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Common Sense Guidance Offers Clarity to Issuers: CSA Confirms Disclosure-Based Rules for Issuers Involved in U.S. Marijuana-Related Activities

The Canadian Securities Administrators (the “**CSA**”) recently published CSA Staff Notice 51-352 *Issuers with U.S. Marijuana-Related Activities* (the “**Staff Notice**”) detailing disclosure expectations for issuers¹ involved in marijuana-related practices or activities in U.S. states that have legalized such activities (“**U.S. Marijuana Issuers**”).² These activities include the cultivation, possession, and distribution of marijuana (“**marijuana-related activities**”).³ Despite the presence of licensing and regulation of marijuana in various U.S. states, marijuana-related activities remain illegal under U.S. federal law.⁴ The Staff Notice provides guidance to U.S. Marijuana Issuers on how they can satisfy the CSA’s disclosure expectations. The expectations outlined in the Staff Notice conform with the disclosure-based system adopted by securities regulatory authorities in Canada. The expectations effectively outline that U.S. Marijuana Issuers are required to provide disclosure to the market to

¹ A reference to “issuer” means a “reporting issuer” as such term is defined under applicable Canadian securities law.

² In this bulletin we use the term “marijuana” rather than the more precise term “cannabis” to track the language in the Staff Notice.

³ CSA Staff Notice 51-352, section I.

⁴ In the U.S. there is a conflict between state and federal law related to marijuana. As the Staff Notice indicates, certain U.S. states permit marijuana use and sale within a regulatory framework notwithstanding that marijuana continues to be listed as a controlled substances under U.S. federal law and accordingly federally illegal.

allow investors to, among other things, make decisions on the basis of all material facts, risks, and uncertainties related to their business.⁵ The Staff Notice outlines the disclosure requirements for issuers on the basis of the type of activities being undertaken, and the consequences of inadequate disclosure.

Disclosure Requirements for All Issuers

U.S. Marijuana Issuers must describe the nature of the issuer's involvement in the U.S. marijuana industry and include the disclosure indicated for the direct, indirect, or ancillary industry involvement types, each of which is discussed in further detail below. Additionally, U.S. Marijuana Issuers are required to provide disclosure that marijuana remains illegal under U.S. federal law and that the forbearance-based enforcement approach is subject to change,⁶ and also discuss the resultant risks, including the risk of adverse enforcement action. The issuer is further required to state whether and, if so, how the issuer's U.S. marijuana-related activities are conducted in a manner consistent with any U.S. federal enforcement priorities, discuss the issuer's ability to access both public and private capital, and indicate what financing options are available to support continuing operations.⁷

Disclosure Requirements for Issuers Involved in Cultivation or Distribution

Issuers with direct involvement in the cultivation or distribution of marijuana, either through their own engagement in those activities or through that of a subsidiary, must outline the regulations for the U.S. states in which the issuer operates, confirm how the issuer complies with applicable licensing requirements and the regulatory framework enacted by the applicable U.S. state, discuss the issuer's program for monitoring compliance with U.S. state law on an ongoing

⁵ CSA Staff Notice 51-352, section II.

⁶ In a memorandum dated August 29, 2013 addressed to "All United States Attorneys" from James M. Cole then Deputy Attorney General of the United States, (the "Cole Memorandum"), the U.S. Department of Justice stated that it is not an efficient use of limited resources to direct federal law enforcement agencies to prosecute those that are abiding by state laws allowing use and distribution of medical marijuana. It remains uncertain as to whether prosecutorial priorities will shift in the future, however at present the U.S. Department of Justice is not prioritizing prosecution if the requirements of the Cole Memorandum are met.

⁷ Supra note 4.

basis, outline internal compliance procedures, and disclose any material non-compliance as well as material citations or notices of violation.

Issuers with indirect involvement in the cultivation or distribution, such as issuers who have a non-controlling investment in an entity that is involved in cultivation or distribution of marijuana, must outline the regulations for U.S. states in which the issuer's investee operates, and provide reasonable assurance that the investee's business is in compliance with applicable licensing requirements and the regulatory framework enacted by the applicable U.S. state.⁸

Disclosure Requirements for Issuers with Ancillary Involvement

Issuers with material ancillary involvement in the marijuana industry, such as those who provide goods or services (including financing, branding, or leasing) to third parties that are directly involved in the U.S. marijuana industry, must provide reasonable assurance, either through positive or negative statements, that the customer or investee's business is in compliance with the licensing requirements and the regulatory framework enacted by the applicable U.S. state.⁹

Consequences of Non-Compliance

U.S. Marijuana Issuers who do not provide appropriate disclosure may be subject to regulatory action, such as receipt refusal in the context of prospectus offerings and referrals for appropriate enforcement action. In addition, with respect to continuous disclosure obligations, U.S. Marijuana Issuers may be subject to requests for restatements of non-compliant filings. In our view, it is likely that the securities regulators in Canada will implement periodic continuous disclosure reviews for U.S. Marijuana Issuers much like the review process for industries such as mining. If a U.S. Marijuana Issuer does not comply with the guidance in the Staff Notice then one tool the applicable securities regulator will likely use is to require the issuer to retract and restate the applicable disclosure. Accordingly, it would be prudent for U.S. Marijuana Issuers to retain

⁸ Ibid.

⁹ Ibid.

professional advisors who have knowledge of this evolving industry and who are able to craft continuous disclosure that conforms to the guidance provided in the Staff Notice.

The CSA staff further note that if the U.S. federal government changes its forbearance-based enforcement approach, then the CSA will re-examine its views with regards to U.S. Marijuana Issuers.¹⁰

Responses to the Staff Notice by Securities Exchanges in Canada

Concurrent with the release of the Staff Notice, the Toronto Stock Exchange (the “**TSX**”), the TSX Venture Exchange (the “**TSX-V**”), and the Canadian Securities Exchange (the “**CSE**”) each released notices regarding their respective policies concerning U.S. Marijuana Issuers. The responses from the stock exchanges remain consistent with their respective historical approaches to U.S. Marijuana Issuers.

In an October 16, 2017 news release the CSE applauded the Staff Notice and the clarity that it has provided U.S. Marijuana Issuers. Further, the CSE indicated that it remains committed to listing and providing services to U.S. Marijuana Issuers.¹¹ Richard Carleton, CEO of the CSE, is quoted as saying that the Staff Notice “...provides significant comfort to these issuers that their Canadian listings will remain in good standing as long as they provide the disclosure that is rightly required by regulators.”¹² This approach remains consistent with the CSE position, as more particularly outlined in the CSE’s news release of August 4, 2017,¹³ indicating that the CSE supports the listing of issuers involved in the U.S. marijuana industry provided that appropriate risk disclosure is made, and that such issuers operate in accordance with the applicable laws at the state level.

The TSX and the TSX-V approaches are similar to each other (not surprisingly as they have common ownership), but the polar opposite

¹⁰ Ibid.

¹¹ Canadian Securities Exchange (CSE), News Release, “CSE Comments on CSA Staff Notice Regarding Issuers with U.S. Cannabis-Related Activities” (16 October 2017).

¹² Ibid.

¹³ CSE, News Release, “CSE Confirms Position on U.S. Cannabis Listings” (4 August 2017).

of the approach taken by the CSE.¹⁴ The TSX and the TSX-V have each indicated that they consider marijuana-related activities in the U.S. to be a violation of their respective listing requirements due to the federal prohibition on marijuana in the U.S. For issuers that are U.S. Marijuana Issuers seeking a listing on the TSX or TSX-V, the current guidance indicates that listing approval would not be accepted. For currently listed issuers who may seek to transition into the U.S. marijuana industry or buttress existing businesses with such activities in the U.S., their continued listing status would at a minimum be subject to a continued listing review and possibly be in jeopardy. Finally, for those issuers that are currently listed on the TSX or TSX-V and are U.S. Marijuana Issuers, such issuers would be subject to a continued listing review and it appears that the stock exchange listing could be in jeopardy unless and until such issuer divested the offending assets and/or ceased the applicable marijuana-related activities. However, it is important to note that the TSX and TSX-V specifically stated in their notices that they will continue to monitor legal developments in the U.S.

Conclusion

The expectations of the CSA, and the positions confirmed by each of the CSE, the TSX, and the TSX-V, serve to provide clarity regarding the obligations and restrictions of U.S. Marijuana Issuers, and those issuers seeking to enter the marijuana space in the U.S. The disclosure expectations that the CSA has imposed are a reflection of the Canadian securities regime as being disclosure-based, and the Staff Notice can be considered a clarification of the type of disclosure that would be required under applicable securities laws. The responses from each of the stock exchanges¹⁵ also serve to reinforce that they continue to hold the same positions: the TSX and TSX-V will continue to view marijuana-related activities by issuers listed on their respective exchanges as non-compliant with their exchange rules, and the CSE will continue to allow the listing of U.S. Marijuana Issuers, while all parties commit to monitor developments in the area

¹⁴ Toronto Stock Exchange (TSX), Staff Notice to Applicants, Listed Issuers, Securities Lawyers and Participating Organizations, 2017-0009 (16 October 2017); and TSX Venture Exchange, Notice to Issuers, "Business Activities Related to Marijuana in the United States" (16 October 2017).

¹⁵ Ibid.

as they may arise. The Staff Notice provides greater clarity and should be a well-received development to U.S. Marijuana Issuers and issuers who may seek to incorporate marijuana-related activities into their businesses.

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a cautionary note

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