Toronto Law Journal

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

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Canadian National Security Reviews: 10 Takeaways

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Introduction

Canada, like many other countries, has adopted a regime for reviewing foreign investment. The regime was established in the 1970's as an express response to concerns about perceived American domination of the Canadian economy. In 1985 the regime was significantly transformed, becoming much less protectionist in tone and substance. While the system was originally designed to protect against foreign control, it is now transforming, primarily, into a national security review mechanism, like the CFIUS system in the United States.[2] In this brief we provide an overview of the Canadian national security review system and some practical tips for navigating through it.

Decreased General Foreign Investment Review Concern

The first significant point to note with respect to developments in Canada is that the review system under the *Investment Canada Act* (ICA) has been amended to intentionally remove the vast majority of foreign investments from the traditional review. That traditional review is focused on whether such an investment provides a 'net benefit' to Canada. While all acquisitions of Canadian businesses by entities controlled by foreign persons must be notified to the Investment Canada authorities, only those exceeding certain thresholds require approval, and those approval thresholds have increased markedly.

In 2015 the mechanism for determining the value of transactions subject to review was switched from an asset value (at least for most transactions) to an enterprise value (except for acquisitions by non-WTO investors or State Owned Enterprise (SOE) investors and acquisitions of "cultural" businesses) and the threshold went from C$369 million in asset value to C$600 million in enterprise value. Subsequently due to a scheduled ramp up, due to inflationary increases, and due to free trade agreements (including those with EU members, the United States, Mexico, the CPTPP members, as well as others), the enterprise value threshold has risen to C$1.568 billion for trade agreement investors and C$1.045 billion for WTO non trade agreement investors. These thresholds will continue to increase annually based on Canada's annual nominal GDP growth rate.

The result has been that a significant number of transactions have been removed from the traditional 'net benefit' review. For the most recent year for which statistics are available, 10

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[2] The system also has a fairly robust set of provisions dealing with protection of "cultural" industries, which is outside the focus of this Brief.

transactions met the threshold and applied for review, as opposed to 22 the year before. Consequently, for truly large transactions review as to whether a transaction is of net benefit to Canada will continue to be required, but the vast majority of transactions now fall beneath the review thresholds. The opposite is true with regard to National Security Reviews.

More National Security Issues

Before 2009 there was very little expressed concern in Canada with respect to national security issues in foreign investment. One transaction, the proposed acquisition of MacDonald Dettwiler and Associates' geospatial division by a major U.S. defence contractor, Alliant Techsystems, may have been blocked on national security grounds under the general "net benefit to Canada" test. Beyond that, little if anything is known and little concern was evidenced with respect to the national security issue.

In 2009, however, an express power to review transactions respecting their implications for national security was enacted. In this brief we provide a quick overview of the key considerations as well as some practical suggestions.

Key Takeaways

1. **What level of control is necessary?**

   Answer: No control is necessary—any investment by a non-Canadian in a Canadian business (including acquisition of an interest in an existing Canadian business or establishment of a new Canadian business) may be reviewed on national security grounds if it is thought to be problematic. So, when involved in sensitive industries or transactions involving sensitive investors (discussed below) proceed at your own risk. No transaction is too small to escape potential challenge, and no equity holding is too minimal if it is something that could give rise to a national security concern.

2. **What types of deals get reviewed?**

   Answer: The guidance document issued by the Investment Canada authorities indicates that transactions involving Canada's defence capabilities and interests, sensitive technologies, critical infrastructure (such as telecommunications, pipelines, electricity generation or transmission), foreign intelligence and activities of illicit actors (such as terrorist groups or organized crime) are most likely to attract scrutiny. The national security interest may also involve "co-location" concerns, *i.e.*, proximity to sensitive sites. Based on media reports in 2015, a proposed investment by a Chinese SOE to build a fire alarm production facility was blocked on national security grounds due to its proximity to a Canadian Space Agency facility.

3. **Transactions involving Investors from which Countries are most likely to get closer scrutiny?**

Answer: Unambiguously China and Russia top this list. Of those transactions which were reviewed and either blocked, allowed subject to conditions, or were withdrawn because of the challenge, between 2012 and 2018 (15 transactions in total), all but 3 involved China or Russia. Of the 3 which did not involve China or Russia it is understood that Chinese or Russian interests were involved with two of those three investors. In addition to investors from China and Russia, anecdotal evidence suggests that there is a reasonably high sensitivity to investors from certain Middle Eastern jurisdictions.

4. **Are SOE Investors Special?**

Answer: Yes. State-Owned Enterprise (SOE) investors are special. As a general matter under the *Investment Canada Act*, SOE's attract greater scrutiny and lower thresholds. With respect to national security, the issue tends to be whether SOE investors from certain jurisdictions are likely to be thought of as true arms of the state, as opposed to more traditional pension fund type SOE investors. Certainly, as a practical matter, Investment Canada authorities are very interested in who SOE investors are and how they are controlled.

5. **Are Private Equity Investors An Issue?**

Answer: Private equity investors are not an issue *per se*. However Investment Canada authorities are increasingly interested in understanding who the major beneficial owners are in private equity funds, despite *de jure* control by fund management. Investment Canada authorities will pay particular attention to investment by funds where a significant percentage of the funds are held by investors from jurisdictions which attract greater scrutiny.

6. **How can you minimize risk?**

Answer: Inevitably, an investment which is in a sensitive business and/or by firms from sensitive jurisdictions will attract interest. The best way to minimize risk is to recognize proactively when you have an investment of that sort, consider what the sensitive issues are and whether there are steps that can be taken to reduce the risk. For instance, in private equity investments the decision may be taken to restrict investment from certain jurisdictions and to give careful thought to who will sit on the board of directors of controlling corporations.

Another practical step which can be taken, to avoid confusion and delay where an investment is occurring in a sensitive sector, is to meet in advance or at the time of notification with the Investment Canada authorities to make sure that they are fully aware of the investment and understand the arguments as to why it is not problematic.

The Investment Canada authorities welcome these meetings, and, anecdotally, such meetings have proved successful in reducing or eliminating reviews where the facts support that conclusion.

7. **How can you know ahead of time if there is a problem?**

Answer: File early. Because national security reviews can occur in any transaction, whether or not it exceeds the thresholds for the traditional 'net benefit' review, it is not necessary that there be a filing before the transaction closes. The *Investment Canada Act* only requires that a notification filing occur within 30 days post-closing, and no filing at all is required if there is no acquisition of control. However the fact that a transaction did not have to be notified, or notified in advance, does not mean it will not be subject to a national security review. The problem in that case for the purchaser is that the transaction may be subject to review post-closing, at which time the vendor, having received its money, is no longer interested in the issue and the full risk falls on the purchaser. Vendors may be happy with this outcome but most purchasers are not. As a practical matter in most transactions where there is thought to be a potential national security review risk, purchasers will insist that an *Investment Canada Act* notice be filed more than 45 days pre-closing and that there be a condition that the 45 day period expire without notification that there may be a national security review.

8. **What timelines apply to reviews?**

Answer: The national security process starts when the Investment Canada authorities receive the investor's notification (or application if the transaction exceeds the applicable "net benefit" threshold) of the transaction as required under the *Investment Canada Act*, or when the transaction closes in the case of minority investments which do not require notification. The authorities have 45 days, which can be extended for a further 45 days by giving notice to the investor, to conduct an initial triage review. If the Investment Canada authorities have national security concerns following this review, they may begin a full in-depth review by issuing an order for review. If the authorities issue a notice to extend the initial triage review or an order for a full in-depth review, the investor cannot close the transaction (if it is not already closed) unless and until it is cleared by the authorities to do so. The full in-depth review may take up to 90 days (with potential further extension with consent of the investor). If the national security concerns remain at the end of in-depth review, the matter will be referred to the Canadian Federal Cabinet, which has a further 20 days to make its final determination. Therefore, the entire process can take up to 200 days (or longer with the investor's consent).

Timeline for National Security Review

Review Step	Length of Time
Filing of *Investment Canada Act* notification or application, or closing of the acquisition (in the case of a minority acquisition)	Day 0
National Security authorities engage in initial triage review, and may order a full in-depth review	45 days (90 days if a notice to extend the initial trial review is issued)
National Security authorities engage in full in-depth review, and may refer the matter to the Federal Cabinet	45 days (90 days if a notice to extend the in-depth review is issued) >90 days (with agreement of the investor)
Federal Cabinet considers the matter and makes final decision to block, approve or impose conditions	20 days

9. **What are the possible outcomes of a national security review?**

Answer: At the end of a national security review, the Federal Cabinet has broad powers to require the investor to take measures to address the national security concerns. This may include: blocking a proposed transaction, permitting the closing of the transaction if certain conditions are met, or requiring the investor to unwind the transaction if it already closed. If a transaction is subject to a full in-depth review, it is highly unlikely for the transaction to be later cleared without conditions. In the 15 transactions subject to a full in-depth review between 2012 and 2018, four were blocked, four were allowed to close with conditions, five were ordered to be unwound, and the parties abandoned the transactions in the remaining two.

10. **Do Canadian authorities speak with their friends respecting national security reviews?**

Answer: Yes. Canada's authorities speak with their colleagues elsewhere, particularly with CFIUS and other members of the "five eyes" community. So, like with merger review, consistency in the story is important when dealing with various agencies. If one of Canada's security friends has a concern with the transaction, that may be problematic for the deal. On the other hand, if authorities elsewhere tell their Canadian cousins that they are not concerned, then that will generally militate in favour of Canadian

approval. There may, of course, be particular Canadian issues which apply, even if there are no concerns elsewhere, but all things being equal, it helps.

Conclusion

As noted at the outset, the *Investment Canada Act* has undergone a shift in emphasis over the last half dozen years. Thresholds have been raised and "net benefit" reviews are less frequent than they were in the past. There is a sense that the Investment Canada authorities are more interested in supporting capital investment in Canada, even in relatively large transactions which are subject to review.

By contrast, National Security Reviews, which did not exist prior to the last decade, have become an increasing concern with respect to sensitive sectors and investors from sensitive jurisdictions. The issue has become a significant one for counsel planning transactions. We hope that the checklist in this Brief is of some high level assistance at early transaction planning stages.

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.

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If There's Anything That You Want: Indemnification of Estate Trustee Legal Fees

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There are numerous reasons for acting as an estate trustee: prestige; compensation; overseeing treasured assets; or merely the feeling of having helped wrap up a dear friend or family member's affairs. With this responsibility, however, comes significant risk. Lurking around every corner of estate administration are myriad potential foes: aggrieved beneficiaries; impecunious children; long-spurned creditors; indigent spouses; and, foremost of all, the vexatious litigant.

The alarmed estate trustee, over whom a cloud of litigation hangs, or upon whom the rain already trickles or pours, can find some solace in the law, which states that estate trustees may indemnify themselves for reasonably incurred legal costs. Unfortunately for estate trustees, what constitutes "reasonable" legal costs is a subject coloured with uncertainty, a legal saga that has seen whirls and undulations.

Amidst the confusion, there has been one fixture or constancy: it is reasonable for an estate trustee to claim legal costs from a proceeding in which "the *trust* is a party" rather than one in which "the actions of the *trustee* himself are challenged". In the latter instance, a trustee may still be reimbursed, but his or her entitlement to indemnification is not automatic; it is granted once the trustee vindicates himself or herself.[1] Everything else—whether an estate trustee can use estate funds for personal causes, how to demarcate personal interests from estate interests, what is reasonable conduct, what self-interest comprises, when reimbursement can be made—is enveloped in a degree of shadow.

In this article, we endeavour to shed light upon these shadowed questions. We seek to highlight the prominent and curious cases of the past century or so, as well as to identify the relevant trends, lasting precedents, and anomalies.

The Longstanding Indemnification of Legal Fees

Perhaps mindful of keeping the estate trustee's position desirable given its necessity in society, the Courts have long indemnified trustees as a part of equity.[2] There was, in fact, a prevailing view that legal fees should be paid from estates. That is why we see in old cases like *Mitchell v. Gard* such an emphasis that estates should bear legal costs where the litigation arose from a

[1] *Fenwick v. Zimmerman*, [2008] CarswellOnt 4827 at para. 13
[2] "Revisiting A Trustee's Right to Indemnification", Suzana Popovic-Montag, 2003 *Estates and Trusts Reports (Articles)* 50 E.T.R. (2d) 161.

fault lying "at the door of the testator" or from those with an interest in the estate residue, or where the litigation was reasonable in the circumstances.[3]

In Ontario, the indemnification principle was enshrined in the *Trustee Act*:[4]

> 23.1 (1) Expenses of trustees - A trustee who is of the opinion that an expense would be properly incurred in carrying out the trust may,
>
> (a) pay the expense directly from the trust property; or
>
> (b) pay the expense personally and recover a corresponding amount from the trust property.
>
> (2) Later disallowance by court - The Superior Court of Justice may afterwards disallow the payment or recovery if it is of the opinion that the expense was not properly incurred in carrying out the trust.

For well over a century, properly incurred expenses have consisted of reasonably incurred legal fees: "Now, nothing ought, I think, to be adhered to more sacredly than the general principle, which is, that a trustee or executor having done his duty, having faithfully accounted, and having brought forward the estate committed to his charge, should not be deprived of his costs upon light grounds."[5]

The trouble, then as now, arises when courts have been tasked with determining whether a trustee has acted selfishly or for the trust, performed his or her duty or committed a breach.

***Goodman Estate v. Geffen*: When Interests Align**

Goodman Estate v. Geffen involved the allegation that two trustee brothers unduly influenced their sister. It failed, and the brothers sought remuneration for their legal fees. The respondents argued that the brothers, by defending themselves of this charge, were acting out of self-interest and should thus pay personally for their fees.

On first glance, in its analysis the Court seems to have advanced an inconsistency. On the one hand, it endorses Sir Robert Megarry V.C.'s summarization of the costs rule:

> In so far as such person [trustee] does not recover his costs from any other person, he is entitled to take his costs out of the fund held by him unless the court otherwise orders; and the court can otherwise order only on the ground

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[3] *Mitchell v. Gard* (1863), 3 Sw. & Tr. 275, 164 E.R. 1280.
[4] R.S.O. 1990, c. T.23
[5] *Birks v. Micklethwaite* (1864), 33 Beav. 409.

> that he has acted unreasonably, or in substance for his own benefit, rather than for the benefit of the fund.[6]

On the other hand, the Court awarded legal costs to trustees who very much acted "in substance for [their] own benefit". The key word in this quotation is "rather". An estate trustee may act self-interestedly, and receive costs, so long as this conduct does not run contrary to the interests of the estate—*i.e.* "rather than for the benefit of the fund".

Whereas before *Geffen* an estate trustee's costs claim may have been precarious if the overwhelming tinge of the action was self-interest, what we get from *Geffen*, in part, is a greater understanding that benefits can be mutual, not merely exclusive or competing: "I do not consider the co-existing interest of trustee and beneficiary a valid basis for denying costs. Similarly, the fact that the Geffen brothers were acting in the interests of their children, nephews and nieces does not, in my view, cast any doubt upon the propriety of their actions."[7]

This case leant estate trustees and prospective estate trustees more assurance that their legal fees could be recovered; as we shall see, however, this assurance has subsided in recent years.

***McDougald Estate v. Gooderham*: Loser Pays Applies to Estates**

The Ontario Court of Appeal found that the traditional practice that legal fees be absorbed by the estate has been correctly displaced.[8] The "loser pays" principle governs, with some exceptions. If an estate trustee has engaged in unnecessary or ill-advised conduct, or if the legal fees are attributable to his or her administration—and not "at the door" of the testator—then he or she should bear his or her own legal fees. If, however, there are public policy grounds present, such as the need to resolve an ambiguity in the will, then the executor should be indemnified.

As other cases, such as *Sawdon Estate v. Watch Tower Bible and Tract Society of Canada*, have shown, costs order can be blended, meaning that a portion of legal fees can come from the estate and another portion can come from the losing party.[9]

***Georganes v. Bludd*: A Deviation**

In *Georganes v. Bludd*, the estate trustees drew on $55,000.00 in estate funds to pay for legal fees which they had accumulated in defending their personal interests in a home.[10] Justice Price found that these payments were improper and ordered that the trustees reimburse the estate.

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[6] *Goodman Estate v. Geffen*, [1991] CarswellAlta 91 (S.C.C.) at para. 75.
[7] *Goodman Estate* at para 77.
[8] *McDougald Estate v. Gooderham*, [2005] CarswellOnt 2407 (O.N.C.A.) at para. 80.
[9] *Sawdon Estate v. Watch Tower Bible and Tract Society of Canada*, [2014] O.N.C.A. 101 at paras. 96-97.
[10] *Georganes v. Bludd Estate*, [2014] O.N.S.C. 4655 at para. 15.

Whereas in *Geffen* the Court found that an executor could wear two hats, that of executor and that of beneficiary, and have his or her legal fees paid out of the estate, *Georganes* marks a significant departure from this flexibility; instead, the test appears to be, of the two hats the executor is wearing, which is larger and more prominent?

***DeLorenzo* and *Furtney Estate*: Timing**

In *DeLorenzo v. Beresh*, the court said that parties should bear their own costs prior to the resolution of the matter: "Ultimately the issue of whether the trustee is entitled [to] charge the estate with his legal fees may turn on the outcome and it should be determined on a passing of accounts or court application, if not agreed to by the beneficiaries."[11]

However, in *Furtney Estate v. Furtney*, the court took the opposite view: "An estate trustee does not require the consent of the beneficiaries or a court order prior to having litigation expenses, reasonably incurred by the estate trustee, paid from estate funds."[12]

***Brown v. Rigsby*: The Old Road Adjoined by New Scarecrows**

The Court of Appeal in *Brown v. Rigsby* championed the approach in *Geffen*, reiterating that an executor should be repaid for reasonably incurred legal fees, but he or she should bear the legal fees accruing from a self-interested endeavour.

In their application of the law to the facts, the Court decided that the executors should pay, in this instance, because of their "failure to exhibit timely candour", which the Court viewed as both unreasonable and self-interested.[13] The legal costs could be directly traced to the estate trustee's lack of disclosure.

In the wake of *Brown v. Rigsby*, several layers have been added onto the prevailing test. In *Ford v. Mazman*, an estate trustee's "animus" defeated her request for reimbursement.[14] In *Selkirk v. Selkirk*, an estate trustee paid personally owing to his failure to "provide accounts to support his expenditures".[15] In *Sweetnam v. Williamson Estate*, the estate trustees received no reimbursement as the Court found them to be "adversarial and unreasonable".[16]

Concluding Remarks

In days long past the law was generous in its provision of indemnification of legal fees for estate trustees. As time progressed, a whisper grew into a firm voice, asking whether it was fair for an estate—and by consequence, the beneficiaries—to bear the legal costs. There then emerged

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[11] *DeLorenzo v. Beresh*, [2010] O.N.S.C. 5655 at para. 23.
[12] *Furtney Estate v. Furtney*, [2014] O.N.S.C. 3774 at para. 44.
[13] *Brown v. Rigsby*, [2016] O.N.C.A. 521 at paras. 18-19.
[14] *Ford v. Mazman*, [2019] O.N.S.C. 1297 at para. 18.
[15] *Selkirk v. Selkirk*, [2019] O.N.S.C. 298 at para. 14.
[16] *Sweetnam v. Williamson Estate*, [2017] O.N.C.A. 991 at para. 11.

a caveat to the traditional indemnification entitlement: if the trustee's conduct was self-interested or unreasonable, then the estate need not pay. From the ensuing flexible approach in *Geffen*, to the confusion engendered in *Georganes*, and finally to the Court of Appeal's sturdy decision in *Brown*, we now have a good idea of "reasonably incurred legal fees" —despite the common blurred lines between personal interests and estate interests.

If the estate trustee wants future reimbursement, he or she should not act to the detriment of the estate, nor allow selfish concerns to wax too strong, nor engage in any other bad conduct, such as failing disclosure obligations. The estate trustee who is pulled into litigation—owing to the testator's faults, the will's ambiguities, or the aims of beneficiaries—shall receive costs protection. The estate trustee who walks or stumbles into a fight, however, does so at his or her own peril.

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The Canadian Cannabis Sector: Financing in Difficult Times

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Dire predictions in the media about the "bubble bursting" or the floodgates opening for insolvencies in the Canadian cannabis sector has certainly not been helpful to those cannabis producers seeking financing. Whether these predictions are exaggerated or not, to date there have only been a handful of Canadian cannabis producers that have actually commenced insolvency proceedings. One of the first filings under the *Companies' Creditors Arrangement Act* (the "**CCAA**") by a Canadian cannabis producer was by AgMedica Bioscience Inc. and certain of its related entities ("**AgMedica**") on December 2, 2019. Although this is only a single case and CCAA filings have been far and few to date in the Canadian cannabis sector, AgMedica offers some real insight to the challenges currently faced by cannabis producers in raising capital or obtaining financing in the present market.

Overview

AgMedica is a licensed producer of cannabis products. The Chatham, Ontario-based company generates revenues primarily by the cultivation, processing and distribution of these products. AgMedica has operations across Canada and holds two cannabis licenses. By 2019, it was clear that AgMedica was running out of cash. It tried to raise money several times throughout 2019. A planned initial public offering ("**IPO**") over the summer failed after the withdrawal of the underwriters. The company then attempted to raise approximately $60-million in debt but that too failed in October, 2019. On December 2, 2019, AgMedica was granted protection under the CCAA. The relief included a debtor in possession ("**DIP**") loan in the principal amount of $1 million from the initial DIP lender to cover the first 10 days of the CCAA proceedings. On its return to court on December 12, 2019, AgMedica obtained further relief including the approval of the DIP loan in the principal amount of $7.5 million from the subsequent DIP lender.

Some Lessons

The challenges faced by AgMedica in raising money may be instructive to other cannabis producers seeking financing during these difficult times. If these negative market conditions continue to persist, the availability of financing for the cannabis sector may become increasingly limited and expensive.

If commercial funding is not available outside of insolvency proceedings for licensed cannabis producers, a CCAA filing and possible DIP loan may be an option. The CCAA generally applies to a "debtor company" that has liabilities in excess of $5 million. The company must also be

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"insolvent". While the CCAA does not define "insolvent", there are certain statutory tests provided under the *Bankruptcy and Insolvency Act* (the "**BIA**") and a company satisfying any of these BIA tests will be considered insolvent for the purposes of the CCAA. In addition, under the case law, the insolvency requirement has become more flexible or less onerous, in that a corporation will be considered insolvent under the CCAA if there is a reasonably foreseeable expectation at the time of filing of a looming liquidity crisis that will result in the debtor company not being able to pay its debts as they become due without the benefit of a stay of proceedings.

In the face of a looming liquidity crisis, the debtor company may need the protection of the CCAA. It is often said that the CCAA provides the company with "breathing space" in order to restructure. This is partly achieved by way of a stay of proceedings, which generally prevents creditors from taking enforcement steps against the debtor company. On filing under the CCAA, a court may make an order staying all proceedings in respect of the debtor company for a certain period.

Besides the stay protection under the CCAA, the debtor company will also likely need money in order to continue operations during the restructuring. As illustrated in *AgMedica*, the debtor company often cannot obtain alternative financing outside of CCAA proceedings before running out of money. Courts have held that DIP financing should be granted to "keep the lights on" and allow the continued operations of the debtor company during a restructuring. Without it, the business may fail, jobs may be lost and other stakeholders negatively impacted.

However, DIP financing comes at a cost. Interest on the loan may be at a premium. There are also professional costs associated with such financing. In addition, a DIP lender will expect its loan to be secured by way of a super-priority DIP charge on the assets of the debtor company. DIP financing involves what may be a significant re-ordering of priorities from those in place before the CCAA filing, in the sense of placing encumbrances or charges on the collateral or assets of the debtor company ahead of those presently in existence. This is often referred to as "priming" (or subordinating) existing security under the DIP charge.

In summary, the *AgMedica* CCAA proceedings are important or precedent-setting for three main reasons. Firstly, AgMedica is one of the first cannabis producers to file for creditor protection under the CCAA. If other cannabis producers are unable to obtain financing outside of insolvency proceedings, the terms and conditions of the DIP financing in *AgMedica* may be instructive in their negotiations with DIP lenders.

Secondly, the *AGMedica* case represents one of the first decisions in which the court had to deal with the new reforms of the CCAA. These legislative reforms came into force on November 1, 2019, about one month before the start of the *AgMedica* CCAA proceedings. One reform is the shortening of the initial stay period. Under the old CCAA, the initial stay of proceedings obtained on an initial filing could not exceed 30 days. Under the legislative reforms of November 1, 2019, the initial stay period was changed to 10 days. Another reform is that the relief on the initial application must now be limited to relief that is "reasonably necessary" for

the continued operations of the debtor company. The same reforms of November 1, 2019 also impact DIP financing under the CCAA: the initial DIP financing can only be for the first 10 days and the terms of that 10-day loan are limited to what is "reasonably necessary" for the continued operations of the debtor company during that period. This means that a debtor company will only have 10 days after the initial CCAA filing to return to court to get broader relief including, if necessary, an extension of the stay period and an increase in the amount of the DIP loan (beyond the initial 10 day period). In *AgMedica*, the initial CCAA application was heard by the court on December 2, 2019 and the court granted, among other things, a stay of proceedings to December 12, 2019 and a DIP loan for that period in the principal amount of $1 million secured by a DIP charge. On the return or "comeback"date of December 12, 2019, the stay period was extended by the court to March 12, 2020 and the DIP loan and charge increased to $7.5 million. Some have suggested that as a result of these recent legislative reforms there will now be a "skinny" Initial CCAA Order (with limited relief to cover the first ten days) on an initial application and a "longer" Amended and Restated Initial Order (with broader relief) on a subsequent application.

Finally, the treatment of *Cannabis Act* licenses under the CCAA is an open question. As noted above, AgMedica holds cannabis licenses. It is uncertain whether or not these licences can be sold, transferred or assigned to a purchaser under the CCAA. The *AgMedica* CCAA proceedings contemplate a going concern sale of certain assets as part of its restructuring. The licence transfer issue therefore may become a significant hurdle over the course of these proceedings.

Fogler, Rubinoff LLP provides a full range of legal services to participants in the cannabis industry. We represented the initial DIP lender in the *AgMedica* CCAA proceedings.