

# Marijuana: Allard has no Appeal



Last Thursday the federal government made official what most of us expected: there will be no appeal of the medical marijuana *Allard* decision from the Federal Court. Quoting Health Minister Jane Philpott, “We will respect the decision of the Federal Court.”

Justice Phelan’s February, 2016 reasons in *Allard* were well-written, well thought out and from a reasonable legal standpoint almost unappealable. The government’s decision is not a surprise. Now it’s time to look at the implications for the medical and recreational marijuana industries.

A quick refresher can be found here. In short, the Federal Court looked at the regulations governing the production and sale of medical marijuana, and found they were unconstitutional because they contravened the *Charter of Rights and Freedoms*. The Court struck down those regulations, but as is common in this kind of ruling (see *Bedford*, the prostitution decision) gave the federal government some period of time in which to address the problem. Here, the Liberals have six months in which to draft replacement regulations. The MMPR law remains in effect until then.

Notably, the old group of growers (MMAR’s) were allowed to continue under the *Allard* decision. Since it’s been a month since the decision was handed down, from today the new MMPR’s have a 5 month window on their shelf life.

The most important thing to take from this is that if there are no new regulations within that sharply-defined time, there will be no law governing medical marijuana apart from MMAR. That would mean that the MMPR licences already granted (a list

of those for-now licenced producers is here) would disappear without compensation to the licence holders. Almost all of the equity value would be wiped out. All capital sunk into the growing operations could be salvaged by converting the facilities to another kind of production (tomatoes, cucumbers, oranges ... ) where the margins are thinner and the competition is much greater. It's not a pretty possibility.

The current MMPR holders (and their shareholders!) absolutely need the Trudeau government to introduce the new regulations by the middle of August, 2016. The alternative is financial destruction.

That alternative, while theoretically possible, almost certainly will not play out. Politically, I can't think of any realistic scenario in which the Liberals would deliberately choose not to introduce replacement regulations. Logistically, the Health Minister has said that work on new regulations is already underway. Now it's a race to the 6 month finish line.

Which takes us to the first part of our analysis, which is to recognize that the medical marijuana market and the recreational / decriminalized market are two very distinct markets. Whatever the Liberals do over the next five months will affect only the medical market, which is a relatively small marketplace. The decriminalization of marijuana is still years away. The takeaway here: don't invest now if you're counting on decriminalization to drive near-term value.

For the MMPRs then, the greatest uncertainty is what those replacement regulations will look like. Within the medical market, here are some of the major questions the Liberals need to address:

- who can authorize marijuana for medical purposes? For now it's only medical doctors. Will the regulations extend to dentists, nurse practitioners, chiropractors, naturopaths, midwives, pharmacists? Expanding that group

will likely expand the market

- What is the distribution model? Under the current system the patient has to research which of the licenced producers to use, get qualified to place an order with that producer, order the product, and have the product securely mailed from the MMPR to the end user. It's not a clean simple process. Can it be streamlined? Any changes will have some impact on the costs to the producers
- The current system is complicated enough that middlemen have popped up. They intermediate themselves between the end user and the producers, and trap a referral fee for making a recommendation. It's a grey part of the market that isn't much discussed in polite company. Will that practice be confirmed under the new regulations? Will it be outlawed? If it is outlawed, who will then help the end users find the product they need?
- what is the tax rate on the producers? On the distributors? On the end user? Does the GST apply? Will the tax burden be passed through to the patient?
- Governments use the *Income Tax Act* as a tool of social manipulation. (See here for one analysis of this). The entire system of tax credits, deductions, pensions and payments is a Rube Goldberg mechanism designed to incent and discourage behaviours on the individual, corporate and provincial levels, in accordance with the latest values of our elected officials and popular appeal. It's open to the Liberals to lever behaviour in the medical marijuana market with this same tool. For example, the new regulations could create the opportunity that a treasury investment into a licenced grower could be a "flow through investment", just as in the junior mining and oil & gas markets. This would mitigate the investor's capital risk and hopefully stimulate investment
- Depending on who you ask, the number of patients depending upon the MMAR growers is between 25,000 and

45,000. The CBC reports it as 28,000. That's a large part of the market. How will that court-validated system of MMAR co-exist with the Liberals' new regulations? Which grower gets those patients?

- The MMPR process created under the Conservatives reflected that party's view of medicinal marijuana. The process was long, complex and uncertain, resulting in many would-be applicants becoming discouraged and dropping out. That reduced the market, much to the Conservatives' satisfaction. Will the Liberals make it easier to become a licence holder? That would be appealing to new applicants, but would be a severe blow to the costs already sunk by the MMPR holders, eating into their early-mover competitive advantage.

All of this creates a fair amount of uncertainty in the market. Increased uncertainty leads to increased risk, and increased risk means less equity value. Look at the chart for Canopy Growth, the proxy for the larger public medical marijuana market, since the *Allard* decision was released – the 10% decline in the stock price is partially driven by investors recognizing this risk.

Over the next few months, and assuming the Liberals introduce the new regulations, investors will have to balance the uncertainty risk against what each investor thinks those new regulations might contain, and then make this call: is the marijuana market overvalued, undervalued, or fairly valued? Fortunes will be made and lost on this decision.