

CANNABIS

Licensing	216
Infused Products	216
Branding, Packaging and Labelling	216
Promotion	217
Mergers and Acquisitions	219
Securities Regulation	220
The Year in Review and Outlook	221

By Ranjeev Dhillon, Rami Chalabi and Matthew Sanders



CANNABIS

With the enactment of the *Cannabis Act* (Canada) in 2018, Canada became the first G7 nation to federally legalize adult use of recreational cannabis permitting its production, distribution and sale. Since that time, the regulatory regime has evolved and the cannabis industry has continued to grow at a rapid rate, both domestically and internationally.

Licensing

Responsibility for the oversight of the cultivation, production and distribution of cannabis is shared between federal, provincial and territorial governments and municipalities. Health Canada provides licensing and a legal framework for the cultivation and production of cannabis through various licences. An individual or business is required to obtain a licence issued by Health Canada in order to conduct various cannabis-related activities, including the cultivation of cannabis, the sale of cannabis for medical purposes, analytical testing and research, with various sub-licences being available based on the nature and size of the activity. Licence holders must comply with the *Cannabis Act* and its regulations, as well as compliance with other applicable federal, provincial and territorial legislation and municipal laws.

Licences related to distribution are issued at a provincial and territorial level. The distribution of cannabis varies by province and territory through private sales, government sales or a hybrid of the two.

Infused Products

At the time of legalization, product offerings were primarily limited to dried cannabis flower and cannabis oils, due to a strict regulatory environment. Subsequently, the federal government introduced new regulations to permit a much wider range of cannabis-infused products, including edibles, extracts suitable for vaping products, and topicals. The regulations provide for strict production parameters and guidelines with respect to these products, including limits on THC and certain ingredients and additives, and restrictions on the use of vitamins, mineral nutrients, meat products, caffeine and alcohol.

Branding, Packaging and Labelling

Cannabis and cannabis accessories are prohibited from being sold in packaging or with a label: (i) if it could reasonably be expected to appeal

to minors (i.e., those under 18 years of age); (ii) that sets out a testimonial or endorsement; (iii) that depicts a person, character or animal; (iv) that is associated with any particular lifestyle; or (v) that contains any information that is false, misleading, deceptive or likely to create an erroneous impression about its characteristics.

It is also prohibited for cannabis to be sold if it has not been packaged in accordance with the packaging and labelling requirements set out in the applicable legislation. Those packaging and labelling requirements vary between the classes of cannabis and address characteristics of the package or container itself (e.g., capacity, surface colours and displays, scent, bar codes, etc.) as well as the label applied to it (e.g., product characteristics, producer information, brand elements, expiry date, ingredient list, health warnings, etc.).

Promotion

The *Cannabis Act* provides for broad and stringent restrictions on the promotion of cannabis, cannabis accessories and cannabis-related services, subject to certain narrow exceptions. Many of the provinces' and territories' legislation and policies impose additional promotion restrictions on top of those set out the *Cannabis Act* and its regulations. These restrictions are imposed in the interest of protecting the health and safety of Canadian citizens, with a particular emphasis on minors.

The *Cannabis Act* defines the term "promote" as the making of a representation (other than on a package or label) in respect of an item or service, for the purposes of selling that item or service, by any means, whether directly or indirectly, that is likely to influence attitudes, beliefs and behaviours about the item or service.

There are certain activities that are not intended to be caught by the scope of the promotion restrictions and which are expressly stated as being outside of their scope of applicability: (i) certain creative works, commentaries and opinions that depict or address cannabis, a cannabis accessory and/or a cannabis-related service but for which no consideration is given; and (ii) business-to-business promotions by persons authorized to produce, sell or distribute cannabis and persons who sell cannabis accessories and/or cannabis-related services that are directed at persons authorized to produce, sell or distribute cannabis (and not at consumers).



Fundamentally, it is prohibited to promote cannabis, cannabis accessories and any cannabis-related service unless otherwise authorized under the *Cannabis Act*. The statute goes on to confirm that there can be no communications of price or availability, testimonials or endorsements, depictions of persons or characters or animals, implication of a particular emotion or lifestyle, or any other representation that could be appealing to minors.

In addition to the core prohibition, the *Cannabis Act* and its regulations provide other supporting restrictions, including, among other things, prohibitions on: (i) falsely, deceptively or erroneously promoting cannabis, cannabis accessories or cannabis-related services or their traits (which is considered by Health Canada to include any claims about intended effects of consumption); (ii) using foreign media channels to promote in Canada in a non-compliant manner; (iii) sponsoring persons or events in particular ways; (iv) naming a facility in a particular way; and (v) sellers of cannabis and/or cannabis accessories doing or providing anything as an inducement for the purchase of cannabis or cannabis accessories (e.g., “buy one get one free” promotions, contests, loyalty programs, etc.), subject to an exception for certain business-to-business inducements (e.g., wholesale discounts).

Despite the restrictions, the *Cannabis Act* also provides several narrow channels of permitted promotions, namely:

- **Informational promotion.** A promotion through which factual information is conveyed to consumers about cannabis, a cannabis accessory, a cannabis-related service or the item or service’s characteristics (including price or availability), subject to certain delivery parameters;
- **Brand-preference promotion.** A promotion of cannabis, a cannabis accessory or a cannabis-related service by means of its brand characteristics, subject to certain delivery parameters;
- **Point-of-sale promotion.** A promotion by the applicable seller of cannabis, a cannabis accessory or a cannabis-related service at the point of sale where the promotion conveys only its availability and/or price; and
- **Brand elements on non-cannabis items.** A promotion of cannabis, a cannabis accessory or a cannabis-related service by means of placing a



brand element on an item that is not cannabis or a cannabis accessory; provided that the applicable item not: (i) be associated with minors; (ii) be reasonably considered appealing to minors; (iii) be associated with a particular lifestyle; or (iv) exceed certain numerical, placement and size parameters set out in the *Cannabis Regulations*.

Any person is permitted to engage in informational promotions and brand-preference promotions in respect of cannabis accessories and cannabis-related services, but only persons who are authorized to produce, sell or distribute cannabis can do so in respect of cannabis. Any such informational and brand-preference promotions must, among other things: (i) be communicated to a person 18 years of age or older and identifies them by name; (ii) be in a place where minors are not permitted by law; or (iii) be communicated by means of telecommunication where reasonable steps have been taken to ensure that minors cannot access it.

Beyond the federal restrictions and authorizations described, many of the provinces and territories impose supplementary restrictions that compound the promotional difficulties faced by industry participants. Evidently, promotion capabilities are heavily restricted within Canada and require careful navigation when trying to implement a promotional initiative.

Mergers and Acquisitions

Similarly to other highly regulated industries, transactions involving cannabis industry participants require the navigation of certain idiosyncrasies. In addition to all of the traditional considerations that should be accounted for in the context of any corporate transaction, cannabis industry participants must evaluate the impact of certain factors that are unique to their industry and that have the potential to significantly impact the prospects of their businesses once a transaction is completed.

The following are some of the primary considerations that must be considered in the context of mergers, acquisitions and securities transactions (e.g., capital raises) involving cannabis industry participants:

- **Licence Transferability.** The licences issued under the federal, provincial and territorial legislation to cannabis industry participants are not independently transferable to another person. This fact influences



the structure of any particular transaction in that licences may only effectively be transferred through the purchase and sale of the entities that hold them (i.e., a share purchase transaction). In the context of an asset purchase transaction, including in which a facility that is the subject of a licence, the licence in question will not automatically flow with ownership of the purchased assets. The purchaser of the facility would effectively have to reapply for the licence that was held by the seller in respect of the purchased facility should it be desired.

- **Regulator Consent and Notice Rights.** Cannabis-related regulators have inserted themselves into the transaction process in several ways. Applicable legislation, the regulators' imposed policies and/or commercial agreements between industry participants and the regulators (e.g., supply agreements with provincial and territorial wholesalers) frequently provide the regulators consent and notice rights that must be abided by in the context of a transaction. These rights can serve as conditions that must be satisfied prior to closing or post-closing obligations. In either case, their stipulation has afforded regulators certain enforcement powers that can be exercised where the industry participants' obligations are not fulfilled.
- **Security Clearance and Personal Disclosure.** When a person acquires a significant ownership interest in a licence-holding entity, they may be obligated (in the case of licensed producers) to obtain security clearance under the federal legislation or (in the case of licensed retailers) to provide significant personal disclosure to applicable provincial and/or territorial regulators, similarly to their respective licensing processes. As previously described, the level of personal detail required to be disclosed in both such processes is very significant and may be considered untenable by individuals associated with a purchaser.
- **Ownership Restrictions.** Certain provinces prohibit licensed producers from acquiring significant ownership interests in licensed retailers. These restrictions must be carefully navigated where industry participants want to achieve a degree of vertical integration.

Securities Regulation

As previously noted, the legalization of cannabis at the federal level in Canada stands in contrast to the regulatory framework in the United States. Although a number of U.S. states have legalized cannabis in some



form, it remains a controlled substance under federal law. The Canadian Securities Administrators (CSA) have published guidance for companies with U.S.-based cannabis activities, and the Toronto Stock Exchange (TSX) undertook a listing review of cannabis companies with U.S. operations and maintains that its issuers are not permitted to participate in marijuana-related activities in the U.S. The Canadian Securities Exchange, in contrast to the TSX, has taken a more permissive approach, requiring only fulsome disclosure of these activities (consistent with the position of the CSA).

The Year in Review and Outlook

During 2022, there were several significant developments in the Canadian cannabis industry:

- In December 2022, Health Canada announced amendments to the *Cannabis Act* and accompanying regulations to do, among other things, the following: (i) to increase the public possession (and purchase) limits for cannabis beverages from 2.1 litres (five cans of 355 millilitres each) to 17.1 litres (48 cans of 355 millilitres each); and (ii) to update the regulation of non-therapeutic research with human participants to allow for the easier conduction of cannabis research involving human participants.
- Beginning in 2021, certain licensed producers introduced “edible extract” products into the recreational market in order to try and benefit from the higher THC allowances for extracts relative to edibles. In or around late-2022, Health Canada began asking some of the relevant licensed producers to stop selling their products out of a concern for non-compliance.
- Health Canada began its legislative review of the *Cannabis Act* (which was supposed to begin the year prior after three years of legalization), and which industry stakeholders hope will be the catalyst for progressive industry changes.
- In July 2022, Health Canada’s Science Advisory Committee on Health Products Containing Cannabis released a report on their findings to date, which will likely serve a guiding resource in the preparation of any legislation that legalizes and regulates health products containing cannabis or that otherwise updates the regulatory framework applicable to CBD.
- The Alcohol and Gaming Commission of Ontario provided clarifying guidance on what business-to-business inducements would be



permitted between licensed producers and licensed retailers. This included the express statement of an allowance for licensed retailers to contract licensed producers to producer retailer-branded products.

While there have been a variety of significant updates to Canada's cannabis industry in recent months, the future is unpredictable due to the industry's inherent volatility. Given the relatively difficult financial circumstances that have been faced by industry stakeholders for the past several years, most stakeholders hope to see developments in the way excise duty obligations are applied or further updates to the THC concentration limits applicable to edibles, extracts and topicals.

There is hope that the Canadian government will assist cannabis industry stakeholders in the short-term. Justin Trudeau, the Prime Minister of Canada, stated, "Now that we've got the public health and safety stuff out of the way, or on the way, I think you're absolutely right we should absolutely take a closer look at 'OK, what do we do then to make sure that this is a beneficial industry?'" As part of the 2022 federal Canadian budget, the federal government noted that as the legal cannabis industry in Canada grows, there are opportunities for the federal government to "streamline, strengthen, and adapt the cannabis excise duty framework specifically, and other excise duty regimes under the *Excise Act, 2001* accordingly." That work is being conducted, in part, by Innovation, Science and Economic Development Canada, a federal agency that focuses on increasing Canada's share of global trade. Such government assistance is required given the current sombre economic outlook in the industry which likely continue to lead to more strategic financing transactions, bankruptcy proceedings and consolidation among stakeholders.

FOR MORE INFORMATION, PLEASE CONTACT:

Ranjeev Dhillon

rdhillon@mccarthy.ca

416-601-8327

Rami Chalabi

rchalabi@mccarthy.ca

416-601-8125

Matthew Sanders

msanders@mccarthy.ca

416-601-4306

