

Cannabis Industry Warned by CSA to Improve Governance

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On November 12, 2019, the Canadian Securities Administrators issued Multilateral Staff Notice 51-359 - *Corporate Governance Related Disclosure Expectations for Reporting Issuers in the Cannabis Industry* (the "Notice") to provide cannabis and other issuers in emerging growth areas with supplemental information related to the disclosure of financial interests in significant corporate transactions. Staff of various securities regulatory authorities including Ontario, British Columbia, Quebec, New Brunswick, Saskatchewan, Manitoba and Nova Scotia have observed instances when corporate governance related disclosure was deficient in the aforementioned matters.

The Notice focuses on the following issues, each of which will be described in further detail below:

1. disclosure of financial interests in disclosure documents for significant corporate transactions; and
2. independence of board members.

1. Disclosure of financial interests in disclosure documents

Early rounds of issuer financings are frequently funded by high net worth individuals or friends and family of the founders. As the market continues to expand, many issuers and their directors and executive officers also participate in financings of other issuers, leading to a higher than usual cross-ownership of financial interests. The Notice advises that the cross-ownership of financial interests is considered to be material information for investors and their investment/voting decisions, and should be disclosed in the applicable disclosure documents (such as prospectuses, material change reports, take-over bid circulars, listing statement/filing statement or an information circular, as applicable (each, a "Disclosure Document")).

Tests for materiality change depending on the particular Disclosure Document and circumstances. For example, materiality for the purposes of Form 51-102F2 - *Annual Information Form* requires an issuer to consider the significance of information to investors in light of all circumstances, whereas the test for materiality in Form 62-104F1 - *Take-Over Bid Circular* is "what material facts...would reasonably be expected to affect the decision of the security holder".

The Notice advises that cross-ownership of financial interests results in conflicts of interest that may lead investors to re-examine other variables including purchase price, transaction timing or other payments that might otherwise not be considered without such disclosure.

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Disclosure of the cross-ownership of financial interests should be based on the broader materiality requirements of the applicable Disclosure Document.

2. Independence of board members

The Notice cautions issuers against identifying a board member as independent without giving adequate consideration to potential conflicts of interest or circumstances that might compromise his or her independence. Particularly, directors should pay attention to personal or business relationships with other directors and executive officers, and should confirm the absence of material relationships which would impact their independence. Reporting issuers should consider the impact of relationships or any other factors that may compromise independence, including whether disclosure of these factors is warranted in the circumstances.

The Notice also reminds reporting issuers that securities regulation notes that the chair of the board should be an independent director. Where this is not appropriate, an independent director should be appointed to act as a lead director in order to provide investors with comfort that structures are in place to permit the board to operate independently.

The Notice encourages reporting issuers to develop written codes of conduct to help govern instances that might give rise to a conflict of interest and assist in setting standards for ethical decision making and compliance.

The Notice can also be accessed at the following link:

https://www.osc.gov.on.ca/en/NewsEvents_nr_20191112_csa-outline-corporate-governance-disclosure-expectations-cannabis-issuers.htm