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CGA Comment on CDFA Proposed Regulations – August 2018

On behalf of the California Growers Association, representing over 1,000 cannabis businesses in 46 counties, the below comments represent our perspective on the proposed regulations.
Eight months into state permitting, the regulated cannabis market lags far behind expectations.

The official numbers, including Q2 state tax revenue at less than 50% of projections, underscore the consensus of our membership: that state and local regulation has been even more difficult to navigate than expected, that high costs and bottlenecks have created substantial barriers to compliance, and that competition with the unregulated market continues to be a major challenge.

Although statute prevents regulators from addressing several key issues, including over-taxation, there's many steps the CDFA can take to improve things significantly. Given the serious challenges confronting the regulated market, CDFA should consider wide-ranging and ambitious reforms alongside smaller technical fixes.

A few themes run throughout our members' feedback on the proposed regulations.

First, it's important to recognize that, despite challenges, most licensed growers continue to cultivate at a small scale. Of the 1,273 individual businesses that held cultivation licenses on August 6, 65% were permitted for less than 10,000 square feet, and 92% were permitted for less than an acre. However, many small growers find themselves in precarious positions and will find it difficult to come into compliance as things currently stand. The market is rapidly trending towards the largest cultivators: since May 25, the overall number of licensees has dropped by 28%, and the share of acreage attributable to the 1% of licensees cultivating over four acres has increased from 15% to 24%. Communities that are economically dependent on small-scale cultivation are facing an escalating crisis, and state action will be necessary to fulfill Proposition 64's intent to "ensure the nonmedical marijuana industry in California will be built around small and medium sized businesses."

Second, many well-intended regulations that are appropriate for large and/or urban businesses are major barriers from the perspective of small, cottage, or off-grid businesses. Standardized operational hours, no-notice inspections, and expensive annual fees are examples of regulations that are especially burdensome from the perspective of small farmers who are based in remote areas, lack access to capital, and don't qualify for traditional small business loans.

Finally, fulfilling the CDFA's legislative mandate to protect the public means ensuring that regulated cannabis can compete with unregulated alternatives. As the regulated market struggles to compete with illicit competition, practical and financial costs of compliance are a major factor. If the regulated market fails, the state will not realize its goals for public safety, environmental sustainability, or tax collection.

We appreciate your attention to these difficult issues, and we look forward to continuing to work with you to develop rules that promote the success of California's regulated marketplace, protect public health and safety, and reduce barriers to entry for the thousands of small and independent cannabis businesses throughout the state.

Respectfully,

HD Allen

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Executive Director

Summary of Comments

1. Enforce a cap on total cultivation acreage per licensee.

2. Assess lower annual licensing fees for light deprivation operations that only conduct a single harvest per year.

3. Clarify rules regarding samples between businesses, as recommended by the Cannabis Advisory Committee.

4. Remove the requirement in §8102(f) to specify daily operational hours for cultivation sites, and instead a) allow inspections during normal business hours (8-5) while providing reasonable notice of at least two hours and b) allow cultivators to specify seasonal operations.

5. Amend §8400(d) to allow certain records to be kept outside the licensed premises, so long as they can be made immediately available to CDFA on request.

6. Amend §8300(c) and §8301 to allow sale of seeds by cultivators.

7. Amend §8200 to create licensing tiers for nurseries and processors, including "self-processing" or "micro-processing" tiers for small farms processing their own product.

8. Allow small cultivators and nurseries – defined by gross receipts or cumulative cultivation area – to share a single premises for drying, processing, harvest storage, and immature plant areas in cases where they hold multiple licenses.

9. Amend §8402(e)(2) to grant regulators discretion to allow normal commercial cannabis activity in the event of an extended METRC outage.

10. Beta test METRC prior to release.

Comments on CDFA Regulations

1. Enforce a cap on total cultivation acreage per licensee.

As regulations are finalized and the state issues its first annual licenses, enforcing a cap on total cultivation acreage continues to be both a practical and legal necessity.

One of Proposition 64's expressly stated purposes is to "ensure the nonmedical marijuana industry in California will be built around small and medium sized businesses by prohibiting large-scale cultivation licenses for the first five years."

Specifically, the statute reads:

> "26061(c): No Type 5, Type 5A, or Type 5B cultivation licenses may be issued before January 1, 2023."

Despite the language and intent of Prop 64, CDFA has so far failed to implement the will of the voters. By allowing single businesses to stack unlimited numbers of "small" licenses, individual licensees have been able to accumulate as many as fifty acres of total cultivation area. As of August 6, the top 1% largest cultivation licensees – the 14 licensees growing over four acres – accounted for nearly a quarter of total licensed cultivation acreage. Licensees growing more than one acre, who account for just 8% of all cultivation licensees, accounted for nearly half of total licensed cultivation acreage.

This imbalance has also increased rapidly over time: as of May 25, licensees growing over four acres accounted for 15% of licensed cultivation area, and licensees growing over one acre accounted for 37% of licensed cultivation area. Those proportions have now increased to 24% and 45%, respectively.

An acreage cap is necessary to implement key other protections required by law. Although 26061(d) prohibits large farms from holding distribution licenses, CDFA regulations allow mega-farms to be fully vertically integrated. The combination of unlimited cultivation area and full vertical integration threatens to allow a few consolidated businesses to shut out the small and medium sized businesses that Prop 64 was intended to protect.

The implementation of 26061(c) and (d) is critical to the success of the regulated market in California and was a key piece of Proposition 64. These regulations must be changed to implement the will of the voters and protect the integrity of the regulated market.

2. Amend §8200 to assess annual fees at the lower "outdoor" fee tier for cultivators who use light deprivation, but no artificial light, and only complete one harvest per year.

Proposed regulations would charge substantially higher "mixed-light" cultivation fees to farmers who utilize light deprivation but no artificial light. These fees are about 2.5 times higher than the fees for "outdoor" cultivation, and total an additional $7,000 per year for a small farmer cultivating under 10,000 square feet.

In its Initial Statement of Reasons (ISOR), CDFA states that farmers using light deprivation are charged higher fees because light deprivation enables multiple harvests per year. While true in some cases, this reasoning doesn't consider the many situations in which farmers utilize light deprivation while only completing one harvest per year. Triggering early flowering with light deprivation can be essential in response to environmental conditions such as water scarcity and late-season fog, and can also enable earlier harvests to meet market demand when supply is low. With track-and-trace in effect, CDFA will be able to easily verify whether a cultivator is completing multiple harvests per year.

Lowering annual fees for farmers who only complete a single harvest a year would decrease barriers to entry for thousands of small farmers who lack access to capital and don't qualify for traditional small business loans. It would also be in alignment with the Cannabis Advisory Committee, which recommended this policy by an 18-1 vote at its March meeting. As small farmers struggle to come into compliance due to high taxes, testing and distribution bottlenecks, and local land use issues, this change would be a commonsense way for CDFA to support the regulated market as it continues to struggle against unlicensed competition.

3. Clarify rules regarding samples between businesses, as recommended by the Cannabis Advisory Committee.

The ability for producers to provide samples to distributors and retailers is essential in any industry, and follows long-standing practice in the cannabis industry. Samples can help small producers gain a foothold in the marketplace, and ensure that patients and customers have access to high-quality products.

Our understanding is that providing samples is technically allowed under current regulation so long as samples are not given away for free, as would be prohibited under Business and Professions Code Section 26153. CDTFA also provides guidance to distributors on B2B handling of cannabis samples on its website at http://www.cdtfa.ca.gov/industry/cannabis.htm#Distributors, under Sales of Samples or Promotional Items," and requires these items to be labeled as "not for resale."

That said, regulations currently don't provide clear guidance on how samples can be entered into track and trace or recorded if they are not intended for final sale to the consumer. Regulations clarifying that samples may be provided between businesses for a nominal fee, must be labeled

as "not for resale," and may not be sold to a consumer, would help provide businesses with the clarity and confidence to use samples more consistently.

4. Remove the requirement in §8102(f) to specify daily operational hours for cultivation sites, and instead a) allow inspections during normal business hours (8-5) while providing reasonable notice of at least two hours and b) allow cultivators to specify seasonal operations.

§8102(f) would require licensees to specify at least two hours per day, on each weekday, as "operational hours" and guarantee that staff will be on premises during these hours. This requirement is trivial for large-scale farms in accessible areas, but impractical for many smaller farms and farms in remote rural areas. While individual situations vary, our face a number of practical barriers to an inspection policy that relies on set-in-stone daily hours, rather than reasonable notice, to ensure a licensee is on-site for an inspection. These include situations where:

- The farm is individually or family operated, but the owners live 1-2 hours off-farm and don't work on the farm each day, or work on weekends.
- The farm is individually or family operated, and the owner lives on-site, but needs to leave the farm at times for business or personal reasons.
- The farm is behind a locked gate that controls access to several properties and can be opened, but not always immediately and on-demand.
- The farm operates seasonally and is closed for large parts of the year.
- The farm is difficult to access due to weather conditions at certain times of year.

More broadly, requiring licensees to be on-site at certain times each day of the week is inconsistent with the intent of MAUCRSA and Prop 64 intent to promote cottage and specialty-scale businesses. Reasonable notice will allow CDFA to hold licensees accountable without tethering family farms to their land at set times every day of the week.

5. Amend §8400(d) to allow certain records to be kept outside the licensed premises, so long as they can be made immediately available to CDFA on request.

Aspects of §8400 governing where records must be stored appear contradictory or impractical. Section §8400(a) requires all records to be kept for seven years, and §Section 8400(b) suggests that records "shall be kept in a manner that allows the records to be provided at the licensed premises or delivered to the department, upon request," implying that these records may be kept off-premises so long as they are easily accessible.

However, Section §8400(d) suggests otherwise, stipulating that records must be maintained "on the licensed premises." While this requirement is sensible for some records – such as the

licensee's state permit – it is not sensible for other records, including detailed financial statements and personnel records containing private and sensitive information (§8400(d), subsections 6 and 7), especially given that these records must be kept for seven years. We request clarification that these records may be stored off-premises so long as they are easily accessible and made immediately available to CDFA on request.

6. Amend §8300(c) and §8301 to allow sale of seeds by cultivators.

§8300(c) and §8301 suggest that cultivators are prohibited from selling seeds and immature plants unless they also hold a Type 4 Nursery license. Inadvertent seeding of crop, although not common, happens at times, and the capacity to sell seeds may keep a small cultivator afloat if parts of their crop inadvertently go to seed. Cultivators should have the ability to remediate seeds from their crop and sell both the crop and the seed, assuming the flower has been remediated to no longer contain any seeds.

7. Amend §8200 to create licensing tiers for nurseries and processors, including "self-processing" or "micro-processing" tiers for small farms processing their own product.

Under §8200, all nursery and processor licenses are currently charged the same annual licensing fee regardless of size. In reality, nursery and processor business models vary substantially from boutique to very large. Various nurseries and processors have very different profit margins and presumably require different levels of resources to effectively regulate: for instance, some processors are large commercial scale operations, while others are intended to streamline processing from two or three small-scale cultivation licenses held by the same licensee. Nurseries and processors are currently the only cannabis license types - including BCC and DPH licenses - whose fees are not scaled by either size or gross receipts.

8. Allow small cultivators and nurseries – defined by gross receipts or cumulative cultivation area – to share a single premises for drying, processing, harvest storage, and immature plant areas in cases where they hold multiple licenses.

Small cultivators who have obtained multiple licenses in order to accommodate different growing methods (e.g. outdoor and mixed-light cultivation) are currently prohibited from sharing non-canopy areas of the premises, creating substantial unnecessary costs. The capacity to share these should be made available so long as sharing is capped to apply to small cultivators only, consistent with Prop 64's intent to prohibit "large" cultivation licenses until 2023.

9. Amend §8402(e)(2) to grant regulators discretion to allow normal commercial cannabis activity in the event of an extended METRC outage.

§8402(e)(2) currently forbids any commercial transport or transfer of cannabis if a licensee loses access to the track-and-trace system. While we understand the intent of the regulation, we think it should be amended considering the potential for an extended server-side METRC outage, such as the one that impacted Maryland just last month. The current regulation is acceptable in most cases, but regulators should leave themselves discretion to allow normal commercial cannabis activity if necessary to prevent an extended market-wide shutdown, so long as licensees track their activity on paper.

10. Beta test METRC prior to release.

Our members have several concerns about METRC, including its technical usability, its suitability for outdoor cultivation, and the potential that METRC will introduce informal "shadow regulations" that create additional constraints outside the stakeholder-driven regulatory process. Beta testing METRC is a commonsense way to check for bugs or errors before it goes into widespread use.