

# Superior public health and safety outcomes can be achieved by modern independent ecommerce relative to a cost-intensive and superfluous government distribution intermediary.

## BACKGROUND

In July of 2018, cannabis will be legal for sale to adults across Canada. Provinces are responsible for the design of supply chains that suit their constituents.

In a recent Oracle poll 65% of respondents suggested that they prefer accessing cannabis from retail storefronts. This will require either the licensing of private retailers, leveraging of an existing supply chain for age restricted products such as liquor store distribution, or a combination of both. For the remaining 35% of respondents, direct mail is the preferred purchase path. They would like to access legal cannabis products from their computer, place orders through an ecommerce platform, and have regulated cannabis delivered to their homes.

Facilitating both of these purchase pathways is a more holistic approach to attracting users from black market purchase pathways such as corner dealers or unregulated storefronts.

The licensing of retail storefronts will logically require the development of a licensing body. This body would do well to design and implement an application process assessing

merit in categories such as absence of violent criminal history, absence of financial criminal history, absence of gang associations, security competency, funding, supply agreements, location, and quality of the operator.

The deployment of this licensing body will likely take substantial government time and resources. A parallel ecommerce system with robust age verification, proven supply chain transparency, and demonstrable public health and safety outcomes would be comparably quick and easy to implement. Doing so would help the transition from the black market to the legal market.

Retail storefronts will take time. Establishing a licensing board, deploying licensing standards, application preparation, application processing, approvals, and initiating sales could represent an 18 month process even after BC regulations are established. In that time there will be confusion and contention, with consultations and politicization of issues. This process is worth getting right, and worth taking the time to get right.

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## TRANSPARENCY, TRACEABILITY, AND THE ACMPR

A mail order system already exists in this nation. The ACMPR has an excellent track record of traceability, supply chain transparency, identity (and therefore age) verification, recall deployment, and robustness. Patients in rural towns across Canada enjoy access to quality assured cannabis today, even if their municipality opposes facilitation of retail storefronts. This reduces the visibility of cannabis advertising by providing an alternative to the visible storefronts currently supplying British Columbian demand.

Licensed Producers in the ACMPR are required to build distribution mechanisms on their licensed premises to fulfil mail orders with partners like Canada Post and Purolator. Because these shipping facilities are adjoined to LP premises, they meet the exacting Security and Quality Assurance obligations stipulated by Health Canada. This allows LPs to control for risk associated with diversion or contamination in the supply chain with unprecedented robustness. The reporting standards are granular and specialized, with reports demonstrating compliance available for audit by the federal regulator at 72 hours' notice.

No incidence of diversion of ACMPR cannabis to the black market has ever been reported. Cannabis moving from the black market to legal channels has never been reported. Identity and age verification have a 99.9% success rate. The vast majority of deliveries are on time within 2 days of placing orders. The ecommerce system designed and maintained by Licensed Producers is consistent, robust, and proven to be effective. By contrast, any intermediary ecommerce distribution mechanism, requiring substantial upfront investment and development, is both unproven and superfluous.

## POSITION

It is the position of Tantalus Labs that the mail order component of the British Columbian adult use cannabis supply chain is essential in eroding the black market. Furthermore, we believe that the inclusion of a central, government-operated ecommerce intermediary distribution platform provides no added value to the public health and safety outcomes targeted by bill C-45.

Such an intermediary would not enhance supply chain transparency, not reduce diversion of product to and from the black market, and not enhance auditability and reporting outcomes that are proven and consistent in the ACMPR today. Indeed, the increased complexity of integrating a multi-stage, centrally operated ecommerce system would allow more room for errors in reporting and auditing. Finally, the inclusion of such an intermediary would hurt small cannabis producers' ability to thrive in a legal marketplace, reduce job creation, and inhibit entrepreneurial participation.

## OTHER PROVINCES' APPROACH

We are confident that your offices have been studying approaches from other provincial governments, and thus we won't take too much time recapping them. What we can observe as a generality is a spectrum of government control. More monopolistic approaches come from less planning and shorter policy development timelines such as in the case of Ontario. Alberta set out a draft framework then gave constituents time to respond, favoring a mix of government and private retail. It is likely that both of these jurisdictions will implement ecommerce at some level, although Alberta's ecommerce portal will not be deployed on day one. *[Continued next page]*

*[continued from page 2]* Ontario is implementing a government-operated ecommerce platform that will likely leverage the substantial liquor distribution infrastructure that exists today. They have recently invested \$20m in a state-owned ecommerce distribution platform for alcohol involving a web portal, distribution warehouses, centralized logistics, shipping, and end user couriers. Having already invested heavily in this system may well have influenced their decision to opt for a similar model for cannabis. BC has an enviable opportunity to avoid such capital expenditure costs while creating a more effective system by taking a different approach. Copying the Ontario model in BC would add little value to the distribution mechanisms built right into ACMPR firms today, with vaults, shipping lines, and auditable software reporting already in place.

## WHAT'S RIGHT FOR BC

The illegal market in cannabis is well established in BC, both through street dealers and retail dispensaries, supplied by a network of unregulated grow operations. While it will take time for legal cannabis to eat into the market share of the illegal trade, the faster and more effectively the legal alternative can be established, the quicker the public health and safety benefits of a well regulated market will be felt.

The independent ecommerce model, as demonstrated in the ACMPR, can be relied on to consistently deliver to the intended, age and identity verified, recipient without leakage from or to the illegal market. Inclusion of independent ecommerce from day one of the legal market in BC will allow every adult citizen to instantly and reliably

access legal cannabis, instilling consumer confidence in the new market while it is still nascent, and allowing other forms of distribution to be phased in at a controlled rate by the provincial regulators.

British Columbia is set to be a hub for both the cannabis industry and its ancillaries. The province already boasts a wealth of knowledge and world leading talent in agricultural best practice and innovation. The entrepreneurial and innovative atmosphere in the province risks being stifled if the legal market is slow to come to fruition. If our cannabis market is restricted by centrally controlled distribution systems, it will likely favor the simplicity of fewer products and large producers over the complexity of a vibrant and varied free market. An independent ecommerce model would present fewer barriers to entry for small companies, and accommodate a greater variety of options at all stages of the production and supply chain, to better suit consumer needs.

The ecommerce model allows for a direct relationship between craft producers and end users, a feature that small producers are reliant on to provide a competitive edge against major Licensed Producers and the black market alike. A direct relationship allows producers to curate the end user purchasing experience from start to finish, and direct their products to specific demographics rather than attempting to appeal to the lowest common denominator. Where strong relationships may be built in person at high street dispensaries, or even through street dealers, it is all the more pertinent that a sufficient online alternative is created in the legal market. As such, facilitating small producers and allowing them to foster personal relationships with their customer base will benefit producers and encourage users to choose the legal market.

# THE CASE FOR SMALL GROWERS

The Cannabis Control Board of Ontario (CCBO) plans to operate a centralized ecommerce platform that will take orders online from users and ship from distribution centers. The specifics of the user experience, logistics, and fulfillment of this platform are still unclear. The CCBO has not implied the use of proven ecommerce platforms from ACMPR LPs. This threatens the competitiveness of smaller producers and new entrants. Distribution agreements from suppliers and distributors to the CCBO will likely hinge on two core factors: volume (ergo consistency of supply), and price. Both of these mechanisms favor larger producers.

With 60 initial storefronts, and as many as 150 by 2020, consistent supply will necessitate thousands of kilograms of cannabis products to be shipped from LP partners to the CCBO distributor every month. At production footprints as small as 1000 square feet today, craft scale LPs will likely struggle to meet these quotas in one province alone, let alone nationwide.

Price competition is another disadvantage for small producers. The core driver of price efficiency in the ACMPR is scale. Economies of scale create exceptional downward pressure on production costs in cannabis cultivation, as they do in industrial agriculture at large. Capital expenditures and staffing requirements are front loaded for LPs, and a production footprint of 100,000 square feet does not increase cost of production 10x relative to a 10,000 square foot producer. A large greenhouse producer may enjoy a healthy margin selling at \$5/g, whereas that may be unsustainable for a smaller producer.

The solution is simple, effective, and already to hand. If British Columbia adapts existing ACMPR ecommerce practices of age and identity verification for a recreational supply chain, small firms can continue to foster direct relationships with their end users. Small firms already differentiate on brand and quality as opposed to volume and price. If the desire is to generate revenue from a centralized distributor, and ultimately the Government of British Columbia, this can and should be levied in the form of cannabis sales tax as opposed to retail resale margin.

Even the smaller Licensed Producers have an excellent track record of identity verification to date, and there is no security advantage in forcing them to sell to an intermediary. Even in an environment where independent retail is restricted, the existence of independent ecommerce is essential to enable a diverse and decentralized mix of cannabis cultivation small businesses, which is a critical priority of the ACMPR since its inception.

# COST OF CENTRALIZED DISTRIBUTION

The 2015-16 annual report from the Liquor Control Board of Ontario (LCBO) gives a sense of the cost of implementing a centralized ecommerce platform. During this period, LCBO implemented its system for online alcohol retail, the costs of which are listed as part of IT expenses, totaling over \$19m. LCBO annual IT costs from 2012-15 have been consistent at \$8-9m, from which it can be estimated that the cost of implementing centralized ecommerce alone sits in the region of \$10-11m. While the costs of implementing a second centralized ecommerce platform would be reduced, the scale of the costs could easily reach \$100mil+.

Any clearer idea of the costs of a centralized distribution platform is difficult to gain. The Alberta Government has recently revisited its intention to instate a centralized platform, targeting \$168mil as the up front public investment required to deploy such a system. It is our belief that at least \$100mil would need to be deployed over multiple years to implement a distribution intermediary that does not enhance public health and safety outcomes, economic benefits, or competitiveness of BC's firms relative to other provinces.

British Columbia is a province that celebrates the democratization of technology and entrepreneurship. Our innovation leaders have become global examples of government control harmonizing with facilitation. Inhibiting producer's ability to speak directly to their end user without a demonstrable public health and safety outcome would be irresponsible and anticompetitive. It may also provide a disincentive for Licensed Producers to sell through a legal retail system at all.

The ACMPR will continue to exist for at least 5 years into legalization. Firms such as Tantalus Labs have a long list of patients wishing to buy directly from us through this medical system today. Without the ability to sell directly to customers through ecommerce, we are disincentivized to sell to a government distribution intermediary when we can deliver direct to patients today. Our production will be stretched to deal with the medical market alone, so the legal supply chain needs to offer LPs self interested motives to participate and help it grow.