

AN EMERGING CRISIS: BARRIERS TO ENTRY IN CALIFORNIA CANNABIS

ABSTRACT

This report is intended to provide an understanding of why participation in the regulated marketplace is low—and what policy makers can do to improve the situation.

By exploring and summarizing the barriers to entry experienced by cannabis businesses when they seek a state license, this report seeks to inform policy makers in the hopes of solving key problems faced by the regulated community.

California Growers Association

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1. Introduction and Background

On January 1, 2018, California approved its first-ever state licenses for the production, distribution, and sale of cannabis, capping years of intensive deliberation on the rules for the newly-regulated cannabis marketplace. The issuance of these licenses was the culmination of a multi-year process initiated by the passage of the Medical Marijuana Regulation and Safety Act, or MMRSA, which for the first time regulated medical commercial cannabis activity on a state level. In November 2016, the voters approved Proposition 64, which created a parallel but distinct regulatory structure for adult use cannabis. And, in July 2017, the legislature reconciled these two systems in the Medical and Adult Use Cannabis Regulation and Safety Act, or MAUCRSA – the system that we exist under today.

In regulating cannabis for the first time, California was forced to deal with a question that is too often ignored in drug policy discussions: yes, prohibition is a failure; and yes, cannabis should be legal; but how? Policymakers don't often have the opportunity to shape the structure of a \$7 billion market. How should the wealth generated by newly-regulated cannabis be distributed? And who should have a chance to participate?

As the largest cannabis trade organization in California, currently representing over 1,100 small and independent businesses, our answer to these questions has always been simple: the success of the state regulatory system will be determined by the number of businesses that are able to enter the regulated market.

Failure in this goal – meaning, the domination of the regulated cannabis market by a small number of large, consolidated businesses – would be a moral, economic, and practical disaster for the state of California.

Morally, justice will not be restored if the same people who worked for policy reform through

“The unintended consequence of making it so difficult at the local and state level to enter the regulated market is that 80-90% of those who were working with dispensaries prior to 1/1/2018 are being pushed to the black market.

This is not only bad for the regulated market because so much high quality produce is now flooding into the black market, but crime is increasing as a result as well.

I am truly heartbroken to see what the regulatory system has done to the artisan cultivators and manufacturers who were creating diverse, boutique products.

These people who built this industry are not allowed to participate. I hope we can course correct this year.”

Sonoma County Cultivator

decades of persecution, or who suffered under the war on drugs are kept out of the regulated market. Small businesses owners in urban and rural communities should not be dismissed as greedy criminals when all they need is time to transition.

At the same time, the potential economic impact of these regulations are severe. More than sixty thousand cannabis farmers currently operate around the state. We estimate that these farms employ 3.6 people on average, for a whopping 258,000 jobs.

Thousands of people, and dozens of communities around the state, that have been able to sustain themselves and supply patients under SB 420's provisions are being destabilized. Economic depression is the best case outcome—economic collapse is the worst case.

The state is ill-prepared to address these impacts as they will be centralized in places where social safety nets don't exist or are severely strained.

Practically speaking, it will take time to supplant the unregulated marketplace in California. The networks that supply lucrative out of state markets are likely to persist until federal law changes. Law enforcement resources will continue to be strained. Increasing participation in the regulated marketplace will reduce the demands on already scarce law enforcement resources.

If the illicit market cannot be stemmed through regulation, the MAUCRSA's goals for environmental sustainability, public safety, revenue generation, and restorative justice will remain elusive.

THE PROP 64 DEBATE

The role of small, independent, and existing businesses was central to the conversation over MCRSA and Proposition 64. To address these concerns, Proposition 64 is littered with references to “ensuring... the industry in California will be built

around small and medium sized businesses,” “strict anti-monopoly provisions,” and intent to “reduce barriers to entry into the legal, regulated market.” MAUCRSA contains similar language, including a declaration that the legislation furthers Proposition 64's intent in reducing barriers to entry.

So, two months into the regulated system, where do things stand?

The key message of this report is that the current system will not achieve its goals without fundamental and structural changes that allow small and independent businesses to enter into compliance. Beyond its intent language, Proposition 64 made three substantive promises to small and medium sized businesses. Unfortunately, two months after the issuance of the first licenses, it is clear that none of the promises have materialized in practice:

- Prop 64 promised five-year prohibition on large-scale cultivation businesses. Following the decision to remove the cumulative one-acre cap from the emergency CDFA regulations, however, this prohibition is effectively irrelevant. A large-scale cultivation operation may now stack unlimited numbers of “small” cultivation license to grow an unlimited canopy area.
- Prop 64 created a “microbusiness” license, which was generally described as an opportunity for small farmers to vertically integrate at low cost. As this report documents, the microbusiness license has produced exactly the opposite of its intended effect, smoothing the path to vertical integration for well-capitalized retailers while remaining out of reach for small and rural cultivators.
- Prop 64 removed the “independent distributor” requirement in MCRSA. While it was argued that this decision would enable small farmers to “self-distribute” their product to retailers, this report documents that the result, instead, has been the capture of the majority of distributor licenses by retailers or large manufacturers. By comparison,

cultivators – primarily larger ones – have obtained only 9% of state distribution licenses.

The effects of these policies, and others, are very much being felt by our membership. In our survey of membership, despite strong desire to enter into the regulated marketplace, only 15% were “very confident” that they would be able to do so. An additional 35% were “somewhat confident,” with the remaining 50% either “not very confident” or “not confident at all.”

THE FUTURE OF CALIFORNIA CANNABIS

This report will explore some of the reasons why our membership continues to feel that barriers to entry are impracticably high, and proposes solutions designed to ensure that small and independent businesses are able to negotiate start-up costs and participate in a fair, open marketplace.

The inevitable growth in California’s cannabis industry must be balanced by stability. California’s cannabis culture has many things to be proud of, even uniquely so. The California cannabis industry has been – and can continue to be – a model for an industry built on compassion, community, and sustainability rather than profits and endless expansion. Policy and legislation cannot mandate these values, but they can help to ensure that the people and communities that hold them have an opportunity to survive and flourish. As history turns against prohibition, it is essential that California leads the way in demonstrating that this new industry does not have to be built around profit alone: it can, and must, stand for people.

2. The state of cultivation licensing.

California is an agricultural powerhouse. The producers in our state supply not just our country, but the world with a multitude of agricultural commodities and products.

In some ways cannabis is not exceptional—just one of several big-time crops grown in our state.

In other ways, cannabis stands alone:

- Cannabis is federally illegal. It can only be sold here in California. The entire state marketplace probably requires a few thousand acres in cultivation at most, where other crops rely on tens or hundreds of thousands.
- Cannabis is primarily grown by small farmers. Whereas other crops are grown by the acre or hundreds of acres, in cannabis, 2500 square feet in cultivation (one twentieth of an acre) is still not licensable in most counties.
- Cannabis—unlike many crops—requires a license to cultivate.

The biggest challenge of regulating cannabis cultivation in California is the scope of the situation. We estimate there are 68,150 growers in the state. This estimate represents a significant increase compared our past estimate of 53,000. The primary difference is the inclusion of the Type 1C cottage cultivation license. The increase represents the inclusion of an estimated 15,150 cottage growers throughout the state.

As of February 7th only 0.78 percent (534 unique licensees) of these growers are licensed.

While there is no disputing that California has a lot of growers, questions are often raised about how many growers are interested in participating. In order to inform our analysis, we use three different assumptions about rate of interest in participating. Simply put, not all growers are interested in seeking licensure. The experience of the early adopters is

likely to inform the decision of growers who are initially excluded and get the opportunity to participate sometime in the future. The three scenarios considered here are:

- High Participation – assumes 75 percent of growers are interested in participating. There are a total of 51,113 growers interested in state licenses.
- Moderate Participation – assumes 50 percent of growers are interested in participating. There are a total of 34,075 growers interested in state licenses.
- Low participation– 25 percent of growers are interested in participating. There are a total of 17,038 growers interested in state licenses.

Using these three scenarios the state has licensed between 1 to 3 percent of interested growers. There is a long way to go.

DISPELLING A FEW MYTHS

Good policy comes from good information. In addition to widespread information gaps, there is also a huge amount of misinformation in cannabis. The phenomenon of misinformation is driven by two common mistakes:

- **Reliance on comparative analysis.** While there are some lessons to be learned from other states that are regulating cannabis, California is an outlier. Our state has the most robust and productive cannabis industry of any state. Other states replaced an illicit import based market with domestic production whereas California must transition an existing unregulated marketplace.
- **Assumptions and estimates are not facts.** When analyzing anything assumptions are often made. In a situation where good information is scarce, estimates and assumptions are important tools for analysis. However, it must be remembered that these tools are imperfect and should not be confused for objective.

There are a few myths that have become so pervasive that it is necessary to discuss them before considering barriers and incentives.

SMALL FARMS ARE NOT DOOMED TO FAIL.

We've all heard the talking points from businesspeople looking to make their way in cannabis: "Consolidation is inevitable. You may as well just get out of the way. You won't be able to compete."

It is certainly true that many businesses in California will not succeed in the regulated marketplace. However, there is no reason we can't build a well regulated marketplace around the proven success of small and mid-sized businesses—as promised in Prop 64.

Additionally, the suggestion that bigger is better and small business will collapse when forced to compete doesn't match with our experience. It is not

operational inefficiencies that are hurting small growers. Rather, it is the one time costs of regulations or the inability to comply with regulations because of local land-use policy.

Many farmers who are being pushed out of the market and off the land are responding to regulatory challenges, not folding because of operational inefficiencies. To the contrary, the disturbing trend is that many of the best growers—the most dedicated and passionate artisans who can add tremendous value to the state marketplace—are the ones being left behind.

CALIFORNIA CANNABIS IS NOT GROWING.

In fact, in the short term it is likely that the market will contract significantly. California produces more than 15 million pounds of cannabis per year. The state consumes less than 3 million. There are certainly growth segments of the market—there are not enough labs or distributors, for example—but cultivation is not one of them. There may be some growth in demand thanks to new consumers, but it is widely estimated that such growth will be modest because most people in California have had access to cannabis in the past. These factors point to the need to reduce production if regulation is to succeed.

WE ARE NOT ALL RICH...

There is a myth of "green gold" in the hills of the Emerald Triangle. Those myths--while more true at one time many years ago--have long since given way to a more stable state marketplace. Still, the myths persist and the negative impacts are significant:

- An assumption on the part of local governments that cannabis businesses can cure budget woes leading to high taxes.
- A feverish, speculative expectation of returns that is looking for growth oriented, businesses makes capital unobtainable for many business owners.

- A disregard or lack of concern for the cost (especially one time costs) of regulatory compliance.

...AND WE DON'T ALL WANT TO BE.

There are many first-wave social capitalists within the cannabis marketplace. These entrepreneurs differ from more mainstream capitalism in an important

way. Where neoliberal economics seeks constant growth, social capitalists seek stable businesses and prosperous local economies. Many growers think there is a dangerous concentration of wealth in our economy and see cannabis as a way of counterbalancing that trend. This is not to say that our members don't fundamentally depend on profitability; of course, they do. It is simply to say

Small-business owners have a great idea.

They solve a problem in their community. They know their business and target audience. They know what will make their customers happy. They serve their customers.

Entrepreneurs have big ideas.

They dream big. They think big. They come up with ideas that haven't been tested, diagnosed, or worked through. A lot of times they don't even know if their ideas are possible, which gets them even more excited.

Small-business owners hold steady.

They like to know what's coming next and where it's coming from. They make calculated decisions where the outcome is clear. The result may not be huge, but it will typically keep them moving forward.

Entrepreneurs love risk.

They step out on a ledge more often than not. They jump in with both feet knowing that if they put in their full effort, the risk will be worth it more often than not.

Small-business owners think about the things they need to finish this week.

They have daily and weekly to do lists. They manage employees, work with customers, network with new customers, and keep everything rocking and rolling.

Entrepreneurs are thinking ahead six months.

While their team is thinking about what they're doing that week, they tend to skip the now and focus on the future of the company. They have people to manage the business, and if they don't, they soon will.

Small-businesses owners are sentimental with their businesses.

They never plan on selling or handing their business off to someone else unless it's family. They like making the decisions and running the day-to-day.

Entrepreneurs focus on scaling.

They want to grow and grow they will. Although they may not focus on selling the business, they set it up to run without them. They surround themselves with experts while they end up being the rainmaker.

<https://www.entrepreneur.com/article/233919>

that there are multiple ways of prioritizing considerations when planning and operating a business. Maximizing returns is not the only path—and often it is not the moral path or the sustainable path.

Cannabis is probably the most valuable cash crop in California. It is most certainly the least centralized. Cannabis is grown primarily on a cottage, specialty, and small scale. The billions of dollars per year generated by commercial cannabis activity are distributed throughout the state and provide opportunities and benefits in many disadvantaged communities. California should not fail to understand and protect the unique characteristics of this marketplace.

At the very least there needs to be a better balance struck between “green rush” entrepreneurialism and small business owners. Not all cannabis business owners are trying to get rich but they would like to continue in the middle class.

CANNABIS IS NOT ALWAYS A COMMODITY...

Commodities are generally very uniform and are indistinguishable from one another. As such they can be traded differently than products, which are much more variable in their quality and characteristics. Raw cannabis can be either a commodity or a product. At first glance cannabis appears to be somewhat unique. There are a few other examples, like coffee or tea. However, when we look closely we realize that all of agriculture exists in this dual state.

In fact, with the emergence of the local food movement, empowered by the Direct Marketing Act, we are beginning to see that commoditization of agriculture is not a natural state so much as the result of policy decisions.

The implications of the distinction between product and commodity are of critical importance. Where

products provide benefits to farmers, commodities primarily provide benefits to large corporations and stakeholders. Even when commoditized, there is a better way to produce crops: cooperatives. Cooperatives provide for efficiencies of scale in processing while preserving the independent ownership of individual farms ensuring more equitable economies.

Farms – and small farms, especially – provide irreplaceable economic and cultural value to rural California. The commoditization of cannabis is not inevitable, nor is it in the immediate public interest. The priority, at least initially, should be stabilization and transition: not growth.

There are a few characteristics of industrial agriculture that cause concern:

- **Biodiversity to monoculture** – A commodity marketplace relies on standardization and reliability. More of the same product is better and easier to market. This decreases variety for consumers and could be catastrophic for the discovery of new strains.
- **Overproduction** – Commodity markets rely on scale. However, there is no need in the market for larger scale grows. The simple reality is that California produces far more than it can consume. Overproduction has been raised as a significant issue in Oregon by the federal prosecutor and will need to be dealt with in California as well.
- **Reliance on pesticides and synthetics:** Industrial agriculture is marked by a reliance on pesticides and synthetic fertilizers. Cannabis—like any crop—can be grown without those inputs if it is grown on a smaller scale in bio-intensive diversified plots. Cannabis can help reduce our states’ use of pesticides and synthetic fertilizers.

...AND THE “PRICE CRASH” IS NOT WHAT CONCERNS US.

The commodity price for THC oil will certainly be reduced as production operations scale up. However, to say there will be a “price crash” is an oversimplification. Cannabis is a product ripe for value adds. More so than ever, flower can be distinguished by grade and brand. Standards will be established; appellations will be mapped.

Since cannabis can leave the farm either as a commodity or a differentiated product, there is tremendous opportunity to establish a robust, differentiated marketplace that serves the public interest. This market will look like the wine market, with products ranging from a few dollars a gram to \$15 or more—not the tobacco market where prices are relatively standardized.

WE DO NOT USE 6 GALLONS PER PLANT PER DAY.

Cannabis plants are grown using a wide variety of practices. From small indoor plants using water efficient technologies to dry-farmed outdoor, the demands on water supply are equally varied.

Historic efforts to quantify the water used to irrigate cannabis have sought to determine a single number of gallons per day, per plant. The most widely circulated number is 6 gallons a day per plant. This approach to determine water use is flawed and policies that were informed by the 6 gallon figure likely are likely to be flawed as well.

The challenge here is that the diversity of practices used in cannabis cultivation make this a hard thing to simplify. We offer an improved formula. Though this formula is only slightly more complex it offers much greater accuracy: one gallon per pound of finished flower per irrigated day. For ease of making estimates one can assume about 1 pound per 10 square feet.

This new formula is based on extensive feedback from our members regarding actual water usage using industry standard practices.

Several studies have cited the 6 gallon per day figure and they should be regarded with great caution because of the flawed methodology of relying on plant count for an average. Studies are only as good as the assumptions they are based on which—in this case—were deeply flawed.

3. Understanding the barriers.

A barrier to entry is a cost, policy, or market condition that prevents new competitors from entering a marketplace or business.

Sometimes barriers to entry are intentional to ensure public health and safety, or to protect specific economic or social conditions.

Other times they are intentional for more malevolent reasons: businesses seek to create or maintain barriers to help increase their market share and reduce their competition. Cannabis is especially prone to this phenomenon because of the disparate experiences businesses have had at the local level—while a few hundred retail businesses have been able to get local permits over the last decade, the many thousands of supply chain businesses that were required to make this market work were entirely at the whim of these few.

Most often, barriers to entry are unintended consequences of well meaning regulatory efforts.

No matter the source of the barrier, one thing is certain. The State of California must systematically review the cannabis regulations and reduce barriers wherever possible or else a staggering number of businesses will fail while staggeringly few enjoy significant growth. In addition, policy makers must remain attentive and vigilant and continue to reduce barriers as this regulation proceeds.

This reports identifies and summarizes specific barriers to entry that are present in 2018 in California cannabis. Barriers are divided into five categories:

- Timeline
- Local Policy Barriers
- State Policy Barriers
- Financial Barriers
- Cultural Barriers

These new rules are causing a significant disruption in our small communities. People can not afford legalization and must leave. This is destroying our schools and local commerce.

Mendocino County Cultivator

TIMELINE

The timeline for regulation in California is an exercise in extremes. Medical cannabis was legal for twenty years. Recognizing the emergency conditions which had developed on the ground, a bipartisan coalition of lawmakers supported by a broad coalition of stakeholders from industry to law enforcement came together to pass the MMRSA—later amended to be the MCRSA. This legislation had an expedited 2-year timeline. Less than a year into implementation of the MCRSA, the AUMA passed. Leaving less than 6 months to develop regulations, the AUMA and MCRSA were combined to form the MAUCRSA in mid-2017.

Between pilot programs, shifting targets and litigation at the local level, and changing legislative requirements and authorities, the rollout of regulations has been a non-stop process of new deadlines and evolving requirements. This has resulted in general confusion throughout the process. This is a source of frustration for all businesses owners but is also a significant barrier for small businesses who don't have regulatory and compliance staff.

But implementation will take time, Senator McGuire said, asserting it will take five years to bring 40 to 60 percent of the growers and other businesses into the regulatory system and it “will be tough” to get the remaining 40 percent.

It may take law enforcement action to either regulate the “criminal element,” he said, “or better yet, push it out.”

“It’s going to take a decade to dig out of the mess we’re in,” he said.

LOCAL POLICY

Since the passage of MMRSA in 2015, local governments have slowly worked to determine whether and how to regulate commercial cannabis activity. Two and a half years later, progress has been limited. Our survey of California counties, summarized in the map at right, finds that only thirteen of California's fifty-eight counties have passed an ordinance to allow and regulate commercial cannabis activity as of February 2018 (blue). An additional six counties are likely to pass a regulatory ordinance in the near future (black), and fourteen counties are studying the issue with the intent to make a decision in 2018 (white). Twenty-five counties currently have a ban on commercial cannabis activity with no clear plan to reconsider the issue (red).

The first chart on the following page shows this information in a pie chart. The situation does not initially appear so bad. However, when corrected using our experience in other counties the situation gets much more bleak.

In the 12 counties that have issued permits, they have not been universally workable. Many grows, while in permit counties, are in ban zones. Taking Humboldt, Mendocino, Trinity, and Sonoma—four leaders at the local level—we can estimate that only about 47 percent of growers in the county were eligible for permits. The second chart shows the percentage of growers after correcting for this trend—and assuming the same rate of accessibility for the other counties.

A handful of cities – concentrated in Los Angeles, San Diego, the Bay Area, Sonoma County, Sacramento, and the Palm Springs area – have also passed ordinances allowing for indoor cultivation, manufacturing, distribution, and testing. Generally speaking, larger urban areas in coastal regions have regulated commercial cannabis, while cities in the

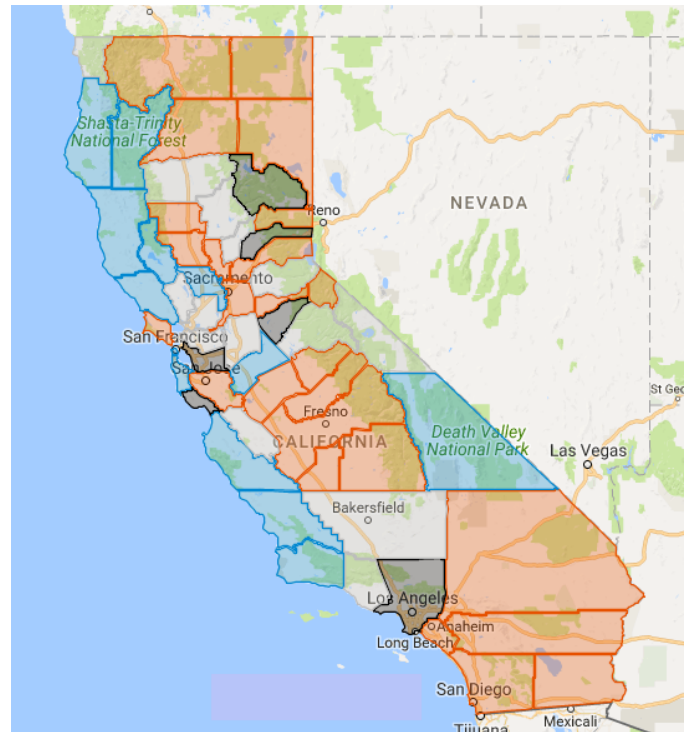


Figure 1. Estimated number of growers in each of the four categories:

- Permits – 29,350
- In process – 16,100
- Studying – 7,550
- Bans – 15,150

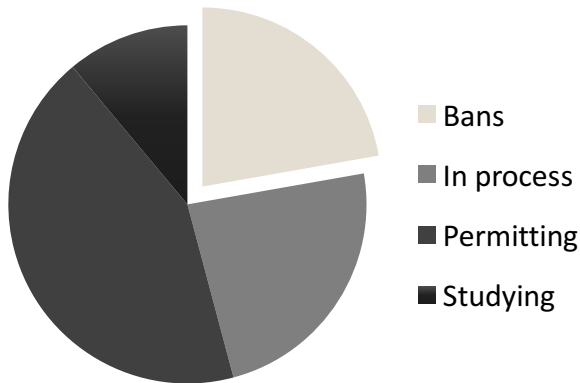
Central Valley and mid-size cities in Los Angeles County have, for the time being, passed bans.

We view the progress of these smaller cities, as well as the twenty “swing” counties in this map - those that are open to regulating but haven’t yet done so - as crucial. Most small and independent businesses lack the capital and flexibility to move to a location with a more liberal ordinance, and have few options if their local governments decide to prohibit their businesses. The systematic risk is that large businesses with more flexibility will locate in a small pool of friendly cities and counties, saturating the regulated California market, while existing small businesses will be left without a path to compliance.

If the current situation continues, the statewide dynamic is likely to look very similar to the situation prior to MAUCRSA’s implementation. Practically

PERMIT LIMITS AND LAND USE RESTRICTIONS

Estimated Percentage of Growers - Organized by local Policy (simple)



speaking, cannabis prohibition will continue in ban counties, and operators in these regions will continue to have the option to sell on the illicit market. Absent local regulation that generates resources for enforcement against non-compliant operations, rural local governments - faced with a large number of illicit operations, a sparse population, and an expansive geography - will lack the resources necessary to enforce against trespass grows, cultivation on public land, and irresponsible operations that damage wildlife and sensitive watersheds.

Urban governments will find themselves in an analogous situation, especially if they're located in regions with widespread bans on commercial cannabis activity. If widespread bans persist in these areas, unregulated and residential cultivation and manufacturing - with the attendant electrical, fire code, and nuisance issues - are likely to continue, and local governments are unlikely to have the resources to effectively enforce their bans.

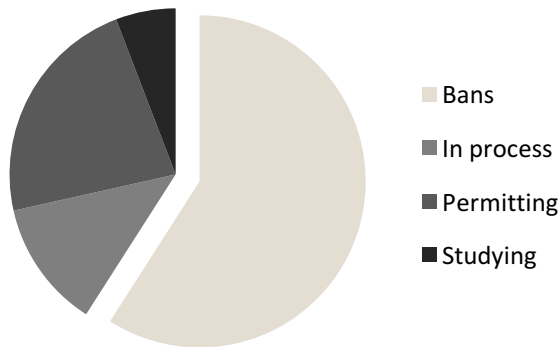
Simply being in a county that is issuing permits is not a guarantee of success. will have the ability to transition into the regulated market, even if they are committed to compliance and have the resources to obtain a state and local license. Some areas have set a limit on the number of permits available: Trinity County, for instance, has only accepted 500 applications, despite over 4,000 cultivators operating in the county. San Luis Obispo County's ordinance caps total cultivation operations in the county at 150, despite several hundred known growers and possibly a thousand or more.

Zoning restrictions can create similar, if more subtle, barriers to entry. In Sonoma County, a ban on cultivation in rural residential and agricultural residential (RR/AR) zones has excluded over 3,000 cultivators from the regulated market. The charts on the previous page illustrate the impact that land use restrictions have had/ is likely to have on participation in the regulated market if the counties currently working on ordinances create similar structures to those already in place.

In urban areas, zoning restrictions - combined with a limited number of friendly jurisdictions statewide - have resulted in severely inflated real estate prices that price smaller businesses out of a chance at compliant operation. Properties zoned for commercial cannabis can be difficult to locate and average between 25% and 50% over market rate for non-cannabis activity. For smaller cultivators, it's often difficult to locate industrially-zoned properties that are appropriate for their size and meet their budget.

For smaller manufacturers, shared space - such as shared commercial kitchens - is crucial to reduce real estate costs. Unfortunately, rules allowing for shared use of space have been delayed, leaving many small manufacturers unable to locate state-compliant real estate during the transition period, even if they are

Estimated Percentage of Growers
 - Organized by local Policy
 (corrected for zoning restrictions)



located in a jurisdiction like Oakland that explicitly encourages the use of shared commercial kitchen space. Developing regulation around shared spaces as soon as possible is essential for hundreds of small manufacturers to have a chance at compliance.

“Extreme zoning restrictions are making it impossible for small cultivators and manufacturers to participate in the regulated market. We simply don’t have the resources to purchase million dollar properties or lease at two and a half times market value. The RR/AR ban has been a disaster.”

-Pure Sonoma, Sonoma County

LOCAL DELIVERY BANS

Access to the regulated market—both for consumers and for producers—is a foundation of success in California. The cumulative total of the local policy patchwork is that many Californians don't have access to regulated cannabis and access to shelf space in the regulated market is highly controlled. Historically, delivery services have been able to fill this gap in the marketplace.

In 2018 it is estimated that as little as 25 percent of the cannabis consumed in the state is purchased from licensed retailers. Preserving access to retail is critical to move sales and consumption out of the unregulated market place and into compliance.

With the passage of MAUCRSA, the state legislature took an enormous step forward by clarifying for the first time that delivery services would have a place in California’s state regulatory system. To this point, though, delivery has been underrepresented among overall licensed retail. As of February 2018, the Bureau of Cannabis Control has issued only 55 delivery licenses. 35 of those licenses - over 60% - have been issued to delivery business in San Francisco or Oakland. In LA County, only six delivery services have been licensed, all in the city of Lynwood. And the city of San Diego - one of the largest markets in the state - has banned delivery entirely, leaving dozens of existing businesses with no path to compliance.

From a small business perspective, delivery services have historically provided a far lower barrier to entry to retail than storefront dispensaries. Delivery services have much lower overhead and fewer land use impacts than storefront dispensaries, allowing businesses to participate in the market even with limited capital and real estate access. They are also crucial to ensuring that seriously ill patients who have limited mobility, or who lack access to a nearby storefront dispensary, are able to access cannabis for medicinal purposes.

Hundreds of delivery services around the state will be left without a path to compliance if the current situation continues. Adding to the concern is that the market effects of delivery permitting have a ripple effect extending beyond the delivery services themselves. A market built on a large number of small delivery services rather than a small number of large dispensaries can provide producers will more entry points into the market, and consumers with more options for retailers targeted to their particular

needs. Producers can organize in cannabis cooperative associations to apply for delivery permits, or form partnerships with independent delivery services that are built to market their specific products. By contrast, a market built on a small number of retailers tends to demand homogeneity and a simplified, consolidated supply chain.

STATE POLICY

Given the complexity of regulating cannabis, it is no surprise that there are a great many barriers identified at the state level. This report focuses on priority issues identified over the last several years.

DIRECT MARKETING

In 1976, California passed the Direct Marketing Act, which enabled farmers to interact directly with consumers through farmers' markets and CSAs. The Direct Marketing Act has provided California's small farmers with the crucial opportunities to form face-to-face relationships with customers, sell at higher retail prices, and encourage a culture of conscious consumption.

Current California cannabis law does not make analogous direct marketing opportunities available to cultivators or manufacturers of cannabis. Instead the regulations require multiple, costly steps in the supply chain. This policy will have a profoundly negative effect on the nature of the cannabis marketplace if not corrected.

“Losing my ability to market directly to patients means that special relationships that we have formed are no longer viable.

Consumers lost the ability to access farm-direct medicine and farmers lose the ability to deal directly with consumers.

This loss is a cost both monetarily and in the ability to represent a small brand that lacks money for marketing.”

Happy Day Farms, Mendocino County

State cannabis event licenses – the powerful tool that currently exists for businesses to interact directly with customers – limit participation to retailers and microbusinesses, and exclude cultivators and manufacturers.

Many small operators have come to rely on the ability to utilize events and direct-to-patient transactions to cover the costs of running their businesses. For the smallest operators, the requirement to shift entirely into a segmented supply chain (which includes lower margins because small operators can no longer fulfill transactions themselves) has potential to drive them out of business.

Over the longer-term, access to direct marketing opportunities will have a major impact on how the cannabis market is structured. The existing appellations program is designed, in part, to raise consumer awareness about the unique production methods, history, and culture of California's cannabis-producing regions. Without access to direct marketing opportunities, however, small operators will find it far more difficult to build the relationships and brand identities that characterize the craft and organic markets for wine, beer, and local food. Direct marketing allows small operators to bridge the gap between the abstract categories created by appellations and the day-to-day reality of cannabis farming.

Direct marketing is also essential to even the playing field between producers and retailers. Historically, retailers have enjoyed major relative advantages in the cannabis market because they were the only formally permitted operators in the supply chain. Today, retailers continue to enjoy structural advantages:

- Every city and county that allows for storefront retail operations imposes a strict numerical limit on the number of permits available. As a result, dispensaries are able to enjoy effective regional monopolies that are not available to any other

license type. Delivery services and direct marketing opportunities are the best antidote to these monopolies, but neither are currently available at a level that will make a major dent in the problem.

- Retailers are currently the only license type with the ability to interact directly with consumers. Retailers have the final say in which products make it to market and are able to brand products under their own name rather than a producer's brand.
- Building on other their advantages, retailers are in a better position to vertically integrate throughout the supply chain. Observers of the California market, including Lori Ajax, have pointed out that a shortage of licensed distributors is a major threat to the success of the regulated marketplace. These shortages are exacerbated by the disproportionate dispensary control over distributors: as is further discussed in the "transportation" section below, 25% of all distributors in California are controlled by a dispensary permittee. As a result, the limited distribution infrastructure that does exist is tilted towards the interests of retailers rather than small producers.

In other industries, the dominance of a small number of consolidated retail-distribution operations is increasingly recognized as a major problem. Writing in the New York Times on the acquisition of Whole Foods by Amazon, antitrust researcher Lina Khan documents the ways in which consolidated retailers have the ability to exert enormous pressures on supplies without drawing antitrust scrutiny:

"Think of Amazon as a 21st-century version of the 19th-century railroads that connected consumers and producers. Because of their gatekeeper role, railroads had power to discriminate, both among users and in favor of their own wares. These middlemen could tax the farmers and oil producers who depended on their rails — or deny them a ride and sink their livelihoods... like the railroads of yore,

Amazon dictates terms and prices to those dependent on its rails. During negotiations with the publisher Hachette over e-book pricing, Amazon showed its might by effectively disabling sales of thousands of Hachette's books overnight... By bundling services and integrating grocery stores into its logistics network, the company will be able to shut out or disfavor rival grocers and food delivery services."

While there is not yet an Amazon of cannabis, small and independent cannabis producers have long understood the way in which these "gatekeeper" dynamics. In the "collective model" the small handful of locally permitted dispensaries in the state were able to exercise a "gatekeeper" type of control over the market.

It is ironic that some of the folks who say the acreage cap is "un American" because it limits the free market are the same folks supporting caps on retailer permits.

Humboldt County Cultivator

As the California cannabis market takes shape, direct marketing is one of several policies that can help ensure a level playing field. Since well capitalized businesses are now able to vertically integrate they are able to gain a clear market advantage over smaller growers. Policy makers must ensure that small operators can hold their own against large, vertically integrated businesses.

TRANSPORTATION

Many of our members are struggling with serious difficulties in arranging for transportation. From seed to sale, a given cannabis product is likely to pass through at least five, and sometimes more than ten, separate licensed businesses. At each step in the

supply chain, the product must be transported by a licensed distributor. A shortage of licensed distributors acts as a brake on the entire supply chain, resulting in severe bottlenecks.

Currently, there are approximately 200 distributors in the state licensed to carry product from about 1,100 licensed cultivators and 500 licensed manufacturers to about 380 licensed retailers. In practice, though, the transportation shortage is more severe than these numbers would suggest.

We conducted a review of the 192 full-service distribution licensees as of February 2018 and found that at least 133 of them (69%) could be confirmed as controlling at least one additional non-distribution permit. Of the 192 total permits, 28% were controlled by a manufacturer; 25% were controlled by a dispensary; 9% were controlled by a cultivator; 3% were controlled by a delivery service; and 4% were controlled by businesses that possessed multiple permits throughout the supply chain. In many cases, vertically-integrated businesses in this category are concerned primarily with transporting their own product, and don't substantially add to the transportation capacity of the supply chain as a whole.

By comparison, only 59 distribution permits (31%) were controlled by a business that appeared focused on distribution only, though in reality this number is probably somewhat smaller due to the difficulty of verifying cross-licensure.

The concrete impact of these imbalances can be better understood by focusing on the regional level. In Humboldt County, there are currently nine independent distributors and seven distributors connected with another business. There are four additional transport-only distributors, all controlled by a cultivation or manufacturing business. These twenty businesses - many of which are not scaled to transport other licensee's products - are collectively responsible for conducting all transportation among approximately 300 CDFA licensees and 40 MCSB

licensees in the county. This imbalance creates supply chain issues, not only for producers, but also for distributors who are focused on quality assurance and marketing, and whose business model is not focused on facilitating thousands of small-scale transportation transactions.

To address transportation capacity issues, the Bureau of Cannabis Control created a transport-only distribution license in their emergency regulations. In theory, this license was intended to decrease the barrier to entry for day-to-day transportation, while leaving fully licensed distributors free to focus on quality assurance, storage, and testing. The BCC also created a subtype of the transportation-only license - the self-distribution license - in order to make transport-only available as an accessory license for a licensee whose main focus was in cultivation or manufacturing.

“Having to have a separate premise just to get a transport only license is making it impossible for the small operators.”

Pure Sonoma in Sonoma County

We believe that transport-only licenses should be easily accessible to any non-retail cannabis business that has a reason to obtain one. Currently, however, cannabis businesses are finding it extremely difficult to obtain a transport-only distribution permit: only about fifteen have so far been issued by the state, mostly to larger businesses. Some of these barriers stem from local governments, which were not aware that a transport-only license would be included in state regulation until December 2017 and have been working to update their ordinances to authorize transportation.

More important barriers, though, stem from the regulations surrounding the license itself:

- Transport-only licenses currently must be based in a separate premise from any other licensed activity. There is widespread confusion over the what type of “premises” is necessary for transportation-only licenses, since transportation-only licensees are not authorized to store cannabis and have no other reason to obtain a physical location. At the minimum, producers should be able to cross-license their licensed premises with a transport-only permit. More broadly, though, there should not be any state-level restriction on the type of physical premises allowable given that transport-only activity has no land use impact. Regulations

“Self-distort, transport only licenses require a physical address, security plan, etc. For a farmer who only intends to harvest their crop and drive it to a processing facility (because the farm does not have buildings allocated to the cannabis operation) this is excessive and unnecessary overhead. This license should be an 'add on' for cultivators and manufacturers that allow them to use existing space.”

Fiddler’s Greens in Sonoma County

written to apply to premises where cannabis is stored - notably Sections 5044 and 5047 of the BCC regulations, which mandate video surveillance and alarm systems on all licensed premises - should also not apply to a transportation-only licensee.

- The Bureau should clarify that a transport-only licensee is authorized to arrange for non-certified testing. Current regulations prohibit transportation-only licenses from arranging for testing; this is consistent with the legislature’s intent in requiring only full-service distributors to arrange for certified testing, but implies that

non-certified testing is also prohibited. As will be further discussed in the next section, reducing barriers to non-certified testing is essential for the supply chain to function properly, and transport-only licenses are well-equipped to perform this function.

- Transport-only licenses are currently required to hold the same \$2,000,000 insurance policy as full distributors. Insurance requirements should be lowered for transport-only licenses that are carrying smaller amounts of product, especially if they qualify as “self-distributors” under the Bureau’s classification.
- The state should consider legislation to allow any licensee to transport less than one ounce of their own flower or less than eight grams of their own concentrated cannabis without a transportation permit. This small-scale transport would still need to be entered into track-and-trace and could only be transported to another licensee’s premises, but should not require any separate licensing fees or regulations given that any person over 21 in California is already authorized to transport these amounts. An exception along these lines would enable a licensee to arrange for small-scale non-certified testing, or provide samples to another licensee, without jumping through additional hoops.

TESTING

Barriers involving testing have emerged as a major barrier for many of our members. These include:

1. A shortage of licensed testing laboratories – under the state-mandated supply chain, laboratories are one of two major choke points that every batch of cannabis product must pass through before sale by a retailer. Currently, however, there are only 22 licensed testing laboratories statewide. Testing prices have increased five to ten times from pre-January levels due to the large quantity of tests running

through a small number of laboratories, and turnaround times have increased substantially.

2. A shortage of licensed distributors – each batch of cannabis must be transported to a laboratory by a state-licensed distributor. As described above, there is a statewide shortage of distributors, especially given that transportation to laboratories is only one of many tasks that distributors are required to perform.
3. Difficulty in arranging for non-certified testing - under state law, testing is only required immediately prior to retail sale once a product is in its final packaged form. Practically, however, there are important reasons for cultivators and manufacturers to arrange for testing earlier than this. From a cultivator’s perspective, non-certified testing is necessary to establish that a product is safe when it leaves the farm; from a manufacturer’s perspective, it’s necessary to ensure that contaminated inputs will not cause their products to fail testing down the line.

Arranging for non-certified testing should be relatively straightforward, since it requires only a small sample of cannabis to be transported to a laboratory, and is conducted for informational purposes only. Under current regulations, though, the process is onerous. As with certified testing, cannabis samples destined for non-certified testing must be transported by a licensed distributor and tested by a licensed laboratory. To help resolve transportation bottlenecks, the Bureau of Cannabis Control has created a distribution transport-only license; unfortunately, 5315(g)(3) of the BCC regulations arguably prohibits these licensees from arranging for testing. These difficulties compound the gap between the licensed supply chain’s capacity and the demands placed on it.

Importantly, the impact of non-certified testing on the supply chain has not been specifically recognized in current law or regulation. The Standard Regulatory Impact Analysis, which estimates that testing costs will increase between five and ten times

from pre-regulation levels, did not take into account that this price increase would be assessed over many different non-certified tests, and not only the certified test prior to retail sale. Further, current regulation does not make any specific provisions for non-certified testing.

Together, these testing burdens create perverse and unintended incentives: to avoid excessive testing costs, some smaller producers been pushed towards monocropping or consolidating production into larger batch sizes. These practices create harms for both cultivators and consumers. From the cultivator’s perspective, it becomes more difficult to produce a diversity of strains that the market demands, and the push towards larger batches decreases quality. From the customer’s perspective, choices and quality are reduced. The most severe impacts are on patients who require access to specific strains to treat their medical conditions: the more cultivators are incentivized to consolidate strains and batch sizes, the less access these patients will have to specialty strains.

WATER RIGHTS AND WATER STORAGE

Environmental protection is a fundamental part of the regulations. Growers are being held to 21st century standard of water diversion and—for the most part—they support it. In order to comply with these regulations many are installing storage and irrigating using stored rainwater. This can be a

The underlying reality is simple: water in California is scarce in the dry season and abundant in the wet season. Cannabis cultivators need to store abundant rainwater so they can minimize the impact of dry-season irrigation. Implementing policies that match that reality is less simple.

complicated process and many unregulated growers have installed unpermitted ponds.

The establishment of a new “Small Irrigation Use Registration” is a step in the right direction and should be celebrated as one of the biggest accomplishments of this regulatory process. More can be done on this line of policy development. A micro-irrigation permit is a worthwhile thing to consider as many of the smallest operators use significantly less than the 20 acre feet allowed by the SIUR.

Unfortunately, the water regulations were developed using incorrect information, as outlined earlier in this report. Accordingly, these requirements are an unnecessary barrier to entry—especially severe for specialty and cottage growers. The state should revisit the water conversation as new data become available and ensure that water resources are being protected without causing unnecessary harm to cultivators.

DIVERGENT ADULT-USE AND MEDICINAL PRODUCTION MARKETS

Our members are strongly supportive of divergent adult-use and medicinal markets at the retail level. However, many of our members are concerned about this divergence at the production level, especially once the current six-month grace period allowing A and M licensees to transact with each other expires.

The distinction between A and M production licenses will add substantially to many start-up costs including licensing, transportation, and testing fees. As long as licensees are incentivized to obtain both licenses to retain flexibility in the marketplace, the state’s attempts to keep regulatory fees low will not be successful. Divergent production markets also create difficult planning decisions for farmers, who will need to determine in advance what proportions of their licensed premises need to be licensed as A or M. Incorrect decisions may result in farmers unable

to move their product through the supply chain, or being forced to sell at lower prices.

Divergent A and M markets at the production level are intended primarily as a hedge against federal intervention. With the Cole Memo rescinded and the future of the Rohrabacher-Blumenauer amendment in constant doubt, however, there is less and less of a confidence that small legalistic distinctions will tilt the scales towards federal intervention against activity that is, at the end of the day, federally prohibited.

Instead, the best hedge that California has against federal intervention may be to ensure that its rules are built to encourage a well-regulated, smoothly-

“The separation of medical and adult use products is going to be labor intensive and expensive for producers, with no added benefit. It puts my business in a unique position because we primarily make non-psychoactive products focused on health/wellness and would prefer to continue to support those patients who go through the effort of getting a medical card and can save the sales tax.

Unfortunately, I don't expect that we'll be able to meet the costs associated with managing a 'medical' line and an 'adult use line' without driving costs for both up considerably which defeats the purpose of patients getting the medical card. A better solution would be to allow producers to make one product line, and allow retailers to discount the sales tax at the register if the patient has a medical card.”

Fiddler’s Greens in Sonoma County

operating marketplace that allows good-faith operators to comply with state rules.

While continuing to track federal developments, the state could allow producers to obtain a single state license that would authorize them to participate in either the A or M market, as per their local authorization.

MICROBUSINESS

In the run-up to the vote on Proposition 64, microbusinesses were frequently cited as a key provision protecting the competitiveness of small and independent businesses. In an interview with the Santa Rosa Press-Democrat, Lieutenant Governor Gavin Newsom “disputed the contention that Proposition 64 opens the door to a commercial marijuana boom,” citing the microbusiness license and comparing it to a “craft brewery.” LA Weekly, referencing “mom-and-pop growers [who] are known for their dedication and expertise in horticulture” quoted a cannabis attorney as suggesting that Proposition 64 would offer protection by prohibiting “large-scale cultivation for the first five years of the program, in order to offset monopoly interests,” while “smaller operators can get a microgrowers licenses (such as for a bud-and-breakfast with on-site cultivation), which is meant to encourage small businesses.”

Despite these intentions, the microbusiness license has largely not achieved its stated goal in reducing barriers to entry over the first two months of the regulatory program. Of the 52 microbusinesses issued statewide as of February 2018, 36 are located in the Bay Area or Los Angeles. Only 10 licenses have been issued in rural areas, most connected with dispensaries located in town, and only three have been issued on the north coast: two in Arcata, and one in Ukiah.

One likely reason for this discrepancy is that the microbusiness license is housed under the Bureau of Cannabis Control, which regulates retailers, rather

than CDFA, which regulates cultivators. As a result, certain microbusiness regulations have been formulated with retail rather than agricultural dynamics in mind. These regulations have contributed to the current situation, in which the microbusiness license operates more as an outlet for retailers who want to produce, rather than producers who want access to retail. So long as this remains the case, the microbusiness will serve largely to streamline licensing for larger urban retailers while doing little to help smaller producers in disadvantaged rural areas.

REGULATORY CONFUSION

In our survey of membership, 57% of our members indicated that lack of clarity on regulations and compliance was either a “significant” or “very significant” barrier to entry. The incredible volume of regulation is part of the issue: the CDFA, BCC, MCSB, Water Board, CDFW, CDTFA, OSHA, local building and fire code, and local regulatory and tax ordinances all have at least some rules which apply to any given business. Cumulatively there are hundreds of pages of relevant regulations, most of which are only months old, and even full-time attorneys and consultants – not to mention the regulatory agencies themselves – are having trouble keeping up.

Informational efforts by public agencies can go a long way in streamlining the compliance process for small businesses. Consultants and attorneys are often a major cost for small businesses, and bad information can lead to misspent resources which are difficult to recover. To the extent that information is accessible mostly through private channels, compliance will be far more difficult for independent businesses.

The three core regulatory agencies have taken positive steps towards making information clearer and more widely available: the Bureau’s recently-released fact sheets on collectives and temporary

events, for example, were widely shared across social media and helped to address substantial ambiguities in law and regulation. Additional outreach of this type would go a long way in addressing ambiguities that continue to exist. This is especially true for auxiliary agencies, like OSHA, which are not heavily involved in cannabis-specific regulation but which are involved in regulation of cannabis businesses

We also have some concerns about the agencies' current practice of responding to compliance primarily through email. Overall, agencies have been responsive through email, and the openness of the process has enabled our members to receive timely answers on a number of uncertain issues. The process could be improved, however, by making these written clarifications publicly available. If agencies are able to arrive at enough internal consensus to clarify a regulation in writing, we feel that it's appropriate to post these answers publicly, and not only in a private email.

Finally, the division of responsibility between CDFA, BCC, and MCSB has created difficulties in ensuring that agencies remain on the same page. Our members have sometimes received contradictory answers to questions from different regulatory agencies, and we are aware of at least one case in which an agency conducted an enforcement action based on a misinterpretation of another agency's regulations. Clear lines of communication between regulatory agencies can help to resolve these problems.

STATE PERMIT PROCESSING

As of February 2018, there is a major backlog of temporary permit applications that have yet to be processed or approved by state agencies. There has been a lack of transparency regarding which permits are processed first and why; in our experience, processing has not been "first come first served" and has not followed any other obvious pattern. Some

members have been left waiting on temporary permits for months despite paperwork which is fully in order.

Delayed permitting can have make-or-break impacts for businesses which are dependent on cash flow, rather than investment capital, to keep their operations above water. As spring approaches, it is absolutely essential that every business that is in compliance with temporary application requirements receive a permit as soon as possible.

Many growers are facing significant delays in the application process. This is absolutely devastating from a cash flow perspective as business accounts dwindle because product is unable to move in the supply chain. This problem will especially severe for growers who are forced to miss a season because of processing delays. Especially vulnerable are outdoor growers who only have 1 harvest cycle per year. If a delay in processing causes them to miss a year, the outcome would be catastrophic.

"...the fees and application processing times should be dramatically reduced."

Cultivator, Humboldt County:

FINANCES

Many of the financial barriers stem from a lack of access to financial institutions. Without access to basic small business development resources and loans, our members are forced into subpar relationships with investors—if capital is even available. This approach to the business of Cannabis is not good for California.

As the state works to solve the banking crisis it is critical to the success of hundreds—if not thousands—of businesses to extend small business development resources, especially low interest loans.

It is not operational inefficiencies that threaten small businesses--rather it is one time costs of regulations. Larger entities can distribute these one time costs over more volume of product or transactions in a shorter period of time. The smaller the business the more intense and severe the impact will be.

“Problem number 1 is over taxation.”

Los Angeles Retailer

TAXES

Taxes were identified as the single greatest barrier to entry for small businesses in our survey of CGA’s membership. The perception of our members reflects what we view as a more general consensus that current cannabis tax policy is propping up the illicit market, preventing compliance from good-faith operations, and contributing to price increases for patients and consumers.

State tax policy cannot be considered in isolation from local and federal tax policies. At the federal level, tax policy is designed to be punitive: IRS Section 280E prohibits cannabis businesses from taking normal deductions for business expenses, producing an effective federal tax rate that can exceed 60%.

At the local level, many governments have passed “gross receipts taxes” that are assessed on revenue at each step in the supply chain. Because they are reassessed on each step in the supply chain, gross receipts taxes can have a much greater impact than they appear to at first glance: a seemingly modest gross receipts tax of 5% can easily exceed a 25% tax on final product when its cumulative impact on cultivators, manufacturers, distributors, laboratories, and retailers is taken into account.

Accounting for local taxes – which are often ignored in comparative tax analysis – we estimate that California’s cumulative state and local tax rate for adult use cannabis is, on balance, the highest in the country. The higher variance in California’s tax rate stems from the substantial variation in local gross receipts taxes, which is not present in other states. Washington and Nevada localities don’t levy special local cannabis taxes; some Colorado localities have tax rates, but smaller ones (the figure here is for Denver, where most cannabis activity occurs); and Oregon caps local tax rates at 3% and allows them to be assessed on retail only.

State	Estimated Effective Tax Rate
California	40-60%
Washington	45.87%
Colorado	37.15%
Nevada	33.1%
Oregon	18%

This is particularly concerning because, at the outset of regulation, California has the strongest incentives to bring large numbers of existing, smaller operators

into compliance. The state with the closest similarity to California in this respect – Oregon – has a substantially lower tax rate.

“[Current policy] makes demands of the market that no market can sustain... the ludicrously convoluted, complicated and exorbitant tax/fee structure very effectively prevents the entry of any small business into the market...”

Humboldt County Cultivator

State government does not control the entirety of the cumulative tax rate, but is the only actor with the flexibility and interest to reduce the tax rate to a level that achieves the consensus goal of increasing the size of the regulated market. Addressing this disparity between the illicit and regulated market is crucial to the regulated system’s legitimacy at every level, including businesses, consumers, and federal government observers.

In addition to a reduced state tax rate, it’s crucial that the state address the burdensome logistics of tax collection, which currently fall disproportionately on producers who are responsible for remitting and transferring the cultivation tax. After a batch of cannabis leaves the cultivation site, the cultivation tax is required to follow each batch of cannabis throughout the supply chain. If the batch is transferred directly to a distributor for final retail sale, the logistics are not especially complicated. More often, though, a cultivation batch will pass through multiple points in the supply chain before it’s transferred to a distributor for final retail sale. A given cultivation batch might pass through a processor, a manufacturer specializing in extraction, and a manufacturer specializing in infusion prior to entering the commercial market. In another industry, the tax payment would transfer electronically and

seamlessly through each business. In a cash-based industry, however, physically moving a cash-based cultivation tax through each point in the supply chain is a major logistical project and a substantial security risk.

Further, despite efforts to reform and streamline collection of the cultivation tax, many cultivators are currently required to remit taxes as soon as a product moves up the supply chain; that is, potentially well before cannabis is tested and cleared to enter the commercial market. The result is that cash-strapped farmers are required to pay their taxes well in advance of a sale, while better-capitalized retailers are only required to remit excise tax to a distributor within ninety days following sale.

Finally, while not strictly a barrier to entry, there is strong sentiment among our members that products donated for the benefit of severely ill patients should not be subject to cultivation or excise tax. While the BCC has provided a formal avenue for compassionate use donations in their emergency regulations, this avenue will be far too expensive for most businesses to pursue so long as donated products are taxed at the average market wholesale price. The moral legitimacy of the regulated market rests on ensuring that regulated cannabis makes medicine more – not less – accessible to patients with serious medical need.

The state is over charging Mom & Pop businesses with fees and licensing. To grow our economies, we must start with small businesses. That is the best way to drive out the illicit market.

Los Angeles Retailer

TIERED LICENSES FEES AND REQUIREMENTS

The original MMRSA contained language that ensured that fees would be tiered based on the size of the business. We are pleased to see this implemented.

This concept could be expanded to apply to other costs and requirements. From taxes to insurance and bond requirements, there are several specific strategies that could be considered.

Generally, this concept should be applied as broadly as possibly as it can be a powerful leveler.

NO ACCESS TO LOANS

Unlike nearly every sector of our economy, cannabis business owners don't have access to ag loans or small business loans. This is a significant barrier. The only capital coming into cannabis is driven by the feverish promises of the green rush. Speculation is rampant; expected returns are unrealistic.

While the focus of the banking crisis is often on public safety impacts of concentrations of cash, the inability to access loans is hurting a lot of business owners.

“[There are] extreme regulations for commercial cannabis that are not applied to any other type of agricultural activity... Many need access to a bank loan to be able to develop the infrastructure required in order to grow outdoors. Without access to such loans there is no way to move forward.”

Canna Code Compliance, Sonoma County

ADDRESSING LEGACY LAND USE IMPACTS

Unlike other farmers, cannabis growers are expected to address all historic land use impacts.

Specifically, prominent in the history of cannabis in California is the collapse of the timber industry. Unregulated until the 1970's, industrial timber has permanently changed the face of our state. When this industry collapsed after all the old growth had been cut, there were thousands of cheap acres on the market.

Infrastructure was shoddy, subdivisions were sometimes out of compliance with codes, and these acres were rural and remote. A great place to escape from it all, as many did in California through the 60's and 70's.

It turned out these acres were also great places to grow cannabis- both for the diversity of micro climates and also for the ability to hide from law enforcement agents, intent on enforcing the baseless policy of prohibition.

Expecting small farmers with tiny footprints to address decades' worth of industrial scale landscape level impacts is unreasonable. However, cannabis growers largely do not oppose the requirements—we are only asking for the same thing others have: reasonable timelines, access to financial resources and technical support, and the ability to continue our operations while we clean up the mess provided we stop contributing to the mess.

There is an amazing opportunity for collaboration here. The stewardship ethic of cannabis growers has deep roots. With better information and better partnerships between regulator and regulated cannabis can help heal many damaged watersheds.

CULTURE

There is a rich cultural heritage of Cannabis in California. The roots of this culture extend to our states early days, and cannabis even played a prominent role in our history even prior to statehood.

Drawing on many sources, from Latino culture, the back to the land “hippies” of the 1960’s, the “compassionate capitalists” of Prop. 215, to the recent infusion of more mainstream business people and the tech industry, all with a flare for global diversity.

The heritage of cannabis is truly a California treasure. However, for much of modern times cannabis has been the source of great conflict, with our communities even ending up the target of a “war on drugs.”

PREJUDICE AND MISINFORMATION

The subject of multi-decadal misinformation campaigns, cannabis and the people who use it, grow it, or sell it have long been treated with prejudice.

This prejudice continues today and is a significant factor in shaping the policy landscape, especially at the local level. Policy makers should consider cannabis in a similar manner to other land use impacts except when obvious evidence exists to treat the crop differently.

OFF GRID LIFESTYLE

It is estimated that as many as 30 percent of the growers in the state live off the grid—or at least of a grid. Cultivation often occurs in rural communities where:

- Cell phone service is limited
- Internet is limited
- Electricity is not available
- Water is provided locally

“Now that we're in 2018, the inability to transport my product will likely be an issue for me later in the year. I'm hoping that the BCC removes the application of the Distribution security requirements from the transport only license. As an off-grid farmer, it is impossible for me to maintain security cameras.”

Happy Day Farms in Mendocino County.

Many of the regulations assume reliable electricity or broadband. This is a significant barrier for many. Great care must be taken to accommodate these vulnerable and disadvantaged business owners. This must be a focus of Track and Trace as the program is unveiled.

MISTRUST: DRUG WAR LEGACY

For years growers have been on the wrong side of the war on drugs. Trust issues run deep. Survey data indicates that 20% of our members have been in the business longer than 20 years, meaning they were operating before medical cannabis was legalized in 1996.

For those drug war veterans trusting the government does not come naturally. The nature of the transition we are going through demands some degree of sensitivity to this legacy. It is important in all things that government conducts itself in a manner that commands the respect of the people; it is especially important when it comes to regulating cannabis.

I told you they were just gonna take all our money and then allow corporations to come in and push us out.

Cultivator, Humboldt County

A DISREGARD FOR THE LAW

Whereas the cannabis movement was built on a disregard for prohibition, today some are building their business models based on a disregard for the intent of the law.

The well capitalized insist that for every protection there is a loophole. For every step the legislature has taken to level the playing field the in the business community have hired lobbyists and attorneys to help devise loopholes and workarounds. Simple rules and robust protections are likely to attract the broadest possible participation and compliance.

BUSINESS ACUMEN

Good farmers are not necessarily good at business. This is especially pronounced in cannabis, a marketplace where keeping minimal records has long been a key to success. There are several ways to overcome this barrier. Some businesses will scale up and bring on management teams. This option is only available to well capitalized, growth oriented businesses.

Other businesses will contract with bookkeepers and accountants. These professionals have only recently begun to development cannabis departments and there is still a shortage of experienced contractors. Business acumen is not a scarce talent—thousands of businesses comply with California regulations every day. However, in the short term these skills are hard to come by in cannabis, simply as a function of the emerging nature of the regulations. With less than two months separating the release of emergency regulations from the issuance of the first state licenses, only full-time attorneys and consultants have been in a position to fully absorb the new rules.

Finally, other businesses will build on a longstanding do-it-yourself culture of cannabis. When a new requirement comes online, a business owner will learn a new skill and adapt. Given the magnitude of the regulatory changes taking place, many business

owners are overwhelmed and need more time to implement this strategy.

COTTAGE BUSINESSES

Cottage businesses are important and unique component of California cannabis.

These businesses are so small that they are only able to generate subsistence or supplemental income. These businesses often fill a critical gap in our economy, functioning as a private sector social safety net.

The cost of losing these businesses will be significant and policy makers should explore all options to help these businesses succeed—or prepare for the fallout of their failure.

The challenges of regulating these businesses are especially significant. These grows are often in residential zones, so issues related to smell and public safety often drive policies that act as barriers.

The cottage cultivation license, established in 2016 with the passage of AB 2516 provides a starting point for conversation for growers. More needs to be done

Myself and thousands of other growers were doing well enough with our home grows

We the community of the real people who built this are not just going to go away. I'm in my 40's and I've been doing this since I was young.

We are small family businesses that have paid our bills and put our kids through college growing herb and now that just doesn't end.

We need a way to become legal operators.

Ventura County Cottage Cultivator

to streamline requirements to reduce the unnecessary burden of regulation for cottage growers.

More needs to be done to help cottage manufacturers overcome real estate barriers. Often times a small scale manufacturer only needs production space a day or two per week; allowing such businesses to share facilities would create significant opportunity.

Cottage retail businesses may be able to transition to delivery services if policies were modified to allow for clustering. Also, expanding event opportunities would help startups get established in retail.

THE CRIMINAL ELEMENT

Some growers commit a crime—like trespassing or growing on public land—in the process of producing cannabis. The criminal activity is a barrier to entry and in order to participate in the regulated market the criminal activity must cease.

Some growers have no intention of getting licenses. They have chosen their lifestyle. Enforcement is the proper tool for these folks.

However, continuing to treat good-faith cannabis growers and business owners as criminals will have negative impacts on the transition process. As this report demonstrates, there are many reasons why good-faith operators may be unable to enter the regulated marketplace. The state should do everything in its power to ensure that these business owners have a path to legality, rather than relying on law enforcement action.

For things to work out much more smoothly the state needs to have a dialogue with community organizers who are making a difference in the Cannabis communities. Change starts from the grassroots not from those in the clouds.

California Minority Alliance

Improving the situation

The purpose of this report is not simply to identify and describe the challenges that are threatening many small businesses in our state. Rather, this report is meant to provide information and context to empower policy makers to help improve the situation. Reducing barriers to entry into the regulated cannabis marketplace for cottage, specialty, and small businesses is a practical, economic, and moral imperative.

CLOSE THE LOOPHOLES

The MAUCRSA is a composite of the MCRSA (passed by the legislature) and the AUMA (passed by the voters). Throughout the development of the MCRSA, policy makers sought to provide for a level playing field. One key provision of the AUMA was the five-year delay on the issuance of large scale cultivation licenses.

Based on an understanding that the transition to regulation would be an intensive and costly process, the five-year delay was a hard fought compromise. Prop. 64 was amended after it was initially filed to include the provisions. The five-year transition period was not meant to “prop up inefficient businesses,” as some large, well represented businesses have claimed. Rather, it was meant to allow smaller producers to get a foothold in the marketplace.

As this report demonstrates, one time regulatory costs are the primary barrier to entry.

Unfortunately, the Department of Food and Agriculture has adopted regulations that are inconsistent with the intent of state law. The emergency regulations that were adopted allow a business to obtain an unlimited number of small licenses and operate them currently, effectively rendering the acreage cap moot.

Not issuing licenses larger than 1 acre while allowing a grower to obtain unlimited small licenses is like setting a daily purchase of limit of one ounce—then allowing a consumer to purchase unlimited grams. It simply doesn't make sense.

PRIORITIES AT THE STATE LEVEL

The State Legislature has broad authority to amend Proposition 64. Section 10 of the initiative provides that:

“The Legislature may by majority vote amend the provisions of this Act contained in Sections 5 and 6 to implement the substantive provisions of those sections, provided that such amendments are consistent with and further the purposes and intent of this Act as stated in Section 3.”

Section 3 states that “It is the intent of the People in enacting this Act to accomplish the following... (x) Reduce barriers to entry into the legal, regulated market.”

There is no shortage of actions the legislature can take to reduce barriers and improve the situation for thousands. In fact, there are so many things that could be done, it can be hard to determine where to start.

DIRECT MARKETING

Create a temporary state license authorizing cultivators and manufacturers to engage in direct sales at special events.

TRANSPORTATION

Ensure that the Transport-Distribution license is obtainable by all—especially the smallest businesses. The ability to get product to the point of first processing will be make or break for many farmers.

TESTING

Current testing requirements are unnecessarily costly, especially for small batch producers. Allow for compositing of batches to reduce cost of compliance.

COTTAGE BUSINESSES

Thousands of cottage businesses are facing a challenging transition. Allow for shared premises, especially shared kitchen and manufacturing space to provide maximum opportunity.

TAXES

California’s cumulative state and local tax rate for cannabis is the highest in the country. The tax rate should be reduced, and collection of taxes should be streamlined to reduce the burden of all-cash transactions.

PRIORITIES AT THE LOCAL LEVEL

In many ways the future of cannabis in California will be decided at the local level. With such a diverse patchwork of regulations the specific priorities will be highly varied. However, there are few priority strategies to consider.

START SMALL.

Due to their limited size, cottage businesses are naturally unattractive to criminals. They are also less likely to cause nuisance impacts with neighbors.

Some counties fear or have experienced a “land rush.” Bringing rapid changes in population and demographics, this phenomenon results from local policies that provide for rapid growth and expansion of the local industry.

This outcome can be avoided by implementing an ultra-cautious “cottage only” strategy. A cautious strategy might include only specialty scale growers, while more moderate ordinances might include small grows, and the more liberal including mid-sized and eventually large grows.

By limiting the size of the businesses that operate, local governments can also take a bite out of violent crime. Smaller businesses inherently have less cash and inventory on hand making for less attractive targets for violent criminals.

CLUSTERS AND COOPERATIVE.

Explore options for incentivizing “cannabis complexes” composed of many small businesses - the most effective solution for urban real estate issues, to this point, has been projects that subdivide a larger green-zoned parcels into many smaller premises. Delivery services, non-volatile manufacturing operations, processing and packaging facilities, and small indoor cultivators typically require only a few hundred to a few thousand square feet of space and are ideally suited for these types of facilities.

For jurisdictions with high densities of problematic grows—such as those sited in high density residential areas with smaller parcel sizes—clustering can be a great strategy. Essentially this strategy involves incentivizing growers to relocate grows to more appropriate areas.

In Humboldt County growers were granted a density bonus. In more cautious counties simple having a pathway to a permit may be enough of an incentive.

Clustering activities can help reduce nuisance impacts from smell or sight, but because of the increased concentration of inventory and commercial activity, it may increase the risk of property crime.

It is important to keep in mind that these types of strategies work best when they provide opportunities for most or all of the inappropriately sited growers to transition. Accordingly, counties should be familiar with Chapter 22 of the MAUCRSA and should consider requiring cooperative ownership of cluster type facilities.

OVERLAY ZONING AND SPECIAL DISTRICTS

Local governments should consider the use of inclusionary or exclusionary zoning, as well as the formation of special zoning districts to either allow for or prohibit cultivation based on neighborhood values. Elections should allow for the residents of these areas to have a direct say in the development and implementation of such tools.

EXPANDED LIST OF PRIORITY ISSUES

This expanded list reflects a brainstorm from within our membership about possible strategies to reduce barriers. We propose the following as a starting point for dialogue. The list is not comprehensive as it is a certainty that more barriers and solutions will continue to be identified.

We are publishing this list for the purposes of stimulating dialogue on the important subjects covered. We encourage both additions to this list or concerns related to these policies to be sent to policy@cagrowers.org. We will consider all comments when we produce a subsequent draft of this report.

Timeline

1. Consider “tiered timelines” allowing more time for smaller businesses.

Permits and local land use restrictions

2. Allow locally registered unlicensed growers to form or join cooperatives for the purpose of obtaining local permits and navigating through the licensing process.
3. Pass resolution to encourage local governments to regulate cannabis businesses.
4. Provide centralized resources to enable local governments to understand regulatory schemes in other jurisdictions.
5. Develop Type S license for shared manufacturing facilities; allow multiple edibles manufacturers to use the same commercial kitchen.
6. Restrict access to new funding for enforcement to only include jurisdictions that have permissive policies at the local level.

Local Delivery Bans

7. Clarify that, while local governments are not required to permit delivery services, they cannot

prevent deliveries into their jurisdiction on public roads.

Direct Marketing

8. Establish a streamlined temporary sales license that allows producers (cultivators and manufacturers) to sell at licensed cannabis events.
9. Allow cannabis events at any locally-permitted venue, not just a DAA or fairground.
10. Allow producers to distribute limited free samples to retailers.

Transportation

11. Remove premises requirements for transportation-only license.
12. Allow transportation-only license to be located at the same premises as another licensed operation.
13. Allow transportation-only licenses to arrange for non-certified testing.
14. Decrease insurance requirements on self-distributors.
15. Exempt transportation-only licenses from Sections 5047 (alarm system), 5044 (video surveillance) of BCC regulation.
16. Allow licensees to transport up to one ounce of flower or eight grams of concentrate without a transportation license.

Testing

17. Decrease barriers to transportation, and to arrange for non-certified testing, as detailed in the “transportation” section.
18. Allow compositing of multiple strains into a single batch test for pesticides and contaminants - this would mirror an Oregon regulation that allows multiple small strains to be tested as a single batch, up to the maximum batch size limits, for contaminants.
19. Consider reducing the number of batches required to be tested - producers with an established record of clean tests could be enrolled in a “skip lot” program where they were

able to skip some testing lots and reduce the overall requirement.

Water rights and water storage

20. Consider Micro Irrigation Use Registration for irrigators storing less than 10 acre feet. Provide that micro irrigation ponds may be installed on class 3 waterways.
21. Explore other ways to streamline decentralized water storage.
22. Exempt rainwater collection and storage from property tax assessments.

Microbusiness

23. Remove state requirements for security and surveillance, and leave these questions to local discretion - rural communities and urban communities have vastly different requirements for security, and surveillance requirements may be impossible for some off-grid businesses to meet. CDFR, recognizing these realities, has left security regulations to local government discretion. The Bureau should allow similar local government discretion for microbusinesses with respect to sections 5044, 5045, and 5047 of BCC regulation.
24. Allow additional activities to qualify for the microbusiness license - microbusinesses must currently be engaged in at least three of cultivation, manufacturing, distribution, or retail. Adding processing, nurseries, and transport-only distribution to this list would make the microbusiness license substantially more accessible.
25. Allow a microbusiness license to be located across multiple premises for different activities.

Regulatory Confusion

26. Budget for more regulatory staff, including interagency coordinator staff and outreach staff.

27. Establish a well moderated online forum for discussion of frequently asked questions.
28. Well moderated online forum for FAQ's and discussions between the regulators and the regulated.

Tiered License Fees and Requirements

29. Bond Requirements: Smaller businesses should not have the same Bond or insurance requirements as larger businesses. Institute a tiered structure for these costs.

Access to Banks/ Loans

30. Establish a revolving loan fund for low cost compliance loans.
31. Explore establishment of a public bank to serve cannabis businesses.

Taxes

32. Lower the excise tax rate.
33. Establish a tiered rate for cultivation taxes.
34. Remove requirement that cultivation tax follow product through the supply chain.
35. Exempt compassionate use donations from taxes.
36. Replace the leaf tax with a potency tax on concentrates.

Legacy Land Use impacts

37. Require CDFW and the State Water Board to provide for adequate timelines to address legacy impacts.
38. Identify sources of grant and revolving loan funding to support large projects restoring legacy impacts.

Prejudice

39. Comprehensively review all state enforcement agencies and ensure proper prioritization and focus.

Mistrust: Drug War Legacy

40. Automatic removal of convictions reclassified by Prop 64.

Business Acumen

41. Ensure small business development programs and technical support programs are available.
42. Expand outreach efforts by regulatory agencies to expand and clarify regulations.

Off grid lifestyle

43. Current regulations require many cultivators to purchase a new generator -- an unnecessary expense. Exemptions should be provided for retrofitting of current generators to meet new requirements. If retrofits are not possible, currently-existing generators should be grandfathered.
44. Establish a streamlined program for retroactive approval of a three-acre conversion of TPZ land.
45. Establish basic protected rights for owner-built homes providing a statewide streamlining program for building permits and affordable housing.

Cottage Businesses

46. Expedite release of the Type S license for shared manufacturing - locating real estate is the first step in the regulatory process for most business in cities. For that reason, the release of the Type S license will only allow small businesses *begin* the process of coming into compliance with state regulation. The longer DPH delays in releasing the license, the more difficulty small manufacturers will have in re-entering the market.
47. Provide for shared premises for delivery license.
48. Provide that cottage cultivation may be irrigated using water diverted consistent with a Small Domestic Use registration.
49. Provide that cottage cultivation is a compatible use for TPZ land provided that all cultivation occurs within a compliant three acre conversion.
50. Allow 2500 sq. ft. for Cottage Outdoor instead of only 25 plants. Define Canopy as the cumulative total square footage as measured by the drip line of each plant.

Criminal activity

51. Enforcement should focus on criminal activity in jurisdictions that are issuing permits. Commercial activity in jurisdictions that aren't issuing permits should still be considered unregulated unless criminal behavior is clearly visible.