



# **Government of South Australia**

NATIONAL COMPETITION POLICY REVIEW

## **PROPOSAL TO LICENCE HYDROPONIC EQUIPMENT RETAILERS**

### **REPORT OF THE REVIEW PANEL Executive Summary and Recommendations**

The views expressed in this report are the views of the Review Panel only and do not represent the views of the South Australian Government. Any action taken in anticipation of the outcome of this report or the review process is solely the risk of the persons taking such action.

January 2002

## EXECUTIVE SUMMARY

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On 25 July 2001, the South Australian Government announced changes to the drug laws aimed at reducing commercial cultivation of cannabis in South Australia. Included in the announcement was a review to consider licensing hydroponic equipment retailers.

A Review Panel was established and charged with evaluating the licensing proposal, and reporting on appropriate arrangements for these retailers, if any. The review was conducted in accordance with National Competition Policy requirements. An Issues Paper on the proposal was produced and was the subject of public consultation. Twenty-nine submissions were received. This report is the result of the Review Panel's deliberations.

The hydroponics industry is the fastest growing sector of the horticultural industry. Over the past ten years, the Australian hydroponics industry has developed from a small, alternative industry into an important contributor to the horticultural sector. In 2001, hydroponic production was valued at \$400 million at the farm gate. In South Australia, the industry is poised for further expansion, including into international markets. The hydroponic equipment industry supports this production. In South Australia, annual turnover generated by hydroponic specialist retailers is estimated at \$52.4 million annually.

While a significant proportion of growth in the hydroponics industry can be attributed to legitimate commercial or small-scale production of fruit, vegetables and flowers, South Australian Police (SAPOL) believe that the increase in the number of specialist hydroponic retailers in the last decade is a reaction to the current legislation which allows the offence of producing cannabis to be expiated if the number of plants is under a certain level and if they are being grown for personal use (as a result of the changes announced on 25 July 2001, the plant limit is currently one). SAPOL considers the expiation system has assisted the development of growing syndicates operated by organised crime and the proliferation of hydroponically cultivated cannabis.

The proposal in the Issues Paper was based on a SAPOL suggestion and SAPOL intelligence about the extent of criminal activity in specialist hydroponics retailers. The proposal envisaged licensing hydroponic retailers who were of good repute, assessed by whether they passed a police integrity test (no criminal convictions, not having been issued with an expiation notice, and no associations with known criminals); and requiring purchasers to fill out an end use certificate and provide proof of identity. The proposal was aimed at specialist hydroponic retailers, as this was the area where SAPOL intelligence showed that both retailers and customers have connections with cannabis trade.

The objective of the proposal, as stated in the Issues Paper, was to reduce or eliminate the production of cannabis on a commercial basis. The Review Panel concludes that this objective is based on a number of assumptions, and is too broad to be achieved by licensing hydroponic retailers. The Review Panel recommends an alternative objective, against which the proposal can be properly evaluated, which is to remove from or prevent from entering into the hydroponic equipment retail industry persons who are associated with cannabis trade.

A scheme to licence hydroponic equipment retailers raises the question of what is "hydroponic equipment"? A wide range of items are used in hydroponics, including fertilisers, growing media, pots, plastic pipes, heaters, fans, electric timers, pumps and lights. These items are

available from hardware, gardening, lighting, aquarium, pool, pump, irrigation and other shops. For the purposes of the licensing proposal, the Issues Paper defined hydroponic equipment as pumps, electric lights and ballast boxes. These items were chosen because they were considered to be essential for growing cannabis indoors and would restrict the impact of the licensing proposal to the smallest range of retailers possible. The Review Panel considered whether these items were appropriate, whether the list of items should be extended, what other items were appropriate, and whether another approach, such as a definition based on the primary intention of the business, would be more effective.

For the purposes of this review, the Review Panel recommends the following definition, which focuses on electrical lighting items, as these are necessary for indoor growing and are essential stock for specialist hydroponic retailers.

Hydroponic equipment is any two or more of:

- Electric lights of 250 watts or more;
- Fluorescent lights which combine the red and blue part of the light spectrum in a way which enhances plant growth, also called grolux lamps;
- Units comprising high intensity discharge lamps, control gear, ballasts, lamp mounts and reflectors, also called ballast boxes.

The idea of specifying two or more of the items is to restrict the application of the definition to the smallest range of retailers possible. Nevertheless, in addition to specialist hydroponic shops, aquarium shops and lighting shops are likely to be caught by the definition. This could be addressed by an exemption mechanism.

The Review Panel is of the view that the scheme would require the owner, operator or employee of, or director of a company which owns, a business selling hydroponic equipment, to be licensed. The scheme is not intended to apply to manufacturers or wholesalers. Employees must be included for the scheme to be effective. If not, a person with no convictions could be set up as an owner or director, and people with criminal records could be employed in the business.

The Review Panel recommends that good repute, in the case of specialist hydroponic retailers, should be assessed on the basis of lack of convictions for offences for possession, production or sale of drugs of dependence and prohibited substances under the Controlled Substances Act, committed in the previous five years.

The licensing proposal in the Issues Paper was given extensive consideration in light of the submissions and other information received. The Review Panel concludes that although it would achieve the alternative objective of removing persons with connections with cannabis trade from the hydroponics retail industry, the costs would exceed the benefits. Such costs include administrative burdens for both business and government; reduction in hydroponic equipment sales; reduction of the number of specialist hydroponic equipment suppliers; a detrimental effect on employment; and the possibility of increased crime resulting from purchaser ID information being illegally accessed and used to find cannabis crops to steal. The licensing proposal is not recommended by the Review Panel.

Four alternative regulatory arrangements were considered - two involving industry participation (self-regulation by code of practice; and co-regulation using the example of retail

industry association membership as a requirement to authorise manufacturers and wholesalers to sell hydroponic equipment); business notification and negative licensing. Based on the evidence available to it, the Review Panel concludes:

- a voluntary code of practice would not achieve the alternative objective of removing persons with connections with cannabis trade from the hydroponics retail industry because it could not ensure the cooperation of the very people it was trying to control. Such a scheme is not recommended by the Review Panel.
- the form of co-regulation considered was a retail industry association operated scheme requiring a retailer to be a member in order to purchase hydroponic equipment, backed up by legislation making it an offence for a wholesaler or manufacturer to sell to a retailer who was not an approved member (approved on the basis of no drug offence convictions). This would not achieve the alternative objective unless it was a national scheme, as retailers would be able to obtain their hydroponic equipment from interstate, making membership of the association irrelevant. Such a scheme needs further consideration by industry, and is not recommended by the Review Panel at this time.
- a business notification scheme (without end use certificate) would achieve the alternative objective; and if the scheme could be restricted to specialist hydroponic retailers only, the benefits would outweigh the costs. Even if this was the case, this scheme is not preferred by the Review Panel because the net public benefit produced would be less than with a negative licensing scheme. It is therefore not recommended.
- a negative licensing scheme (without end use certificate) would achieve the alternative objective, and the benefits would outweigh the costs. Of all the schemes that meet the alternative objective, negative licensing would have the least impact on the industry as a whole and would produce the greatest net public benefit. This scheme is therefore recommended by the Review Panel

The Review Panel's final recommendation relates to its concern that the recent and proposed amendments, which were announced at the same time as the licensing proposal, may impact on the proposal and make it unnecessary. Hydroponic retail industry sources state that the reduction of the number of expiable plants from ten to three in 1999 had a dramatic effect on the industry. If this is so, the recent changes to the legislation which reduced the number of expiable plants from three to one, and the Bill to remove hydroponically grown cannabis from the expiation scheme are likely to have similar impacts on the industry.

The Review Panel recommends delaying the introduction of the recommended negative licensing scheme for specialist hydroponic retailers until the effects of the legislative amendments on these retailers and the broader hydroponic industry can be assessed.

The Review Panel is concerned that it has not been able to consider the broader issue of reducing the commercial production of cannabis. Its terms of reference are confined to evaluating the licensing scheme and reporting on arrangements for hydroponic equipment retailers. Nevertheless, the Review Panel suggests that the Government establish a body to conduct a broad investigation into this issue, particularly ways to reduce demand, and the development of nationally consistent or supportive strategies.

## **SUMMARY OF REVIEW PANEL CONCLUSIONS/RECOMMENDATIONS**

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The Review Panel Conclusions/Recommendations, featured in bold throughout the report, are collected and reproduced below.

### **3. OBJECTIVES**

The objective in the Issues Paper of reducing the commercial production of cannabis is too broad in relation to the proposed restriction.

The objective of the proposed legislation should be:

*to remove from or prevent from entering into the hydroponic equipment retail industry persons who are associated with cannabis trade*

### **4. DEFINITION**

For the purpose of the licensing proposal, the Review Panel recommends that hydroponic equipment is any two or more of:

- Electric lights of 250 watts or more;
- Fluorescent lights which combine the red and blue part of the light spectrum in a way which enhances plant growth, also called grolux lamps;
- Units comprising high intensity discharge lamps, control gear, ballasts, lamp mounts and reflectors, also called ballast boxes.

### **5a. MARKET**

The market is the whole of Australia.

The market comprises the retail supply of hydroponic equipment.

The product is the wide range of items which can be used to grow plants hydroponically.

Competition occurs continuously.

### **5b. MARKET FAILURE**

There is no market failure or provider failure in the hydroponic equipment industry.

Provider failure is only one example of a detriment to society where Government intervention is justified; a concentration of specialist hydroponic retailers with connections with cannabis trade may be another.

### **6.3 POLICE INTEGRITY TEST**

The Review Panel assesses the police integrity test as a condition for licensing as a serious restriction on competition.

For the purposes of achieving the alternative objective of reducing specialist hydroponic retailers' connections with cannabis trade, the Review Panel is of the view that absence of convictions for drug offences is an acceptable criterion for deciding that a person is of good repute.

The Review Panel is of the opinion, that the principle of limiting the restriction to what is necessary to achieve the objective should be followed, and only the following offences are relevant:

- Section 31 - Prohibition of possession or consumption of drug of dependence and prohibited substance;
- Section 32 - Prohibition of manufacture, sale etc., of drug of dependence or prohibited substance;
- Section 41 - Aiding and Abetting an Offence against the Controlled Substances Act.

The Review Panel accepts the SAPOL suggestion to extend this to include any interstate conviction which would have been an offence against these sections if committed in this State; and to include any offence against the legislation which establishes the licensing scheme.

The Review Panel recommends that conviction of one of the above offences within the previous five years is an appropriate limitation on the restriction.

The Review Panel is of the view that the proposed licensing condition, of not having been issued with an expiation notice for a simple cannabis offence, is against the intention of the Expiation of Offences Act and the principle that a person is innocent until proved guilty. This option is not recommended.

The Review Panel is of the view that the costs associated with the proposed licensing condition of not having associations with criminals outweigh the benefits. This option is not recommended.

The Review Panel recommends similar appeal mechanisms to those in the Second-hand Dealers and Pawnbrokers Act for any scheme in relation to specialist hydroponic retailers.

The costs of the Police Integrity Test proposed in the Issues Paper as a condition for licensing outweigh the benefits and it is not recommended.

The recommended condition for licensing is:

- no conviction for an offence against section 31, 32 or 41 of the Controlled Substances Act within the previous five years.

#### **6.4 END USE CERTIFICATES AND PROOF OF IDENTITY**

The Review Panel assesses the purchaser end use certificate and proof of identity requirements as an intermediate restriction on competition.

The costs of the proposal for Customer End Use Certificate and Proof of Identity outweigh the benefits and it is not recommended.

Review Panel recommends that as part of any scheme to regulate hydroponic equipment retailers it be an offence to sell hydroponic equipment knowing that the customer intended to use the equipment for the production of cannabis.

## **6.5 LICENSING - CONCLUSIONS**

The benefits of the proposal in the Issues Paper for licensing scheme for hydroponic equipment retailers comprised of a police integrity check and customer end use certificate and proof of identity are outweighed by the costs, and it is not recommended.

### **7.2 VOLUNTARY CODE OF PRACTICE**

A voluntary code of practice is not recommended.

A mandatory code of practice is not recommended.

### **7.3 CO-REGULATION**

The co-regulation scheme is not recommended at this time. The Review Panel encourages the specialist hydroponics retailer industry to investigate the feasibility of this type of scheme and put its views to the Government.

### **7.4 NEGATIVE LICENSING**

The Review Panel assesses negative licensing as a serious restriction on competition.

A negative licensing scheme (without end use certificate and proof of identity) would achieve the alternative objective of removing people who have connections with the cannabis trade from the hydroponic equipment retail industry.

In the view of the Review Panel, the benefits of negative licensing outweigh the costs. Negative licensing would impose the smallest burden on hydroponic equipment retailers of all the schemes examined by the Review Panel, and is preferred because of the range of retailers included by the definition of hydroponic equipment.

Negative licensing is recommended.

### **7.5 BUSINESS NOTIFICATION**

The Review Panel assesses business notification as a serious restriction on competition.

The Review Panel finds that the costs of the business notification proposal in the SAPOL submission outweigh the benefits, and it is not recommended.

A business notification scheme (without end use certificate and proof of identity) would achieve the alternative objective of removing people who have connections with the cannabis trade from the hydroponics industry.

If the definition of hydroponic equipment could be restricted to specialist hydroponic retailers only, the benefits of a business notification scheme (not including customer end use certificates

and proof of identity) would outweigh the costs. However, this scheme is not preferred over negative licensing because the net public benefit would be smaller.

Business notification is therefore not recommended.

## **9. RECOMMENDED REGULATORY ARRANGEMENT**

The Review Panel recommends delaying the introduction of the recommended regulatory scheme for specialist hydroponic retailers until the effects of the legislative amendments to the cannabis expiation scheme on specialist hydroponic retailers and the broader hydroponic industry can be assessed.

The Review Panel recommends the negative licensing proposal.

The Review Panel notes that if a definition of hydroponic equipment can be developed which captures only specialist hydroponic retailers, a simple business notification scheme would produce a net public benefit, although less than with a negative licensing scheme.