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CSA and CDS Clarify Positions in Response to Recent Developments in U.S. Cannabis Laws and the Sessions Memorandum

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Torkin Manes LLP published an article in November 2017 that provided guidance on the treatment of public issuers with U.S. cannabis-related activities by the Toronto Stock Exchange (“TSX”), Canadian Securities Administrators (“CSA”) and Canadian Stock Exchange (“CSE”).

In response to recent changes in U.S. federal policy, the CSA released an updated policy (Staff Notice 51-352) on February 8, 2018 regarding its position on reporting issuers with U.S. cannabis-related activities (the “CSA Revised Policy”). The CSA Revised Policy confirms the CSA’s disclosure-based approach that was set out in its initial policy and contains additional disclosure requirements for issuers, which are described below.

Recent Developments in U.S. Federal Policy

On January 4, 2018, U.S. Attorney General Jeff Sessions issued a one-page memorandum (the “Sessions Memo”) that rescinded the forbearance-based approach established in the Cole Memorandum, which set out the Obama administration’s policy of de-prioritizing the use of federal funds to enforce cannabis prohibitions in U.S. states that have established a regulatory framework to legalize cannabis.

The Sessions Memo reaffirms the U.S. federal prohibition against cultivation, distribution and possession of cannabis and directs U.S. state attorneys to follow the general principles set out in the U.S. Attorneys’ Manual when exercising discretion in whom to prosecute. These principles require federal prosecutors to weigh all relevant considerations, including federal law enforcement priorities, the seriousness of the crime, the deterrent effect of the criminal prosecution and the cumulative impact of particular crimes on the community. Many U.S. state attorneys have responded to the Sessions Memo by declaring they will continue to follow these well-established principles when deciding which cases to charge and further that they intend to focus on prosecuting crimes that pose the greatest threat to public safety and society, including preventing distribution to minors, combating violent crime stemming from drug trafficking,

averting the operation of criminal enterprises and cartels, as well as keeping a focus on public health and prevention. Other U.S. state attorneys have suggested the Sessions Memo would not lead to an increase in cannabis prosecutions in the subject state at the expense of other high priority enforcement issues, including immigration, the opioid crises and violent crime. Accordingly, although the Sessions Memo has created even more uncertainty in the U.S., it remains to be seen if it will have a meaningful effect in states which have legalized medicinal cannabis and/or recreational adult use of cannabis, particularly given the tax dollars being generated as well as the thousands of jobs that have been created in this industry.

In fact, some commentators believe that the Sessions Memo is “toothless” because of a legislative safeguard, the Rohrbacher-Blumenauer Amendment, which prevents the U.S. Department of Justice from enforcing the U.S. government’s newly established position in the Sessions Memo. The Rohrbacher-Blumenauer Amendment is a rider to the congressional spending bill that prevents the U.S. Department of Justice from spending funds to enforce the *Controlled Substances Act* in states that have legalized medical cannabis. As of January 12, 2018, the McClintock-Polis Amendment was introduced to extend similar protections to recreational cannabis (where state sanctioned). The McClintock-Polis Amendment is not currently law and it is still uncertain whether it will enter into the force of law.

CSA Revised Policy: Considerations for Issuers

The CSA Revised Policy reiterates the disclosure-based approach that was established in the CSA’s initial policy that was released on October 16, 2017. This means that issuers with U.S. cannabis-related activities, provided that they are in compliance with U.S. state laws, will have met their obligations to the CSA by providing full and accurate disclosure of the material facts and risks related to investing in companies that have U.S. cannabis-related activities. In response to the developments in U.S. federal policy, the CSA Revised Policy maintains this approach but has placed additional disclosure obligations to ensure that each issuer’s disclosure includes:

- A prominent statement that cannabis is illegal under U.S. federal law and that enforcement now presents a significant risk;
- Discussion about statements and guidance from federal authorities or prosecutors about the risk of enforcement in any U.S. jurisdiction;
- A quantification of the issuer’s balance sheet and income statement exposure to U.S. cannabis-related activities regarding the risk of intervention; and
- A positive statement indicating compliance with U.S. state cannabis laws.

The CSA Revised Policy also confirms that each stock exchange in Canada may still make its own policies and its own determination on whether to list issuers with U.S. cannabis-related activities. The TSX has previously announced that issuers who contravene U.S. federal law are not in compliance with the TSX’s continued listing requirements, while the CSE has chosen to adopt the CSA’s disclosure-based approach and allow issuers to trade on their exchange so long as investors have been made adequately aware of the risks related their investment. For a more detailed review, please refer to our previous article.

Clarification from CDS

In early August 2017, certain media outlets reported that the CDS Clearing and Depository Services Inc. (“CDS”), Canada’s settlement and clearing agency that processes the vast majority of listed securities, was considering a policy change to cease facilitating trades in securities of any issuer with U.S. cannabis-related activities. This uncertainty led a significant sell-off in the sector, especially for those issuers involved in U.S. cannabis-related activities. Shortly thereafter, on August 17, 2017, CDS provided some clarity and announced that there would be no ban and that it would be working with regulators to arrive at a solution.

On November 24, 2017, CDS provided additional clarity by stating that the solution would be founded on each stock exchange’s role in applying listing requirements, however until February 8, 2018 there was no clear resolution to this issue. Fortunately, on February 8, 2018, CDS reported that it had signed a memorandum of understanding (“MOU”) with various recognized Canadian stock exchanges to address its concerns. The MOU maintains that there will be no ban and confirms that listed issuers with U.S. cannabis-related activities will continue to have their securities cleared by CDS, but that it will be relying

upon Canadian stock exchanges to review the conduct of such issuers. This provided welcomed certainty surrounding the settlement of securities by CDS.

Given the uncertainty created by the Sessions Memo and due to differences in how the Canadian stock exchanges view issuers with U.S. cannabis-related activities, issuers and applicants that have or plan to have U.S. cannabis-related activities should seek legal advice well in advance of listing on a Canadian stock exchange, so as to understand their disclosure obligations, map out and consider the benefits and risks of each exchange, and make an informed decision regarding where to list so as to compliment, and not restrict, the issuer's business plans.

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