

Developments in Cannabis: “Bye Bye Cole”, CSA Reconsiders, New Federal Regulatory Paper, Provincial Updates, and What to Watch for in 2018



With the legalization of cannabis in Canada mere months away, business and regulatory developments relevant to the industry have continued at an accelerated pace. Most notably, the Government of Canada released a consultation paper outlining its proposed approach to cannabis regulation, with almost all of the provinces and territories detailing their proposed plans for the distribution and retail sales of legal cannabis. International developments have also gripped the Canadian market, with U.S. Attorney General Sessions rescinding the Cole Memoranda, an Obama-era guidance to prosecutors that favoured a hands-off approach to state cannabis regimes.¹ In response to increasing uncertainty south of the border, Canada’s main stock exchanges and the provincial and territorial securities regulators (the “CSA”) continue to grapple with how to handle issuers with U.S. cannabis-related activities.

RELEASE OF FEDERAL APPROACH TO CANNABIS REGULATION

On November 21, 2017, in advance of the proposed legalization of cannabis in July 2018, the Government of Canada released its proposed regulatory framework through a new consultation paper entitled “Proposed Approach to the Regulation of Cannabis” (the “**consultation paper**”). The consultation paper will form the basis for final regulations the federal government will publish 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**”) passes and receives Royal Assent.²

As outlined in our May 10, 2017 Update, *What’s Next for Recreational Cannabis? Provincial Policy Considerations after the Introduction of Federal Legislation*, the proposed Cannabis Act leaves much of the regulation of recreational cannabis to the provinces and territories. However, the federal government retains jurisdiction over significant elements of legalization, including licensing, product approval, marketing and criminal

offenses. The consultation paper explains several components of the proposed federal cannabis regime:

Licenses. There will be multiple types of authorization issued by Health Canada to companies in the cannabis industry, including licenses for research, analytical testing, import and export, cultivation, processing, and sale to the public.³ Each type of authorization will be subject to detailed regulatory requirements relating to production, security, location, personnel, reporting practices, and compliance with a proposed federal Cannabis Tracking System. The specific requirements for the different types of licenses that may be granted will be tailored to the scale and type of operation (i.e., “micro-cultivation”, standard cultivation, nurseries, and industrial hemp). Notably, this tailored approach allows for the licensing of craft growers and processors. Also new in the consultation paper is the possibility of licenses for outdoor cultivation, which is currently prohibited under the medical cannabis regime. Supplemental activities, such as transportation and storage, will also be covered by the federal regime.

¹ In August 2013 and February 2014, then Deputy Attorney General Cole (under the Obama Administration) issued two memoranda (the “**Cole Memoranda**”) providing the (then) U.S. federal government’s guidance concerning the enforcement of federal law (including U.S. federal money laundering legislation on the proceeds from cannabis-related business activities). The Cole Memoranda do not have the force of law and can be revoked or amended at any time.

² In a departure from traditional federal regulation-making process, drafts of the regulations under the *Cannabis Act*, which are necessary to enact parts of the consultation paper, will not be published for comment. Interested stakeholders were permitted to comment on the consultation paper up to January 20, 2018.

³ This latter category includes the sale of cannabis for medical purposes, and sale for non-medical purposes to adults in provinces and territories that have not yet enacted a retail framework.

Security Clearances. Certain parties connected to licensed cannabis operators will be required to receive security clearance issued by Health Canada. These parties include major shareholders (25%),⁴ directors and officers, as well as staff in “key positions” who have access to specific security and business process and information. Health Canada has indicated it is open to providing security clearance to applicants who have non-violent or lower risk criminal records.

National Cannabis Tracking System. The proposed federal regime would include a National Cannabis Tracking System to track cannabis from production to sale and require ongoing reporting from operators. A forthcoming ministerial order will outline what information needs to be reported and by whom. The consultation document suggests any person authorized to conduct cannabis-related activities would be required to report into the Cannabis Tracking System.

Products. It is contemplated the following classes of products will be available for sale under the proposed regime: dried cannabis, cannabis oil, fresh cannabis, cannabis plants, cannabis plant seeds, edibles containing cannabis and cannabis concentrates. Edibles and concentrates will not be available for sale in July 2018, but are anticipated to be permitted by the summer of 2019. Manufacturers will be prohibited from mixing cannabis with certain substances, such as caffeine, nicotine and alcohol.

Packaging and Labelling. The upcoming regulations will set out specific requirements for the packaging and labelling of cannabis products. These rules will require that packaging be child and tamper-proof, display health warnings, and contain detailed labelling to describe the product, the THC/CBD content, and other information about the product’s production. Packages, labels, and products will not be permitted if they appeal to youth. To this end, regulations will also limit the use of colours, graphics, and other special characteristics of packaging.

Medical Cannabis. A separate system is proposed to provide patients with access to cannabis for medical purposes. The proposed medical framework will remain substantively the same as the current medical cannabis program. Patients over the age of 18 with valid prescriptions will be able to purchase

from federally-licensed producers and, within prescribed limits, cultivate their own cannabis or designate someone to grow on their behalf.

Health Products and Cosmetics Containing Cannabis. The proposed regime allows health products that contain cannabis to be regulated under the *Food and Drugs Act* through a “scientific, evidence-based approach”. Products discussed in the consultation paper include:

- Health Products (non-prescription and prescription)
- Natural Health Products
- Medical Devices
- Veterinary Drugs and Health Products
- Cosmetics

These products will require approval from Health Canada and will be subject to a review of the product’s claims, safety and efficacy.

PROVINCIAL REGULATORY REGIMES CONTINUE TO TAKE SHAPE

Within the confines of the federal regime, in addition to regulating matters within provincial and territorial jurisdiction, such as the distribution and retail sale of cannabis, the provinces and territories are permitted to prescribe further restrictions and limits. As discussed in our October 23, 2017 Update, *Update on Cannabis Legalization: Governments, Regulators and the Court Weigh In* (the “**Goodmans Oct-2017 Update**”) various approaches have been announced to date, including certain departures from the proposed federal regime. Those changes are discussed in further detail below.

Ontario

In November 2017, the Government of Ontario introduced enabling legislation to allow the province to regulate the use and distribution of recreational cannabis. The legislation establishes a government-owned retailer, the Ontario Cannabis Retail Corporation (OCRC), overseen by the Liquor

⁴ This is a departure from the current federal medical cannabis regime, which has not focused on the shareholders or owners of the licensed producers of medical cannabis.

Control Board of Ontario. The legislation also permits the OCRC to engage in online distribution and imposes a legal age of 19 (above the federal regime's requirement of 18 years of age) for the purchase and use of recreational cannabis.

On January 18, 2018, the Ontario government released a series of proposed regulations for comment related to cannabis regulation. These regulations provide further detail on the province's approach to road safety and places of use for cannabis. As expected, the regulations restrict all cannabis users from using vehicles while under the influence of cannabis, but loosen restrictions on medical cannabis users to transport their cannabis as passengers. Recreational cannabis use is proposed to be prohibited around schools, child care centres and early learning centres. Smoking and vaping would also be prohibited in the common areas of condominiums, apartments, and educational residences. The regulations provide exemptions to permit the use of recreational cannabis in designated smoking hotel rooms, in vehicles used as residences, and in most workplaces that also act as residences.

Ontario is currently soliciting feedback on whether the province should permit cannabis lounges in the future. This permission has long been requested by members of the cannabis advocacy community and industry to allow for a lawful form of public cannabis consumption and to set the ground for cannabis tourism.

Alberta

After deliberating on potential models for distribution, the Government of Alberta has determined to mirror the province's approach with alcohol, allowing cannabis to be sold through private retail stores licensed and regulated by Alberta's Gaming and Liquor Commission. The private retail licenses are expected to be awarded based on a lottery system to qualified applicants. The provincial government will maintain control of the wholesale and distribution of cannabis and will also oversee the online sale of cannabis. As a further restriction on the federal regime, the proposed Alberta legislation will not permit outdoor cultivation of cannabis, requiring cannabis to be grown in an indoor grown room and under one meter high.

Nova Scotia

In a departure from all of the other provinces and territories thus far, the proposed Nova Scotia model will provide for cannabis to be sold in government-run stores *alongside alcohol* and also through government-owned online channels.

Prince Edward Island

The provincial government will retain control of the sale and distribution of cannabis in P.E.I. Sales will be conducted through four retail stores and an online portal. Like many other provinces, consumption will be limited to private residences and users must be 19 years of age or older.

British Columbia

The Government of British Columbia plans to permit the public and private retail sale of cannabis, while allowing the government to retain control of wholesale and distribution. Unlike the Ontario government's stated intention to exclude existing cannabis dispensaries from participating in the retail sale of cannabis,⁵ it is not yet clear how British Columbia's long-standing cannabis dispensaries will be affected by the new regime. British Columbia will set the minimum age to possess, purchase, and consume cannabis at 19 years old. Municipalities will be involved in consultations regarding the type and location of cannabis retail stores.

Manitoba

The Government of Manitoba announced it will maintain control of the supply of cannabis, but allow for the private retail sale of cannabis at prices set by the market. Manitoba has launched an application process for potential private retailers. In a departure from the proposed federal regime, Manitoba's proposed regulators will not permit the growing of cannabis at private residences. Also, unlike most of the other provinces and territories, Manitoba has signalled a willingness to allow non-governmental controlled online sales platforms.

⁵ As discussed in the Goodmans Oct-2017 Update, in addition to seeking injunctive relief in the provincial courts against dispensary operators and their landlords, the Ontario government continues to pursue a coordinated and multidisciplinary strategy against illegal operators.

Saskatchewan

The Government of Saskatchewan announced plans to permit the private sale of cannabis. Similar to Alberta's plans, licenses for private retailers will be chosen through a lottery system, though Saskatchewan is expected to, at least initially, license 13 private retailers and allow upwards of 60 retail stores to operate. The government indicated municipalities can opt out of having cannabis stores within their jurisdictions.

New Brunswick

Like Ontario, the Government of New Brunswick has created a new provincial Crown corporation responsible for the sale of cannabis products in the province. New Brunswick is planning 20 standalone government-owned retail locations and will also launch an online platform. The proposed regulation in New Brunswick also includes a (so far) unique-to-New Brunswick requirement; cannabis must be kept locked in a room or container by the consumer.

Newfoundland and Labrador

The Government of Newfoundland and Labrador will permit the private retail sale of cannabis under a government-run regime of regulation and wholesale distribution. Places of use will be restricted to private residences and users must be 19 years of age or older. The government will set the price of cannabis, buy and import cannabis, and issue licenses for operators throughout the supply chain.

Quebec

The Government of Quebec has opted for a public model of cannabis distribution and retail (including online) sales. Currently, it is anticipated there will be 15 retail stores. Like Manitoba, Quebec's proposed cannabis legislation includes a total prohibition on home-growing as well as a zero-tolerance approach for drivers under the influence of cannabis.

Territories

The Government of Nunavut has not yet released its approach to cannabis. While the Government of the Northwest Territories has not yet introduced its cannabis legislation, it indicated its intent to restrict retail sales to government stores. Local communities will be permitted to prohibit cannabis. Similarly, the Government of Yukon has not yet introduced its final cannabis legislation, however it indicated its system will likely involve the private and public sale of cannabis, both overseen by provincial regulators.

U.S. RESCINDS COLE MEMORANDA

The Trump Administration announced on January 4, 2018 it was rescinding the Cole Memoranda, an Obama-era guidance to federal prosecutors that deprioritized the prosecution of state-licensed cannabis businesses unless these businesses violated state *and* federal law. The Cole Memoranda, originally issued in August 2013 and February 2014, had significantly decreased the threat of federal intervention, opening the doors for individual states to launch a legalized cannabis regime and setting the stage for the cannabis industry to grow within cannabis-legal states. By the end of 2017, 29 states in the U.S. (plus the territories of Guam and Puerto Rico, as well as the District of Columbia) had a legal regime for the medical use of cannabis, with nine states in the U.S. having legalized recreational cannabis.⁶

The rescission of the Cole Memoranda, as expected, has drawn intense protest from the Governors and Senators of states that have a legalized recreational cannabis regime, including Alaska, California, Colorado, Nevada, New Jersey, Oregon, Vermont and Washington. While the complete effect of this shift is not yet evident, the rescission of the Cole Memoranda has reinstated the considerable discretion of U.S. federal prosecutors as to whether they should prosecute cannabis-linked crimes under federal law. This new level of discretion has created a high degree of regulatory uncertainty for U.S. businesses and investors operating in this space.

⁶ Notwithstanding the rescission of the Cole Memoranda, the Rohrabacher-Farr amendment (a U.S. federal law that prohibits the federal Justice Department from spending funds to interfere with the implementation of state *medical* cannabis laws) remains in effect and was most recently renewed as part of the U.S. 'stopgap' spending bill of January 22, 2018.

CANADIAN SECURITIES REGULATORS REACT

In response to the rescission of the Cole Memoranda, the CSA issued a statement on January 12, 2018, indicating it was reconsidering whether its disclosure-based approach to issuers with U.S. cannabis-related activities remained appropriate.

As noted in the Goodmans Oct-2017 Update, the CSA issued a notice last fall that took a permissive approach to the listing of issuers with U.S. cannabis-related activities, on the basis such issuers would be required to disclose the regulatory risks of their operations and provide certain assurances regarding compliance with U.S. and state laws. The CSA notice, however, cautioned that cannabis remained illegal at the U.S. federal level and the Cole Memoranda was subject to rescission or amendment at any time.

With the Cole Memoranda now rescinded, as telegraphed in its fall notice, the CSA is revisiting the issue. It is currently unclear whether the CSA will continue to focus on the disclosure-based regime of Canadian securities law in dealing with issuers with U.S. cannabis business activities or whether the CSA will move closer to the position taken by Canada's main stock exchange, towards an outright prohibition of such issuers from the Canadian capital markets.⁷

In contrast to the TSX, the relatively-upstart Canadian Securities Exchange (CSE) has taken an approach in line with the CSA, allowing issuers with U.S. cannabis operations to list as long as they disclose how they comply with the laws of the state in which they operate and describe the risk they face with regards to federal law. In fact, seizing on this opportunity from the CSA's permissive regime and the TSX's announced prohibition, the CSE has captured a sizable portion of the Canadian capital markets for issuers in the cannabis business. The CSA's review of its approach will have a significant impact on the CSE's continuing ability to host issuers with U.S. cannabis business.⁸

⁷ See the Goodmans Oct-2017 Update for a description of the ongoing review by the Toronto Stock Exchange (TSX) of issuers listed on the TSX or the TSX Venture with U.S. cannabis activities. To date, the exchange has not publicly updated the markets on the status of its review and/or proposed remedies or actions against any issues listed on the TSX or the TSX Venture.

⁸ Another Canadian stock exchange, the Aequitas NEO Exchange Inc., has also welcomed issuers that may be involved in the U.S. cannabis business. The first Canadian specialty SPAC (special purchase acquisition corporation) focused on the cannabis industry has recently listed on the Aequitas NEO Exchange after a successful \$125 million IPO (initial public offering).

UNCERTAINTY, RISK AND REWARD IN 2018 – OUR THOUGHTS

With Canada's cannabis legalization scheduled to come into effect in July of this year, the country's cannabis industry continues to transform itself to prepare for the recreational market. As recent events continue to show, however, the industry will need to adapt and cope with an evolving patchwork of legislative regimes, both north and south of the border, as well as continuing uncertainties of access to the capital markets. It remains unclear whether Canadian producers will stand to benefit from the Trump Administration's moves against potential competitors in the U.S. or whether the lack of U.S. market access will stymie Canadian growth.

In addition, while Canada's provincial and territorial governments remain hard at work to ensure their regimes are prepared for what is expected country-wide to be a high demand market for recreational cannabis, we expect some early missteps by governments managing this file, including supply and security issues in the initial period of legalization.

As Canadians become comfortable with the reality of legal cannabis, it is likely federal and provincial governments will loosen their initially-restrictive regimes. Federally, we expect a careful but more permissive approach to new forms of cannabis products. Similarly, provincial and territorial governments are likely to explore permitting cannabis lounges and licenses for cannabis-related consumption events.

Finally, legalization is also likely to bring further clarity to the valuation of cannabis stocks in Canada. As the recreational market opens and returns roll in, investors will gain a new perspective on important metrics such as the potential size of the recreational market, the impact of legalization on the current underground market for cannabis, the ability of licensed producers to build out capacity on plan and on budget, which licensed producers can meet market demand, and the costs of government regulation.