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U.S. capital markets developments in 2018: From rocks in the ground to rolling with cannabis, and everything in between

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A number of developments from the U.S. Securities and Exchange Commission (SEC) in 2018 will be of special interest to Canadian companies and their investors in the very traditional mining sector and the very non-traditional cannabis sector. Other developments provide cautionary tales for Canadian companies that already are, or may become, public companies or plan to raise capital in the United States.

SEC digs up new rules for mining companies

In October 2018, the SEC adopted rules modernizing the property disclosure requirements for mining companies. The proposed rules align more closely with current industry and global regulatory practices and standards, including Canada's NI 43-101 requirements and those recommended by the Committee for Reserves International Reporting Standards. The SEC's previous disclosure regime, known as "Industry Guide 7," will be rescinded.

The major changes to the former Industry Guide 7 regime include the following:

- **Mineral resources:** Mining companies will now be allowed to disclose specified information about their mineral resources. Industry Guide 7 generally prohibited disclosure of reserve estimates, even though reserve disclosure is required under NI 43-101 in Canada, as well as under the mining property disclosure requirements of other countries.
- **Qualified person**: Mining companies' disclosure of exploration results, mineral resources or mineral reserves must be based on and accurately reflect information and supporting documentation prepared by a mining expert who meets the "qualified person" requirement under the new rules, much like the "qualified person" requirements of Canada's NI 43-101.
- **Technical report summary**: Mining companies must obtain and file a technical report summary from a "qualified person" that identifies and summarizes the information reviewed and conclusions reached by each qualified person about the mineral resources or mineral reserves determined to be on each material property of a mining company. The technical report summary must be filed with the SEC when disclosing mineral reserves or mineral resources for the first time or when there is a material change in the mineral reserves or mineral resources from the last technical report summary filed for the

property. This will align the SEC's requirements more closely with NI 43-101, which requires preparing and publicly filing a technical report in similar circumstances.

Mining companies will be required to comply with the new rules for their first fiscal year beginning on or after January 1, 2021, although earlier voluntary compliance will be permitted.

As a result of the SEC's changes, Canadian mining companies will no longer have to contend with materially different disclosure requirements under NI 43-101 and Industry Guide 7 when conducting cross-border capital raising activities or trying to satisfy disclosure requirements as a public company in both the United States and Canada.

Musk on Twitter made the SEC bitter (or how tweet it is to be fined by you)

In September 2018, Elon Musk, the chairman and chief executive officer of Tesla Inc., settled securities fraud charges brought by the SEC in connection with his tweets relating to a potential going-private transaction involving Tesla at a significant premium to its then trading price. The SEC alleged that Musk tweeted materially misleading information about Tesla's going-private transaction without reasonable basis, including that the source of funding for taking Tesla private was "secured" and that the transaction was certain except for a shareholder vote, despite his knowledge that the potential transaction and the source of funding were actually uncertain and ultimately subject to numerous contingencies.

As part of his settlement with the SEC, Musk paid a fine of US$20 million and relinquished his role as the chairman of Tesla. In addition, Tesla was fined US$20 million for failing to maintain disclosure controls to determine whether Musk's tweets contained information required to be included in Tesla's SEC filings or to evaluate the accuracy or completeness of Musk's tweets.

The takeaway from the incident is that all companies should be aware that material information publicized by them or their management teams using social media accounts is subject to applicable disclosure requirements under U.S. securities laws and should be carefully reviewed from a securities compliance perspective before they are issued.

Sometimes less is more

In August 2018, the SEC adopted amendments to further simplify disclosure requirements for registration statements used in securities offerings and periodic reports. Notable changes for foreign private issuers, including Canadian companies using non-Multijurisdictional Disclosure System (MJDS) registration statements, include the following amendments:

- Registrants no longer have to provide exchange rate data if financial statements are prepared in a currency other than the U.S. dollar because that information is already publicly available.
- Registrants no longer have to include historical and pro forma ratios of earnings to fixed charges and the related exhibit when registering debt securities or preferred stock because financial statements already include the components commonly used to calculate these ratios.

- Form 20-F requires audited financial statements filed in connection with an initial public offering by a non-public foreign private issuer to be no older than 12 months at the date of filing. The SEC has previously permitted issuers to request waivers extending the age of audited financial statements filed in connection with an initial public offering to up to 15 months. The SEC is eliminating the requirement to apply for such a waiver, so long as the foreign private issuer is able to represent that it is not required to comply with the 12-month requirement in any jurisdiction outside the United States and that complying with the 12-month requirements is impracticable or involves undue hardship, which representation has to be filed as an exhibit to the registration statement.
- Form 20-F required foreign private issuers to provide price history of the shares to be offered and listed. This disclosure requirement has been eliminated because market price information is already publicly available;.
- The SEC eliminated the requirement for foreign private issuers to provide disclosure about any dividend restrictions because foreign private issuers are already required to disclose dividend restrictions in the notes to their financial statements.

Get Inline for XBRL

The SEC currently requires public companies to provide information from their financial statements in eXtensible Business Reporting Language (XBRL) format. In June 2018, the SEC approved two amendments to its rules governing XBRL:

- Companies will no longer have to make the XBRL information available on their corporate websites because most users access this information directly from the SEC's EDGAR website.
- The SEC will phase in a requirement for companies to use "Inline XBRL" information in their filings. Inline XBRL refers to the mechanism by which a company can integrate its XBRL information directly into its filing, instead of including the XBRL information as a separate exhibit to its filing. The SEC believes that Inline XBRL will reduce the time and resources for companies to prepare XBRL information and also improve the accessibility of XBRL information for readers.

Foreign private issuers using IFRS, including Canadian registrants (both MJDS and non-MJDS filers), will be required to use Inline XBRL for fiscal periods ending on or after June 15, 2021.

SEC says be hypervigilant about cybersecurity

In February 2018, in light of a number of recent high-profile hacking incidents against public companies, the SEC issued interpretive guidance on disclosure requirements for cybersecurity risks and incidents. In particular, the SEC

- urged companies to provide more than generic and boilerplate cybersecurity-related disclosures. While the SEC recognized that companies should not have to provide specific disclosures that may present a roadmap for breach of their security systems, companies should provide disclosures that are tailored and specific about things such as the impact of any hacking incident, the range of harm, the amount of data compromised and other

impacts on the company's reputation, as well as litigation risks;

- urged companies to provide timely disclosure. While recognizing that it takes time to investigate and understand the full picture of any hacking incident, the SEC emphasized that an ongoing investigation itself is not sufficient to justify avoiding disclosures of a material incident and reminded companies to update their prior disclosures on any hacking incidents if subsequent investigations reveal additional and superseding information;
- encouraged companies to adopt comprehensive polices and procedures related to cybersecurity and to assess the compliance with and sufficiency of those policies and procedures regularly; and
- emphasized that because major hacking incidents constitute material non-public information, companies' insider trading policies should be updated to prohibit trading by insiders using their knowledge of cybersecurity incidents.

In October 2018, the SEC also issued a report on a number of public companies that were victims of cyber-related frauds. The focus of this report was on whether these public companies might have failed to maintain sufficient systems of internal accounting controls to provide reasonable assurances that those cyber-related frauds were detected and prevented, as required by U.S. securities laws. In particular, the SEC found that the success of these frauds were often due to employee failures to understand and follow internal control requirements.

While the SEC decided not to pursue enforcement action against the affected companies, it reminded all public companies of their obligation to ensure that their employees have sufficient training to detect and prevent cyber-related fraud.

The other side of the coin

Raising capital by offering digital assets such as "coins" or "tokens", which areoften referred to as initial coin offerings (ICOs), has been very popular in recent years, particularly in the technology industry and among retail investors. Attempts to regulate the offer and sale of digital assets using traditional securities laws have presented a significant challenge for regulators. During 2018, the SEC published several important guidances and took a number of significant enforcement actions in connection with digital assets and ICOs. Please see our article on the digital assets and ICOs titled "Cryptoassets in 2018: Prices down, enforcement up, institutional interest steady".

High times for Canadian cannabis companies

The past year set many milestones for Canadian cannabis companies, which raised a significant amount of capital in the U.S. markets. Please see our articles on the cannabis industry captioned "Canadian cannabis companies conquer U.S. capital markets" and "Canada first G7 country to legalize retail cannabis".