

TRENDS

CANNABIS

As part of our quarterly series on current trends across different industries, we first take a look at what's on the horizon for cannabis. As the Canadian *Cannabis Act* works its way through Parliament, the Canadian cannabis sector continues to experience an extremely dynamic, fast-changing environment. Here are a few legal trends to watch for as the industry becomes more sophisticated.



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Financing and Capital



Cannabis issuers continue to be extremely active players in the Canadian capital markets. Demand for capital from businesses in the sector continues to be significant, as businesses continue ramping up capacity in hopes of capturing first mover advantage in this nascent industry.

Thus far, cannabis companies looking to raise financing have primarily relied on equity markets. However, with high demand for capital expected to continue throughout 2018, equity markets have become less reliable sources of capital, especially for new sector entrants. Increasingly, some cannabis companies have begun to slowly pivot away from dilutive equity financing in a search for debt financing to fund their growth.

Canada's major banks have largely taken a cautious approach to the industry, with some limited exposure to the sector, but no major Canadian bank lending extensively or routinely in the cannabis space. However, credit unions, debt funds, equipment financiers and private lenders have increasingly been looking at and lending to cannabis companies.

For licensed producers with a U.S. nexus, private debt has taken on increased importance. The recent rescission of the “Cole Memorandum” by the U.S. Attorney General has made traditional banks and investors even more wary than before of companies with cross-border activities. The Canadian Securities Administrators have confirmed that they will continue to permit Canadian reporting issuers with U.S. cannabis-related business activities to obtain financing in the Canadian public markets, with significant disclosure requirements, but these companies have limited access to major stock exchanges. For these producers, private debt may be of particular importance.

As the industry matures, revenues increase (to potentially encourage cash flow-based lending), and stigma diminishes, large financial institutions may revisit their willingness to lend into cannabis markets, although with a close eye on U.S. and international developments. The reduced regulatory and legal risks that legalization will bring, coupled with the revenue opportunities from the expanding recreational market, may make the opportunity a more appealing one for large institutions — with the proviso that the cross-border implications of any bank activity with industry participants with U.S. exposure will likely mean cross-border participants will not have access to Canadian banks until the U.S. federal legal regime is clarified.

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Taxation



Discussions regarding taxation of legalized cannabis will likely intensify as the march toward legalization progresses. On November 10, 2017, the Department of Finance Canada announced a consultation on the proposed excise duty framework for cannabis products. The proposed framework included a requirement that all Health Canada licensed producers of cannabis products also obtain a Canada Revenue Agency (CRA) excise licence, similar to alcohol and tobacco producers, and prohibited the production of cannabis product by non-excise licensed producers once the *Cannabis Act* regime comes into force.

Effectively, this means that all licensed producers must obtain a second licence to carry on business. The licence applications have not yet been published, but if they are similar to the current alcohol and tobacco excise licences, they will require detailed information about the cannabis producers’ facilities and business plans. Therefore, we are expecting cannabis producers to be working with the CRA and advisers to ensure that their excise licences are issued in time for the *Cannabis Act* regime.

Another area to watch relates to exemptions from the excise tax, and possibly even GST/HST (and provincial sales taxes). Particularly for cannabis products sold for medicinal purposes, the industry has argued that exemptions should apply, similar to prescription medication. It remains to be seen to what extent the government will be swayed by these arguments.

The 2018 federal budget referenced new excise tax exemptions in this regard. Namely, the excise duty framework will generally only apply to cannabis products that contain tetrahydrocannabinol (THC), the primary psychoactive compound of cannabis. Packaged products that contain concentrations of no more than 0.3 per cent THC will generally not be subject to the excise duty under the proposed framework. The budget stated that low THC products are used to treat medical conditions (though we note that this change will likely help spur further interest and investment into the segment of the cannabis market focused on

cannabidiol, a nonpsychoactive cannabis compound, a product area that many analysts and observers have already predicted to be an important component of the overall cannabis market going forward).

Pharmaceutical products approved by Health Canada with a drug identification number that are derived from cannabis and that can only be acquired through a prescription will also not be subject to the excise duty. These proposals, which are not yet drafted into law, are an indication that the industry representations have had some effect, and additional exemptions are possible.

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Intellectual Property Rights and Branding

As the cannabis industry in Canada continues to grow, it will become increasingly important for emerging businesses to differentiate themselves. One strategy that should be considered is the development and maintenance of strong intellectual property rights.

At the very least, cannabis companies should be aware of the rights available for different aspects of their business (i.e., plants, products, processes, paraphernalia, etc.). As discussed in a previous [article](#), a cannabis plant may be protected by either plant breeders' rights or one or more trade secrets, and a patent may be sought for other cannabis-related inventions (a cannabis plant is generally not patentable in Canada). However, the most effective way to differentiate one's business is to develop a strong brand through the strategic use of trade-mark rights, a trend we will certainly see as we get closer to legalization.

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For nearly 10 years, the Canadian Intellectual Property Office (CIPO) has accepted applications to register trade-marks for a wide range of goods and services related to cannabis, including word marks, design marks, and packaging shape and design.

Since cannabis cannot yet be sold legally in Canada, and given the requirement that a trade-mark must be used in commerce in association with each good and/or service listed in its application prior to issuance, the number of registered trade-marks in

the cannabis area is expected to rise significantly come legalization. To date, CIPO has only issued approximately 200 cannabis-related trade-mark registrations, despite receiving more than 2,000 applications. The demand is reflected at CIPO, as the terms “dried cannabis” and “dried marijuana” were added to its list of acceptable goods and services for trade-mark applications in early January 2018.

In developing a trade-mark strategy, businesses should be acutely aware of packaging, labelling and marketing legislation that will dictate whether a trade-mark may actually be used in commerce (and therefore registrable), even though it may meet other specific trade-mark requirements. The coming legislation will directly impact when, how and to whom cannabis goods and services may be advertised and sold.

Generally, Health Canada's proposed regulations are stricter than what is imposed on the alcohol industry, but not quite as strict as tobacco. Such a balance is aimed at engaging consumers enough to diminish the illicit market without impacting youth. The proposed laws specifically restrict the sale of

cannabis and its accessories that may reasonably be construed as appealing to young people or include elements that encourage consumption. Cannabis brands depicting a person, character or animal are also restricted, and those that contain false, misleading or deceptive information about characteristics such as potency, health effects, composition, etc., are prohibited. Health Canada's consultation document on the regulatory framework was open for public comment until January 20, 2018; therefore, we expect further guidance on what the cannabis branding landscape will look like in the coming months.

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