

Guidance on Control and Ownership

April 2022

Public Comment

Please note: the Cannabis Control Commission (Commission) is accepting public comments in response to this guidance from April 11 through May 2, 2022 at 5 p.m. All submissions should be emailed to Commission@CCCMass.com with the subject line “Guidance on Control and Ownership: Public Comment”.

*The following guidance is provided to address questions regarding the definitions of **Person or Entity Having Direct Control** and **Person or Entity Having Indirect Control** contained in 935 CMR 500.002 and 935 CMR 501.002. This document interprets regulatory changes which took effect on January 8, 2021. This document is not legal advice. It is meant to address frequently asked questions and concerns about the definitions of the terms above as they relate to legislatively mandated limits on the number of adult use cannabis licenses that can be held by any individual or entity. Please consult an attorney if you have any questions regarding the legal requirements that apply. Capitalized terms used but not defined in this guidance shall have the meaning set forth in 935 CMR 500.000 and 501.000.*



Introduction

Consistent with legislative intent, the Cannabis Control Commission (Commission) is committed to ensuring that the regulated adult-use cannabis industry offers the opportunity for full participation by small businesses and farmers. As a way to ensure that bigger businesses do not crowd out smaller competitors, The Commission’s authorizing statute mandates an upper limit to the number of licenses that any person or entity can be granted. Section 16 of M.G.L. c. 94G states:

No **licensee** shall be granted more than 3 marijuana retailer licenses, 3 medical marijuana treatment center licenses, 3 marijuana product manufacturer licenses or 3 marijuana cultivator licenses; provided, however, that a licensee may hold 3 marijuana retailer licenses, 3 medical marijuana treatment center licenses, 3 marijuana product manufacturer licenses and 3 marijuana cultivator licenses.

When the Commission, through regulation in 2021, authorized the granting of two new categories of licenses – Delivery Courier and Delivery Operator – it expanded the legislatively mandated ownership cap limits to include those license types (935 CMR.500.050 “No Person or Entity Having Direct or Indirect Control shall be granted or hold more than a combined total of two Delivery Operator and/or Marijuana Courier Licenses at any time”).

The Commission supports the legislative intent in this matter and, through its regulations, seeks to enforce the ownership cap limits described above. Doing so required the development, in its initial regulations promulgated in March 2018, of regulatory definitions for Licensee and for the subsidiary terms **Owner**, **Person or Entity Having Direct Control**, and **Person or Entity Having Indirect Control**.

Briefly, an individual or an entity is defined as a “**Licensee**” if they are an Owner (possessing 10% or more of the equity in a Marijuana Establishment or if they have direct or indirect control.

“**Owner**” is defined as any Equity Holder that possesses 10% or more of the equity in a Marijuana Establishment, MTC or Independent Testing Laboratory.

“**Equity Holder**” means a person or entity that holds or may hold as a result of one or more of the following including, without limitation, vesting, conversion, exercising an option, a right of first refusal, or any agreement that would trigger an automatic transfer of or conversion to equity, any amount of equity in a Marijuana Establishment or an MTC.

“**A person or entity having Direct Control**” means any person or entity having direct control over the operations of a Marijuana Establishment, which satisfies one or more of the following criteria:



- a) An Owner that possesses a financial interest in the form of equity of 10% or greater in a Marijuana Establishment;
- b) A Person or Entity that possesses a voting interest of 10% or greater in a Marijuana Establishment or a right to veto significant events;
- c) A Close Associate;
- d) A Person or Entity that has the right to control or authority, through contract or otherwise including, but not limited to:
 - 1. To make decisions regarding operations and strategic planning, capital allocations, acquisitions and divestments;
 - 2. To appoint more than 50% of the directors or their equivalent;
 - 3. To appoint or remove Corporate-level officers or their equivalent;
 - 4. To make major marketing, production, and financial decisions;
 - 5. To execute significant (in aggregate of \$10,000 or greater) or exclusive contracts; or
 - 6. To earn 10% or more of the profits or collect more than 10% of the dividends.
- e) A Court Appointee or assignee pursuant to an agreement for a general assignment or Assignment for the Benefit of Creditors; or
- f) A Third-party Technology Platform Provider that possesses any financial interest in a Delivery Licensee including, but not limited to, a Delivery Agreement or other agreement for services.

“A person or entity having indirect control” is defined as any person or entity having indirect control over operations of a Marijuana Establishment. It specifically includes any Person or Entity Having Direct Control over an indirect holding or parent company of the applicant, and the chief executive officer and executive director of those companies, or any person or entity in a position indirectly to control the decision-making of a Marijuana Establishment.

While the Commission included these definitions in its original regulations, applicants, Licensees and their representatives have raised questions over time with regard to the interpretation of these definitions to ensure that they are in compliance with the license cap limits. Additionally, as the industry has evolved, novel forms of corporate financing, organizational structure, and ownership have emerged both for companies first starting up as well as for increasingly frequent acquisitions, mergers, and restructuring of existing entities. In response to questions and concerns that have been raised, the Commission offers the following guidance to clarify definitions and terms.



1. Clarify “Close Associate”

“Close Associate” is defined in the regulations as:

A Person who holds a relevant managerial, operational or financial interest in the business of an applicant or Licensee and, by virtue of that interest or power, is able to exercise a significant influence over the corporate governance of a Marijuana Establishment, an MTC or Independent Testing Laboratory licensed under 935 CMR 500.000. A Close Associate is deemed to be a Person or Entity Having Direct or Indirect Control.

Under the Commission’s regulations, a Close Associate is considered to be a “Person or Entity Having Direct or Indirect Control.” Consequently, among other requirements, a Close Associate is subject to the limits on ownership and control in 935 CMR 500.050(1)(b).

To be a Close Associate, one must be able to exercise significant influence over the corporate governance and operations of a Marijuana Establishment (ME), Medical Marijuana Treatment Center (MTC), or Independent Testing Laboratory (ITL). The Commission considers someone to have “significant influence” if that person has the power to make, veto, or control the operating and financial policy decisions of an entity. Someone who has the ability to make a decision that cannot be overridden has significant influence. Someone who has the power to bind the entity or otherwise to make decisions on behalf of the entity has significant influence.

The significant influence exercised by a Close Associate must be actual and not merely potential. So, simply holding a position or title does not make a person a Close Associate. A Close Associate is one who has the power, by contract or their authorized powers, duties, and actions, to bind the company or actually make decisions, as opposed to simply being able to give or offer potentially influential advice. A Close Associate is able to control, not just influence.

A Close Associate does not need to have a financial interest in the business of an applicant or a Licensee. A person with a financial interest in the business that is below the 10% ownership threshold may be a Close Associate, but only if that person is able to exercise control or otherwise has decision-making authority.

The Close Associate classification serves to capture individuals who have control, even if that individual does not hold an (Executive) position.

Examples:

- A consultant, a contractor, a former CEO, the director of cultivation, the director of a lab, a party to a contractual agreement, may all be Close Associates, but only if the particular person has control or decision-making authority.



- Former CEO of Licensee A sells company to Licensee B. Former CEO kept on by Licensee B to continue running the day-to-day operations of Licensee B and to utilize his or her expertise. Former CEO has no executive role or position in Licensee B, has an ownership stake of less than 10%, and is kept on the payroll without a formal position. This former CEO is a Close Associate if he or she makes decisions for the Licensee on a day-to-day basis, directly oversees and actually directs the operations of the Licensee with such directives being veto proof. The former CEO who plays a purely advisory role, but whose advice need not be heeded by the Licensee, is not a “Close Associate.”
- Consultants who are empowered by contract or other understanding to make and execute substantive policy and operation decisions for an applicant or Licensee are Close Associates. Consultants who consult and offer non-binding advice to company decision-makers, are not Close Associates, even if their advice is influential.
- A Close Associate is not an executive officer or board member who has significant influence on business. The Commission considered an executive officer or board member to be already covered by other categories under Person or Entity Having Direct Control. See Section 4 of this Guidance.

2. Clarify “Equity Holder”

Owner/Ownership, defined by the Commission’s regulations as any Equity Holder that possesses equity of 10.00% or more (10% threshold) in a ME, MTC, or ITL, is prima facie evidence of control. Through this guidance, the Commission clarifies that unexercised stock options, warrants, and/or convertible debt notes do not qualify as “possessing” equity and, therefore, is not included in the assessment of whether an individual or entity meets or exceeds the 10% threshold.

If and when stock options, warrants, and/or convertible debt are exercised or vest, the resultant equity ownership will be immediately considered as possession of equity to be assessed against the 10% threshold. As a reminder, the Commission must be notified through a Change of Ownership and Control application filed by the Licensee with the Commission. The Commission must approve the submitted change application prior to any individual or entity, who was not previously disclosed to the Commission, gaining control or ownership in a Licensee.

Similarly, equity for which an individual or entity holds the right of first refusal will not be counted against the 10% threshold until and unless equity is purchased based upon those rights.

As with all contracts between applicants/Licensees and third parties, the Commission will evaluate the terms of each contract to determine if they grant either direct or indirect control to those third parties, even if the equity ownership of the third party stays below the 10% threshold.



While future rights to equity will generally not be counted towards the 10% threshold until exercised, covenants and provisions that generally come with certain debt agreements or instruments may constitute control. However, the Commission will distinguish between contractual provisions that grant actual control or decision-making authority over the Licensee as opposed to contractual provisions that are merely protective of investments, but which do not equate with control. Contractual provisions that grant lenders the ability to make decisions affecting the day to day running of a Licensee, to pro-actively initiate actions on behalf of a Licensee, or to impose outcomes on the company may constitute control. In contrast, contractual provisions that recognize the collateralized nature of a secured lender's investment and based on such recognition grant the lender the right to consent to the sale of an asset or to the sale of the business, are not control covenants. Likewise, contractual provisions that grant a secured lender consent or approval rights with regard to a Licensee or its parent incurring further indebtedness (much the way a home mortgage provider may have a right to consent to a home equity line of credit or a second mortgage) do not amount to control. Contractual provisions that simply give secured lenders the ability to prevent a company from overleveraging itself are not control covenants.

Note regarding Equity Benefits: The Commission's regulations provide certain benefits for applicants and Licensees that are majority owned by Social Equity Program participants and Economic Empowerment Applicants (Equity Benefits). The purpose of Equity Benefits is to fulfill the Commission's statutory mandate to promote and encourage participation in the cannabis industry by those who have been disproportionately harmed by cannabis prohibition.

The Commission encourages investment in businesses owned by Social Equity Program (SEP) Participants and Certified Economic Empowerment Applicants (EEA). The Commission does not, however, condone efforts to undermine the Commission's mission, for example, by exploiting SEP and EEA statuses. The Commission will scrutinize agreements to assess egregious or deprecatory provisions. In a facts and circumstances analysis, contractual provisions that, taken together, are excessively disadvantageous to SEP Participants or EEAs may be deemed to establish an investor as a majority owner thereby disqualifying an entity of the Equity Benefits and assessing ownership with existing license caps.

Examples of excessively disadvantageous terms may include, without limitation: preferred returns or distributions of profits excessively disproportionate to the equity held and investment made; terms that do not account for the asset value of a License or the associated Equity Benefits; interest that are drastically higher than market rates; provisions that give an investor or class of investors the ability to elect a number of directors drastically disproportionate to their interest; payments based on revenue (rather than profits); stock options that are granted for no consideration to the current stock holder; contractual provisions that automatically convey



ownership from one investor to another at the end of the exclusivity period, at the unilateral election of the receiving investor.

Note regarding Change of Ownership and Control Applications: While contracts submitted to the Commission for review may contain triggering events or future dates of conversion and/or exercising warrants pertaining to equity, nothing in this guidance shall preclude the Licensee from submitting a Change of Ownership and Control application for consideration and approval by the Commission prior to any contemplated changes being effectuated.

3. Clarify “Significant Event”

A person or entity that “possesses a voting interest of 10% or greater in a ME or MTC or a right to veto significant events” is considered to be a Person or Entity Having Direct Control.

In response to questions about what events constitute a “significant event,” the Commission provides the following examples:

Examples of “significant events” include, but are not limited to:

- mergers and acquisitions;
- applications for additional licenses;
- sale of the company;
- sale of license(s);
- hiring and firing of C-level executives;
- relocation of the ME, MTC, or ITL;
- restructuring of the company.

Examples of events that do not rise to the level of being significant:

- hiring and firing of consultants or employees other than C-level executives;
- nomination of C-level executives.

4. Clarify that a Member of the Board of Directors is a Person or Entity Having Direct (or Indirect) Control

Through this guidance, the Commission clarifies that a member of the board of directors or board of managers (Board Member) – for example a member of a board of directors or a board of managers – is presumed to be a

Person or Entity that has the right to control or authority [...] to make decisions regarding operations and strategic planning, capital allocations, acquisitions and divestment,



one of the criteria for being a Person or Entity Having Direct Control, defined in 935 CMR 500.002, 501.002.

This presumption arises because the board of directors generally has the power to make strategic planning, operational, financial, and other major and significant decisions for the company. Therefore, a Board Member is likely to meet this criterion, even where a single board member may not meet the definition of a Close Associate because the Board Member's decisions, through its voting powers, may fail or be rejected.

The Licensee has the burden of demonstrating to the Commission that a Board Member does not have the right to control or authority to make decisions regarding operations and strategic planning, capital allocations, acquisitions and divestment. For example, a Licensee can rebut the presumption of a Board Member's control by submitting an affidavit that the Board Member is recused from all matters relating to or impacting its Massachusetts businesses. If a Board Member can demonstrate that on matters regarding operations and strategic planning, capital allocations, acquisitions and divestment, a given Board Member has a voting interest of less than 10%, they likely do not meet this criterion.

A Board Member may have direct or indirect control of a Licensee. To be a person with indirect control of a Licensee, one must meet the definition of a Person or Entity Having Direct Control for the Licensee's parent (or above) company. See Section 5 of this Guidance for more discussion about indirect control. Thus, where a person serves as a Board Member of a Licensee's parent company (or above), it is presumed that the Board Member is a person with indirect control over the Licensee.

As in the case of a Board Member's presumptive direct control of a Licensee, a Licensee may rebut the presumption of a Board Member's indirect control. The Licensee must demonstrate that decision-making authority of the board of the parent company is such that decisions by that board cannot and does not impact the Licensee's operations and strategic planning, capital allocations, acquisitions and divestment. For example, where approval by the board of a parent company is not required to transfer funds to the Licensee or to apply for additional Licenses in Massachusetts – this may indicate the board does not have indirect control over the Licensee.

5. Clarify "Indirect" Control

Through this guidance, the Commission clarifies as follows:

- 1) A person or entity will be deemed an Owner of a parent/grandparent company and, therefore, to have indirect control of a ME or MTC, if their equity holding in the parent/grandparent company of a Licensee gives them possession of equity that meets or



exceeds 10% of the equity in the subsidiary ME.

Examples:

- Entity/Individual A owns 50% of the equity of Entity B which in turn owns 25% of the equity of Marijuana Establishment C. Entity/Individual A will be deemed an owner of Marijuana Establishment C (50% of 25%=12.5% which is above the 10% ownership threshold)
 - Entity/Individual W owns 50% of the equity of Entity X which in turn owns 25% of Entity Y which in turn owns 50% of Marijuana Establishment Z, then Entity/Individual A will not be deemed an owner of Marijuana Establishment Z (50% of 25% of 50%=6.25% which is below the 10% ownership threshold.
- 2) Even without meeting or exceeding the 10% threshold through equity held in a parent/grandparent entity, a parent/grandparent person/entity may be deemed as having indirect control of a Licensee if they have the power to exercise any of the authorities listed in the definition of persons or entities having direct control and as clarified in other sections of this guidance document with respect to that ME or MTC.
- The Commission retains the rights to review all contracts and operating agreements between grandparent(s), parent(s) and MEs and MTCs and to determine whether the parent/grandparent entity can exercise any of the aforementioned authorities that would cause the Commission to deem that the grandparent/parent had control of the ME/MTC.

Questions?

If you have additional questions regarding types of Marijuana Establishments, please contact the Commission at (774) 415-0200 or Commission@CCCMass.Com.

