Briefing Note on Federal Regulation of Cannabis

Kootenay Cannabis Development Council

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BACKGROUND

The Kootenay Cannabis Economic Development Council was formed in 2020 and represents diverse actors in the Kootenay region who have a role in the cannabis sector. Monthly meetings of the Council fosters a deeper understanding of the needs and opportunities for the sector. From this foundation, we formulate and advance policy and program proposals that will enable the region's mature cannabis sector to transition to and thrive in the legal recreational market.

The purpose of this paper is to highlight the key challenges that the craft cannabis sector faces due to federal policy.

INTRODUCTION

The three year review of the Cannabis Act is required by law to take place in the 18 months following the three year anniversary of legalization, October 17, 2021. The scope of the review described in the Act is very narrow. It if it is not broadened, it will limit the options for a more robust review and, ultimately, revisions to how the cannabis sector is regulated.

It is noteworthy that this is not a new sector. Cannabis production and its integration into the culture, economies, labour options, and agricultural sector in our region goes back decades. It would be useful to understand if the Regulatory Impact Assessment undertaken in advance of the creation of the Cannabis Act adequately addressed the impact on the existing sector. While it would, admittedly, have been a challenge accessing primary data on a previously illegal sector, proxy data could have, at the very least, given an indication of the scope and significance of the sector. For example, the average household income in the Central Kootenay Regional District is rated amongst the lowest in British Columbia. Yet the number of restaurants, ski hills, expensive homes and vehicles throughout the region bely this official statistic. Three years after legalization, it may be that a more fulsome impact assessment would be warranted, one that seeks to understand the impact on the legacy sector and its contributions to our region and more broadly across Canada.

In the following sections, we elaborate on the issues that face cannabis producers and, where relevant, we propose a path forward.

CRIMINAL FRAMEWORK

The Cannabis Act and its regulations exist under the Canadian criminal law system. Many of the issues discussed in this document stem from this reality.

We regret that the Cannabis Act and its implementation is characterized by what McGill University Associate Law Professor Alana Klein has labeled a “heavy reliance on punitive and authoritarian approaches”. She elaborates that while the “Act lifts many current criminal restrictions and abolishes mandatory minimum sentences for cannabis offences...it continues to rely heavily on criminal sanction, and actually raised maximum penalties in some circumstances.”[1]

Criminalization elements have been strengthened and are out of proportion relative to other controlled substances. The Cannabis Act “abolishes mandatory minimum sentences for cannabis offences, but it continues to rely heavily on criminal sanction, and actually raises maximum penalties in some circumstances. For example, an individual distributing over 30 grams or providing marijuana to a minor now faces imprisonment for up to fourteen years, the same maximum penalty for producing child pornography or aggravated assault of a police officer. Trafficking in amphetamines, LSD, mescaline, or psilocybin (mushrooms), or possession for the purpose of trafficking those substances carries a maximum of only ten years. Even if the longest sentences will be reserved for the most extreme breaches, raising maximum penalties to fourteen years elevates marijuana offences to the level of the most serious crimes, and creates serious consequences for anyone convicted.”[2]

As a result, “some of Canada’s most vulnerable populations have had their ability to participate fully in Canadian society eroded by criminal records received as a result of the war on drugs. Indeed, people with a criminal record have a harder time securing employment, which restricts their ability to make a living salary and the financial contributions they can make to their families and communities.”[3]

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[1] Alana Klein, *What Jurisdiction for Harm Reduction: Cannabis Policy Reform under Canadian Federalism*, page 135.

[2] ibid.

[3] Akwasi Owusu-Bempah et al, *Unequal Justice: Race and Cannabis Arrests in the Post-Legal Landscape,* page 125.

INCONGRUENT AGENCY

Our Council believes that oversight of the production of cannabis, particularly for craft cultivators, needs to be situated in an agency that is actually mandated to support the industry to flourish. The pre-existing regulated medical cannabis regime perhaps unduly focused the scope of oversight to health only, ignoring the fact that the recreational cannabis sector draws on pre-existing farms and businesses. These very businesses that were to be the target of the transition to the legal recreational realm cannot be fully understood or well regulated with only a health and enforcement lens.

Importantly, Health Canada has no mandate to support cannabis businesses. This has resulted in regulations that do not consider what is realistic for businesses to operate and places an unnecessary burden on operations. Likewise, Health Canada has no agricultural expertise, and they treat the production and packaging of cannabis flower intended for the recreational market in a manner comparable to how they treat the production and packaging of pharmaceutical drugs.

Other jurisdictions, including the state of California[4], have delegated oversight of cannabis production, particularly at the cultivation stages (seeds, nursery and growing) to agencies that include a mandate to assist the sector to transition and to thrive. Small and medium-scale cannabis licensing managed by such an agency would enable the sector to benefit from programs that target and seek to increase the likelihood of success for commercial enterprises. These include a host of measures that promote the safe and successful operation of farms, including appropriate chemical use, employee safety and training, financial support, and technical advice.

We propose that Health Canada restrict its oversight to medical and pharmaceutical cannabis products. Narrowing Health Canada's oversight to the strictly health-related aspects of regulation may result in a more successful transition for legacy producers, while not compromising on the health oversight where it is warranted. Such a change would allow them to focus on achieving a safe supply in competitive markets, focusing on quality rather than rejigging market forces with regulations. Regulations should ensure a fair playing field for a healthy, competitive market.

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[4] The Department of Cannabis Control licenses and regulates commercial cannabis activity within California. DCC was formed in late 2021 by merging three state cannabis programs, including the CalCannabis Cultivation Licensing, formerly under the Department of Food and Agriculture. https://cannabis.ca.gov/

HEALTH CANADA POLICIES AND PROCEDURES

It is our understanding that Health Canada received a larger than expected volume of licence applications following legalization, out of proportion to the staff resources available. No increase of resources occurred to address the staffing shortage. On the contrary, in an attempt to cull out less serious applicants, they changed their internal policies to require that all applicants complete the construction of their facility **prior** to licensing. This results in an unfair level of risk for the proponent, particularly given that no indication is given over the course of the licensing process as to the viability of their application. It also likely results in higher than necessary costs for construction, since many proponents will "hedge their bets" and seek to meet every possible contingency.

In contrast, when British Columbia changed their meat inspection regulations and required a costly facility construction or renovation, the agency tasked with overseeing the licensing process, the BC Centre for Disease Control (BC CDC), provided facilities guides to proponents[5]. Prior to any construction was undertaken, proponents submitted a licensing package that included the proposed facility specifications and process descriptions. If approved by the BC CDC and adhered to by the proponent, then the proponent could be assured of a license.

Cannabis licence applicants have consistently reported lengthy delays in processing any paperwork submitted both before and after licensing, including in response to a Health Canada request for information. Throughout these lengthy delays, proponents do not hear from Health Canada on the success of or need for amendments for their submissions. One of our Council members with a Cultivation License waited 11 months before they learned that they had succeeded in their Sales Amendment, losing $50,000 each month that passed.

LICENCE MODEL

Currently a cannabis cultivator can obtain either a micro and standard licence. There is a significant scale gap between micros and standard licences. A micro cultivation licence holder is restricted to a plant canopy that is less than 200 meters squared while there are no size constraints on a standard licence holder.

While the initial costs for a micro license may be more modest, the canopy size constraints of micro class licences puts them at an economic disadvantage because

[5] These included the "Abattoirs code of good practice: Critical Design, Operational, and Equipment Guidelines for Licensed Abattoirs", "Plant Construction, Equipment and Operations Guidelines to Qualify for Licensing" and a related and detailed Checklist for proponents.

they cannot realize economies of scale nor produce amounts that would enable them to maintain a retail presence for more than short periods of time.

We propose annual limits for outdoor micro licences that are based on the volume harvested, not on space parameters. An annual volume of production (determined in consultation with craft producers) would allow producers to meet that limit as they see fit and that best aligns with their business and sustainability goals. Another option would be to follow the licence model used by California which enables a licence holder to produce on the corresponding acreage (ie. licence to produce on 1, 2, or 4 acre plots). The canopy size restriction on micro cultivators makes it challenging to meet minimum product batch size requirements from both processors and retailers.

There needs to be a licence and appropriately scaled requirements for production larger than micro but much smaller than most large standard licence holders.The licences should be graduated[6] so that they can be upgraded as consumers and business success demand. Health Canada would do well to consider adding one or two more levels of license classification. A 'small' license could be structured to have lower costs than the standard operator running a larger footprint. This would open up the industry to those who operate on the lower side of standard production, but without the large jump in costs incurred by a standard operator. A 'large' license could apply to those in the highest range of square footage. This would help level the field in terms of operators incurring expenses that are more appropriate to their income potential, and would encourage more innovation and diversity in the cultivation industry overall. It would also likely bring more legacy businesses into the regulated system as it makes more financial and competitive sense.

EXCISE DUTIES

One of the biggest issues hampering producers of all sizes (but especially craft cannabis producers) is the excise duty regime. It is currently set at $1/g or 10%, ***whichever is higher***. There has been a significant price compression since the outset of legalization. Since the licence holder is obligated to pay the higher amount, at $1 per gram, the excise duty is more often than not 30-130%. This elevated excise duty regime has no parallel in any other regulated industry in Canada.

[6] An existing and well-established model is the internationally-lauded graduated licensing scheme that British Columbia applies to the meat processing sector in the province that supports a range of scales with commensurate facility, oversight, and production requirements and costs.

Some companies pay 3 times as much in excise duty every month as they do in payroll. The current excise regime makes it so that companies cannot be profitable. The profit that they would have made (due to sound business decisions) all goes to the government. This is unsustainable, and will result in a market where solely the largest public companies remain, due to their ability to absorb these costs with the millions of dollars they received for their shares.

Additionally, this excise duty regime does not differentiate between medical and recreational cannabis. Charging this much duty on medicine is completely unacceptable. Most prescription medicines are exempt from excise duty to keep the costs of medicine as accessible as possible; the few prescription medicines that are not exempt pay a modest excise duty. Medical cannabis is the only prescription medicine that has an excise duty regime anywhere near this high.

TESTING

Cannabis producers and processors, like the producers of any consumable product, must have the ability to undertake product and market research. As with any sector, this is vital for developing products, expanding business opportunities and staying relevant to changes in the market, consumer trends and needs.

For cannabis producers, as with any sector, the ability to conduct cost effective product research is critical. Such product and market research should be allowed without the requirement for an additional Research & Development Licence. Product testing should be an option for personnel within the company and with a designated group of consumers who can help to identify characteristics of the product and help to refine it, including but not limited to flavour, aroma, effect of growing and curing methods, and palatability of consumables.

MICROBIALS LIMITS

A properly cured product – meat, cheese or cannabis – will include beneficial microorganisms. To meet the product quality and characteristic goals of many of the legacy growers, particularly those growing in living soil and following organic practices, beneficial microbials must be present. The current testing regime with a zero tolerance for microbials is a significant barrier for small scale producers.

One result of this is that cultivators are discouraged from growing small batches of specialized cultivars due to the testing costs per batch and processor batch minimums. This is having a negative impact on cannabis genetic diversity.

Small scale producers put a lot of time and care into growing the highest quality cannabis that they can. Many craft growers use permaculture practices, growing organically and using living soil. This inevitably leads to a higher level of microbial life, but it is beneficial microbial life. The current limits defined in the regulations require these growers to irradiate their flower in order to legally sell their product. Since they are growing high quality craft cannabis, this irradiation greatly reduces the quality of their final product and diminishes one of their primary differentiators from large scale enterprises. It adds a significant cost to their process (irradiation is expensive) while simultaneously reducing the value of their crop.

We recommend that the regulator adopt a science-based approach to microbials. Rather than a zero tolerance, enforce limits for pathogenic microbials rather than a blanket prohibition that enforces the destruction of beneficial microbials. Existing models can be found in Washington and California. These jurisdictions do not have a generic aerobic bacteria test, but rather focus on pathogenic testing.

LABELS & MARKETING

Sections 26 and 27 in Subdivision B of the Cannabis Act restrict what can be on a label or package. The current packaging restrictions put micro-cultivation and micro-processing facilities at an extreme disadvantage compared to larger companies. Specifically, it is smaller scale companies that have a story that is of interest to consumers. It is smaller scale companies that grow organically, grow in small batches, grow using aquaponics, aeroponics, or living soil, hang dry, hand trim, cure slowly, and work tirelessly on developing new genetics.

In every consumer industry, craft producers first connect with many of their customers through their labeling. They share their story, brand, and differentiators on their packaging, and consumers that care about quality take the time to find something that matches their values. With the current Composition Requirements framework[7] small producers are unable to connect with a substantial portion of their market niche due to their inability to share these critical pieces of information.

The Sections 26 and 27 of the Act have been interpreted to preclude the option for cannabis to be labeled as certified organic. Organic certification is a process-based

[7] See this HC guide: https://www.canada.ca/en/services/health/publications/drugs-health-products/composition-requirements-cannabis-products/guide.html

standard, NOT a product standard[8] and provides information to the consumer about how the plant was grown or processed under the Canadian Organic Regime. Despite this, certification labels are not allowed on the packaging. This discourages practices that are healthier for the environment and the consumer, and precludes those that adhere to organic standards from being able to communicate their production practices in the marketplace.

SECURITY CLEARANCE

Currently, security clearance is the penultimate step in the licensing process. Obtaining a licence requires significant investment of time, effort, and money by licence proponents and carries a high level of risk. Particularly in the rural and craft cannabis realm, many of the participants have a history in the sector, which helps to ensure knowledgeable proponents and staff. Ostensibly, historical cannabis simple possession records should not preclude a successful security clearance application. Unfortunately, the justification for rejecting a security clearance application is often opaque and can result in obligations to change key personnel late in the licensing process. This approach to security requirements impacts the participation of those who have been part of the legacy market, severely restricts who may enter the legal industry and continues cultural stigmas against cannabis.

Security clearance must be shifted to the beginning of the licensing process and PRIOR to any significant investment by the proponent. The current sequence of approval by Health Canada requires that the licence proponent build costly, purpose-built facilities with no confirmed security clearance from Health Canada.

The security clearance process can result in denials based purely on conjecture. If an applicant was ever documented as going on a walk or having a conversation with a known criminal, they can be denied a security clearance with the current framework, even if the applicant had no idea whatsoever that this person had a criminal connection.

It will be important to ensure that non-violent records do not preclude successful security clearance, given the long history of prohibition, stigma, and racialized policing of cannabis possession.

Criminal record checks are standard for many activities in Canada, such as volunteer sports coaching. We recommend following this model and delegating security clearance

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[8] See here for information on the distinction: https://asq.org/quality-resources/learn-about-standards

to authorities outside Health Canada with the relevant expertise and ability to provide a faster turn-around for licence proponents.

INSPECTION & AUDIT

All license holders are subject to inspections and audits. Larger standard license holders may have the in-house capacity to optimally prepare for these processes but for smaller enterprises they can be unduly challenging. In order to foster the success of our existing license holders, clearly communicated inspection and audit expectations, in advance, will enable licensees to best prepare for and meet the requirements.

Currently, there is no public standard on what constitutes an infraction, and many infractions handed out seem to be quite subjective, and more often than not are due to the lack of expertise amongst Health Canada staff. Many infractions today are overturned when licensed producers challenge them. Establishing a public standard (normal practice for other regulated industries in Canada) would solve this issue.

As a regular part of doing business, inspection and audit documentation provided by Health Canada needs to include clear definitions of what constitutes a minor, major or critical infraction, combined with options for a pathway to resolution.

LICENSING AND OPERATIONAL COSTS

The current regulatory regime requires dual compliance with both the Cannabis Act and the clinical trial requirements under Division 5 of Part C of the Food and Drug Regulations. This does little to enhance public awareness of the health risks associated with cannabis use, nor does it improve access to a quality-controlled supply. Instead, it imposes unnecessary regulatory barriers and costs that discourage the very research that would help realize these objectives.

The financial requirements to enter the market are far too high and drive the sector towards a high volume, undifferentiated product model. The cannabis industry is denied or restricted access to many banking and other professional services[9]. With limited ability to secure robust financial backing and the high costs incurred in both securing and maintaining a license, micro license holders in particular face a higher risk of failure, due to the cost of entry, lengthy licence turnaround times, and limited ability to market.

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[9] This is often due to the fact that many of the banking and other service providers operate in the USA as well as Canada. Given the current federal prohibition of recreational cannabis that exists in the USA, many cross-border service agencies refuse to engage with the legal recreational cannabis sector in Canada.

In order to overcome these barriers, we recommend the creation of cannabis-specific programs through agencies such as Pacific Economic Development Canada and Farm Credit Canada, in order to enable access to financing for start-ups and those wishing to expand who are unable to access the services of conventional financing institutions[10].

FINAL THOUGHTS

The public health goals of the Cannabis Act have failed the sector it seeks to regulate with the numerous negative repercussions. The inability for many of the established enterprises to transition to the legal market has:

- ➡ Perpetuated the black market for cannabis
- ➡ Relegated the close to 20 percent of adolescents aged 15 to 18 who regularly use cannabis[11] to procure cannabis from adults or, more likely, through historical (and still illegal) market channels
- ➡ Driven many experienced producers out of business with the resulting loss of expertise, investment, genetic material
- ➡ Undermined a key economic driver in our region
- ➡ Reduced employment options for women, who are overrepresented amongst cannabis workers
- ➡ Allowed the legacy sector to continue without oversight and the protections afforded to employees, environment, and quality of product that comes from being part of a regulated sector

As with any sector, oversupply will resolve itself through the mechanics of the marketplace. The imposition of unnecessarily high compliance costs by Health Canada is not an appropriate means to limit product supply and it unduly harms legacy and smaller scale producers.

We endorse Health Canada's role in ensuring a safe medical and pharmaceutical supply of cannabis. But our experience is that they are unable to effectively serve a sector that has a long history in British Columbia and that is a vital part of our rural economies and landscape.

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[10] Community Futures Central Kootenay developed and delivers a small but vital loan program for our region's craft cannabis sector.

[11] Daniel Weinstock, *Will Legalization Protect our Kids?* page 72.

Our goal is to see licensing of the cultivation and processing of recreational cannabis reside with an agency that is able to provide the necessary internal expertise and has a clear mandate to support the sector to transition and thrive under legalization.

We hope to see a parliamentary committee that will allow for a more robust review of the intent and impact of the Cannabis Act and associated regulations. Ideally the outcome of such a review will be the creation of a more enabling environment for the successful transition of the legacy cannabis sector. This will improve the options for meeting the original goals of the Act for a safe and healthy recreational cannabis sector, and for enabling thriving businesses that are embedded in and contribute to the wellbeing of our communities.