

# Cannabis Will Not Decriminalize in 2018

Cannabis will not be decriminalized in calendar 2018. No amount of wishing is going to make it happen.

The timing of decrim is extremely important for the impact on valuations, reputations, cash burn, equity raises, staffing decisions, compensation schemes and M&A activity. The longer it takes for decrim to actually take place, the more risk exists for investors, including new risks brought by the pending federal election.

“Decrim” means the first day a retail consumer can walk into a retail store and legally purchase a cannabis product. That means none of the following qualify as decrim:

- when the Senate sends Bill C-45 (the *Cannabis Act*) back to the House of Commons for Third Reading (expected to be on or about June 7/18)
- when the Liberal-majority House of Commons gives Bill C-45 that Third Reading and quickly sends it back to the Senate for its own Third Reading;
- when Royal Assent is given by the Governor-General to Bill C-45; or
- if Canada deals with the international treaties it signed policing the sale of narcotics, which by definition includes cannabis.

Those events will take time to play out, but are mere milestones on the path to decrim. There are other major impediments that will push the first retail date into 2019, and possibly into 2020.

On that list of impediments is that Parliament must deal with Bill C-46 (the *Drugged Driving Act*). Our prior analysis of that problem is here. That problem alone pushed back the

effective date of decrim to at least December of 2018.

Law enforcement agencies across Canada are calling for further delays in decrim so they can obtain the necessary equipment and training to deal with drivers impaired by cannabis. It's not as simple as dealing with a driver impaired by alcohol. Habitual users or persons who've inhaled second-hand smoke can have THC in their systems for weeks, and there is as yet no science or consensus behind how much THC is too much for a driver.

If there are no reliable roadside devices that don't report false negatives or positives, then the *Drugged Driving Act* if passed risks being found unconstitutional as constituting an unreasonable search under the *Charter of Rights and Freedoms*. It is vital that Parliament get this right to avoid having the law struck down.

This isn't new news. Back in 2017, the Canadian Press reported on this issue and said, "Canada's police services say there is zero chance they will be ready to enforce new laws for legalized pot by [summer, 2018]."

The situation hasn't gotten better. As the National Post reported two weeks ago, "...officials with the justice and public safety departments say it's still unknown when roadside screening devices to test for drug impairment will be approved for use."

The *Post* article reports on other infrastructure delays related to roadside testing and police training. Police forces must wait for the Attorney General to sign an order before they can order roadside testing units, assuming any exist which are reliable. For the Attorney General to sign that order, Bills C-45 and 46 must be passed by the House and the Senate, and then a 30-day public consultation period must run. Public Safety then would require time to prepare training and certification for officers on approved devices, and then those

officers must be trained.

None of that can start until Bill C-45 and its associated regulations are brought into legal status. Those two processes cannot run in parallel.

Another major delay involves Canada's First Nations. Section 35(1) of Canada's *Constitution Act, 1982* states, "The existing aboriginal and treaty rights of the aboriginal peoples of Canada are hereby recognized and affirmed." That has been interpreted by the courts to impose an obligation on the Crown to meaningfully consult with First Nations when such aboriginal and treaty rights could be impacted by legislation.

On May 1 of this year, the Senate Committee on Aboriginal Peoples recommended in writing the Liberals delay legalizing cannabis for up to a year to address the legislation's potential for harmful effects in Indigenous communities. The committee said in its report on Bill C-45 that the government did not adequately consult with First Nations, Inuit and Métis communities before pushing ahead with its plan to legalize the drug. If the Liberals don't heed the Senate's report, this failure to consult could ultimately render the *Cannabis Act* invalid as a constitutional breach.

Imagine Bay Street's reaction if that were to happen. Billions of dollars of shareholder value would be erased seconds after the court decision were rendered.

Odds are that won't happen, but the Crown's obligation to consult with First Nations on decrim will bring a delay.

Then comes The Big Risk. The next federal election in Canada is set for October, 2019. Parliament will be dissolved sometime during the summer of 2019 to allow for the election campaign. If decriminalization is delayed a year, as requested by law enforcement and recommended by the Senate Committee, Bill C-45 and Bill C-46 may not make it into law before

Parliament is dissolved. They would then die on the House floor.

Then there would be a delay for the election itself, and then there would be a further delay as the new government takes power, and then further delays as new legislation and regulations would have to be written. Then there would be the same delays as laid out above related to First Nations and general public consultation. That would push the effective date of decriminalization to at least the summer of 2020.

Those delays bring the risk the federal Conservatives would win the 2019 election. That party has a much stronger anti-cannabis stance than does the Liberal Party. If Trudeau Mania 3.0 doesn't play out and the Liberals don't win a majority, expect the next version of decriminalization to be more severe, creating a smaller recreational market. That would negatively impact the cannabis companies.

Counter-balancing that federal election grief is provincial election hope in Ontario, Canada's most populous province. Roughly 36% of Canadians live there. Under the current provincial plan, assuming decrim happens, the current ruling party advocates for a single-source model, where the only source for recreational cannabis would be from government-operated stores. Basic supply chain issues would limit the size of the market, and therefore negatively impact valuations of the cannabis producers. But there is a provincial election underway, and it doesn't look good for the incumbent. The provincial Conservatives, currently polling in first place, have said they would implement a hybrid distribution model with both government and private stores. This would have the effect of eliminating some supply chain bottlenecks and increasing revenue for the cannabis companies.

Decrim will happen. When is an open question. Make your own decision and vote with your investment dollars.

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# A Timeline for Decriminalization of Marijuana

Even though KellyAnne Conway claims otherwise, a fact is a fact, and there can be no 'alternative facts'. And it is a fact that unless you have a medical exemption, your use of marijuana in Canada is illegal. The loosening of social mores does not change the fact of illegality.

The price of the shares of public marijuana companies have risen and fallen in tandem with Supreme Court decisions, the *Allard* decision out of the Federal Court, and policy announcements from Health Canada. The companies' only real value is in the licence – the real estate and cash exist only because of the licence. In such a highly regulated space, being an intelligent investor demands a knowledge of the legal arena.

One need look only at Canopy Growth, the largest such company in Canada. Its shares took an insane streak up to almost \$18 in November, creating a market cap of roughly \$1.6B. The unaudited six month revenue number ending Sept 30/16 was \$15M, implying a full year run-rate of \$30M, or a bit under 2% of that market cap. That was a valuation equal to 50 times go-forward revenue, reminding us of the ludicrous and eventually unsupportable valuations of the dotcom era.

Canopy Growth's share increase was directly attributable to market expectations that the federal government would loosen restrictions for medical purposes, and would soon introduce legislation to decriminalize marijuana in Canada. That would

increase the size of CGC's market and cash flow. Shareholders were giddy. Then reality intruded. Health Canada actually announced certain restrictions on how much marijuana would be funded for veterans, the reality of which brought the stock back to a more defensible value. Over the course of a month, roughly \$800,000,000 was ground off CGC's market cap.

This isn't to pick on CGC. It's the largest and likely best known Licenced Producer, so it stands as a good proxy for the industry as a whole. The shares of other LP's and applicants endured similar roller-coaster rides in their respective share prices, for similar reasons.

So what's next on the legal front? With each of *Smith* and *Allard* affirming patient rights, and the new ACMPR regulations reflecting those expanded rights despite international treaties governing the sale of marijuana, investors' sights should be set on the timing of decriminalization.

Note there is a massive difference between the introduction of legislation to decriminalize, and the actual final act of decriminalizing. Decrim will be a slow political process, not an event. There likely will be an uncertain number of years between the introduction of proposed legislation and the final date of enacting the statute.

Even the federal Health Minister, Dr. Jane Philpott, doesn't know. Earlier this month she was specifically asked if marijuana would be fully legal and available in Canada before the next federal election in 2019. She answered, "At this point, I can't give you a specific timeline."

She added, "We need to make sure that there is a strict regulatory process in place and that there are restrictions in terms of access. We also have work to do on the public education front."

It's clear from the rest of her interview the feds aren't in a rush to push the legislation through the system.

In Canada at the federal level, here is how a new statute is created under that system. The process involves many stages and many different forms of review.

A new bill is first proposed in the House of Commons, usually but not always by the party then in power. That bill is introduced to the House and is deemed to have been given a 'First Reading', almost always without debate. The Second Reading involves a more detailed look at the proposed statute by the House, including a review of the philosophy behind the bill and an overall review of the actual wording used in the bill to express that philosophy. There is public debate at this stage among the members of the House.

After edits, the bill is sent to a Committee of the House for a much more granular examination of the bill, its intents, the precise wording, and the impact it may have on other existing statutes. The Committee can seek the advice of the public and of outside experts, and can make proposed amendments to the bill. This can be a lengthy process.

After the Committee stage, the bill goes back to the House for Third Reading, debate and amendments before a final vote is called on the final wording.

That's halfway through the process. The bill then has to follow the same byzantine routine through three readings and a committee in the Senate. The Senate as a house of sober second thought is supposed to look at the proposed legislation from a less partisan viewpoint.

Assuming the bill makes it all the way through that, it is then submitted to the Governor-General for royal assent and to convert that bill into a law. It is a lengthy process, and will be especially complicated for as sensitive an issue as marijuana.

This timeline has an additional complication, which is the the thorny issue of the Single Convention, a treaty signed by

Canada and 180-some other countries governing international marijuana laws. The government has not given any indication how it intends to escape that treaty.

There will likely be a small market bump in the share prices when the legislation is announced. Some insiders are expecting that announcement to come on April 20, the annual "4-20 day" which is a key part of marijuana culture. That announcement, whenever it is made, has already largely been priced into the market so don't expect a large bump. From then on, expect a multi-year experience as the bill winds its way through readings, committees, and the Senate, and as the share prices bump up and down in response.

Don't overlook the real risk that decrim may take place many years in the future. To protect your investment dollars, find public companies that can survive purely on their respective medical marijuana sales. Their survival should not depend upon near-term legalization of marijuana. If their predicted success is predicated upon an assumption of imminent decriminalization, that is a clear indicator of a weak business plan, a short-term thinking management team, and a flawed risk assessment process. Find the companies that can survive for the next several years purely on medical, and for whom decrim would be a bonus.

If pushed for a favourite, we'd point to CGC, the first and largest of the LP's, and to Aurora Cannabis.