³⁸⁸

<https://www.conyers.com/wp-content/uploads/2021/06/2021-05-BVI-Article-Offshore-SPACs.pdf>. Under Cayman Islands law, a director is a fiduciary with respect to the corporation and owes the corporation a duty to act in its best interests and to refrain from self-dealing, abuse of power, and conflicts of interest. Caroline H. Bullerjahn & Morgan Mordecai, *Limiting SPAC-Related Litigation Risk: Disclosure and Process Considerations* n.12, HARV. L. SCH. F. ON CORP. GOV. (Mar. 14, 2021), <https://corpgov.law.harvard.edu/2021/03/14/limiting-spac-related-litigation-risk-disclosure-and-process-considerations/>.

³⁸⁵ Murray Roberts & George Weston, *‘De-SPAC’ Transactions: A Cayman Islands and British Virgin Islands Perspective*, A.B.A. BUS. L. SEC. (June 15, 2021), <https://businesslawtoday.org/2021/06/de-spac-transactions-a-cayman-islands-and-british-virgin-islands-perspective/>.

³⁸⁶ Ann Beth Stebbins & Maxim Mayer-Cesiano, *What Am I Getting Myself Into? Five Questions Prospective SPAC Directors Should Ask* 2, SKADDEN, ARPS, SLATE, MEAGHER & FLOM LLP (Apr. 13, 2021), https://www.skadden.com/-/media/files/publications/2021/04/the-informed-board/what_am_i_getting_myself_into.pdf.

³⁸⁷ *Delaware Finds Stockholder Claims Against SPAC Fiduciaries Subject to Entire Fairness Review*, COOLEY LLP (Jan. 10, 2022), <https://sle.cooley.com/2022/01/10/delaware-finds-stockholder-claims-against-spac-fiduciaries-subject-to-entire-fairness-review/>.

³⁸⁸ Layne & Lenahan, *supra* note 252; see also Ann Beth Stebbins & Maxim Mayer-Cesiano, *What Am I Getting Myself Into? Five Questions Prospective SPAC Directors Should Ask* 3, SKADDEN, ARPS, SLATE, MEAGHER & FLOM LLP (Apr. 13, 2021), https://www.skadden.com/-/media/files/publications/2021/04/the-informed-board/what_am_i_getting_myself_into.pdf (“Public company boards are generally required to have a majority of independent directors.”).

Second, consistent with admonitions by SEC officials,³⁸⁹ SPAC sponsors should treat de-SPAC mergers like initial public offerings and perform both the type of diligence associated with traditional IPOs and the valuation-focused diligence common in the merger context.³⁹⁰ Litigants have asserted a lack of pre-merger diligence in multiple SPAC suits.³⁹¹ This is unsurprising given the significant number of disclosure events associated with the archetypal SPAC life cycle.³⁹² While due diligence is essential with regard to both SPAC IPOs and de-SPACs, the latter is even more critical. The best strategy for SPAC management to avoid litigation based on inadequate disclosure is to perform robust due diligence of the target and then disclose all material information concerning both the diligence and potential conflicts to public stockholders in advance of the redemption deadline and the de-SPAC vote.³⁹³ SEC Chairman Gary Gensler has observed that “[t]here is inconsistent and differential disclosure” among the multiple parties involved in SPAC transactions.³⁹⁴ And a report prepared in May 2022 by Senator Elizabeth Warren’s office noted that “SPAC sponsors have had pervasive problems with inflated, inadequate, and even fraudulent disclosures, to the detriment of retail investors.”³⁹⁵ In

³⁸⁹ See Tom Zanki, *SEC Official Warns That SPACs Offer No Legal Shortcuts*, LAW360 (Apr. 8, 2021, 7:53 PM EST), <https://www.law360.com/articles/1373533/sec-official-warns-that-spacs-offer-no-legal-shortcuts> (quoting SEC’s John Coates for proposition that de-SPACs should be treated as the “real IPO”).

³⁹⁰ Adam Brenneman et al., *Rising Threat of Securities Liability for SPAC Sponsors*, HARV. L. SCH. F. ON CORP. GOV. (Nov. 9, 2020), <https://corpgov.law.harvard.edu/2020/11/09/rising-threat-of-securities-liability-for-spac-sponsors/>.

³⁹¹ James Heyworth & Julia L. Bensur, *Still in the Crosshairs: Plaintiffs Continue to Take Aim at Post-Merger SPACs*, SIDLEY AUSTIN LLP (Dec. 6, 2021), <https://malitigation.sidley.com/2021/12/still-in-the-crosshairs-plaintiffs-continue-to-take-aim-at-post-merger-spacs/>.

³⁹² Gary M. Lawrence et al., *A Bridge Over Troubled Waters: The Role of Due Diligence in Mitigating SPAC Litigation Risks*, A.B.A. BUS. L. SEC. (Aug. 13, 2021), https://www.americanbar.org/groups/business_law/publications/blt/2021/08/spac-litigation-risks/.

³⁹³ See Alan Stone et al., *Court of Chancery Opens Door to Entire Fairness Review of SPAC Mergers*, HARV. L. SCH. F. ON CORP. GOV. (Feb. 6, 2022), <https://corpgov.law.harvard.edu/2022/02/06/court-of-chancery-opens-door-to-entire-fairness-review-of-spac-mergers/> (“Disclosure of all material facts regarding the proposed de-SPAC transaction is the chief deterrent for viable claims against SPAC directors.”).

³⁹⁴ Gensler Remarks, *supra* note 267.

³⁹⁵ *The SPAC Hack: How SPACs Tilt the Playing Field and Enrich Wall Street*

MultiPlan, the court referenced alleged materially misleading disclosures in the proxy statement, which negated plaintiffs' ability to knowledgeably exercise their redemption rights.³⁹⁶ Improved accuracy, clarity, and consistency of disclosures can reduce the risk of liability.³⁹⁷

Third, in the absence of SEC rulemaking³⁹⁸ or legislation by Congress to remove the safe harbor for SPACs,³⁹⁹ a de-SPACed company still should carefully consider utilizing more modest projections than it might otherwise prefer to use. Fourth, charters or bylaws should include federal forum provisions. Such provisions can help minimize the potential exposure by SPACs and their directors to duplicative state and federal court litigation of Securities Act claims. Fifth, sponsors should consider including exculpatory clauses in their SPAC charters. In numerous jurisdictions, such clauses can protect directors from fiduciary duty claims other than those alleging disloyalty and bad faith.⁴⁰⁰

VI. CONCLUSION

Cannabis securities class action litigation has proliferated in recent years. This development reflects two broader trends: (1) the rise of event-driven securities litigation and (2) the inevitable wave of de-SPAC securities class action and derivative litigation that followed the SPAC explosion in the United States in 2020 and

Insiders 14 (May 2022), Prepared by the Office of Sen. Elizabeth Warren, <https://www.warren.senate.gov/imo/media/doc/SPACS.pdf>.

³⁹⁶ *In re MultiPlan Corp. S'holders Litig.*, 268 A.3d 784, 818 (Del. Ch. 2022).

³⁹⁷ See Edward Micheletti et al., *Green Light on SPAC Deal Suit Puts Fiduciary Duty in Context*, LAW360 (Jan. 10, 2022, 7:11 PM EST), <https://www.law360.com/articles/1453634/green-light-on-spac-deal-suit-puts-fiduciary-duty-in-context> (analyzing the decision in *MultiPlan* and concluding that "particularized disclosures may be one way to mitigate risk of a similar result").

³⁹⁸ The comment period for the SEC's proposal to amend the rules applicable to SPACs expired in June 2022 and a final SEC vote could occur by the end of 2022. Tom Zanki, *SEC's Tighter Rules for SPACs Panned at Conference*, LAW360 (June 15, 2022, 4:32 PM EDT), <https://www.law360.com/securities/articles/1503120/sec-s-tighter-rules-for-spacs-panned-at-conference>.

³⁹⁹ In May 2022, Sen. Elizabeth Warren announced plans to introduce legislation (the SPAC Accountability Act of 2022) that would codify much of the SEC's March 2022 proposal and extend it in certain respects. Tom Zanki, *Warren Readies Bill to Stamp Out SPAC 'Abuses'*, LAW360 (May 31, 2022, 8:45 PM EDT), <https://www.law360.com/articles/1498141>.

⁴⁰⁰ *SPAC Litigation Boom*, *supra* note 329, at 6.

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2021. Cannabis market participants can take multiple steps to minimize their risk of encountering such litigation. Perhaps the single most important step with respect to SPAC litigation is for sponsors to perform robust due diligence of the target CRB, and subsequently disclose all material information concerning the diligence and potential conflicts of interest to public stockholders in advance of both the deadline for them to redeem their shares and the de-SPAC vote.