

# Canadian Securities Administrators mandate additional disclosure in response to Sessions Memo

February 12, 2018

On February 8, 2018, the Canadian Securities Administrators (the **CSA**) published revised CSA Staff Notice 51-352 - Issuers with US Marijuana-Related Activities (the **Notice**), which sets out the CSA staff's disclosure expectations for specific risks facing issuers carrying on marijuana-related activities in US states where such activities are authorized under regulatory frameworks in such states (**US Cannabis Issuers**).

As detailed in our October 17, 2017 **Insight**, the CSA previously acknowledged that US Cannabis Issuers face unique regulatory risks based on the conflict between state and federal laws in the US. The CSA imposed specific disclosure obligations to educate investors and the capital markets with respect to such risks.

In a memorandum issued on January 4, 2018, United States Attorney General Jeff Sessions increased that conflict with the reversal of a President Obama-era policy that the United States Department of Justice (**DOJ**) would not devote resources to the prosecution of persons acting in compliance with state cannabis laws. Most notably, Attorney General Sessions' memorandum (the **Sessions Memo**) rescinded the 2013 guidelines issued by Deputy Attorney General James Cole, commonly known as the Cole Memo, which stated that, while the DOJ is committed to enforcing the United States Controlled Substances Act, it is also committed to focusing its limited investigative and prosecutorial resources on more significant threats in the most effective, consistent, and rational way. The Cole Memo enumerated certain enforcement priorities related to cannabis that remained important to the federal government, including the distribution of marijuana to children, revenue from the sale of marijuana going to criminals, and the diversion of marijuana from states where it is legal to states where it is not. For further information regarding the Sessions Memo see the Dentons **Insight** dated January 12, 2018.

Following the release of the Sessions Memo, the regulatory framework applicable to US Cannabis Issuers became uncertain. The CSA released a statement on January 12, 2018 (the **CSA Release**) advising that the CSA was considering whether its disclosure-based approach for US Cannabis Issuers remained appropriate in light of the rescission of the Cole Memo. The CSA Release noted that the CSA would communicate more details about its position "shortly", but provided no indication of a timeframe. The lack of guidance and the confirmation in the CSA Release that issuers with no US marijuana-related activities and that otherwise operate in compliance with applicable Canadian laws "are not the focus" created increased uncertainty for US Cannabis Issuers seeking to access the Canadian capital markets.

The Notice constitutes the guidance promised by the CSA Release and alleviates certain concerns faced by the Canadian capital markets participants. Rather than restricting US Cannabis Issuers' access to the Canadian capital markets, the Notice imposes additional disclosure requirements that apply to such issuers, including those with direct and indirect involvement in the cultivation and distribution of marijuana and those that provide goods and services to third parties involved in the US marijuana industry. The mandated disclosure is required to be included in prospectus filings and other disclosure documents, such as an issuer's annual information form and management's discussion and analysis. Among other things, the Notice requires that US Cannabis Issuers:

1. prominently state that marijuana is illegal under US federal law and that enforcement of relevant laws is a

significant risk;

2. outline related risks, including the risk that third party service providers could suspend or withdraw services and that regulatory bodies could impose certain restrictions on the issuer's ability to operate in the US;
3. quantify exposure to US marijuana-related activities on the issuer's balance sheet and operating statement; and
4. disclose if legal advice has not been obtained, either in the form of a legal opinion or otherwise, regarding: (a) compliance with applicable state regulatory frameworks; and (b) potential exposure and implications arising from US federal law.

In addition to the foregoing, US Cannabis Issuers with direct involvement in cultivation or distribution of marijuana must also: (a) outline the regulations for US states in which the issuer's investee(s) operate; and (b) discuss the issuer's program for monitoring compliance with US state law on an ongoing basis, outline internal compliance procedures and provide a positive statement as to its compliance with US state law.

US Cannabis Issuers with indirect involvement in cultivation or distribution of marijuana must: (a) outline the regulations for US states in which the issuer's investee(s) operate; and (b) provide reasonable assurance, through either positive or negative statement, that the investee's business is in compliance with applicable licensing requirements and the regulatory framework enacted by the applicable US state and promptly disclose any non-compliance, citations or notices of violation, of which the issuer is aware, that may have an impact on the investee's licence, business activities or operations.

Rather than prohibiting US Cannabis Issuers from participating in the Canadian capital markets, the Notice reaffirms the CSA's "disclosure-based" approach to regulation and broadens the scope of the disclosure required of US Cannabis Issuers in an effort ensure that investors and market participants are educated in respect of the risks associated with US Cannabis Issuers.

## Dentons' analysis

In light of the Sessions Memo and the CSA Release, the guidance provided by the CSA in the Notice is instrumental to reassure the Canadian market by providing comfort to both investors and US Cannabis Issuers that US Cannabis Issuers will not automatically be cease traded as a result of US operations. The Notice confirms that as long as US Cannabis Issuers comply with the mandatory disclosure prescribed by the Notice, they will continue to be eligible to access and participate in the Canadian capital markets and alleviates the concern of a potential prohibition that arose in light of the CSA Release.

As with the previously required disclosure, going forward, we expect that much of the disclosure required to be made by US Cannabis Issuers will become standardized as the CSA framework becomes increasingly well-established in the Canadian market. In addition, the guidance provided by the CSA will hopefully provide comfort to new market participants and institutional investors, allowing them to participate in an industry that has historically been a retail space.

Notwithstanding the foregoing, US Cannabis Issuers will need to be cognizant of the increased disclosure obligations and the risks of non-disclosure and ensure that they are fully apprised of the legal framework in the US states in which they operate and are properly communicating the level of risk that investors may face to their shareholders and the market generally.

In addition, a number of third party service providers have begun to impose restrictions on issuers seeking to utilize their services, including covenants not to participate in the cannabis industry in the United States. As a result, US

Cannabis Issuers will need to carefully consider the reactions of, and resulting requirements imposed by, third party service providers, including transfer agents, depositories and financial institutions, as a result of the Sessions Memo.

## Contact us

As summer 2018 draws closer, each of the provinces and territories will continue to rapidly formalize their respective frameworks for the regulation of recreational cannabis. In addition to Canadian licensed producers, the Canadian capital markets have experienced a rapid influx of US Cannabis Issuers seeking to raise capital and obtain stock exchange listings in Canada. This trend is anticipated to continue as regulatory frameworks for the cultivation and sale of cannabis continue to emerge. Dentons' leading Cannabis group will continue to work closely with policy makers, Canadian licensed producers, US Cannabis Issuers and other key stakeholders, and provide frequent Insights on these important developments.

If you wish to discuss the Notice or the Sessions Memo, and their possible implications for your business or the Canadian cannabis industry generally, please contact Eric Foster or **Andreas Kloppenborg**.

## Your Key Contacts



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