

## PUBLICATION

### Cannabis Issuers can expect tightened corporate governance disclosure

Saptarshi (Rishi) Chakraborty

November 20, 2019

The Canadian Securities Administrators issued a recent *Staff Notice* 51-359 (excluding Alberta) where they concluded there has been “a higher than usual cross-ownership of financial interests amongst cannabis issuers and their directors and executive officers.”

Alberta has opted out of this Staff Notice which raises some questions and practical considerations that Alberta-based reporting issuers and their advisors will need to contend with.

Key takeaways from the Staff Notice:

- Securities regulators from British Columbia, Saskatchewan, Manitoba, Québec, Ontario, New Brunswick and Nova Scotia (“participating jurisdictions”) recently circulated staff notice 51-359 – Corporate Governance Related Disclosure Expectations for Reporting Issuers in the Cannabis Industry (“SN 51-359”).
- SN 51-359 advises reporting issuers operating in the cannabis sector to provide additional disclosure to its investors or shareholders regarding “cross-ownership of financial interests” in the context of M&A transactions.
- There is no bright-line test or any quantitative thresholds to aid issuers to determine when cross-ownership of financial interests should be disclosed. Instead, issuers and their legal counsel are required to focus on materiality requirements (specific to the disclosure document in question) to determine whether disclosure is warranted.
- Securities regulators have concluded that cross-ownership of financial interests results in a conflict of interest and, as such, disclosure of such interests aids investors or shareholders in making an informed decision regarding an investment or their decision to vote for or against a proposed corporate transaction.
- While SN 51-359 is specifically addressed towards reporting issuers operating in the cannabis sector, its contents are equally relevant to other reporting issuers, especially those operating in emerging growth industries.

Staff Notice discussion:

#### 1. *Financial Interests and Related Disclosure in M&A disclosure documents*

Staff concluded that there has been “a higher than usual cross-ownership of financial interests

amongst cannabis issuers and their directors and executive officers.” For the purposes of the staff notice, “financial interest” includes situations in which one party to an M&A transaction (or any of its directors or executive officers) may have a conflict of interest as a result of ownership, control, or direction of equity, debt or other investments, or business relationships, related to the transaction counterparty.

Staff is of the view that cross-ownership of financial interests results in a conflict of interest. Given the conflict of interest, reporting issuers should provide a detailed disclosure of any cross-ownership of financial interests in the context of M&A transactions. Staff considers this as material information that investors or shareholders ought to know. Therefore, reporting issuers are being encouraged to adequately disclose any cross-ownership of financial interests to their investors or shareholders in the relevant disclosure documents so that such investors or shareholders can make informed investment or voting decisions.

While the disclosure document will vary depending on the structure of the proposed transaction, typically disclosure documents will include either a prospectus, material change report, a take-over bid circular, a listing statement/filing statement, or an information circular.

## 2. Board of Directors' Independence

Staff also observed that despite National Instrument 58-101 - Disclosure of Corporate Governance Practices and National Policy 58-201 - Corporate Governance Guidelines, cannabis issuers have identified board members as being independent, without adequately considering potential conflicts of interest or other factors that may compromise their independence.

Staff encourages reporting issuers to adopt a written code of business conduct and ethics to address, among other things, potentially challenging situations that may arise during the normal course of business. A model code may include provisions for: (a) when and how conflicts of interest should be disclosed to other board members as well as to the public; (b) how to address the disclosure of cross-directorships and executive officer positions in the context of M&A transactions and (c) disclosure of cross-ownership of financial interests in the context of an impending M&A transaction.

### Our Insights and Observations:

The absence of Alberta from this Staff Notice raises additional considerations for Alberta-based reporting issuers that include:

- whether SN 51-359 will impact Alberta-based reporting issuers whose principal regulator and whose *only* reporting jurisdiction is Alberta but whose securities are not listed on any recognized Canadian stock exchange?
- we expect SN 51-359 will impact Alberta-based reporting issuers even if their principal regulator is in Alberta if:
  - (a) their securities are listed either on the TSX, TSX-V or the CSE, and/or
  - (b) the M&A transaction involves entities that are either from or are reporting issuers in one or more Participating Jurisdictions;
- In time, Alberta-based reporting issuers may have to contend with voluntarily disclosing cross-ownership of financial interests in disclosure documents;
- Alberta-based reporting issuers should closely monitor the geographic distribution of their current security-

holders to determine the impact of SN 51-359; and

- the absence of a bright-line test or any quantitative thresholds governing disclosure of cross-ownership of financial interests leaves such determination to the subjective interpretation of issuers and their legal counsel. Often, we find such determinations to be complex and subjective to the issuer. In addition, issuers will need to consider the impact of the disclosure relative to the circumstances of a specific transaction.

If you have any questions about your corporate governance disclosure options, we can help. Contact a lawyer in our [Cannabis group](#)—we would be happy to assist you.