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Bankruptcy for Cannabis Companies: Canada’s Newest Export?

Stephanie Ben-Ishai*

I. INTRODUCTION

Recreational cannabis was legalized in Canada over a year ago. Canada became only the second country, after Uruguay, and eleven

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American states, to legalize recreational cannabis.\(^1\) However, the black market continues to supply 83.9–88% of the market since it is significantly cheaper than legal cannabis.\(^2\) Marijuana represents nearly half of the $300 billion dollar global illegal narcotics market and is the drug of choice for most of the world’s 250 million illicit drug–users.\(^3\) Much has been written on the role that justice debt plays in the cycle of poverty.\(^4\) To that end, legalizing cannabis not only deprives organized crime of its single biggest source of income but also protects consumers from the debts associated with its criminalization. Canadian policymakers also had to consider other aspects of legalization, including how it fits into existing commercial law, the appropriate level of tax, and restrictions on its sale.

However, it remains unclear how the new industry will fare with the inevitable commercial bankruptcies. As with all other sectors in the economy, the cannabis industry relies on certainty to deal with financial failure. Getting this policy wrong can discourage entrepreneurial activity and new business growth. Thus, the improvement of a country’s bankruptcy system is crucial to realize the benefits of legal recreational cannabis. This article asks a question that has received less consideration—how should countries’ legal systems deal with inevitable financial failure in this newly legal industry? With legalization comes new opportunities for investment and innovation, from growers, to brick and mortar stores, to “weed tech” and breakthrough science. A well-developed method for dealing with financial failure in this industry is crucial to avoid the fear of the unknown, which is holding the industry and its many beneficiaries back.

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This article offers an evaluation of Canada’s approach to addressing financial failure in this industry. It also seeks to provide insights for Canada’s law reform process, as well as for countries including Mexico, South Africa, and New Zealand as they continue to evaluate reforms to the treatment of cannabis. Part I reviews the businesses risks involved in entering the legal cannabis market. Part II considers the acceptance of the cannabis industry by capital markets. Part III reviews the insolvency processes and challenges that exist for cannabis companies, including in the United States for comparison. Part IV provides a narrative on the best practices for cannabis legalization and areas for reform. Part V suggests that while Canada’s insolvency system could benefit from reform, a significant external benefit of legalization of recreational cannabis may be the potential for American companies to use the Canadian bankruptcy system while it remains illegal federally in the United States. Part VI concludes.

II. BUSINESS RISKS IN ENTERING THE LEGAL CANNABIS MARKET:

Governments are able to generate substantial revenue from taxing the legal sale of cannabis. As a result, it is in their best interests to have as many licensed cannabis producers, sellers, cultivators, processors, and retailers as is practical in order to eliminate the black market. That being said, the potential for oversaturation in the cannabis market is a serious concern for current and future business owners. If supply outstrips demand, cannabis businesses may not be able to generate enough revenue to cover their business expenses and, inevitably, some will fail.

a. Oversaturation

In Canada, the cannabis market has not yet become oversaturated. For example, Ontario capped the retail marijuana licenses that would be issued at 25, despite receiving 17,320 expressions of interest. An additional 50 retail licenses will be issued after October 2019, eight of which will be for

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dispensaries on reserves. In contrast, British Columbia is not limiting the number of retail cannabis licenses that can be issued. As of November 5, 2019, there were 160 licensed cannabis retailers in that province. Saskatchewan is taking a phased approach, where 51 cannabis retail licenses were available in the first round of license allocations. Depending on the demand for more retail licenses, the province may allocate additional licenses in a second round of applications.

Health Canada, which has the authority to issue seller, cultivator, and processor licenses, does not currently limit number of licenses that can be issued. That being said, it is possible that the Canadian cannabis market could become oversaturated due to the lack of a license cap from the Western provinces. If oversupply occurs, the price of cannabis will drop, potentially leading to solvency issues for producers and dispensers.

The problem of oversaturation could be exacerbated by a lack of brand loyalty in the cannabis industry. Unlike alcohol or tobacco, which had multiple established brands before advertising was restricted, cannabis brands are establishing themselves in a constrained environment. For instance, companies are not allowed to present their products in a way that associates its brand with “glamour, recreation, excitement, vitality, risk or daring.” Provincial governments can place further restrictions on “brand-

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7 Retailers, B.C. Liquor Distribution Branch, http://www.bcedbcannabisupdates.com/opportunities/retailers (last visited Jan. 30, 2020) (scroll down to FAQ and click on “Q. Will there be a cap on the number of cannabis retail licenses in BC?”).
12 Cannabis Act, S.C. 2016, c. 16, § 17(1)(e) (Can.).
preference” promotions, including branded apparel. Other strategies that may encourage customer loyalty, including points programs, may violate federal rules, although the scope of that prohibition remains unclear. Finally, the lack of adequate legal supply in some markets is diminishing brand loyalty. A customer who might prefer the product from one company may purchase cannabis from another if that is all that is available at their local dispensary. These factors contribute to a challenging environment for new players seeking to differentiate their product in the marketplace.

b. Regulatory Requirements & License Suspensions

As a new industry, the regulatory risk for the cannabis industry is high. Federal and provincial regulators across the country have made numerous changes to cannabis regulations in the short time that it has been legal. As a result, if cannabis businesses operators are not up to date with the latest regulations, they risk having their license revoked or suspended, which would prohibit the business from operating and earning revenues.

These regulatory changes can have major financial consequences for new or potential license-holders. For example, Health Canada recently announced that new applicants must have a fully-built site compliant with the Cannabis Regulations at the time of their application. Before it was

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15 Kristine Owram, Canada’s Pot Market is Still Struggling to Meet Demand and it’s About to Get Much Worse, FINANCIAL POST (June 5, 2019), http://business.financialpost.com/cannabis/canadas-shambolic-pot-market-will-soon-get-much-worse.
a requirement to be granted a license, 70% of applicants who passed the initial paper-based application did not provide evidence about their facility. Health Canada was concerned that it was expending scarce resources reviewing paper applications for applicants who may not be in a position to begin operations if they received a license. Although requiring applicants to have a fully built site before they apply may speed up the licensing process, these new rules will negatively affect cannabis entrepreneurs’ ability to access capital, likely depressing the number of license applicants.

Before the licensing changes, applicants who were in the queue to have their applications reviewed would receive a pre-approval letter from Health Canada. This pre-approval helped reassure investors that a license would be forthcoming and made it easier for entrepreneurs to secure capital. Often these funds were used to build a production facility that would be compliant with the applicable regulations. Therefore, with the new requirements, it is more likely that new cannabis players will be shut out of the market or have short stints in the cannabis industry. As a result, the established cannabis players have an additional advantage to new market entrants, making it more likely that the new players will be forced into insolvency or be acquired by larger businesses.

With the legalization of recreational cannabis, the cultivation, processing, and distribution of the substance has become highly regulated in an attempt to prevent the sale of cannabis on the black market, and to ensure that consumers are receiving safe, high quality product. If Health Canada becomes aware that a licensed cannabis company is selling cannabis from an unauthorized source, they can suspend or revoke its license. If this happens, that company will not be able to continue operations, to their financial detriment. Bonify Medical Cannabis (“Bonify”), a cannabis retailer in Manitoba, provides a recent example of


19 Id.
20 Id.
how this process can unfold. Health Canada suspended Bonify’s license for not complying with the requisite production practices after an investigator claimed that senior managers brought 200kgs of unlicensed cannabis into the production facility. The provincial regulator also suspended the sale of Bonify products. Bonify’s CEO said that the company could function without sales for as long as a year while the license suspension was being appealed. It was reinstated after eight months. Had the suspension been longer, or Bonify less-capitalized, it is likely that the company’s fixed expenses would have made the company insolvent while the license was suspended.

In some instances, a company may choose to suspend its sales in an effort to comply with a Health Canada investigation. CannTrust, one of Canada’s largest cannabis companies, suspended the sale of its product on July 8, 2019, after Health Canada became aware of five unlicensed rooms producing cannabis. Health Canada froze the use of 5,200 kilograms of cannabis that was produced in the unlicensed rooms and CannTrust voluntarily put a hold on an additional 7,500 kilograms of cannabis. In response, CannTrust’s stock price plummeted 37%. Once Health Canada completed its investigation into the company’s illegal business practices, it cancelled CannTrust’s license to sell and produce cannabis for growing

23 Id.; see also Cannabis Regulations, SOR/2018-144, §§ 79–92 (Can.) (information on the good production practices).
24 Id.
29 Ferreira, supra note 27.
illegal cannabis. In order to regain regulatory compliance, CannTrust agreed to destroy $12 million worth of plants, and $65 million worth of inventory. In late October 2019, the company announced that it had laid off a quarter of its workforce in a bid to reduce its expenses until its license can be reinstated. If the license is not reinstated within 35 weeks of the temporary layoffs, CannTrust will be responsible for $800,000 in severance payments. It remains to be seen if the company will be able to recover from its loss of investor, shareholder, and regulatory confidence, or will require insolvency proceedings.

In summary, if Health Canada suspended or revoked a licence, or opened an investigation, it could affect a cannabis company’s ability to generate cash flow. This would make it difficult, particularly for new or small businesses, to cover its fixed expenses, such as rent, wages, and any monthly interest payments. Cannabis companies must be diligent in following the mandated regulations for cannabis production and distribution in order to remain operational licensed cannabis companies. The frequent changes to these regulations present a business risk for their operations.

c. Litigation Risk

A third business risk associated with cannabis regulations is the potential for product recalls and individual or class action lawsuits if cannabis produced and sold does not meet Health Canada standards. For example, OrganiGram, New Brunswick’s largest licensed supplier of medical marijuana, was accused of selling pesticide contaminated products in 2016, which resulted in product recalls in 2016 and 2017. In response, a class action suit was certified on January 18, 2019, by the Nova Scotia Supreme Court. The plaintiffs in the class action are seeking

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31 Id.
33 Id.
35 Id. at ¶ 368.
damages for experiencing adverse health effects because of the contamination.\textsuperscript{36} OrganiGram has insurance that will cover the cost of legal fees and may also cover any monetary damages associated with the suit.\textsuperscript{37} Unlike with CannTrust and Bonify, OrganiGram’s license has not been suspended, and it can still generate revenues. However, the consequences to its reputation may negatively affect its sales, which could lead to financial issues.

There is also a risk that cannabis companies could be held responsible for health problems caused by their product, even if they met Health Canada regulations. Courts in both Canada and the United States are adjudicating lawsuits in which governments are seeking to recoup healthcare costs from tobacco companies and opioid manufacturers.\textsuperscript{38} In Canada, these claims are expected to run into the tens of billions of dollars.\textsuperscript{39}

Despite legalization, provincial governments warn consumers that cannabis can cause lung problems similar to smoking tobacco, mental health challenges, and low birthweight and learning difficulties for babies exposed to cannabis in utero.\textsuperscript{40} The Canadian Paediatric Society has counseled that teenagers and young adults should not use cannabis because

\textsuperscript{36} Id. at ¶ 4.
\textsuperscript{39} Hudes, supra note 38; Mulier & Rastello, supra note 38.
\textsuperscript{40} Cannabis and Your Health, HEALTHLINKBC (Oct. 10, 2018), http://www.healthlinkbc.ca/health-topics/cannabis-your-health.
it has the potential to irreversibly change brain development.\textsuperscript{41} Manufacturers of cannabis-related paraphernalia are also potentially at risk of litigation for health problems, as illustrated by growing concerns and cases against vaping companies.\textsuperscript{42}

Publicly traded firms can also face legal action related to securities violations. Once the public became aware of CannTrust’s potentially unlicensed production, a complaint was filed with the Ontario Securities Commission (OSC).\textsuperscript{43} The complaint questioned if CannTrust was engaged in fraud and intentionally putting investors at risk by not disclosing the fact that they were wilfully contravening regulations.\textsuperscript{44} The OSC opened a quasi-criminal investigation to investigate the allegation of fraud, which carries a penalty of up to five years in jail and fines of up to $5 million per conviction.\textsuperscript{45} Outside of the OSC investigation, 14 law firms, 13 from the U.S. and one from Canada, have initiated class action lawsuits against CannTrust.\textsuperscript{46} The Canadian law firm, Strosberg Sasso Sutts LLP, located in Windsor, Ontario, is seeking $250 million in damages for negligent misrepresentation and liability for primary market misrepresentation and secondary market disclosure pursuant to the Securities Act.\textsuperscript{47}


\textsuperscript{44} Id.


\textsuperscript{46} Ferreira, \textit{supra} note 40.

When licensed producers and sellers gain access to the cannabis industry, good production practices with permitted chemicals and pesticides will reduce the risk of costly legal proceedings and reputational harm that can occur from product recalls and investigations. Additionally, with strict regulations, cannabis businesses, especially large publicly traded ones, need to safeguard against unauthorized activities that contravene securities law, affect market share, put investors at risk, and bring about unwanted legal proceedings.

**d. Licensing**

Due to restrictions on the number of detail locations in some provinces, illegal dispensaries have become relatively prevalent. In Ontario, where there are currently only twenty-five licensed cannabis retailers for 14.5 million people, Toronto officials have laid forty-one charges related to non-licensed cannabis dispensaries.\(^48\) At the time of writing, there are thirty-two illegal dispensaries operating in the city, despite the potential fines of up to $1 million.\(^49\) Part of the incentive is that illegal dispensaries can make in excess of $20,000 in sales daily.\(^50\) This profitability results in shuttered illegal dispensaries often re-opening in a different location with a different name.

These dispensaries, however, are not without risk for landlords. Those who rent commercial space to illegal dispensaries may be liable for criminal charges and steep fines. If charged and found guilty, commercial landlords renting to illegal cannabis dispensaries can be imprisoned for up to two years or be fined up to $250,000.\(^51\) Even before the legal process determines if these remedies are appropriate, the municipality could issue an interim closure order, which deprives the landlord of income, and could result in mortgage default or foreclosure.\(^52\) Additionally, the Crown can seize the property if it can illustrate that it was used for an unlawful

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\(^{49}\) Cannabis Control Act, 2017, S.O. 2017, c. 26, Sched. 1, § 6 (Can.).

\(^{50}\) Illegal Cannabis Shops, supra note 48.

\(^{51}\) Cannabis Control Act, supra note 49 at §§ 13(1), 23(1).

The Crown can also make an order for the forfeiture of any proceeds of unlawful activity, including rental payments received from a tenant operating an illegal dispensary. This order does not have to accompany a conviction; rather, it can be made when charges are laid. Therefore, commercial landlords can be put in unpredictable situations if they are leasing commercial space to a dispensary operating without a license. Landlords need to know precisely who they are renting their space to in order to prevent receipt of a fine or being subject to a forfeiture.

III. Capital Markets Acceptance

By one measure, the cannabis industry has been successful in seeking capital in the financial markets. In fact, the industry has been so successful at raising money that it has led to concerns that the market is over-capitalized. For example, in 2018, Tilray’s shares soared more than 1,000%, making its market capitalization larger than that of major established companies, surpassing American Airlines. When cannabis was first legalized, the market capitalization of the industry as a whole in Canada exceeded that of publicly traded grocery stores, implying that consumers would spend more on cannabis than on groceries. In the long-run, it was unlikely that a mature industry with established players selling necessities would be surpassed by a novel sector selling recreational products. After a strong initial debut, the stock prices of major cannabis companies have declined by more than 50%. Despite this slide, there are very few indications that cannabis companies are not able to receive adequate funding from the capital markets.

Another important source of revenue for these new companies is access to credit at affordable rates. However, while the legal cannabis

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53 Civil Remedies Act, S.O. 2001, c. 28, § 8(1) (Can.).
54 Reiter & Chung, supra note 49.
55 Id.
56 Sarah Halzack, The Cannabis Market is Looking Up, Even if Cannabis Stocks Aren't, BNN BLOOMBERG (Sept. 19, 2019), http://www.bnnbloomberg.ca/the-cannabis-market-is-looking-up-even-if-cannabis-stocks-aren-t-1.1318673.
58 Id.
industry is growing exponentially, institutional investment in the cannabis industry by Canadian banks is lagging behind. Banks have been hesitant to invest in cannabis-related businesses out of fear of reputational harm and the high-risks associated with new industries. The Royal Bank of Canada explicitly said that it would not provide banking services to companies "engaged in the production and distribution of marijuana." Additionally, in an effort to manage risk, Scotiabank has made the decision to "prohibit the opening of accounts for customers classified as a 'marijuana-related business.'"

Since the legalization of recreational cannabis, credit unions, which provide financial services to its embers on a cooperative basis, have taken the lead in extending credit to the legal cannabis industry. For example, Alterna Savings & Credit Union Ltd. was the first financial institution to lend money to a cannabis company in Ontario. The company, Canopy Growth, is now the largest publicly traded cannabis producer in the world. Since that first investment, Alterna has made approximately $750 million in cannabis-related loans and deposits, which is estimated to be distributed amongst sixty licensed cannabis producers in Canada. In a similar vein, the Windsor Family Credit Union recently lent $25 million (USD) to Aphria Inc, a Canadian medical marijuana company. Although cannabis-related companies are obtaining credit through credit unions, the joy may be short-lived, as interest rates for these loans are often well above normal averages. Some loans to cannabis-related businesses require

60 Schwarzberg, supra note 56.
62 Id.
65 Id.
66 Id.
67 Schwarzberg, supra note 59.
interest rates of up to 15%. The average prime interest rate charged by the Bank of Canada and other financial institutions is currently 3.95%. Even major players, such as Aphria and Canopy, are paying higher interest rates than they would receive through banks, at between 4.68% and 10%, depending on the loan. With relatively high interest rates accompanying loans granted by credit unions, it is important to determine whether cannabis-related businesses, especially those that are beginning operations, will have the capacity to generate enough revenue to manage the loans that they have acquired.

It is important to note that, while there was initial hesitation from Canadian banks, some banks are warming up to the idea of providing loans to cannabis-related businesses. In 2018, the Bank of Montreal (BMO) led a $175 million financing through the sale of shares for Canopy Growth, and the Canadian Imperial Bank of Commerce (CIBC) was a part of a $20 million credit deal with MedReleaf Corp. In 2019, BMO and CIBC, along with Concentra Bank, provided up to $80 million in secured financing to PharmHouse Inc., a medical marijuana company. BMO and CIBC collaborated once again to provide a $65 million secured term loan to Cronos Group, and a $65 million secured term loan to HEXO. RBC, although initially against providing services to cannabis-related businesses, participated in its first share sale involving CannTrust, valued at $200 million. If banks continue to provide loans to cannabis-related businesses, at average interest rates, their capacity to remain in business will increase, reducing the likelihood of loan default and bankruptcy. Further, providing credit and financial services to a wide spectrum of

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68 Id.
73 Id.
cannabis businesses, both large and small, will ensure diversity in the Canadian legal cannabis market, and contribute positively to its growth.

IV. INSOLVENCY PROCESSES AND CHALLENGES

a. Overview

Despite the novelty of the industry, some cannabis companies have already filed for creditor protection, or bankruptcy and insolvency protection. The first reorganization was for Peloton Pharmaceuticals Inc., which conducted research to develop, produce, and distribute pharmaceutical-grade cannabis. While waiting for their Health Canada permit, the company hired staff and prepared the working area in the cultivation facility. These expenses of maintaining these operations became too onerous to cover without income, leading the company to file a proposal for reorganization in 2016. Public documents reveal that it had 53 unsecured creditors and one preferred creditor with liabilities totaling $5,329,460.45. With a total of $788,205.44 in assets, Peloton had a deficit of $4,541,255.01. Pursuant to the Bankruptcy and Insolvency Act (BIA), the interim receiver was given the power to possess Peloton’s property, solicit buyers and investors of the company’s assets, and share capital. Peloton’s proposal for reorganization was approved by the Court, and the company was ultimately acquired by Aurora Cannabis for $7 million.

A second example of a Canadian cannabis company involved in insolvency proceedings comes from British Columbia. Ascent Industries Corp., under its subsidiary Agrima Botanicals Corp., filed for creditor protection under the Companies’ Creditors Arrangement Act (CCAA).

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76 Id.
77 Id. at ¶ 4.
79 R.S.C. 1985, c. C-36 (Can.).
after Health Canada suspended its license.\textsuperscript{80} The license was suspended in September 2018 for failure to meet compliance requirements. Of particular interest in this case is that Ascent has subsidiary companies in the U.S., but only one, which holds real property in Nevada, was a party to the proceedings.\textsuperscript{81} That being said, the property located in Nevada is not included in the listed assets for sale.\textsuperscript{82} A subsidiary of one of Ascent’s secured creditors bought all of Ascent’s rights, titles and interests to specific assigned contracts, intellectual property assets, personal property, and real property for $29 million.\textsuperscript{83}

\textit{b. Provincial Legislation}

While these examples illustrate the availability of both of Canada’s main bankruptcy and restructuring regimes (the BIA and the CCAA) to cannabis companies, regulatory challenges in applying them remain. With the federal legalization of recreational cannabis in Canada, provinces and territories were able to develop their own legislation and regulations for the cultivation, distribution, sale, and possession of cannabis. As a result, there are 13 different systems managing cannabis and cannabis licenses throughout Canada. Some provincial/territorial cannabis statutes specifically outline what responsibilities licensees, trustees, and receivers have during insolvency proceedings, some grant interim or temporary licenses to trustees or creditors in possession, while others still are silent. As a result, cannabis companies need to be cognizant of how their respective province or territory treats insolvent cannabis companies.

In British Columbia, the \textit{Cannabis Control and Licensing Act}\textsuperscript{84} includes a section that clearly explains who has specific rights and responsibilities when a licensee goes bankrupt. Section 29(2) states:

\begin{quote}
If an interim receiver, receiver, custodian, trustee, receiver manager or liquidator has been appointed under the \textit{Business Corporations Act}, the \textit{Law and Equity Act},
\end{quote}

\textsuperscript{80} Filing for Creditor Protection at ¶ 5., 2019 BCSC 1880, No. S-192188 (Can. B.C.S.C.). \textit{See also id.} at s 3(1).
\textsuperscript{81} In re Ascent Industries Corp. et al. (Mar. 1, 2019) British Columbia S-192188 (Can. B.C.S.C.) at ¶ 5. \textit{See also id at s 3(1)}.
\textsuperscript{82} \textit{Id.} at ¶ 9.
\textsuperscript{83} \textit{Id.} at ¶¶ 50-53.
\textsuperscript{84} \textit{Id.} at ¶¶ 14–15, 18, 22.
the Personal Property Security Act, the Supreme Court Act, the Bankruptcy and Insolvency Act (Canada) or the Winding-up and Restructuring Act (Canada) for a licensee, the person appointed has the powers and obligations of the licensee.

Although this is a simple statement, it removes any confusion that a court appointed trustee or receiver might have when working on behalf of a cannabis company.

In Newfoundland, the Cannabis Control Act85 allows for a temporary cannabis license to be issued to a creditor in possession, or a trustee in bankruptcy, for one year in order to dispose of the cannabis store or the cannabis retail location.86 Similarly, Yukon’s Cannabis Control and Regulation Act87 allows the Cannabis Licensing Board to issue a six month interim license to an assignee, receiver, or trustee in bankruptcy if the original licensee loses control of their business or premises.88 While holding the interim license, the assignee, receiver, or trustee assumes all privileges and liabilities of a licensee.89 Alberta’s Gaming, Liquor and Cannabis Regulation90 also allows a temporary license for three months to be issued to a person to carry on activities permitted by the original licensee if they dispose of the business.91

Saskatchewan’s regime currently provides the most direction to trustees and receivers for cannabis businesses. The Cannabis Authority has the power to transfer a cannabis license if a trustee in bankruptcy or a court-appointed receiver.92 If a cannabis license is cancelled and cannabis is forfeited to the Cannabis Authority, the Cannabis Authority can request the Court of Queen’s Bench to appoint a trustee, receiver, custodian, receiver manager, or liquidator to manage the forfeited cannabis.93 Further, when a trustee, receiver, custodian, receiver manager, or liquidator is

85 Cannabis Control and Licensing Act, S.B.C. 2018, c. 19 (Can.).
86 Id. at § 40.
87 Cannabis Control Regulation Act, S.Y., c.4 (Can.).
88 Id. at § 38(1).
89 Id. at § 38(5).
90 Gaming, Liquor and Cannabis Regulation, Alta. Reg. 143/1996 (Can.).
91 Id. at § 115.
92 The Cannabis Control (Saskatchewan) Regulations, R.R.S. c C-2.111 Reg 1, § 3-14(1)(g) (Can.).
93 Id. at § 3–15(5).
appointed, they have the power to, “sell, dispose of or otherwise deal with the cannabis, and distribute any proceeds from the cannabis in a manner directed by the court.”

Clarity about the transferability of the cannabis license, and the duties of the trustee, receiver, or assigner are vital for insolvency practitioners navigating this new industry. However, at the time of writing, only five of the 13 provinces and territories have legislation or regulations that address insolvency processes and the status of the cannabis license during insolvency. To help ensure the orderly restructuring or unwinding of cannabis businesses, the remaining provinces and territories should add guidance about insolvency to their cannabis statutes.

c. Cannabis on Reserves

The Cannabis Act currently has no framework for the sale of cannabis on First Nation Reserves, despite sustained concerns regarding the lack of engagement with First Nation communities during the legislative process. Given the lack of consultation with First Nations communities and the increasing recognition of Indigenous sovereignty, the Senate Committee on Aboriginal Peoples recommended that the bill’s implementation be delayed by a year. This suggestion was not adopted. Instead, the government has started consultations with First Nations groups with an aim of amending the Cannabis Act to better reflect Indigenous concerns. However, the regulation of cannabis on reserve is tied up in larger questions about Indigenous sovereignty. Some communities want a continued ban on cannabis on their lands – a decision

94 Id. at § 3–15(7).
96 Donovan, supra note 88; Koutouki & Lofts, supra note 88 at 723-74.
97 Koutouki & Lofts, supra note 95 at 723–724, 727.
which the federal government has pledged to support.\footnote{Jorge Barrera, \textit{Ottawa Won’t Fight First Nations that Choose to Ban Cannabis: Blair}, CBC News (Oct. 3, 2018), http://www.cbc.ca/news/indigenous/fn-senate-pot-1.4849876.} The regulatory framework becomes even more complicated for First Nations who want to take advantage of the opportunities presented by cannabis or have been operating dispensaries for decades. Numerous communities have taken the position that the federal and provincial regulations do not apply to their lands.\footnote{Jorge Barrera, \textit{Next Federal Government Needs to Amend Cannabis Act, Say First Nations Chiefs}, CBC News (Sept. 29, 2019, http://www.cbc.ca/news/indigenous/cannabis-first-nations-laws-1.5299972>. (hereinafter, First Nations Chiefs); Donovan, supra note 88.} Others have passed their own laws that meet or exceed the requirements off-reserve.\footnote{Colin Graf, \textit{How First Nations Are Dealing with Thriving, but Illegal, Cannabis Stores}, VICE (Dec. 20, 2018, 10:34am), http://www.vice.com/en_ca/article/kzv54m/how-first-nations-are-dealing-with-thriving-but-illegal-cannabis-stores.} These laws have led to questions about how these communities would enforce their regulations, and about their validity where they conflict with federal legislation.\footnote{First Nations Chiefs, supra note 99.}

Another point of contention with the status quo on cannabis is that First Nations communities currently have no mechanism to collect revenues from cannabis sales. Currently, the federal and provincial governments split the excise taxes received from cannabis.\footnote{Jorge Barrera, \textit{Ottawa in Talks to Work Out Cannabis Rules for First Nations Territories}, CBC News (Aug. 26, 2019, 4:00 AM), www.cbc.ca/news/indigenous/cannabis-first-nations-framework-1.5258544.} Even if cannabis is sold on reserve, there is no formal way that the band council or other governmental body can directly benefit from it. Before the writs were drawn up for the 2019 federal election, the government had been working with First Nations groups to develop a workable revenue-sharing and jurisdictional arrangement.\footnote{Id.} The Commissioner of the First Nations Tax Commission has proposed that First Nations should be able to keep 75-100\% of the excise or commodity taxes generated from cannabis sales on reserve.\footnote{Id.} These controversial topics are unlikely to be resolved in the near future.\footnote{The new Cabinet was named on November 20, 2019. It is unlikely that the legislative calendar will allow for amendments to the \textit{Cannabis Act} to become law until late 2020 at the earliest.}
Provincial governments are also struggling with how best to address the question of dispensaries on-reserve. Some provinces have encouraged these businesses to apply for a license, while others have set up a lottery specifically for them.\textsuperscript{106} At the time of writing, there are many dispensaries on reserve which are operating without a license. In Ontario, the provincial police estimate that there are 79 unlicensed cannabis distributors operating on 23 First Nations.\textsuperscript{107} As with federal government regulations, it remains to be seen if provincial regulations will be enforced on reserve. Some illegal dispensaries have been raided, although there does not appear to be widespread enforcement.\textsuperscript{108}

In an insolvency situation, First Nations cannabis businesses could face additional complexities than those off-reserve. Creditors will have different recourse to satisfy unpaid debts depending on the corporate structure of the business. If it was incorporated by a band or Indigenous person, the distinct legal character of the corporation would allow the creditor to proceed as they would off-reserve.\textsuperscript{109} However, if a cannabis dispensary was set-up as a sole proprietorship, partnership, or by the band itself, most secured creditors would have no recourse for default.\textsuperscript{110} This is because the \textit{Indian Act} prevents banks or other lenders from attaching their loan to property situated on reserve unless they are a band or another “Indian” as defined by the \textit{Act}.\textsuperscript{111}

\section*{V. Areas for Reform & Points of Clarification}

This section draws on the Canadian experience to suggest best practices that should be followed to ensure that cannabis companies are not treated differently than any other legitimate business regarding bankruptcy relief.


\textsuperscript{107} First Nations Chiefs, supra note 99.

\textsuperscript{108} Id.


\textsuperscript{110} \textit{Indian Act}, R.S.C. 1985, c. I-5, § 89(1) (Can.).

\textsuperscript{111} Id at § 89(1).
Countries looking to legalize recreational cannabis should do so at the federal level before the regional, provincial, or state level governments have the ability to do so. This will ensure that the entire country will have uniform standards enforced, despite the slightly different regulatory schemes at the local level. If recreational cannabis legalization occurs at the federal level first, all other federal laws and regulations should be updated to ensure that there are no operability issues.

A second consideration that needs to be addressed is the appropriate level of supply. If there are no limits on the number of licenses that can be issued, there may be more supply than demand, which can result in companies going bankrupt. Some jurisdictions are restricting the number of licenses available due to concerns of oversupply. However, avoiding bankruptcy cannot be the only concern for governments regulating the cannabis industry. Too much intervention in the name of preventing oversaturation can lead to diminished supply and inefficiencies. Before legalization, some scholars argued that placing a cap on cannabis retail licenses would only benefit the black market, as supply and wait times for cannabis would be an issue.112 Their warning has been proven correct by Ontario’s experience with legalization. On the day that all licensed storefronts were expected to begin operations, only nine of the twenty-five officially opened their doors to the public.113 Not only does an inadequate supply encourage cannabis consumers to seek the product on the black market, depriving governments of potential tax revenue, it undercuts the regulations aimed to protect consumers. If a surplus of businesses can satisfy Health Canada’s requirements, the market will self-adjust to resolve concerns about market oversaturation.

Further, even though the initial number of licensed retailers was low, supplier of Canadian cannabis are now expected to rapidly increase.114 One analyst predicts that Canada will experience an oversupply of

cannabis in its dried form by January 2020. This oversupply is anticipated to lead to a new problem – getting it to market. The analyst predicted that there would be enough dried cannabis to supply 617 retail stores, yet there will only be 400 operational cannabis stores by the end of 2019. Additionally, with cannabis-infused edibles, extracts, and topicals recently becoming legal, some cannabis consumers may turn to the edible market and from dried cannabis – making the issue of oversupply even more challenging and hard to predict in the short-term.

A third area of potential reform is the restrictions on license ownership or concentration. While some provinces and territories do not limit the number of licenses that can be issued, there are instances where a single entity or person is capped to a specific number of cannabis retail licenses in a given province or territory. For example, Alberta Gaming, Liquor and Cannabis does not place a limit on the number of retail cannabis licenses that can be issued. However, no person or entity can hold more than 15% of the total retail cannabis licenses in the province. Therefore, if 200 retail licenses were issued, a single person or entity could only possess 30 of them. Until December 31, 2020, an individual or entity can only hold a maximum of 42 licenses.

Similarly, British Columbia, which also does not cap the number of retail licenses that can be issued, only allows a single entity to hold a maximum of eight licenses. Saskatchewan, which initially issued 51 cannabis retail licenses, does not limit on the number of licenses that a person or entity can possess. In fact, Saskatchewan’s cannabis regulations allow a license holder to sell their interest in their cannabis retail store license. As a result, larger cannabis companies have bought out many

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116 Id.


118 Id.

119 Id.

120 Cannabis Licensing Regulation, B.C. Reg. 202/2018, § 6(3) (Can.).

smaller cannabis businesses. Of the 51 licensed cannabis retail stores in Saskatchewan, only 34 are currently in operation. When the licenses were first issued, Canopy Growth, operating under its subsidiary Tweed, Westleaf, and Fire & Flower Holdings Corp., only owned seven. These companies now hold 17 of the 34 operating licenses, or 50% of the retail cannabis market in the province.

Monopolization can be problematic because consumers are limited in their product selection, and smaller independent retailers are often shut out of the market. These pressures can limit innovation and entrepreneurship. As a result, provinces and territories that do not limit the number of licenses a single entity or person can hold should consider whether or not it will provide their economy with sufficient diversity of choice.

VI. CANADIAN BANKRUPTCY FOR AMERICAN CANNABIS COMPANIES

Similar to Canada, the federal level of government has jurisdiction over bankruptcy in the United States. This constitutional distinction is relevant since cannabis remains illegal federally, despite its legalization in a number of states. As a result, bankruptcy trustees have refused to liquidate the assets of marijuana companies, and sought to dismiss the restructuring plans of a cannabis company that proposed to pay creditors with funds from marijuana sales. This prohibition applies even for corporations that supply cannabis-related companies. For example, in In re Way to Grow Inc., et al, the debtor’s reorganization plan was rejected by the Court because it depended on sales of “equipment, chemical, product or material which may be used to manufacture a controlled

125 Id.
substance.” Some states have attempted to bridge this gap by amending their receivership laws to benefit marijuana-based companies, but the broad relief of bankruptcy remains unavailable.

The inability of American cannabis companies to access bankruptcy relief through federal bankruptcy courts creates a significant opportunity for Canada. American cannabis companies that are publicly traded in Canada may be able to take advantage of our insolvency regime for cannabis companies. If a parent company is located in Canada, it is possible that subsidiaries located in the U.S. will enjoy the benefits of federal legalization of recreational cannabis in Canada. This may encourage American cannabis companies to set up their operations strategically to give them a safety net if things go wrong.

American cannabis companies with a presence in Canada may also be able to utilize Chapter 15 bankruptcy proceedings to restructure a business or liquidate assets that would otherwise be illegal in the U.S. Chapter 15 bankruptcy proceedings provide mechanisms for dealing with cross-border insolvency cases to protect the interests of creditors and the debtor involved in the proceeding. Additionally, unlike other types of bankruptcy proceedings in the American system, Chapter 15 proceedings do not create an estate of the debtor’s property. Therefore, the American trustee does not need to possess or administer cannabis related assets or financial proceeds. However, if a Chapter 15 debtor is seeking recognition of a Canadian court’s insolvency proceedings, the trustee may argue that the recognition should not be allowed as it is against public policy of the United States given the federal ban on cannabis.

To help guide the application of the public policy exception provided for in section 1506 of the Bankruptcy Code, three principles have been identified:

127 Id at 127.
131 Rosell, supra note 123.
132 See generally Bankruptcy Code, supra note 123, at §§ 541(a), 704, 1106 (other than Chapter 15 methods of bankruptcy in the United States); Rosell, supra note 123.
133 See Bankruptcy Code, supra note 123, at § 1506.
(1) The mere fact of conflict between foreign law and U.S. law, absent other considerations, is insufficient to support the invocation of the public policy exception.

(2) Deference to a foreign proceeding should not be afforded in a Chapter 15 proceeding where the procedural fairness of the foreign proceeding is in doubt or cannot be cured by the adoption of additional protections.

(3) An action should not be taken in a Chapter 15 proceeding where taking such action would frustrate a U.S. court’s ability to administer the Chapter 15 proceeding and/or would impinge severely a U.S. constitutional or statutory right, particularly if a party continues to enjoy the benefits of the Chapter 15 proceeding.134

In short, Chapter 15 can allow for circumstances where American companies reorganized in other countries could benefit from options they would not be able to if the proceedings had happened in the United States. One example of this is with non-debtor third-party involuntary releases. This mechanism to exculpate non-debtor officers and directors from liability is not widely available in domestic restructurings in the U.S..135 In contrast, a non-debtor release was enforced by the Bankruptcy Court after being ordered by a court in Ontario.136 This experience illustrates that Chapter 15 could be used to the benefit of insolvent cannabis companies, even while the federal prohibition remains in place domestically.

VII. CONCLUSION

Developing the regulatory framework for a new industry is always challenging for policymakers. This is especially so for the legalized

cannabis industry, which, unlike other new industries, had millions of interested consumers on the first day it became legal. The controversy over legalization also ensured that the industry would be tightly regulated by governments. While some of these choices speak to the safety of the product, many have had a dramatic effect on framing the business risk in the sector. The Canadian experience is already beginning to illustrate the effects of these policy choices on the business risks faced by cannabis entrepreneurs. These challenges include the ever-changing and sometimes overlapping regulatory landscape, over/under supply, and market concentration.

These policy choices can have consequences for any industry. However, they are felt particularly acutely by this nascent sector that has often struggled to meet the demand of millions of Canadians. Coupled with the expectations of a “green gold rush,” it is inevitable that some of these new companies will fail. Clear procedures and responsibilities, as in Saskatchewan’s laws, would be a good exemplar for other provinces to consider. The lack of insolvency proceedings south of the border also makes it more likely that our courts will need to contend with a higher number of cannabis bankruptcies – presenting both a unique opportunity and major challenges. Policymakers should begin preparing for this eventuality while this young sector is still growing to ensure that all parties involved understand what happens when things go wrong.