

## Corporate and Commercial

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### What's Next for Recreational Cannabis? Provincial Policy Considerations after the Introduction of Federal Legislation

*If passed, the proposed Cannabis Act and Bill C-46 will legalize recreational cannabis as of July 2018. In response, the provinces and territories are considering public policy and regulatory approaches to the distribution and sale of recreational cannabis.*

On April 13, 2017, Bill C-45 (the proposed *Cannabis Act*) and Bill C-46 (amendments to the *Criminal Code*) were introduced into Parliament. If passed as currently proposed, these bills will permit and regulate the recreational use of cannabis, including possession of up to 30 grams of cannabis by adults over the age of 18 and, subject to provincial and territorial legislation, possession of up to 5 grams by youths between the ages of 12 and 18. The new law will also create a new licensing regime for the production, marketing, and delivery of cannabis. However, this proposed federal legislation also leaves much of the products' regulation in the hands of the provinces and territories. As such, the Government of Ontario, alongside other provinces and territories, are presently racing against the currently-anticipated July 2018 implementation date for the proposed federal legislation, to structure the distribution and sale of cannabis within provincial borders.

#### **The Cannabis Act and Criminal Code Amendments**

The aim of the federal government's legislation is to protect youth and deter criminal involvement in the distribution of cannabis. If passed, the legislation will allow access to quality-controlled cannabis for recreational purposes while restricting youth consumption. The federal government has made it clear

that its approach is not intended to stimulate economic activity, but to create a highly-licensed and regulated public health and security compliance regime.

Highlights of the proposed federal legislation include:

- Amendments to the *Criminal Code* that decriminalize possession of up to 30 grams of cannabis and allow adults to possess four cannabis plants of a height of no more than one meter and, subject to provincial and territorial legislation, allow possession of up to 5 grams by youths between the ages of 12 and 18.
- A federal licensing scheme for recreational cannabis that will co-exist with the current Access to Cannabis for Medical Purposes Regulations regime (ACMPR). ACMPR licensed producers will be grandfathered and granted a recreational license.
- New license requirements for licensed producers (LPs), including strict standards regarding the permitted forms of recreational cannabis, as well as requirements for inspections, packaging and labelling, security, serving sizes, potency, production, tracking, transportation and advertising.
- Permits that allow for the import and export of cannabis for scientific research and medical reasons, and for industrial hemp.

Notably, provinces and territories have asked for clarity to determine if the ability to purchase cannabis from LPs through the mail will continue after provincial regulation begins and, if so, which level of government will regulate this space permanently.

#### **Oversight and Investigative Powers for the Minister**

The *Cannabis Act* will establish a new licensing application process and criteria for applicants. Once licensed, companies involved in any activity related to cannabis will be subject to a new inspection process.

Inspectors will have significant powers to investigate non-compliance with the statute and its regulations, public health concerns (i.e. use of non-compliant

chemicals) and security issues. This will also include the right to enter premises, seize property, and request information.

Companies can also be ordered by a designated Minister to produce information on matters of public health, safety, and compliance issues, as well as to fund and carry out tests and studies to satisfy their concerns, either preventatively or in reaction to a concern. If the Minister so chooses, it may order a company to pay significant administrative monetary penalties, take remedial measures, or issue a recall to resolve compliance, public health or public safety concerns.

The *Cannabis Act* takes an approach similar to the *Tobacco Act* to prohibit and regulate certain types of cannabis-related promotional activities and packaging options. Specifically, the federal government plans to regulate the serving sizes, issue packaging and labelling requirements, and place standardized health warnings on its products. In addition to a general public health concern, the federal government can use these powers to prevent advertising, displays, and products that are appealing to youth. Further guidance is expected in the coming months, to clarify how LPs can comply with these rules and still provide factual information about their products to consumers.

## **New Responsibilities for the Provinces and Territories**

The proposed federal legislation leaves a considerable amount of discretion over the customer experience and business environment to the other levels of governments. Among other things, the provinces and territories must determine how and where cannabis will be sold, assign retail and distribution licenses to market participants, partner with municipalities to consider zoning and public health regulations, consider the use of the drug in public spaces, determine taxation policy, and decide whether to further restrict the possession or age limits. However, provincial and territorial governments are still digesting the proposed federal legislation, seeking clarity regarding their jurisdiction, the process and manner in which provincial retail and distribution systems are to comply with federal requirements, and numerous discrepancies between the federal government's communication materials and the text of the legislation.

A number of provincial governments have cautioned that a full-fledged provincial regime may not be possible by the federal deadline of July 2018. In Ontario, a provincial cross-ministry secretariat was organized in early 2016 to explore, among a myriad of other policy areas for provincial consideration, alternative distribution and retail options. These are being analyzed from a health, taxation, public safety and consumer perspective.

## **Potential Options**

The following broad options have been considered by the Ontario government and outside public policy experts. While the discussion below is focussed on Ontario, it is expected that other provinces and territories will consider similar options and weigh them against factors specific to their jurisdictions, such as demographics and public sentiment.

1. *Crown Retail and Distribution.* In this model, the Liquor Control Board of Ontario or a cannabis-specific provincial crown agency (the “**Crown Agency**”) would purchase cannabis from LPs and sell it at government-run retail agencies. Private sector involvement would be limited to production of the crop and goods and services peripheral to cannabis's consumption. This model may or may not allow for limited marketing opportunities for LPs to differentiate their products and for private sector involvement in “cannabis bar”-type environments.
2. *Hybrid*  
*A: Crown Distribution with Private Retail.* The Crown Agency could play a more limited role as the distributor of cannabis and a regulator of private retailers. In this approach, the private sector would be responsible for the sale of cannabis in a government-prescribed format (including as to matters such as diversity of products, pricing, security and record-keeping). This approach may make this model less appealing for LPs who are interested in entering the retail market to sell their own manufactured and branded product directly to consumers.

*B: Private-Crown Retail Competition with Crown Distribution Monopoly.* The Crown Agency could be both a retailer and a distributor, while also

permitting private companies to act as licensed retailers. This option may encourage a more competitive retail market in favour of consumers, while retaining a strong government influence over the industry.

3. *Full-Scale Private Sector.* Common in U.S. state jurisdictions that have legalized cannabis, this model would allow the private sector to engage in all aspects (production, distribution, and retail) of the recreational cannabis business. If this model was to be selected, it is likely that the industry would remain highly regulated by both federal and provincial authorities in a manner similar to alcohol and tobacco.

## Analysis of Options

The Full-Scale Private Sector model appears to be the least likely one to be adopted by the provinces and territories, in particular the present Ontario government.

First, adopting such an approach would be a significant departure from Ontario's tradition of state involvement in the distribution of regulated productions (i.e., tobacco and alcohol), and it may be perceived as overly similar to the current dispensary model. The Government of Ontario has repeatedly stated its disapproval of the activities of the dispensary community, such that continuing the development of a Full-Scale Private Sector model is likely to be perceived as inconsistent, including with prior distribution models used for other controlled substances. Similarly, the risk of negative headlines derived from private sector non-compliance or errors make this model an unlikely choice for the government.

Second, legitimizing the Full Scale Private Sector model while adequately providing for the public safety requirements would likely involve costs perceived by provincial regulators as in excess of those necessary to successfully implement a state controlled or hybrid model. To regulate a Full-Scale Private Sector model, the government would need to establish a significant regulatory agency or function for all aspects of the industry to limit the compliance risks in this nascent industry. The costs required to successfully enforce compliance across the spectrum of industry will likely raise questions as to whether it would be more cost-efficient or more effective from a regulatory perspective to structure the industry with material

government involvement as an industry player.

The Government of Ontario is more likely to consider the Crown Retail and Distribution approach or both Hybrid models. From Queen's Park's perspective, government involvement in some fashion may lower reputational risk and increase the ease of regulation and taxation, despite potential consumer choice setbacks or economic opportunity costs.

Between these two hybrid models, there are different factors that are likely swaying internal provincial deliberations. For example, the Centre for Mental Health and Addiction, the federal Task Force on Cannabis Legalization and Regulation, and other health stakeholders have recommended that provinces and territories avoid co-locating cannabis and alcohol. The Ontario government has indicated that it understands this concern and is thus unlikely to ignore these recommendations. However, the Ontario government may need to be flexible in rural and northern areas where building segregated retail outposts is expensive and where it has already permitted LCBO to sell in grocery stores.

In determining which model to adopt, the provincial and territorial governments will likely focus on a model that maximizes their ability to (a) most effectively and efficiently regulate market players from a youth protection, public health and safety angle, (b) track and secure cannabis products, and (c) to a lesser extent, effectively tax the sale and distribution of cannabis. To lower risk, the provincial and territorial governments may be tempted to set up its own retail outlets or be swayed by external arguments in favour of distribution from existing secure institutions like pharmacies.

To implement a Hybrid model, the provincial and territorial governments will also likely look to certain U.S. states' experience to establish a multi-license system for the sale, distribution, storage, and transportation of cannabis. In Ontario, shaped by its existing Smoke-Free Ontario policies, the government will also need to consider the U.S. experience in its deliberations on the regulation of 'consumption' areas, where customers would be allowed to consume cannabis on-site at certain business or during particular events.

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## Partnering with Municipalities

Another important aspect to be considered is the role of municipal partners. For example, in the event that a Hybrid model is adopted where Crown Agencies operate distribution and retail outlets, there may be a tension between provincial objectives and municipal views on when, where, and how cannabis should be sold within municipal borders.

If private retail is permitted, municipal governments are likely to view these businesses as both a taxation opportunity and a planning challenge. Based on an examination of the U.S. experience with cannabis, as well as Ontario's history with the dispensary model to date, municipalities may opt for significant limitation of cannabis distribution within their boundaries or for sophisticated licensing and land-use schemes in support of tax and planning goals. For example, Toronto's municipal government already uses business licensing regimes and planning tools to limit or regulate certain business sectors. Vancouver has already started issuing business licenses to existing dispensaries, with specific by-laws and fees aimed at regulating the placement and operations of these businesses. These regimes could be replicated and expanded to control the location and operation of cannabis businesses.

It is likely that provinces and territories will prioritize working with the cities and townships to ensure that the municipalities have the capacity to control the location and density of private retailers, especially in relation to schools, hospitals and other sensitive sites. Similarly, provincial and municipal public health officials will likely share functional jurisdiction over ensuring the safe sale and consumption of cannabis within cities. However, it remains to be seen if municipal policy and priorities in these areas will conflict with potential Crown retail outlets.

Municipalities will also likely be particularly concerned from a public health and security perspective that homeowners will be allowed to grow four cannabis plants at home. They are likely to raise questions with both governments as to who will enforce this limitation and whether it can further regulate planting permissions.

## One Certainty: The Requirement for Licenses and Compliance Measures

While regulatory choices are not yet finalized, there is a strong likelihood that the private sector will become more and more involved in aspects of the production, distribution and sale of cannabis. Regardless of which form of regulation takes hold, Goodmans lawyers can assist clients to prepare for and overcome new and oncoming regulatory hurdles and commercial requirements.

In particular, private sector companies should begin to consider the existing and future opportunities that may emerge and their associated compliance requirements:

- Capital requirements and fund raising opportunities
- Research and development, licensing and other partnership opportunities
- Federal licensing and inspection of LPs, regulatory requirements for production and cross-province/territory distribution as well as import and export considerations
- Provincial and municipal approvals, licensing and permits for the location, build, and presentation of retail storefronts, distribution centres, transportation and production facilities, designated social consumption areas, as well as employment policies and workplace and safety considerations.

As one of Canada's pre-eminent business law firms, Goodmans possesses market-leading expertise and can advise companies involved, or interested in participating, in the cannabis industry, including the ongoing policy and regulatory considerations at all levels of governments. In addition, Goodmans has significant experience within the current ACMPR regime (and its predecessor regimes), from operational aspects such as administrative and municipal matters, packaging and advertising, intellectual property, real estate and contractual matters, to strategic initiatives and capital market transactions.