

Goodmans^{LLP} Update

CSA Further Scrutinizes Disclosure by Cannabis Reporting Issuers

On November 12, 2019, the Canadian Securities Administrators (CSA) published [Staff Notice 51-359](#) (the “**Staff Notice**”), highlighting inadequacies in disclosure of financial interests in M&A transactions by cannabis reporting issuers. In particular, the Staff Notice focuses on disclosure of financial interests and potential conflicts of interest arising from the personal and business relationships of insiders. This is expected, given the recent corporate governance and disclosure challenges involving a number of the cannabis reporting issuers in Canada, both large established companies and smaller industry players.

This Staff Notice follows the CSA's guidance in [Staff Notice 51-357](#) (see our October 10, 2018 Update, [CSA Provides Guidance on Disclosure Expectations for Cannabis Issuers](#)), which highlighted common deficiencies and best practices for issuers in the cannabis industry, focusing on the production of transparent information pertaining to financial reporting, risks and uncertainties.

Disclosure of Financial Interest in M&A Transaction Documents

The Staff Notice notes that the cannabis industry's expansion has largely been fueled by financing from a relatively small group of players, leading to an unusually large degree of cross-ownership of financial interests amongst these parties. These financial interests may include overlapping debt and equity interests, or other business relationships. The CSA is of the view that cross-ownership results in a conflict of interest in M&A transactions and must be disclosed as the conflicts may lead investors to re-examine other variables such as price, timing and contingencies.

In response to an observation of undisclosed financial interests, the CSA has called for increased disclosure of any cross-ownership and potential conflicts of interest between parties to a transaction, whether held by the purchaser, target, or the directors or executive officers. Importantly, the Staff Notice indicates that this information is material for investors and should be disclosed even if the 10% financial interest that usually triggers disclosure under securities legislation is not met. For the CSA, this broad materiality requirement applies to any applicable disclosure document, including a circular, a listing statement, a filing statement, a prospectus and a material change report.

Independence of Board Members

The CSA also observed cannabis issuers identifying board members as being independent, without giving adequate consideration to potential conflicts of interest. Conflicts may arise from personal or business relationships with other directors and executive officers of the issuer or where a director has a direct or indirect material relationship with the issuer that interferes with a director exercising independent judgment. Issuers must consider the impact of these relationships or any other factors that may compromise independence and whether disclosure is warranted in these circumstances.

The Staff Notice also reminds issuers that the chair of the board should be an independent director, or alternatively, an independent director should be appointed as a lead director.

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Finally, the CSA encourages issuers to adopt a written code of business conduct and ethics that incorporates guidance for dealing with conflicts of interest and related disclosure. Investors should be made aware of the structures that are in place to facilitate board independence.

With the heightened attention on the industry and the recent challenging capital markets leading to increasing M&A activity in the industry, cannabis reporting issuers should pay heed to the CSA guidance, as it can be expected the CSA will continue to heavily scrutinize the M&A and disclosure documents by industry participants.

For further information, please contact any member of our [Cannabis Group](#).

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