CSA NOTES INADEQUATE DISCLOSURE OF FINANCIAL INTEREST IN CANNABIS M&A

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On November 12, 2019, staff of the securities regulatory authorities in Ontario, British Columbia, Quebec, Saskatchewan, Manitoba, and Nova Scotia (the "Regulators") issued *Canadian Securities Administrators Multilateral Staff Notice 51-359* Corporate Governance Related Disclosure Expectations for *Reporting Issuers in the Cannabis Industry* (the "Notice") to provide supplementary guidance related to disclosure of financial interests in the context of mergers, acquisitions or other significant corporate transactions. The unique growth of the cannabis industry in Canada, which initially relied significantly on equity investments by high net worth investors and friends and family of founders, has created a "higher than usual cross-ownership of financial interests among cannabis issuers and their directors and executive officers". Regulators note that this cross-ownership or control has not always been adequately disclosed or addressed. The Regulators cautioned that the issues raised are not unique to issuers in the cannabis industry and may equally apply to other reporting issuers, particularly in emerging growth industries.

Two situations singled out in the Notice are (i) non-disclosure of financial interests in the context of a transaction involving a merger, an acquisition, or another form of reorganization or structuring, and (ii) whether a business or other relationship may compromise a director's independence.

Disclosure of Financial Interests

Financial interests, which include any debt or equity investment that a person may have, as well as more broadly the other business relationships that may exist, may result in conflicts of interest between an issuer, its directors and officers, or other entities that may be counterparties to a transaction. The Regulators note that such information should be considered "material information" under applicable securities laws, because of the potential of the information to influence investors or cause them to evaluate factors related to the transaction in a different light, including price, timing, and contingent payments.

As a result, regardless of the form of disclosure document provided for a transaction, the disclosure must include a description of the financial interests and address any potential conflicts that interest may raise. We envision this could include cross ownership interests, contracts in which a director or officer may have an

interest, whether directly or through an entity which the director or officer is a director, officer, or holds a financial interest in, and other relationships that may not be otherwise considered material information in the ordinary course of business.

Independence of Board Members

Independence of a director is determined through both specific disqualification criteria (such as persons who hold executive positions with the issuer, or are remunerated by the issuer) as well as a requirement that the director does not have a relationship with the issuer, which could interfere with their independent judgment. Such a relationship is considered to be a 'material relationship' under the parlance of securities legislation. The Notice provides that financial interests in the issuer, in a counterparty to a transaction, or potentially personal or business relationships among directors or executive officers, should be considered in making a determination as to whether a board member is truly independent or whether they have a material relationship with the issuer.

The Notice asserts that conflicts of interest may arise due to "personal or business relationships with other directors and executive officers of the issuer". While National Instrument 52-110 *Audit Committees* contains categories of relationships that constitute material relationships in Parts 1.4 and 1.5, these categories are specifically noted in the Notice to be "examples of what types of relationships may be considered material relationships". As such, these categories should not be treated as exhaustive, and boards are cautioned to adopt an expansive interpretation of when personal relationships between board members may influence independent judgment.

Guidance

The Notice provides two ways forward for issuers in the cannabis industry to tackle conflicts due to financial interests by the issuer or its directors and executive officers. Firstly, the disclosure documents of the issuer in any transaction should provide adequate information about the financial interests to allow investors and the market generally to give proper consideration to such matters. Secondly, issuers are encouraged to adopt a code for business conduct and ethics that addresses conflicts of interest, and their disclosure to both the board and the public, and provides guidance on ethical decision making and compliance. This suggested code would act in concert with the requirements already imposed on issuers, and their directors and officers, by corporate and securities laws, and would be a tool for compliance by such parties with the law.

The guidelines should be carefully considered by Cannabis issuers going forward, but also provide guidance more broadly to issuers, and specifically issuers in an emerging industry that may result in commonality among the investors and major actors.

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A Cautionary Note

The foregoing provides only an overview and does not constitute legal advice. Readers are cautioned against making any decisions based on this material alone. Rather, specific legal advice should be obtained.