AIRD BERLIS

CSA Highlights Need for Financial Interest Disclosure in Cannabis-Related M&A Transactions and Expresses Corporate Governance Concerns of Cannabis Issuers

Nov 19, 2019

By Sherri M. Altshuler, Jeffrey K. Merk and Russell J. Sanders

On November 12, 2019, staff of the securities regulatory authorities in Ontario, British Columbia, Quebec, New Brunswick, Saskatchewan, Manitoba and Nova Scotia (collectively, "**Staff**") issued CSA Multilateral Staff Notice 51-359 – *Corporate Governance Related Disclosure Expectations for Reporting Issuers in the Cannabis Industry* (the "**Staff Notice**"). The Staff Notice highlighted the need for financial interest disclosure in cannabis-related M&A or other significant transactions, and disclosure of director independence and conflicts of interest. Notably, the Staff Notice emphasizes the importance of issuers in the cannabis industry providing investors with: (i) the necessary information to make a reasonably-informed investment or voting decision in the context of a significant transaction; and (ii) governance related disclosure to provide investors with the information they require to make informed decisions. While the Staff Notice is directed towards cannabis companies, its content is equally relevant to companies in other sectors, including those operating in emerging growth industries.

Disclosing Financial Interests

Staff noted that they have observed higher than usual instances of overlapping debt and equity interests, or other business relationships, among cannabis issuers and their directors and officers.

Staff also expressed concern regarding the lack of financial disclosure of the various cross-ownership relationships between parties to significant corporate transactions. In particular, Staff noted there have been transactions where either the acquiror or the acquiree (or a director or executive officer of either party) failed to disclose their financial interest in the other entity.

Staff is of the view that in the context of M&A transactions, detailed disclosure of all cross-ownership of financial interests is material information for investors and their investment/voting decisions, and should be disclosed to investors in a relevant disclosure document, including in a prospectus, material change report, take-over bid circular, listing or filing statement or information circular.

Importantly, Staff commented that financial interest disclosure by the acquirer, the acquiree and the directors and officers of either party, should be disclosed "even if the quantum of the financial interest may not trigger the specified quantitative disclosure thresholds under securities law." This lowered threshold of financial interest disclosure should be thoroughly and thoughtfully considered by persons and entities involved in M&A transactions, particularly since by omitting a *de minimus* threshold for financial interest disclosure, the Staff Notice suggests that any economic interest must be disclosed to allow security holders to make better informed decisions about the merits of an M&A transaction.

Director Independence

Independence and the ability of directors to exercise independent judgment are hallmarks of many aspects of corporate governance. To qualify as independent, a director must not have a direct or indirect "material relationship" with the issuer.

The Staff Notice notes that cannabis issuers frequently identify directors as independent without having regard for potential conflicts of interest or other factors that may compromise their independence. Staff specifically identified the possibility that personal or business relationships with other directors and

executive officers could impact the board's determination of that person's independence. Importantly, boards of directors and their advisors should thoroughly and thoughtfully examine a broad range of relationships that directors may have when considering the independence of each director and should certainly not limit this examination to those relationships highlighted in National Instrument 52-110 *Audit Committees* as being circumstances where certain individuals are considered to have a material relationship with an issuer.

Staff also reported observing issuers having one individual simultaneously serve as the chair of the board and as the chief executive officer, and commented that where it is impracticable for an issuer to appoint an independent chair of the board, an independent lead director should be appointed. To ensure that practices are in place for ethical decision making and compliance, Staff encourage issuers to adopt a written code of business conduct and ethics addressing the disclosure of conflicts of interest.

The Capital Markets team at Aird & Berlis has strong expertise in advising on M&A transactions, including in the cannabis sector, and in establishing and maintaining corporate governance best practices and principles. If you require any assistance with the foregoing, please contact us.

*The authors would like to thank Lynn Tay, an articling student at Aird & Berlis, for her assistance with the article.

Authors

Sherri M. Altshuler
Partner
T 416.865.3081
saltshuler@airdberlis.com

Jeffrey K. Merk
Partner
T 416.865.7768
jmerk@airdberlis.com

Russell J. Sanders
Associate
T 416.865.7734
rsanders@airdberlis.com