

Goodmans^{LLP} Update

Cannabis Regulations: Inclusions Regarding Security Clearance and Key Investors

On June 27, 2018, soon after Bill C-45, *An Act respecting cannabis and to amend the Controlled Drugs and Substances Act, the Criminal Code and other Acts* (the “**Cannabis Act**”) received Royal Assent, Health Canada announced and distributed advance copies of the *Cannabis Regulations*. The Regulations had been, to a large degree, anticipated by the release last fall of the “*Proposed Approach to the Regulation of Cannabis*”, which described the government’s expected approach to, among other things: licences, permits and authorizations allowing individuals and companies to grow and sell cannabis; security clearances for high level employees and major shareholders of licensed cannabis operators; packaging and labelling requirements; cannabis for medical purposes; and health products and cosmetics with cannabis.

Notwithstanding the significant disclosure made last fall, the announced *Regulations* provide substantially more detail regarding two topics of particular concern to the industry, namely, security clearance requirements, and disclosure obligations relating to key investors.

Security Clearance Requirements

To mitigate the risk of organized crime infiltrating the legal cannabis market, the following parties connected to a licensed cannabis operator will be required to obtain security clearance issued by Health Canada:

- Directors and officers;
- Any individual who exercises, or is in a position to exercise, direct control over the corporation (Health Canada will be looking at factual control rather than legal control¹);
- The directors and officers of any corporation or cooperative that exercises, or is in a position to exercise, direct control over the corporation (i.e., directors and officers of a holding company);
- Any individual who is a partner in a partnership that exercises, or is in a position to exercise, direct control over the corporation;
- The directors and officers of any corporation that is a partner in a partnership that exercises, or is in a position to exercise, direct control over the corporation; and
- Master growers, head of security, and quality assurance persons.

Health Canada previously indicated that it is open to providing security clearance to applicants who have non-violent or lower risk criminal records. The *Regulations* specify that, in granting security clearance, numerous factors will be considered. These include circumstances of any convictions, their number and frequency, the date of the most recent event or conviction and any sentence or other disposition. It will also take into account whether the applicant acted in contravention of certain provisions of the *Cannabis Act*, *Controlled Drugs and Substances Act*, and the *Criminal Code*, and whether the applicant has been involved in any violent criminal organization.

Key Investor Reporting

As expected, the *Regulations* impose extensive requirements regarding the retention of specified operations-related information. A noteworthy inclusion was the requirement to retain and disclose to the government information related to “key investors”. The *Regulations* broadly define a key investor as a person that exercises, or is in a position to exercise, direct or indirect control over the holder of a licence by virtue of (a) having provided money, goods or services directly or indirectly to the holder; or (b) holding an ownership interest or other right or interest in, or in respect of, a business operated by the holder or, if the holder is an organization, in or in respect of the organization. Information relating to key investors that must be retained and disclosed includes:

- Name and mailing address;
- A description of the means by which the key investor exercises, or is in a position to exercise, control over the licence holder;

- Details regarding the transaction by virtue of which the key investor became such an investor;
- Details regarding each instance in which the key investor provides money, goods or services directly or indirectly to the licence holder;
- Details regarding any benefit the key investor receives from the licence holder;
- Details regarding each instance in which money is repaid or goods are returned; and
- If known, whether the key investor's controlling interest in the licence holder has been, will be, or could be assigned, pledged, mortgaged, hypothecated or sold, in whole or in part, to any person.

Other Regulations

Aspects of the *Regulations* were not expected. Most notably, in hopes of lowering production costs to compete with the illicit market, outdoor cultivation by licensed producers will be permitted. Also, holders of licences for cultivation are authorized to possess cannabis plants and cannabis plant seeds acquired before legalization and not in accordance with the *Access to Cannabis for Medical Purposes Regulations*, if they disclose the quantity they will have in their possession on the effective date of the license. There will also be no cap on THC potency for flowers. Cannabis oil, however, will be restricted to 30 mg of THC per millilitre of oil.

Cannabis license holders should be aware of all the requirements and prohibitions set forth under the *Regulations*. In addition to the provisions discussed above, the *Regulations* provide detailed guidance in respect of licensing, security clearance, physical security, packaging and labelling, importing and exporting, retention of information and disclosure, and cannabis for medical purposes that will prepare businesses for October 17 legalization.

Goodmans Cannabis Group

Goodmans LLP has a leading cannabis practice in the corporate/commercial field, having been actively involved in the industry from the beginning. Our corporate cannabis lawyers have extensive knowledge of the various players in the industry and have provided strategic business advice on governance, financing, licensing, regulation, capital markets, mergers and acquisitions and real estate matters. Our clients include start-ups, importers and exporters, and financial institutions related to the cannabis industry.

In addition, Goodmans is uniquely positioned with its extensive regulatory, health and intellectual property practices to advise new and existing market entrants. In particular, given our extensive work with respect to “traditional” pharmaceuticals regulated under the Food and Drugs Act and its associated Regulations (legislation used, in part, as the model for the upcoming Cannabis Act Regulations), we uniquely understand the industry, are equipped to address regulatory concerns that may arise, and know how to best protect and enforce our clients’ intellectual property. This includes matters such as licensing and regulation in the industry’s preliminary stages and future issues that may arise with regulators and competitors, including with respect to labelling and packaging, patent and trademark applications and prosecutions and the protection of trade secrets and confidential information.

For more information on any of the above information, please contact any member of our [Cannabis Group](#).

¹ Per Health Canada’s “Cannabis Licensing Application Guide”, control includes the ability to control by any direct or indirect influence, and it may exist even without the ownership of any shares, and it can take many forms.

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