



CANNABIS

For MuniServices (an Avenu company) each project engagement starts with knowing that each local jurisdiction must determine what is best for its community. In this policy update we address the issue of dealing with unlicensed cannabis businesses.

Dealing with Unlicensed Cannabis Business Operators in California. *By Brad Rowe, Avenu/MuniServices, Cannabis Policy Advisor*

California cities must address existing unlicensed operators and the proliferation of new unlicensed cannabis businesses. Protection of the newly regulated industry, and respect for the law are dependent on a clear response from city regulators and law enforcement. The city can utilize a number of tools to cut down on the existing illicit market of growers, manufacturers, and retail operations including strong initial communication, non-criminal enforcement, cooperation with California State authorities, creative focused sanctions and rewards, exploring alternative licensing options, moving to the licensed market from the unlicensed market and providing a favorable environment of taxation and licensing when compared to surrounding jurisdictions.

Eliminating unlicensed participants in any industry can prove challenging. Some of these operators have no intention of getting a license and some want to play by the rules but have not figured out the process. Cease and desist letters sent out earlier this year by the Bureau of Cannabis Control stated that if the operators in question were in fact engaging in unlicensed commercial cannabis activity they must cease all commercial cannabis operations until obtaining a valid state license. The California Department of Food and Agriculture has a tip line for complaints regarding illegal cannabis companies.

How do cities avoid falling into the traditional role of “whack a mole” pushing an unlicensed operator out of a storefront or plot of land only to have them reemerge down the road? In general, regulatory compliance rolls downhill. Getting retailers properly licensed, inspected and compliant will better ensure their buy-in; that they source quality regulated product from licensed distributors and manufacturers who will then in turn source regulated product from licensed cultivators. The general idea is to close the market to unlicensed operators; then to push with sanctions and pull with incentives to get operators and consumers out of the unlicensed and “grey market”. This may not only build a rewarding ethos toward compliance and bring in a sense of fairness to your business community; it will accelerate the rate at which the city captures market share and in its regulatory framework. Three years ago, at the inception of its regulated cannabis market, the State of Washington cannabis markets were split evenly in thirds between the adult use, medicinal and illicit. The difference between retail prices and licensed cannabis in California is more severe so it would be reasonable to expect that our cities will have a steeper hill to climb toward compliance.

Cities can manipulate sanctions and rewards to induce suppliers and consumers out of the unlicensed market. Tactics that front-load enforcement and inspections increase the likelihood of a sanction and improve behavior. They also increase the ratio of compliant businesses and ease detection of non-compliant ones. This positive feedback loop, if done properly, can push the local cannabis industry into a regulated environment easier and more cost effective to monitor in the future. Allowing violations to go unchecked attracts more criminal activity, decreases the chances of detection and pushes the community into a higher equilibrium of unlicensed operations. The upfront investment in enforcement and inspections can provide an amortizable lower cost long term solution. Selling cannabis without a license is a violation of state law.



The state Bureau of Cannabis Control (BCC), is working with local district attorneys to put unlicensed operators out of business. A “citizen complaint” resulted in the arrest of an Orange County resident for unlawfully operating a cannabis dispensary in Costa Mesa on August 24, 2018. The BCC has issued more than 1,000 letters to cannabis businesses operating without state licenses – putting them on notice. Demonstrations like these set the tone and provide leverage for cities to tamp down illegal operations with the implicit and actual backing of the State. Cities may consider first requesting the State’s data and particulars with regard to the local targeted businesses; and further to coordinate local efforts with the timing of state level communication and actions.

Communications directly to the consumer about the benefits of buying regulated and labeled product that has been tested for quality and potency will help validate the higher prices in the licensed market. Purer, scientifically produced products will be particularly important for consumers with respiratory conditions or compromised immune systems. Advancing research on medical cannabis uses countering public health challenges like the opioid crisis will weight public opinion in favor of the regulated market and could assist in drying up illicit markets for heroin, diverted prescription pills and other abusable drugs that fuel small time dealers and larger trafficking organizations.

Cannabis laws have traditionally been enforced unequally by race and location throughout American history. Notable support for Prop 64 hinged on addressing negative impacts on affected communities as well as eliminating large expenses for related criminal justice. Policies that reduce arrests, prosecution and incarceration work to improve social determinants of health such as employment, housing, stress and social exclusion. California has the highest rates of recidivism in the country in part from violations of the terms of community supervision. Cities could slow the progression from community supervision back to illicit jobbing by working with the counties to review the terms and conditions of probation;

reducing or eliminating cannabis use as a violable term of supervision. Cities may encourage licensees to absorb labor talent previously enlisted in the unlicensed market through tax credits or preferential licensing. Notification to local employment agencies and CBOs of these newly reclassified workers and creation of industry related job search and vocational training opportunities could further enhance this directive.

Non-criminal code enforcement may also prove more effective for cities. The threat or action of actually shutting off utilities, or sanctioning based on building, zoning and fire code inspections can have an equal or greater impact without taxing the criminal justice system or those that get caught up in it. Realistically, some cities have more control over power and water utilities or regulatory agencies than others. A compliance strategy including clearly communicated sanctions, and rewards like “transitional” licensing can be very effective as well. The best threat is one that does not have to be carried out. Prioritizing the most egregious offenders and overtly putting them on notice can make the city’s intentions clear. Police, fire and inspections can ultimately present a strong case to the unlicensed operator that compliance is the best option. The transitional licensing could command a higher rate including a temporary elevated tax during a probationary period. To better establish legitimacy and monitor progress: police and inspections departments could benefit from tracking arrests, prosecution efforts, and license revocation by race, gender, age; then to review to check that potential bias issues are caught early and dealt with transparently and in coordination with local civil rights and academic groups.

Another method for bringing in unlicensed operators out from the shadows would be to offer a Nano, or *true* micro, license to grow and sell smaller amounts of products. The current “micro” license offered in California is, despite its name, really meant for larger vertically integrated operators.



This basic expansion of licensing could be offered to allow individuals or a small group to operate in a business zoned area. Benefits could include a low-cost tiered licensing process, preferential introductory tax rates and compliance assistance from the City. To further attract non-licensed participants, the city could facilitate non-cash transactions and tax payments. Reduction of risk could shift some unlicensed operators to the regulated system. Options here range from smart kiosks and armored car services to accepting tax payments via PayPal type options and money orders. The State Senate and Assembly are actively working to pass a financial institutions bill (SB-930) to establish a statewide cannabis banking system. As such cities should monitor progress here to be responsive.

In general, creating a welcoming, positive and friction minimized regulatory environment should pay dividends in higher tax revenue, fewer headaches and fewer non-licensed operators in the area. Using the city's convening power to bring together the local Chamber of Commerce and other business organizations to welcome the new cannabis licensees will help to normalize new licensees and to better insure social pressure that they will operate inside of compliance standards.

Many cities have a capable and forward-thinking leadership team and enough support from the community to make the cannabis legalization implementation phase a socially positive, revenue-generating endeavor. To do so it will need to establish and protect the licensed businesses in a way that brings current consumers and operators in the illicit markets over to Main Street and keep them there. *Mr. Rowe is a Cannabis Policy Advisor at Avenu/ MuniServices, Policy Lecturer at UCLA and Pepperdine universities, and Director of RPM. Email: bradrowe@luskin.ucla.edu. Website: rowepolicymedia.com.*

SELECTED STATE LEGISLATION

AB 2020/ Quirk, Cannabis: Local Jurisdiction Licensees: Event Permits: : *This bill is on the Governor's Desk.* The cannabis event organizer license is an annual license required before a temporary event license may be obtained from the BCC. These licenses are granted for no more than four days with onsite sales only conducted by retailers authorized to sell cannabis. AB 2020 was introduced on behalf of the City of Oakland to help permit cannabis sales at the annual Art and Soul Festival. The bill enables licensed cannabis farmers markets, tastings and infused dinners. Similar events such as the Chalice Festival in San Bernardino at the County Fairgrounds have been relatively crime free. Supporters contend the bill supports small business and increase tax revenue and permits some level of local control. Permit fees structure still need to be worked out and given equity consideration.

AB 2164/ Cooley, Local Ordinances: Fines and Penalties: : *This bill is on the Governor's Desk.* The bill provides that a locality may provide a reasonable time for a licensee to correct a cannabis cultivation violation prior to the imposition of fines or penalties. It specifically pertains to building, plumbing, electrical, or other similar issues, that do not create an immediate danger to health or safety. The bill allows the ordinance to provide for the immediate imposition of penalties, enforcement, collection, and administrative review by the local agency. A person contesting that order may seek review by filing an appeal to the superior court for a fresh hearing as a non criminal civil case. Several groups including the California Apartment Association and CalChamber, opposed the measure indicating that, without ability to proactively inspect properties, unsuspecting landlords could face penalties without first getting a chance to appeal and remedy the problem. The Rural County Representatives of California expressed support stating the bill provides appropriate authority to local governments.



AB 2402/ Low, Consumer Privacy: Access to Data: Canna. Customers: *This bill is on the Governor's Desk.* This bill deems medicinal cannabis cards as "medical information" defined by the Confidentiality of Medical Information Act. It prohibits a licensee from disclosing a consumer's personal information to a 3rd party except to allow payments to be made; nor from denying the consumer service for not consenting to disclose personal information to a 3rd party not directly related to the transaction. Cities often need to review and evaluate this information as it relates to business activities. Many local governments use consultants in the capacity as "agents" because these local governments do not have the resources nor expertise related to the commercial cannabis industry. With this bill, as an agent of a local government, the consultant has the same authority to review and evaluate all pertinent information related to the business activities. MuniServices / Avenu weighed in on amendments to the bill which affect these abilities. A recent amendment preserved the ability of local governments to regulate cannabis commerce while protecting the consumers' data.

SB 930/ Hertzberg, Banks for the Cannabis Industry: *This bill did not reach the Governor's Desk.* Cannabis banking has been difficult for businesses and cities. Nearly all banks or credit unions use Federal Reserve systems for transmittal of funds putting them under supervision of federal agencies. Cannabis is illegal under Federal law, severely limiting access. To get around these restrictions: licensees have traditionally worked with cash or developed creative workarounds like "don't ask don't tell" relationships with local banks. Fewer than half of the cannabis operations nationwide are fully banked leaving billions of dollars difficult to track and audit and creating opportunity for embezzlement and robbery. California Secretary of the Treasury John Chiang assembled a Cannabis Banking Working Group challenging the State to design easily accessible solutions to protect the safety of business and government employees, handle large dollar volumes while minimizing revenue losses and permit agencies to make deposits.

This bill addresses these obstacles in a significant though somewhat restricted manner. It would provide for the licensure and supervision of cannabis limited charter banks and credit unions, or "cannabis depository institutions" or "CDI." It would restrict the activities of CDI to accepting deposits and issuing and redeeming special purpose checks and prohibits them from engaging in banking activity with any other financial institution that lacks a limited purpose charter. Licensees would have to comply with the Financial Institutions Law and other applicable banking and credit union laws like maintaining private insurance for assets, providing transparent fee schedules. Portions of the bill are left purposefully vague. The bill prohibits these CDIs from engaging in mainstream banking activity however does not define exactly what that is. It also requires compliance with standard financial laws except when those laws are inconsistent with a provision of this bill. Localities may want to gain some clarity on what the potential impacts from both of these issues are before supporting the bill.

SB 1409/ Wilk, Industrial Hemp: *This bill is on the Governor's Desk.* Hemp is a non-psychoactive plant with thousands of industrial, agricultural and food applications and serves as a soil decontaminant. The plant enjoys a mythological ethos based in some substantiated roots in American history. A majority of U.S. sales of hemp food and personal care products are earned by California companies. Despite its close relation to the psychoactive Cannabis sativa bred for THC, hemp contains under 0.03% THC. Despite concern that it would be used to hide marijuana grows, hemp cannot be used for this purpose as the shade works as a smother crop for weeds that need sunlight and can downgrade marijuana potency through cross polination. SB 1409 updates current law to streamline production of industrial hemp in California and allow farmers to grow and produce for commercial and industrial uses. It broadens availability of hemp by deleting certification requirements requiring cultivars and seed sources be accredited on or before January 1, 2013.



The bill allows clonal propagation and generally allows farmers to grow hemp for any purposes such as the extraction of CBD and anti-psychotic to THC. The bill further enables the California Department of Food and Agriculture to carry out an agricultural pilot program similar to effective examples in Colorado and Oregon possibly advancing the State's understanding of hemp and marijuana extracts through endeavors like the upcoming UC Riverside research grow. Counties would still need to develop an annually renewable fee structure and capture data on location and purpose of the grow. Localities could waive registration requirements potentially creating competition between neighboring agricultural communities.

SB 1459 / Cannella, Cannabis Permitting: *This bill is on the Governor's Desk.* The measure gives counties time to review pending commercial cannabis applications and complete the environmental review process and is intended to help counties get through the backlog of cannabis permit applications. Counties like Humboldt were looking at finalizing 900 local permits without assistance from the state. Unless these agencies process the regulatory permits before the year is out, licensed cannabis businesses would need to stop operations, thereby disrupting a growing market and expected tax revenue. County agricultural commissioners (CACs) are requested to report on cannabis statistics to stabilize the marketplace and to encourage unlicensed growers to enter the regulated market. The bill currently enjoys a strong majority of support in both the senate (33 to 4) and assembly (73 to 1). *The bill was thoroughly amended.* Some benefits to localities in these revisions include reduced reporting requirements, moving provisional permit control from the temporary licensee to the locality, ability to set provisional fees, and removal of certain time restriction.

Questions remain around the bill's intent regarding licensees sanctioned by localities and to whether or not they are entitled to appeals to the Cannabis Control Appeals panel. Other challenges to cities from the bill are language that could trigger mandates for local programs, non-allowance of renewal of these licenses and restrictions requiring candidate licensees have in hand a permit for the same premise and activity. A notable amendment discarded track and trace requirements during the provisional period; challenging localities attempting to conduct financial and compliance audits.

STATE REGULATIONS

California Bureau of Cannabis Control (BCC) Hearings / Public Comment: The BCC is creating new regulations to replace the existing emergency regulations for the implementation of the Medicinal and Adult-Use Cannabis Regulation and Safety Act. During the public comment period of the regulatory process individuals and organizations were encouraged to participate. The BCC distributed proposed text of regulations including 5416(d) "Delivery to a Physical Address" which states that a delivery employee may deliver to any jurisdiction within the State of California. Language in Prop 64 left room for broad interpretation specifically the ability of local governments to, "ban nonmedical marijuana businesses". MuniServices / Avenu made public comment arguing the text challenges local government control to prohibit cannabis business in their jurisdiction. Arguments may continue between interpretations of the phrase meaning the locality can only control *licensing* a business or if it has greater control of what business is *conducted* there. MuniServices / Avenu also provided commentary opposing the 10 day turnaround in 5002(c-28) "Annual License Application Requirements" which states the local jurisdiction must respond within 10 days of receiving the Bureau's authorization of a permit; the failure to do so would result in automatic validation of the authorization.



FEDERAL BILLS

HR 1227/ Garrett, Removing Cannabis from Fed Controlled Substances List: Originally put forth by Sen. Bernie Sanders (D-VT) this bill sponsored by Tom Garrett (R-VA) and Tulsi Gabbard (D-HI), amends the Controlled Substances Act. It states that the Act's regulatory controls and penalties do not apply with respect to cannabis. It removes it from schedule I, a classification of drugs with a high potential for abuse and no currently accepted medical value. The bill does however make it a crime to knowingly ship or transport marijuana into a state where its receipt, possession, or sale is prohibited. The bill would make it possible to allow federally insured banks and credit institutions to enter the market without risk of federal intervention, eliminate billions in dollars in cannabis related criminal justice costs, and would stimulate medical and non medical product innovation. Opponents are concerned about further proliferation and normalization of cannabis and some of the public health and safety risks that come with increased prevalence.

S. 1689/ Booker, Marijuana Justice Act of 2017: This bill amends the Controlled Substances Act to remove cannabis from schedule I; and to eliminate criminal penalties for an individual who imports, exports, manufactures, distributes, or possesses with intent to distribute. It reduces certain federal funds for states without legal cannabis regulation if the state has a disproportionate arrest or incarceration rate for cannabis offenses. The bill directs federal courts to expunge minor cannabis convictions. It establishes the Community Reinvestment Fund to be used by the Department of Housing and Urban Development. This fund would reinvest in communities most affected by the war on drugs. The bill would provide \$500 million in funding for key services and community development in the country's hardest-hit areas. Part of the funding will come from cuts to state law enforcement and prison construction. It would also automatically expunge cannabis possession from individuals' records across the country, allow those serving time for cannabis crimes to seek resentencing.

S. 3174/ Schumer, The Marijuana Opportunity and Freedom Act: Sen. Schumer's (D-NY) introduced legislation supporting decriminalization of cannabis descheduling it at the federal level. It would invest \$100 million per year in research to understand medical benefits for diseases as well as recognize the effects of THC on the developing brain, driving and public health. It would authorize a grant program for \$20 million per year to incentivize states and local governments to adopt expungement or sealing programs for convictions of simple possession of marijuana. The bill would involve the Small Business Administration by creating dedicated funding streams, amounting to 10% of all cannabis tax revenue, to support women and minority owned cannabis business. It would include a provision for protecting kids by restricting advertising to youth and non-users.

Federal decriminalization note: An unintended consequence of the broadening of cannabis regulation and additional tax burdens on consumers could result in increased entry of illicit market activity. Federal decriminalization would reduce trans-state shipment and production workflow impediments and potentially put California growers in national competition with Virginia tobacco and Iowa corn farmers. A national market would also provoke interest from large food, tobacco and alcohol companies that could leverage their large manufacturing, distribution and lobbying resources. National mergers and consolidations of these types are already beginning in Canada.

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