

SEPTEMBER 28, 2018

Ontario Releases Framework for Private Retail Cannabis Sales

Authors: [Patricia L. Olasker](#), [Brian Kujavsky](#), Russell Hall and Brent Winston

With less than three weeks before cannabis becomes legal for adult use in Canada, Ontario has finally tabled its approach to retail distribution. Among the myriad aspects of the recreational cannabis industry left to the discretion of the provinces, retail distribution may have the largest impact on consumers and producers alike.

Highlights

- The Alcohol and Gaming Commission of Ontario will be responsible for the issuance of retail licences and for oversight of licensed retailers.
- Licences will be required at both the entity and the store levels.
- There will be no cap on the number of retail licences issued in Ontario.
- Licences will not be transferable.
- Licensed producers may operate only one retail location, and that location must be within the production site for which the producer is licensed.
- The ability of licensed producers to invest in retail is likely to be limited by regulation to non-controlling interest.
- Consumption is permitted in any area where smoking tobacco and/or use of e-cigarettes is permitted.
- An opportunity appears to exist for operators of currently illegal dispensaries to participate in the new retail regime.
- The Ontario government will be the exclusive wholesaler of cannabis and will continue to operate the online retailer.

Patchwork Regulation

From the dizzying patchwork of provincial legislation that will regulate the cannabis industry, we can discern three different distribution models:

- a public model whereby a Crown entity will be the sole distributor of cannabis in the province;
- a private model whereby a Crown entity will be responsible for the wholesale purchase of cannabis, but retail sales to the end consumer will be made by provincially licensed and regulated private retailers; and
- a hybrid model, whereby a Crown entity will be responsible for the wholesale purchase of cannabis, but both government operated and private retailers will sell to the end consumer.

Ontario's Changed Approach

Ontario's prior Liberal government proposed a public model under which cannabis was to be sold through a subsidiary of the Liquor Control Board of Ontario. Although 40 stores were planned to be opened in 2018, as of July 2018, only four locations had been selected.

On August 13, 2018, Ontario's newly elected Progressive Conservative government announced that it would be changing its approach and would instead allow the sale of recreational cannabis through privately owned retail locations.

With little time before the *Cannabis Act* comes into force and no legislation in place to govern a private retail regime, Ontario has conceded that it will not have bricks and mortar retail in place by October 17, 2018. Instead, cannabis will initially be available exclusively online through the Ontario Retail Cannabis Corporation, an entity under the jurisdiction of the Ministry of Finance. The province of Ontario has entered into supply agreements with 26 licensed producers to supply the Ontario market upon the *Cannabis Act's* coming into force.

Ontario aims to have a private retail model in place by April 2019. Yesterday, Ontario took the first step toward that objective: Bill 36, which amends the *Ontario Cannabis Act, 2017* (renamed the *Cannabis Control Act, 2017*) and enacts the *Cannabis Licence Act, 2018* (CLA), passed its first reading in the Legislative Assembly of Ontario. If passed, the CLA will regulate the licensing, operations and oversight of private cannabis retailers in Ontario.

Changes to the Ontario Cannabis Regime

Licensing

Under the CLA, the Alcohol and Gaming Commission of Ontario will be responsible for the issuance of retail licences and for oversight of licensed retailers. Licences will be issued at both the entity and store levels because potential retailers will be required to apply for both a retail operator licence and a retail store authorization for each proposed location. Retail operator licences, retail store authorizations and cannabis retail manager licences will not be transferable under the CLA.

Unlimited Licences

There will be no cap on the number of retail licences issued in Ontario; however, the CLA makes it possible for the province to restrict via regulation the number of retail store authorizations that may be issued to a single entity.

Prior Cannabis Conviction Not a Bar

The CLA also requires that managerial personnel of a licensed retailer hold a retail manager licence. Although the CLA enumerates certain grounds that render an applicant ineligible to receive a retail manager licence, a conviction or charge for a prescribed offence under the *Controlled Drugs and Substances Act* in relation to cannabis will not preclude an applicant from obtaining a retail manager licence.

Opt-Out for Municipalities

Additionally, municipalities will have the ability to prohibit bricks and mortar locations, and must pass a resolution to that effect no later than January 22, 2019. Municipalities may rescind such a resolution and opt back in to the cannabis retail framework at a later date. However, a decision to opt back in would be final and irreversible.

One Retail Outlet per Licensed Producer and Affiliate

Of note, section 4(4) of the CLA provides that a licensed producer may operate only one retail location, and that location must be within the production site for which the producer is licensed. Furthermore, the CLA prohibits a licensed producer *and its affiliates*, as defined by the regulations, from holding more than one retail store authorization between them.

Because there are no draft regulations yet under Bill 36 currently, "affiliates" remains an undefined term. If the term is given its customary statutory definition (i.e., parent-subsidiary relationships and entities under common control), it will mean that licensed producers will be prohibited from owning or controlling a cannabis retailer, other than the one retail location permitted under the CLA. Licensed producers that do not have a production site in Ontario may be excluded from participating in the Ontario retail environment.

Consumption

The prior Liberal government proposed to limit consumption of cannabis exclusively to private residences. The new Act significantly eases these consumption restrictions, permitting cannabis consumption any place that it is legal to smoke tobacco under the *Smoke-Free Ontario Act*. The maximum fines for consuming cannabis where it is not permitted are proposed to be \$1,000 for a first offence and \$5,000 for subsequent offences. As is the case with tobacco, smoking of cannabis in private residences will be subject to any lease agreements or condominium bylaws.

Looking Forward

With a proposed framework in place, speculation can begin as to what Ontario's retail cannabis landscape will look like come April 2019. The framework appears to be designed to favour independent retailers and offer Ontarians a variety of retail experiences.

Illegal Dispensaries Going Legit?

An opportunity appears to exist for operators of currently illegal dispensaries to participate in the new retail regime. Ontario's Finance Minister, Vic Fedeli, indicated that any retailers operating illegally after October 17 will be prohibited from obtaining a licence in Ontario, leaving the door open for any illegal dispensaries to shut down prior to October 17 and still be eligible to receive a retail licence.

The CLA provides that a conviction or charge for a prescribed offence under the *Controlled Drugs and Substances Act* in relation to cannabis will not preclude an applicant from receiving a retail operator licence or a retail store authorization. Thus, even dispensary operators who have been charged or convicted of cannabis-related offences in the past may be able to participate in the private retail market.

With the expected crackdown on the illicit market upon the *Cannabis Act* coming into force, legitimization could be the path of least resistance for those currently operating in the grey market.

Will Licensed Producers Find a Way to Participate?

The limit of one retail location per licensed producer and its affiliates will no doubt put a damper on plans of retail expansion that some well-capitalized producers may have had in mind. This approach can be contrasted against the private model proposed by the Alberta government, which projects 250 retail locations being in place during the first year of legalization. Alberta will not allow more than 15% of the total licences available to be issued to a single entity, allowing for the possibility of up to 37 licences being issued to a single party.

Certain licensed producers have attempted to position themselves to participate in private retail environments through strategic investments and acquisitions. However, this may prove challenging under the Ontario framework.

For example, in September 2018 Canopy Growth Corporation acquired Hiku Brands Company Ltd., which already has in place a national retail footprint through its brand Tokyo Smoke. Depending on how the term "affiliate" is defined in the CLA, Canopy may not be able to leverage Tokyo Smoke's presence in Ontario. On the other hand, Aurora Cannabis Inc. holds a 19.9% interest in Liquor Stores N.A. Ltd. (Liquor Stores), a leading private retailer of liquor in Western Canada. Aurora's investment would likely not result in Liquor Stores falling under the definition of "affiliate," and consequently Aurora may be able to participate indirectly in the Ontario retail market.

The proposed limitations placed on licensed producers' ability to participate in the retail market have stifled investor optimism. On September 27, 2018, shares of prominent cannabis companies such as Canopy, Aurora and Aphria Inc. dropped by 4.94%, 4.18% and 6.42% respectively. This marked a second straight day of downward trends for publicly listed licensed producers. The initial announcement on September 26, 2018, that the Ontario government was proposing to limit licensed producer participation in the retail market appeared to kick-start this trend. This is a situation to be monitored as Bill 36 attempts to pass its way through the legislature.

Impact on Medical Cannabis Market?

With the anticipated accessibility of adult-use cannabis, some have questioned the logic of the highly restrictive medical cannabis regime. Currently, the *Cannabis Act* provides that the only way to access cannabis for medical purposes is to obtain a "medical document" from a

“health care practitioner,” register as a client with one – and only one – licensed producer, order online or over the phone from that licensed producer and wait for delivery by an authorized carrier.

As of March 2018, Alberta and Ontario represented the two largest provincial markets for medical cannabis by patient registration and total shipments.¹ With both provinces opting for a private model for adult-use cannabis sales that imposes no cap on potential retail locations, the convenience and accessibility of the recreational market may lead to cannibalization of medical cannabis sales.

¹<https://www.canada.ca/en/health-canada/services/drugs-medication/cannabis/licensed-producers/market-data.html>

Key Contacts: [Patricia L. Olasker](#) and [Brian Kujavsky](#)