

## The Canadian Cannabis Sector: Financing in Difficult Times

Vern DaRe, Partner and Rick Moscone, Partner, Foglers, Rubinoff LLP<sup>1</sup>

Dire predictions in the media about the “bubble bursting” or the floodgates opening for insolvencies in the Canadian cannabis sector has certainly not been helpful to those cannabis producers seeking financing. Whether these predictions are exaggerated or not, to date there have only been a handful of Canadian cannabis producers that have actually commenced insolvency proceedings. One of the first filings under the *Companies’ Creditors Arrangement Act* (the “CCAA”) by a Canadian cannabis producer was by AgMedica Bioscience Inc. and certain of its related entities (“AgMedica”) on December 2, 2019. Although this is only a single case and CCAA filings have been far and few to date in the Canadian cannabis sector, AgMedica offers some real insight to the challenges currently faced by cannabis producers in raising capital or obtaining financing in the present market.

### Overview

AgMedica is a licensed producer of cannabis products. The Chatham, Ontario-based company generates revenues primarily by the cultivation, processing and distribution of these products. AgMedica has operations across Canada and holds two cannabis licenses. By 2019, it was clear that AgMedica was running out of cash. It tried to raise money several times throughout 2019. A planned initial public offering (“IPO”) over the summer failed after the withdrawal of the underwriters. The company then attempted to raise approximately \$60-million in debt but that too failed in October, 2019. On December 2, 2019, AgMedica was granted protection under the CCAA. The relief included a debtor in possession (“DIP”) loan in the principal amount of \$1 million from the initial DIP lender to cover the first 10 days of the CCAA proceedings. On its return to court on December 12, 2019, AgMedica obtained further relief including the approval of the DIP loan in the principal amount of \$7.5 million from the subsequent DIP lender.

### Some Lessons

The challenges faced by AgMedica in raising money may be instructive to other cannabis producers seeking financing during these difficult times. If these negative market conditions continue to persist, the availability of financing for the cannabis sector may become increasingly limited and expensive.

If commercial funding is not available outside of insolvency proceedings for licensed cannabis producers, a CCAA filing and possible DIP loan may be an option. The CCAA generally applies to a “debtor company” that has liabilities in excess of \$5 million. The company must also be

---

<sup>1</sup> This paper is republished with the permission of Fogler, Rubinoff LLP

“insolvent”. While the CCAA does not define “insolvent”, there are certain statutory tests provided under the *Bankruptcy and Insolvency Act* (the “BIA”) and a company satisfying any of these BIA tests will be considered insolvent for the purposes of the CCAA. In addition, under the case law, the insolvency requirement has become more flexible or less onerous, in that a corporation will be considered insolvent under the CCAA if there is a reasonably foreseeable expectation at the time of filing of a looming liquidity crisis that will result in the debtor company not being able to pay its debts as they become due without the benefit of a stay of proceedings.

In the face of a looming liquidity crisis, the debtor company may need the protection of the CCAA. It is often said that the CCAA provides the company with “breathing space” in order to restructure. This is partly achieved by way of a stay of proceedings, which generally prevents creditors from taking enforcement steps against the debtor company. On filing under the CCAA, a court may make an order staying all proceedings in respect of the debtor company for a certain period.

Besides the stay protection under the CCAA, the debtor company will also likely need money in order to continue operations during the restructuring. As illustrated in *AgMedica*, the debtor company often cannot obtain alternative financing outside of CCAA proceedings before running out of money. Courts have held that DIP financing should be granted to “keep the lights on” and allow the continued operations of the debtor company during a restructuring. Without it, the business may fail, jobs may be lost and other stakeholders negatively impacted.

However, DIP financing comes at a cost. Interest on the loan may be at a premium. There are also professional costs associated with such financing. In addition, a DIP lender will expect its loan to be secured by way of a super-priority DIP charge on the assets of the debtor company. DIP financing involves what may be a significant re-ordering of priorities from those in place before the CCAA filing, in the sense of placing encumbrances or charges on the collateral or assets of the debtor company ahead of those presently in existence. This is often referred to as “priming” (or subordinating) existing security under the DIP charge.

In summary, the *AgMedica* CCAA proceedings are important or precedent-setting for three main reasons. Firstly, *AgMedica* is one of the first cannabis producers to file for creditor protection under the CCAA. If other cannabis producers are unable to obtain financing outside of insolvency proceedings, the terms and conditions of the DIP financing in *AgMedica* may be instructive in their negotiations with DIP lenders.

Secondly, the *AGMedica* case represents one of the first decisions in which the court had to deal with the new reforms of the CCAA. These legislative reforms came into force on November 1, 2019, about one month before the start of the *AgMedica* CCAA proceedings. One reform is the shortening of the initial stay period. Under the old CCAA, the initial stay of proceedings obtained on an initial filing could not exceed 30 days. Under the legislative reforms of November 1, 2019, the initial stay period was changed to 10 days. Another reform is that the relief on the initial application must now be limited to relief that is “reasonably necessary” for

the continued operations of the debtor company. The same reforms of November 1, 2019 also impact DIP financing under the CCAA: the initial DIP financing can only be for the first 10 days and the terms of that 10-day loan are limited to what is “reasonably necessary” for the continued operations of the debtor company during that period. This means that a debtor company will only have 10 days after the initial CCAA filing to return to court to get broader relief including, if necessary, an extension of the stay period and an increase in the amount of the DIP loan (beyond the initial 10 day period). In *AgMedica*, the initial CCAA application was heard by the court on December 2, 2019 and the court granted, among other things, a stay of proceedings to December 12, 2019 and a DIP loan for that period in the principal amount of \$1 million secured by a DIP charge. On the return or “comeback” date of December 12, 2019, the stay period was extended by the court to March 12, 2020 and the DIP loan and charge increased to \$7.5 million. Some have suggested that as a result of these recent legislative reforms there will now be a “skinny” Initial CCAA Order (with limited relief to cover the first ten days) on an initial application and a “longer” Amended and Restated Initial Order (with broader relief) on a subsequent application.

Finally, the treatment of *Cannabis Act* licenses under the CCAA is an open question. As noted above, *AgMedica* holds cannabis licenses. It is uncertain whether or not these licences can be sold, transferred or assigned to a purchaser under the CCAA. The *AgMedica* CCAA proceedings contemplate a going concern sale of certain assets as part of its restructuring. The licence transfer issue therefore may become a significant hurdle over the course of these proceedings.

Fogler, Rubinoff LLP provides a full range of legal services to participants in the cannabis industry. We represented the initial DIP lender in the *AgMedica* CCAA proceedings.