

CANNABIS REBOOT – DEALING WITH SHORTAGES IN ONTARIO

By Don Bourgeois and Rick Moscone

Overview of Phased Approach

The Government of Ontario announced an interim change in direction for the private retail sale of cannabis — including the delay in the application process. The application processes for licensing as an operator of retail stores and for retail store authorizations have been postponed. As a result, the applications will no longer be available as of Monday, December 17, 2018. Additionally, the Government will not initially be taking a market approach but a phased approach to the licensing of operators and the authorization of retail stores. While it is expected that a more market approach will be taken later in 2019, the Government has not provided further details at this time.

On December 13, the Minister of Finance and the Attorney General addressed an issue that has received attention in the cannabis sector — a concern about the sufficiency of supply of lawful cannabis from federally-licensed producers to meet consumer demand. The Government, as a result, made a change in its policy — presumably on an interim basis — in three areas:

- The licensing and authorization of private sector retail stores for cannabis will be phased, with the initial phase being up to 25 licences and retail store authorizations for April 1, 2019. These stores will be distributed throughout Ontario based on Regions;
- The AGCO will implement a lottery system to determine who is eligible for the initial licences to operate a retail store and for the necessary retail store authorizations. Interested parties will be able to submit an expression of interest to the AGCO from January 7 to 9, 2019, which will be put into a lottery pool for a draw. The draw will be conducted on January 11, 2019 and results will be posted on the AGCO website within 24 hours;
- The lottery process will be overseen by a third-party fairness monitor to ensure equality and transparency of the treatment of the expressions of interest and the appropriate distribution of stores in each region of the province. The AGCO, it is understood, is procuring a fairness monitor and will be announcing details of the expression of interest requirements and the lottery process in the near future.

It is not known if the Government's intention is to have further phases using the lottery approach or if Phase Two will be the initially-announced market approach.



[Don Bourgeois](#)

Counsel Gaming & Gambling

t: 519.580.4923

dbourgeois@foglers.com



[Rick Moscone](#)

Partner

t: 416.941.8858

rmoscone@foglers.com

Fogler, Rubinoff LLP
Lawyers
77 King Street West
Suite 3000, PO Box 95
TD Centre North Tower
Toronto, ON M5K 1G8

t: 416.864.9700

f: 416.941.8852

foglers.com

Regulation 497/18

Ontario Regulation 468/18 is the General Regulation under the *Cannabis Licence Act, 2018* and was made less than a month ago. As noted in previous briefing notes, the Regulation provides direction to the AGCO on certain policy matters, most of which remain in place. For example, there is no change to the concept of "affiliates" for purposes of licensed producers or the maximum number of retail stores that a licensed operator may operate once full implementation occurs. Other public policy initiatives that remain in place include the buffer zone from a school, the definition of "public interest" for purposes of objections to a retail store authorization, and the operational requirements.

Ontario Regulation 497/18 amends the General Regulation in several important areas to implement the Government's new phased approach. It is useful to note that it works within the existing regulatory model that is in place which involves both a licence to operators to operate a retail store and the need for a retail authorization for each retail store. Only an operator may apply for and hold a retail store authorization.

The key amendments in Ontario Regulation 497/18 are:

- Section 8.1 — this new section provides for maximums, allocation and application restrictions for store authorizations and, implicitly, for the initial number of operator licences. The Regulation divides Ontario into five (5) regions based on census divisions and allocates a maximum number of retail store authorizations for each Region:
 - Toronto Region — five retail store authorizations
 - GTA Region — six retail store authorizations
 - East Region — five retail store authorizations
 - North Region — two retail store authorizations
 - West Region — seven retail store authorizations

It is important to note that the total number of retail store authorizations that may be issued and in effect at any given time is 25. Subsection 8.1(2), which establishes this limit, does not require that the retail stores be open. Section 7 of the *Cannabis Licence Act* allows the operator a year to open the retail store, which means an operator could "sit-on" a retail store authorization for up to 12 months. This ability to do so re-enforces the potential "value" of one of the 25 retail store authorizations that will be permitted in Phase One. It is expected that the AGCO will include measures in either the lottery process or as conditions to the operator licence or retail store authorization that will mitigate against the lottery winner either sitting-on an authorization or from selling it to the highest bidder. The lottery process itself, though, probably limits the potential for selling of Phase One opportunities.

Subsection 8.1(4) places other limitations on who may receive a retail store authorization. It effectively limits an operator — and its affiliates — to a single retail store authorizations. A licensed producer or an affiliate of a licensed producer may not receive a retail store authorization. A cannabis retail store may not be located in a municipality with a population of less than 50,000. These limitations are in place "until such time as more than 25 retail store

authorizations may be issued" — however, given the Government has not indicated how many phases there will be, it is possible that the Government may put in place multiple phases, amending that subsection to increase that 25 number each time.

- Section 8.2 — This section puts in place the framework for the AGCO's lottery system for the selection of the initial 25 retail store authorizations and the use of the expression of interest process. A person may not apply for a retail store authorization unless that person:
 - has submitted to the Registrar a written expression of interest, in the form and manner specified by the Registrar. The expression of interest must identify the Region in which the person wishes to locate a cannabis retail store, and
 - is notified by the Registrar that the person may apply for a retail operator licence.

This approach will place substantial pressure on both the AGCO and the applicants to ensure that the licensing process moves efficiently and effectively in the second half of January and throughout February and March. It is possible that a person may be successful in being selected through the lottery process to open one of the 25 retail stores but then not be licensed in a timely manner. It is advisable that those who submit an expression of interest be certain on their eligibility for a licence and that any "fish-hooks" with respect to "affiliates" and other factors that may result in ineligibility be addressed very early in the process or avoided altogether.

It is useful to comment on the lottery process itself. Subsection 8.2(2) makes it clear that the Registrar must use a process that does not allow for any discretion — on the part of the Registrar or any other person — as to which expressions of interest are selected. The subsection reads as follows:

...the Registrar shall choose a method for selecting which of the persons who have submitted an expression of interest may make an application that does not rely on the exercise on the part of the Registrar or any other person.

This subsection was probably put in place to provide comfort that the selection cannot be influenced by anyone, including Cabinet or others within or outside of the Government.

A person may submit an expression of interest for more than one Region — but will only be authorized to open one retail store. However, a person may not submit more than one expression of interest per Region; indeed, subsection 8.2(4) provides that a person who submits to the Registrar more than one expression of interest with respect to the same Region may not apply for a retail operator licence. Subsections 8.2(5) and (6) extend this measure to two or more persons who are affiliates. Subsection 8.2(7) makes it clear that each potential applicant for a licence and all of its affiliates will be limited to one retail store in one Region — and any attempts to try to circumvent the limitation may have draconian results.

The Registrar will, as noted above, prescribe the form and manner of the expression of interest. One logical question is whether the expression of interest will be for "a site in a Region" or for "a specific site in a Region". It seems unlikely that the Registrar will require the submitter to identify a specific site, given that municipalities have until January 22, 2019 to opt-out and the

expressions of interest are due prior to that date. Alternatively, the Registrar may allow for some flexibility in the specific site after the lottery process is completed. It is expected that the Registrar will provide the form and manner for the expression of interest in a timely manner so that submitters have a reasonable opportunity to make reasoned decisions.

- Section 8.3 — this section provides that sections 8.1 and 8.2 are revoked on December 13, 2019. This section suggests, therefore, that the Government's intention is that the lottery system be used once and thereafter that it will revert to the market approach. There is no legal prohibition from the Government amending the Regulation again should it determine that there are sufficient grounds, in its view, to do so.
- Section 12 of *Ontario Regulation 468/12* is a technical provision — it revokes the existing limit of 75 retail store authorizations per licensee and its affiliates, which is re-imposed as of December 13, 2019. It appears to be a technical provision and not an articulation of a new policy direction on the overall cap of 75 retail store authorizations for any operator.

Conclusion

It is, of course, a mug's game to debate whether the December 13, 2018 introduction of a phased approach is a good decision or not. Regardless, that is the decision of the Government and, based on its announcement, being done to address supply issues. It is not clear whether the Government will put in place another phase in 2019 if supply issues are lessened but not fully resolved at this time. It appears the public policy is to have two phases towards a market approach — Phase One for April 1, 2019 to December 13, 2019 that limits Ontario to 25 retail stores that are geographically-distributed throughout five Regions. Phase Two, absent any further changes, will be an open market approach.

In the case of some of those Regions, decisions being made by municipalities in those Regions may have significant impact on the overall market development that go beyond 2019. For example, with Mississauga and Markham opting-out, will that increase the perceived value of retail store locations in the City of Toronto but adjacent to those municipalities? Or will it put pressure on retail store locations in Brampton? Milton? Oshawa? The requirement that the municipality have a population of at least 50,000 will have a further practical restriction in the East, West and Northern Regions.

Applicants will also need to review their existing arrangements in light of section 8.2. Applicants will need to be very clear on who is and who is not involved to address any "affiliate" issue. While *Ontario Regulation 497/18* does not, on its face, create any negative implication on an applicant in the longer term (post-Phase One) should a section 8.2 disqualification occur, applicants should be cognizant of the saying "You never get a second chance to make a first impression".

On the other hand, the phased approach does allow potential participants to develop strategic approaches and business plans. The initial timing, which involved up to 1,000 or more retail store authorizations potentially being approved for April 1, 2019, meant that decision-making was very compressed. The phased approach may allow for operators who are successful in the

Phase One lottery process to learn from a pilot retail store, and for those who were not successful to take the time to develop their concepts and relationships.