

CANNABIS

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# Cannabis in Canada: No longer just getting started

The legalization of the recreational or “adult-use” cannabis market in 2018 brought with it some growing pains, including initial distribution and supply chain issues, as well as the effect of the illegal market, which continues to thrive. Through 2019, provinces and territories were looking to overcome these challenges by considering changes to their age of consumption, as well as their retail licensing, distribution and wholesale models. At the federal level, Canada legalized three new classes of cannabis products: edibles, topicals and extracts. These additions are expected to change the legal cannabis landscape significantly. However, before these new classes are even available for legal sale, the market has been affected by adverse events allegedly relating to consumers vaping illicit cannabis products. These events have created some cautious attitudes towards cannabis companies’ risk profiles.

In addition, declining share prices appear to have slowed the pace of public offerings by cannabis companies in the later part of the year and may lead to increased M&A activity and market consolidation in the industry in 2020. Enterprises that were early and fast movers in the sector and that successfully executed strategic partnerships, cornerstone investments, take-privates and

capital raising transactions that resulted in strong balance sheets can expect to prevail in the industry. The cannabis industry is here to stay, notwithstanding the current market climate.

## Purported supply issues and continued illegal sales

Following legalization, the Canadian media reported rampant consumer complaints about national supply shortages of legal cannabis for the adult-use market. The reality is that despite cannabis being legally available for adult use, many Canadians continue to purchase cannabis through illegal sources. According to results from Statistics Canada's [National Cannabis Survey](#), as of the third quarter of 2019, a large percentage of Canadians surveyed continued to report obtaining cannabis from illegal sources in 2019 (42%).

The Ontario provincial government cited federal supply shortages as the cause for consumers' inability to access legal cannabis, resulting in the illegal market continuing to flourish. Health Canada, however, has maintained that the supply of cannabis is not the cause of Canadian consumers' hampered access to legal cannabis. Perhaps substantiating this claim, Health Canada also [published data](#) based on the information compiled from the Cannabis Tracking System which demonstrates that cannabis inventories (i.e., cannabis held in stock by a licensed cultivator, processor, distributor or retailer that is packaged, labelled and ready for sale) exceeded cannabis sales (both medical and non-medical) in each month from October 2018 to August 2019.

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## Provinces implement and adjust new legislation

The federal *Cannabis Act* confers on provinces and territories the authority to regulate a variety of aspects of adult-use cannabis in Canada, including retail and online sales and minimum age requirements.

### (a) Ontario retail stores

Prior to legalization, each province and territory established its own legislative regime to permit the operation of retail and online stores. However, in Ontario, it was not until April 1, 2019 – a number of months after federal legalization of cannabis for adult use – that consumers were able to purchase cannabis from a licensed brick-and-mortar retail store.

The *Cannabis Licence Act* (Ontario) initially restricted the retail store allocation in Ontario to just 25 stores. Persons wishing to apply for a retail licence did so by submitting an expression of interest. The Alcohol and Gaming Commission of Ontario (AGCO) then ran a lottery to select 25 prospective licencees. Approximately 17,000 expressions of interest were submitted to the AGCO in January 2019 for these 25 coveted retail licences.

On July 3, 2019, Ontario announced that a second lottery would be held for an additional 42 licences to be allocated to private retailers in Ontario. Eight more licences were made available for retailers on First Nations reserves in the province.

Some of the larger publicly-listed cannabis licence holders have stated that the lack of retail stores in Ontario has played a role in earnings results being lower than anticipated. We expect that the Ontario government will make changes to the licensing regime to remove the cap on the number of retail stores in Ontario in the near future to open the retail store market.

### **(b) Proposed age restrictions for adult-use cannabis in Québec**

In late 2018, proposed legislation was tabled in Québec to increase the minimum age requirements for cannabis use from 18 to 21. With the adoption of [Bill 2](#), the change in legal age of consumption will come into effect on January 1, 2020. Québec's provincial law society, the Barreau du Québec, previously warned lawmakers that legislation setting the minimum age above 18 (the legal drinking age in Québec) would be susceptible to legal challenge under section 15 of the *Canadian Charter of Rights and Freedoms* which prohibits discrimination on the basis of age.

Bill 2 also introduces a ban on consumption in public spaces such as parks and on sidewalks. Municipalities however will be allowed to authorize the consumption of cannabis in certain public areas where there are no children present.

## **New classes of cannabis – edibles, topicals and extracts become legal**

As described in more detail in our Osler Update "[Health Canada releases final regulations for new classes of cannabis](#)," on October 17, 2019, the federal *Cannabis Act* and Cannabis Regulations were amended to add three new classes of cannabis: (a) edible cannabis, (b) cannabis extracts and (c) cannabis topicals. However, given that the Cannabis Regulations require federal licence holders to provide 60 days' notice to Health Canada before any new cannabis product can be made available for sale, the earliest legal sales of such products can occur is mid-December 2019.

Each of these new classes of cannabis are subject to limitations on the amount of tetrahydrocannabinol (THC) that may be contained in the product. THC is a phytocannabinoid that produces the "high." In addition, products that mix cannabis with either alcohol or tobacco will not be available for legal sale.

### **(a) Edible cannabis**

Under the Cannabis Regulations, edible cannabis means a substance or mixture of substances containing any part of a cannabis plant, including the phytocannabinoids produced by or found in such plant and any substance identical to any such phytocannabinoid, and that is intended to be consumed in the same manner as food.

There are a number of restrictions on edible cannabis products, including (a) the requirement to meet general food safety standards, and (b) the prohibition on the addition of vitamins, minerals and caffeine (other than at naturally occurring levels).

There is also a restriction that provides that cannabis licence holders must not produce, package, label or store edible cannabis at a site if food that is for retail sale is also manufactured at that site unless the food for retail sale is manufactured in a different building.

### (b) Cannabis extracts

Cannabis extracts are products produced by (a) subjecting cannabis to extraction processing, or (b) synthesizing a substance found in a phytocannabinoid produced by or found in a cannabis plant.

Cannabis extracts cannot contain (a) ingredients that are sugars, sweeteners, sweetening agents, amino acids, caffeine, colouring agents, essential fatty acids, glucuronolactone, probiotics, taurine, vitamins or mineral nutrients, and (b) ingredients that may cause injury to the health of the consumer when the product is used as intended.

### (c) Cannabis topicals

Cannabis topicals are substances that are intended for use, directly or indirectly, exclusively on external bodily surfaces (e.g., lotions or creams). Cannabis topicals are not permitted to contain any ingredients that may cause injury to the health of the consumer when the product is used as intended or in a reasonably foreseeable way.

## Potential litigation

Adverse events, allegedly related to consumers vaping illicit products containing THC, have served as a reminder of the potential product liability litigation risks for the cannabis industry. Indeed, the Nova Scotia Court of Appeal's decision in *Downton v. Organigram* marked the first certification of a cannabis product liability class action in Canada.

As might be anticipated when a public company suffers a decline in its share price over a period of time, several securities class action lawsuits have been filed against some of the larger cannabis companies in the wake of falling share prices.

## Looking forward

Although the legislative landscape has evolved significantly over the past year and growing pains have been felt in several areas, we expect that the cannabis industry will continue to grow and progress. Looking forward to 2020 and beyond, we are monitoring several areas:

- further changes to provincial retail sales, distribution and wholesale models in Canada to expand the role of private participants and potentially permit more vertical integration within the Canadian cannabis industry
- the introduction of new cannabis edible, topical and extract products as additional partnerships are formed in the industry and research continues to advance, both in Canada and internationally

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- potential litigation and its effect on cannabis companies' risk profiles – particularly, potential product liability or securities class action claims
- the continued evolution of the United States market, as discussed in [Cannabis in the United States – The Laws of the Land in 2019](#), and its likely impact on Canadian companies and in particular, Canadian companies' ability to continue to lead the marketplace
- the likely continuing uncertainty and confusion in the marketplace relating to products containing cannabidiol (CBD), as Canada continues to regulate the sale of CBD products the same way as other cannabis products and the United States takes a more lenient approach to CBD products derived from industrial hemp

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