UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF NEW YORK

GANESH KASILINGAM, Individually and on Behalf of All Others Similarly Situated, *Plaintiffs*, -against- TILRAY, INC., BRENDAN KENNEDY, and MARK CASTANEDA, *Defendants*.	:	20-cv-03459 (PAC) **OPINION & ORDER**

Following the dismissal of Plaintiffs' First Amended Complaint ("FAC") without prejudice, Defendants Tilray, Inc. and Brendan Kennedy now move to dismiss Plaintiffs' Second Amended Complaint ("SAC"). The SAC asserts securities fraud claims against both Defendants under Section 10(b) of the Exchange Act and Rule 10b-5 promulgated thereunder, as well as control person liability against Kennedy under Section 20(a) of the Exchange Act.[1] The motion is GRANTED in part and DENIED in part.

BACKGROUND

The Court articulated the backdrop of this case in its previous Opinion, and now reiterates key facts and summarizes newly pleaded allegations. *See Kasilingam v. Tilray, Inc.*, No. 20-cv-03459, 2021 WL 4429788 (S.D.N.Y. Sep. 27, 2021).

All allegations are drawn from the SAC and documents incorporated therein. However, as they did in their first motion to dismiss, Defendants ask the Court to conduct a full context review and take judicial notice of certain documents. Req. Full Context Rev., ECF No. 101. Defendants specifically asks the Court to review documents as "integral" to Plaintiff's complaint; SEC filings

[1] 15 U.S.C. §§ 78j, 78t(a); 17 C.F.R. § 240.10b-5.

as a matter of public record; and news articles discussing Tilray and the cannabis industry. *Id.* The Court disagrees with Defendants that it is required to do a "full context review" on a motion to dismiss in a securities fraud action. *Id.* at 1–2; *see Gray v. Wesco Aircraft Holdings, Inc.*, 454 F. Supp. 3d 366, 382 (S.D.N.Y. 2020) (noting that the rules surrounding securities fraud complaints "permit" courts to consider documents incorporated into the complaint and matters of judicial notice), *aff'd*, 847 F. App'x 35 (2d Cir. 2021). Further, to the extent the Court *does* consider Defendants' extensive record, it may only do so to "determine what the documents stated," not for the truth of the matter asserted. *Roth v. Jennings*, 489 F.3d 499, 509 (2d Cir. 2007) (quoting *Kramer v. Time Warner Inc.*, 937 F.2d 767, 774 (2d Cir. 1991)).

Defendants rely on these documents to contradict the allegations in the complaint. *See, e.g.*, Def's MOL at 10 n.13, ECF No. 100. It is improper for this Court to supplant the allegations of the Plaintiff at the pleadings stage, so it declines to take judicial notice of Defendants' news articles. *see Akerman v. Arotech Corp.*, 608 F. Supp. 2d 372, 380–81 (E.D.N.Y. 2009) ("Despite the several 'heightened' pleading requirements imposed on securities fraud plaintiffs, their allegations are still accepted as true at the 12(b)(6) stage." (citations omitted)); *Gagnon v. Alkermes PLC*, 368 F. Supp. 3d 750, 763 (S.D.N.Y. 2019) ("[C]ourts may take judicial notice not of the truth in news articles, but that their contents are publicly available."). Defendants further produce several SEC published documents. While many of these documents are referenced in the SAC and appropriate to consider on a motion to dismiss,[2] several are undated and/or unsigned, and therefore unverifiable.[3] *See In re Take-Two Interactive Sec. Litig.*, 551 F. Supp. 2d 247, 262 n.4

[2] See Greene Decl., Exs. 2, ,4 ,5, 8, 9, 10.

[3] See Greene Decl., Exs. 11, 12.

(S.D.N.Y. 2008). Therefore, though the Court reviews all documents incorporated into the SAC,[4] it declines to review the unincorporated SEC documents. *Gray*, 454 F. Supp. 3d at 383 (declining to review SEC documents that are not incorporated into the complaint). The Court reserves further review of the documents for summary judgment. *See In re Top Tankers, Inc. Sec. Litig.*, 528 F. Supp. 2d 408, 418 (S.D.N.Y. 2007).

I. The Parties and Class Period

Defendant Tilray, Inc. ("Tilray") is a publicly traded company that produces and sells marijuana, hemp, and related products globally. SAC ¶¶ 24–25, ECF No. 95. Defendant Kennedy has been Tilray's President and Chief Executive Officer since January 2018.[5] *Id.* ¶ 26. In 2011, Kennedy and other non-party individuals (the "Kennedy Group") created Privateer Holdings Incorporated ("Privateer") to invest in the nascent cannabis industry. *Id.* ¶ 30. In 2014, the Kennedy Group formed Tilray's predecessor as a Privateer subsidiary. *Id.* Over time, the Kennedy Group privately sold economic interest in Privateer but retained voting control through "supervoting" shares. *Id.* ¶ 31. In July 2018, when Tilray held its initial public offering, Privateer purchased the majority of the shares. *Id.* ¶ 3.

Plaintiffs are purchasers of Tilray common stock during the purported Class Period—from January 16, 2019, through March 2, 2020. *Id.* ¶ 1. They bring this action on behalf of a putative class of those who purchased Tilray stock during said Class Period, which spans from the day after Tilray entered a high-profile co-marketing deal with Authentic Brands Group (the "ABG Agreement") until the day Tilray announced it had impaired its valuation of the ABG Agreement

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[4] This includes Kennedy's Forms 3 and 4s from the relevant time period, which may be considered for the truth of the matter asserted. *In re Bear Stearns Companies, Inc. Sec., Derivative, & ERISA Litig.*, 763 F. Supp. 2d 423, 582 (S.D.N.Y. 2011).

[5] Mark Castaneda is no longer named as a defendant in the SAC.

by $102.6 million and also written down the value of its inventory by $68.2 million. *Id.* ¶¶ 81, 138–45. Before it was impaired, under the ABG Agreement, Tilray would have paid ABG $100 million, and an additional $150 million in future consideration. *Id.* ¶ 71(a). In exchange, Tilray would expand globally as ABG's preferred cannabis supplier, receiving up to 49% of net revenue from ABG-branded cannabis and a guaranteed $10 million payment annually. *Id.* ¶¶ 70–71. The Agreement was later renegotiated to relieve Tilray of its obligation to pay future consideration. *Id.* ¶ 136. In exchange, ABG was relieved of its obligation to pay Tilray $10 million annually. *Id.* According to Plaintiffs, Defendants made materially false and misleading statements throughout the Class Period to inflate Tilray's stock price. *Tilray*, 2021 WL 4429788, at *2.

II. The Share Exchange and the Aphria Merger

Just before the Class Period began, Privateer sent a letter of intent stating its desire to execute a downstream merger with Tilray (the "Share Exchange"). *Id.* ¶¶ 160, 168. The Share Exchange was completed on December 12, 2019. *Id.* Plaintiffs allege the Share Exchange had three goals: "(a) eliminate Privateer's corporate sales tax, (b) control the flow of Privateer investors' Tilray shares into the market, and (c) secure personal control over Tilray . . . ." *Id.* ¶ 159. As part of the Share Exchange, investors agreed to a two-year lockup (the "Lockup Agreement") during which time they could not sell their shares. *Id.* ¶ 160(d).

Meanwhile, in Fall 2019, Tilray entered merger negotiations with a large Canadian company, Aphria Incorporated ("Aphria"). *Id.* ¶ 182. In 2020, Aphria would "repeatedly place the transaction on hold in light of other concerns," including the COVID-19 pandemic. *Id.* ¶ 196. Eventually, on December 15, 2020, the companies merged (the "Aphria Merger"). *Id.* The Class Period ended on March 2, 2020, when the allegedly false statements were disclosed in Tilray's quarterly earnings call and year-end filings for 2019. *Id.* ¶¶ 138–45.

III. Misleading Statements

The SAC reiterates prior allegations concerning Defendants' alleged exaggeration of Tilray's gross margins and the value of the ABG Agreement. *See Tilray*, 2021 WL 4429788, at *3–6. The alleged false statements fall into three categories: (1) the value of Tilray's inventory and its gross margins; (2) the misclassification of labor as an input; and (3) the value of the ABG Agreement.

A. *Inventory*

Plaintiffs allege Defendants overstated inventory to exaggerate Tilray's gross margins, a "critical metric" which made the company appear more profitable than it was. SAC ¶¶ 40, 63. During the Class Period, when asked about the market for CBD in the United States, Kennedy said, "we're modeling pretty conservatively for 2020 for US CBD. Until we have that regulatory change, we are not going to adjust our numbers up." *Id.* ¶ 128. Kennedy also claimed that Tilray was "building inventory." *Id.* ¶ 110. Despite Kennedy's assurances of the company's "conservative" modeling, Tilray's SEC filings indicated significant growth in its inventory.[6]

According to Plaintiffs, this growth was a farce. They allege Tilray overvalued "worthless" trim—materials left over after harvesting the buds and flowers of the cannabis plant—and other unsellable formulated oils. SAC ¶¶ 55, 63, 99, 111. They cite one former employee's recollection of "bags and bags, and boxes and boxes of end-of-run materials," materials which were not given a defined internal value but ascribed a value on financial statements of over $40 million. *Id.* ¶¶ 61–63 (internal quotation marks omitted). Plaintiffs allege there was "no way to sell" these materials

[6] Tilray's reported inventory grew from $16.2 million at the end of 2018, to $48.7 million after the first quarter of 2019, to $75.3 million halfway through 2019, and ultimately $111.5 million at the end of the third quarter of 2019. *Id.* ¶¶ 90, 98, 114, 134.

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