

Legal update

Commercial and legal considerations of marijuana legalization

June 2016

Food and agribusiness

The Government of Canada's proposal to legalize marijuana for recreational use in 2017 has been the focus of considerable media attention, and has spurred the interest of individuals and companies desiring to enter the budding industry. This article will highlight some of the potential commercial and legal issues that will likely confront prospective market entrants.

Legal landscape of the marijuana industry

At present, the precise regime that will be implemented by the Government of Canada is not known; however, the regulatory considerations below will bear considerable commercial consequences. Each of the following has been analyzed in light of the current regulatory framework, its ever-changing nature and the corresponding business implications.

Licensing – The current licensing regime allows Health Canada to oversee the medical marijuana industry by restricting access to the market and continually enforcing compliance. The *Marihuana for Medical Purposes Regulations* (MMPRs) meticulously stipulate each step of the production and distribution process, governing activities related to production, sale, storage, transportation and destruction of dried marijuana. Licenses under the MMPRs are issued, denied and revoked at the absolute discretion of Health Canada. The prospect of a perpetually denied or delayed application presents a degree of risk for both companies and their respective investors, as the regulated industry is still in its infancy.

It is likely that the stringent requirements for applications, as well as the ongoing supervision and oversight of Health Canada (or an applicable governmental authority), will continue in the recreational-use marijuana regime. For this reason, companies that wish to enter the market would be well advised to ensure, and its investors and financiers be equally cognizant of, full and diligent compliance with the licensing requirements.

Distribution and the Allard Decision – Despite the detail and intricacy of the MMPRs, uncertainty lingers regarding the enforcement and illegality of alternative methods of distribution. Health Canada issued an information bulletin reaffirming that compassion clubs and dispensaries under the MMPRs are illegal.¹ In spite of this,² the city of Vancouver, in June 2015, implemented a municipal licensing regime to regulate the operation of marijuana dispensaries (thus, allowing dispensaries that abide by the relevant municipal guidelines to operate).

Further convoluting the landscape in February 2016 is Justice Michael Phelan's Federal Court decision. In what has become commonly known as the "Allard Decision," the court ruled that the distribution system as mandated by the MMPRs unjustifiably infringed upon the life, liberty and security interests described under Section 7 of the Charter of Rights and Freedoms.³ The declaration was suspended for six months to allow the newly elected Liberal government

to amend the MMPRs. Only months later in May 2016, the city of Toronto undertook a city-wide raid as part of “Project Claudia,” an investigation and operation to shut down marijuana dispensaries across the city that resulted in product seizures and several criminal charges.⁴ Not only must the lack of uniformity be addressed by the new licensing regime, but the proposed method of distribution⁵ and taxes (as may be applicable) will also bear a significant impact on business models and profitability.

Advertising, Promotion and Use – Substances such as tobacco, alcohol and medical marijuana are subject to strict advertising and packaging controls to ensure public health safety. In Ontario, tobacco retailers are generally prohibited from advertising tobacco products and using any display that would allow a potential purchaser to view or handle the tobacco product before purchasing it. Under the MMPRs, advertisements for medical marijuana are prohibited entirely, and various companies have bemoaned the difficulty in promoting brand uniqueness and differentiation, in addition to the dissemination of information to potential consumers.⁶ It is highly likely that similarly strict regulations will apply to recreational use marijuana as well; however, the impact on the multitude of social media platforms will be difficult to predict.

Commercial landscape of the marijuana industry

According to Health Canada,⁷ there are currently 31 producers of dried medical marijuana licensed under the MMPRs, with numerous interested producers either applying for or awaiting approval.⁸ Companies currently licensed under the MMPR regime are likely poised to control a large portion of the future recreational-use market. Optimistic predictions state that current statistics are likely only a restrained indication of the potential market capitalization of the nascent marijuana industry. While this may appear promising, here are some commercial concerns:

Sunk Costs – Commercial production facilities require large-scale, sensitive and intricate equipment and machinery that carry significant operating costs. The *Cannabis* genus of plants requires a large amount of sunlight, which forces producers to either operate traditional indoor facilities at steep utility costs or locate and purchase limited geographical locations within Canada for greenhouse operations. In addition, Health Canada must approve each growing facility before production is allowed to commence. In spite of the regulatory and overhead obstacles, producers have shown remarkable innovation and entrepreneurship to lower the cost of growing and cultivating marijuana.⁹

Agri-Business – By its very nature, the agriculture business is subject to multiple factors that can influence crop quality and yield. Marijuana producers have the added complexity of ensuring uniform content of certain psychoactive chemicals, while abiding by production regulations (e.g., plants cannot be treated with pesticides). The growth cycle from seed to harvestable crop varies anywhere from three to six months, which delays profitability whilst incurring significant costs. Seeking and developing advantages that boost the likelihood of successful crop quality and yield will likely require a keen understanding of the regulatory environment by both incumbent and prospective producers.

Market Uncertainty – As of May 2016, there are almost 40,000 registered medical marijuana clients, a number that has shown steady growth in each yearly quarter since April 2014.¹⁰ The industry is believed to be currently valued between \$80 to \$100 million, and could climb as high as \$5 billion post-legalization.¹¹ While such optimism invites enthusiastic entrepreneurs, the future of the industry remains shrouded in mystery. Product diversification, innovation, financing and advertising are some of the many commercial considerations that must be addressed by regulation. Moreover, long-term medical research and findings will also likely play a significant role in shaping both future regulations and the broader public appetite.

Conclusion

The marijuana industry is poised to undergo a drastic paradigm shift, and market analysts have made varying predictions regarding its eventual profitability. Until the Government of Canada tables its proposed legalization regime, it will be difficult to ascertain the breadth and depth of the upcoming regulatory environment. This unique situation means that companies most knowledgeable of regulatory developments will be able to quickly respond and adapt to the new market and place themselves in the best competitive position to succeed.

Dustin Paterson
Byron Tse

Footnotes

- ¹ Health Canada's *Accessing Marijuana for Medical Purposes - Information Bulletin* was issued on June 8, 2015, and provides clarity as to Health Canada's position on the current regulatory framework.
- ² The federal government at the time has opposed Vancouver's municipal regime, stating that all operating dispensaries to be illegal. See: <http://www.theglobeandmail.com/news/british-columbia/vancouver-medical-marijuana-businesses-without-licences-must-close-by-friday/article29761684/>
- ³ *Allard et al v. Her Majesty the Queen in Right of Canada*.
- ⁴ See: <https://www.thestar.com/news/gta/2016/05/26/toronto-police-and-drug-squad-raid-marijuana-dispensaries.html>
- ⁵ The prospect of using the Liquor Control Board of Ontario as a means of retailing marijuana products has been proposed. See: <http://www.cbc.ca/news/canada/toronto/wynne-marijuana-lcbo-1.3364158>
- ⁶ See: <http://ottawacitizen.com/news/local-news/health-canada-warns-marijuana-producers-about-advertising>
- ⁷ Number of licensed producers was obtained from the Health Canada website, updated as of May 20, 2016.
- ⁸ Statistics obtained from Tweed 2014/15 Annual Review.
- ⁹ Aphria, founded by two agri-business experts, was one of Canada's first marijuana companies to produce marijuana in a greenhouse, located in Leamington, Ontario, to reduce lighting costs of traditional indoor facilities.
- ¹⁰ Statistics obtained from the Health Canada website, updated as of May 10, 2016.
- ¹¹ See: <http://business.financialpost.com/news/agriculture/canadian-marijuana-stocks-jump-as-liberal-wins-signals-legalization-on-the-table>

For further information, please contact:

> Alison Babbitt	Ottawa	+1 613.780.8665	alison.babbitt@nortonrosefulbright.com
> Erin M. Ludwig	Calgary	+1 403.267.8309	erin.ludwig@nortonrosefulbright.com

Norton Rose Fulbright Canada LLP, Norton Rose Fulbright LLP, Norton Rose Fulbright Australia, Norton Rose Fulbright South Africa Inc and Norton Rose Fulbright US LLP are separate legal entities and all of them are members of Norton Rose Fulbright Verein, a Swiss Verein. Norton Rose Fulbright Verein helps coordinate the activities of the members but does not itself provide legal services to clients.

References to "Norton Rose Fulbright", "the law firm", and "legal practice" are to one or more of the Norton Rose Fulbright members or to one of their respective affiliates (together "Norton Rose Fulbright entity/entities"). No individual who is a member, partner, shareholder, director, employee or consultant of, in or to any Norton Rose Fulbright entity (whether or not such individual is described as a "partner") accepts or assumes responsibility, or has any liability, to any person in respect of this communication. Any reference to a partner or director is to a member, employee or consultant with equivalent standing and qualifications of the relevant Norton Rose Fulbright entity.

The purpose of this communication is to provide general information of a legal nature. It does not contain a full analysis of the law nor does it constitute an opinion of any Norton Rose Fulbright entity on the points of law discussed. You must take specific legal advice on any particular matter which concerns you. If you require any advice or further information, please speak to your usual contact at Norton Rose Fulbright.