Informational Hearing

Assembly Committee on Business and Professions- Chair, Evan Low

Examining the Plan for Medical and Non-Medical Cannabis Regulation

Tuesday, May 23, 2017, 9:00am
State Capitol, Room 4202

Background

In 1996, California voters passed Proposition 215, legalizing the use of medical cannabis (MC) in the state. In October 2015, nearly 20 years after the authorization of the use of MC, Governor Jerry Brown signed into law a trio of bills (AB 243 (Wood), Chapter 688, Statutes of 2015, AB 266 (Bonta, Cooley, Jones-Sawyer, Lackey, and Wood), Chapter 689, Statutes of 2015, and SB 643 (McGuire), Chapter 719, Statutes of 2015) collectively known as the Medical Cannabis Regulation and Safety Act (MCRSA). MCRSA established the state's first regulatory framework for MC. In 2016, the voters of California passed Proposition 64, the Adult Use of Marijuana Act (AUMA), to legalize the non-medical use of cannabis in the state by 2018. The release of the Governor's proposal regarding cannabis in early spring was an attempt to reconcile a number of discrepancies between MCRSA and AUMA.

This background paper is intended to provide a brief overview of the history leading up to the hearing, the content of existing law, the landscape of the existing MC industry, and a prospective look at additional issues relating to the implementation of MCRSA and AUMA as the state moves toward regulation of the cannabis industry.

History of Cannabis Regulation

The Compassionate Use Act (CUA) and Medical Marijuana Program (MMP). In 1996, California voters approved Proposition 215, otherwise known as the CUA, which protects qualified patients and primary caregivers from prosecution related to the possession and cultivation of cannabis for medical purposes, if recommended by a physician. The CUA prohibits physicians from being punished or denied any right or privilege for making a MC recommendation to a patient. The CUA also makes findings and declarations, including encouragement of the federal and state government to implement a plan to provide for the safe and affordable distribution of cannabis to patients with medical needs.

In an effort to increase access to MC by qualified patients and primary caregivers, and to provide protections to qualified patients and primary caregivers from prosecution for the possession and cultivation of MC, California enacted SB 420 (Vasconcellos), Chapter 85, Statutes of 2003, which established the MMP. The MMP created a MC card program for patients to use on a voluntary basis, which can be used to verify that a patient or caregiver has authorization to possess, grow, transport, or use MC in California. Under the MMP, a person is required to obtain a recommendation for MC from an attending physician; written documentation of this recommendation is required to be submitted to the county of residence of the applicant in order to receive a MC card. The MC identification cards are intended to help law enforcement officers

identify and verify that cardholders are able to cultivate, possess, and/or transport limited amounts of cannabis without being subject to arrest. Lastly, the MMP created protections for qualified patients and primary caregivers from prosecution for the formation of collectives and cooperatives for MC cultivation.

Since the state had not adopted a framework to provide for appropriate licensure and regulation of MC until late 2015, a proliferation of MC collectives and cooperatives that had been largely left to the enforcement of local governments. Consequently, a patchwork of local regulations was created with little statewide involvement.

California Supreme Court Affirms Local Control Over MC. By exempting qualified patients and caregivers from prosecution for possessing, or from collectively or cooperatively cultivating MC, the CUA and the MMP essentially authorized the widespread cultivation and distribution of MC. These laws triggered the growth of MC dispensaries in many localities, and in response, local governments exercised their authority by regulating or banning activities relating to MC. After numerous court cases and years of uncertainty relating to the ability of local governments to control MC activities, particularly relating to the zoning and operation of MC dispensaries, the California Supreme Court, in *City of Riverside v. Inland Empire Patients* (2013) 56 Cal. 4th 729, held that California's MC statutes do not preempt a local ban on facilities that distribute MC. The Supreme Court held that nothing in the CUA or the MMP expressly or implicitly limited the inherent authority of a local jurisdiction, by its own ordinances, to regulate the use of its land, including the authority to provide that facilities for the distribution of MC be prohibited from operating within its borders.

Federal Controlled Substances Act. Despite the CUA and the MMP, cannabis is still illegal under federal law. Under the federal Controlled Substances Act, it is unlawful for any person to manufacture, distribute, dispense, or possess a Schedule I controlled substance, including cannabis, whether or not it is for a medical purpose. As a result, patients, caregivers, and dispensary operators, who engage in activities relating to both medical and non-medical cannabis, could still be vulnerable to federal arrest and prosecution.

United States Department of Justice (USDOJ) Guidance Regarding Cannabis Enforcement. On August 29, 2013, USDOJ issued a memorandum, known commonly as the "Cole" memo, which updated its guidance to all United States Attorneys in light of state ballot initiatives to legalize the possession of small amounts of cannabis, and provide for the regulation of cannabis production, processing, and sale. While the memorandum notes that illegal distribution and sale of cannabis is a serious crime that provides a significant source of revenue to large-scale criminal enterprises, gangs, and cartels, it also states that the USDOJ is committed to using its limited investigative and prosecutorial resources to address the most significant threats, which include the prevention of: (1) distribution to minors; (2) revenue from cannabis from going to criminal enterprises; (3) diversion to other states where cannabis is not legal under state law; (4) state-authorized cannabis from being a cover for trafficking in other illegal drugs or illegal activity; (5) violence in cultivating and distributing cannabis; (6) drugged driving and other public health problems from cannabis use; and, (7) growing, possessing, or using cannabis on public lands or on federal property.

According to the USDOJ, "In jurisdictions that have enacted laws legalizing cannabis in some

form and that have also implemented strong and effective regulatory and enforcement systems to control the cultivation, distribution, sale, and possession of cannabis, conduct in compliance with those laws and regulations is less likely to threaten the federal priorities set forth above. In those circumstances, consistent with the traditional allocation of federal-state efforts in this area, enforcement of state law by state and local law enforcement and regulatory bodies should remain the primary means of addressing marijuana-related activity." The memorandum suggests that the existence of a strong and effective state regulatory system, and a cannabis operation's compliance with such a system, may allay the threat that an operation's size poses to federal enforcement interests, and encourages federal prosecutors to review cannabis cases on a case-by-case basis, and consider whether or not the operation is in compliance with a strong and effective state regulatory system prior to prosecution.

In December 2014, Congress passed, as part of an omnibus budget bill, language that prohibits the USDOJ from spending funds to intercede in state efforts to implement MC. This amendment, known as the Rohrabacher-Farr amendment must be renewed annually in order to continue to constrain federal funding in this way. In April 2017, the Rohrabacher-Farr amendment was included as part of the continuing resolution on the budget.

On February 8, 2017, former-Senator Jeff Sessions was confirmed to head the USDOJ as United States Attorney General under President Trump. Senator Sessions has been a vocal opponent of cannabis use and as Alabama's attorney general, once supported legislation that would establish mandatory death sentences for drug dealers, including cannabis. When pressed on his historic opposition to cannabis use at his confirmation hearing, Senator Sessions did not commit to enforcing the federal law against states that have legalized cannabis use and did not discuss rescinding the "Cole Memo." It is unknown what, if any, impact the new United States Attorney General will have on cannabis laws in those states which have legalized cannabis use.

MC Industry in California and the Motivation for Statewide Regulation. Although the CUA was passed in 1996, statewide regulation of MC, in the form of MCRSA, was not passed until 2015. Although the AUMA will alleviate some of the concerns with an unregulated market, there are still many unresolved issues surrounding the legitimate operations of a cannabis market. Currently, as a result of the lack of a regulatory framework, a number of participants in this industry are part of an unregulated, unlicensed, and untaxed, economy.

Because cannabis remains a Schedule I drug, no pharmacy may dispense cannabis, and federal and state food and drug laws do not apply. For both patients and non-medical users, there is a critical need for meaningful regulatory standards to address testing, purity, potency, labeling, identification and elimination of contaminants, and secure protocols for processing and transport of the product. Without such regulation, harm to consumers is possible given that no health and safety standards exist for cannabis. The same is true in regard to requirements for packaging, labeling, and tracking of the product for the entirety of its life cycle. In addition to health and safety concerns, there has been public demand for cannabis cultivation standards that mirror established agricultural standards in order to alleviate the environmental degradation to watersheds, forests, and rivers across the state caused by illegal cannabis cultivation.

Consequently, with the passage of MCRSA in 2015 and AUMA in 2016, the combined regulatory efforts seeks to address numerous issues and protect consumers through regulation of

MC activities by: (1) establishing oversight and accountability of operations; (2) providing enforcement funding and mechanisms; (3) instituting health, safety, and environmental standards and ensuring they are met; (4) preventing diversion; and, (5) maintaining local control.

MCRSA

Prior to adoption of MCRSA, there had been many legislative attempts to address issues relating to MC including attempts to establish comprehensive regulatory frameworks. After the passage of MCRSA, recognition of the need for statewide regulation persisted and grew stronger, especially in light of the increased environmental, health, and public safety concerns associated with MC. These factors, along with the historic collaboration among members of the Legislature and stakeholders, led to the 2015 passage of MCRSA, which includes AB 243 (Wood), AB 266 (Bonta, Cooley, Jones-Sawyer, Lackey, and Wood), and SB 643 (McGuire).

MCRSA established, for the first time, a comprehensive statewide licensing and regulatory framework for the cultivation, manufacture, transportation, testing, distribution, and sale of MC to be administered by the newly established Bureau of Medical Cannabis Regulation (Bureau) within Department of Consumer Affairs (DCA), Department of Public Health (DPH), and Department of Food and Agriculture (DFA), relying on each agency's area of expertise.

MCRSA vested authority for:

- DCA and the Bureau to issue licenses and regulate dispensaries, distributors, and transporters, and to provide oversight for the state's regulatory framework;
- DPH to license and regulate laboratories and manufacturers; and
- DFA to license and regulate cultivators.

To assist with the regulatory responsibilities, MCRSA allows and AUMA requires the Bureau to convene an advisory committee to make recommendations to the Bureau and licensing authorities on the development of standards and regulations, including best practices and guidelines, in order to ensure qualified patients and consumers have adequate access to cannabis and MC products. MCRSA phases out the collective model and its associated immunity, and replaces it with clear licensing requirements for licensees who engage in commercial cannabis activity and are licensed under MCRSA; those who operate unlawfully according to MCRSA are subject to prosecution. An important cornerstone of MCRSA is the preservation of local control through the requirement of dual authorization from both the state and local government in order to legally operate within the state.

Under MCRSA, local governments may establish their own ordinances to regulate MC activity or choose to ban it altogether. For state licenses, entities may apply for a cultivation, manufacturing, dispensing, testing, distribution, or transport license and are prohibited from holding specific combinations of licenses. For example, testing licensees may not apply for any other license types, and distributors may only obtain an additional license to transport. However, MCRSA provides limited ability for operators to cultivate, manufacture, and dispense MC, also known as vertical integration, but limits cross licensure to two of three of those categories outside of this exception. To assure patient and consumer health and safety, MCRSA requires the DPH to develop standards for the production and labeling of all cannabis products manufactured for human consumption. In addition, MCRSA and AUMA require licensed

cultivators and manufacturers to package all cannabis products in tamper-evident packaging, use a unique identifier to distinguish and track the product, and follow specific labeling requirements; prior to sale at a licensed dispensary, these licensees are required to ensure all cannabis and cannabis products are taken to a licensed distributor for quality assurance and inspection who will ensure that batch testing is completed by a licensed testing laboratory.

To ensure accountability and prevent diversion of cannabis and cannabis products, the DFA is required, in consultation with the Bureau, to establish a track and trace program for reporting the movement of cannabis and cannabis products throughout the distribution chain. The track and trace program requires the use of a unique identifier and secure packaging that provides specified information, including the licensee receiving the product, the transaction date, and the cultivator from which the product originates. To ensure adequate resources for this regulatory scheme, MCRSA provides for a General Fund or special fund loan, of up to $10 million from the General Fund, to the Bureau to support the initial regulatory activities authorized by MCRSA. The licensing fees established by the regulatory authorities are required to repay the loan and then cover the cost of administering and enforcing the framework. To assist with enforcement efforts, MCRSA requires the Bureau to establish a grant program to fund activities by state and local law enforcement to remedy the environmental effects of cannabis cultivation.

AUMA

Under AUMA, cannabis was legalized for non-medical use in a private home or licensed business, allowed adults to possess and give away up to approximately one ounce of cannabis and up to eight ounces of concentrate, and permitted the personal cultivation of up to six plants. The law continues to prohibit smoking in or operating a vehicle while under the effects of cannabis, possessing cannabis at a school or other child oriented facility while kids are present, growing in an unlocked or public place, and providing cannabis to minors.

The authors of AUMA sought to make use of much of the regulatory structure and authorities set out by MCRSA while making a few notable changes to the structure being implemented. In addition, the AUMA approved by the voters adopted the January 1, 2018 deadline for state implementation of non-medical cannabis in addition to the regulations required in MCRSA that are scheduled to take effect on the same date. The same agencies as under MCRSA remain responsible for implementing regulations for adult use.

Under AUMA, the DCA continues to serve as the lead regulatory agency for all cannabis, both medical and non-medical, and renames the existing Bureau as the Bureau of Marijuana Control. AUMA includes 19 different license types compared to the 17 in MCRSA and authorizes DCA (and the Bureau) the exclusive authority to create and regulate a license for transportation of cannabis. Additionally, while MCRSA requires both a state and local license to operate, AUMA only stipulates a state license; however, the state is also directed not to issue a license to an applicant if it would "violate the provisions of any local ordinance or regulation."

One particularly controversial and loosely regulated segment of the cannabis industry is the emergence of cannabis delivery services, especially in light of local bans on cannabis businesses. While not explicitly in the language, AUMA implies that local jurisdictions may move to ban delivery services and the state would be compelled to follow by not issuing licenses under the above provision which prevents conflict at the state and local level.

While the language of AUMA allows for modifications to the law by majority vote of the Legislature, any legislative changes inconsistent with the original intent of the law may require voter approval. If the state and its various agencies of jurisdiction have not finalized regulations, hired staff, and created technology solutions by January 1, 2018, it is unclear how wide-sweeping the consequences may be.

Governor's Proposal and Draft Regulations

On April 5, 2017, the Administration released a proposal to address discrepancies in MCRSA and AUMA's legal frameworks. Draft regulations were released on April 28, 2017, and May 5, 2017. Some of the outstanding issues are noted below.

- **Non-storefront dispensaries and retailers**

  Issue: Proposition 64 allows for a delivery by a retailer licensee but does not include any license for delivery-only retailers. MCRSA allows for dispensaries to deliver to patients but also fails to include a license for delivery-only retailers. However, legislation has been proposed in AB 1575 (15/16) and AB 64 (17/18) to create a license type for non-storefront dispensaries or retailers. Under this license, a dispensary or retailer would maintain a physical location subject to security regulations by the Bureau but the location would be inaccessible directly to customers or patients. Instead, the location would be used to store and deliver products to customers and patients.

- **Harvest Tax**

  Issue: Proposition 64 creates a tax on cultivators of $9.25 per ounce of flowers and $2.75 per ounce of leaves that is due when their harvested cannabis enters the commercial market. For outdoor cultivators in particular this occurs around the fall months when most outdoor cannabis is harvested. This is a time when many cultivators face liquidity problems as they have expended a large of their capital producing their product. Furthermore, because the tax is due prior to the cannabis undergoing lab testing, there is no guarantee that a cultivator will be able to sell their product.

- **Appointments to the Cannabis Control Appeals Panel**

  Issue: Proposition 64 created the Cannabis Control Appeals Panel which will arbitrate licensee's appeals of licensing authority actions. The panel, made up of three Governor's appointees subject to Senate confirmation, will be entrusted with a significant of power in this role. The panel's rulings can only be appealed to the State Supreme Court or the Appeals Court with jurisdiction over the area where the licensee is based. Furthermore, the Legislature can only act under strict circumstances to remove an Appeals Board member.

- **Key regulations**

  Issue: Neither Proposition 64 nor MCRSA define premise despite it being referenced in numerous code sections throughout both laws. The definition of premise is critical to where licensees can be located for both local ordinances and state law. It is also important given the

Governor's proposal prohibits the location of non-medical and medical licensees in the same premise.

Issue: Additionally, the Administration has produced a proposed MCRSA regulation prohibiting the transfer of a license without requiring the new ownership to undergo the application and background check process.

- **DUID reporting and open container definition**

  Issue: Currently, California driving statistics categorize all types of drugs together when issuing reports, making it impossible to track the prevalence cannabis-related DUIs and crashes.

  Issue: While Proposition 64 does not permit operating a vehicle with an open container of cannabis, it failed to create a legal definition.

- **CHP task force and CHP funding**

  Issue: Proposition 64 created several funds for the California Highway Patrol (CHP) to deal with the issue of drug-impaired driving. As administrator of these funds, CHP will play a central role in coordinating California's drug-impaired driving policies.

  Issue: One of the key roles for CHP is establishing and adopting protocols and best practices that can be used by law enforcement. While Proposition 64 allocates $3 million to CHP for this purpose, the funding does not begin until the 2018/19 fiscal year, well after retail sales will likely begin.

- **Inspector**

  Issue: The Governor's proposal includes an open distribution system where licensees can control and distribute products to retailers or dispensaries without the use of an independent distributor. Under MCRSA, all distributors are required to be independent under the rationale that quality assurance, control and testing are most suitably performed by an independent entity to ensure that bad products are not allowed to reach the market.

- **Patient ID Card for sales tax exemption**

  Issue: Proposition 64 exempts patients with the Medical Cannabis Patient ID card from sales taxes when purchasing MC. The Governor's proposal suggests eliminating the Patient ID Card and instead requiring patients to only show their valid doctor's recommendation. This will have significant effects on local government and sales tax revenue because doctor's recommendations are much easier to obtain than the Patient ID Card which is issued by county governments in conjunction with the Department of Public Health. Furthermore, creating a disparity in the taxing requirements between medical and non-medical cannabis will incentivize some customers to obtain doctor recommendations primarily as a way to save on sales taxes.

- **Non-profit agriculture cooperatives by cultivators**

  Issue: Cultivators looking to transition to the licensed market face significant challenges. Many long-time cultivators may not have a viable path to licensure due to license fees, costs of compliance and lack of access to capital.

- **Transportation standards**

  Issue: Transportation is distinct from distribution which only applies to the final step of taking products to retailers or dispensaries while transportation includes moving products in the rest of the supply chain e.g., from a cultivator to manufacturer. MCRSA specifies that all transportation of MC must occur between licensees and creates a license type for transporters. Proposition 64 does not have a license type for transporters and it is silent on whether transportation outside of distribution is subject to minimum standards. It also fails to specify that all transportation of cannabis occur between licensees. While Proposition 64 states that all transport between licensees must be recorded on an invoice, it does explicitly limit transportation to be solely between licensees. Without this clarification, law enforcement could stop a vehicle filled with cannabis in route to a non-licensed location but would be prohibited from taking any action due to this loophole. This expands the opportunity for diversion and illegal activities. In addition, Proposition 64 did not explicitly subject transportation by licensees to regulations.

- **Product testing**

  Issue: MCRSA requires that all cannabis and cannabis products undergo lab testing in the final form that they will be consumed by patients. The Governor's proposal and Proposition 64 do not have a similar requirement.

- **Advertising restrictions**

  Issue: Current advertising restrictions under Proposition 64 only apply to cannabis licensees. There are several cannabis-related businesses, however, that are not currently licensed by the state which are advertising in any capacity they wish absent appropriate regulation. Any tobacco or alcohol related advertisement has to meet certain criteria, not the least of which is limiting the advertisement to age-appropriate audiences. Non-licensed cannabis-related businesses are free at this moment to advertise to any audience, in any medium, regardless of age.

- **Repealing MCRSA provisions unrelated to regulatory system**

  Issue: The Governor's proposal repeals MCRSA. However, a number of MCRSA provisions are consistent with Proposition 64's intent and therefore are allowed to be included in the non-medical cannabis regulatory system. These are important policies that to ensuring successful implementation.

- **Sunset Review for the Bureau**

  Issue: The Bureau, under the DCA, is not subject to a "sunset review" provision as other boards and bureaus are required to have under the DCA.

- **Reporting requirements for environmental violations by non-licensing authorities**

  Issue: MCRSA requires the DFA to work collaboratively with the Department of Fish and Wildlife (DFW), and the State Water Resources Control Board (Board) to enforce rigorous environmental standards for cannabis cultivation. The Governor's proposal explicitly exempts DFA, from taking action based on findings by DFW and the Board.

- **Inclusion and diversity in entrepreneurship**

  Issue: Proposition 64 includes provisions for an Advisory Committee to advise on the development of standards and regulations, including best practices and guidelines that protect health and safety.

- **For-Profit status to allow transition for existing cooperatives**

  Issue: Under Proposition 64 licensees are allowed to operate for-profit. MCRSA implicitly allows licensees to operate for-profit because it refers to commercial cannabis activity. However, any currently operating cannabis business must be organized under SB 420 and collectives and cooperatives under SB 420 are not presently authorized to operate for-profit. Any change in corporate structure requires resubmission of a MCRSA or Proposition 64 application. The question arises when not-for-profit applicants applying for MCRSA and Proposition 64 licenses submit their applications: can they apply as for-profit companies or must they restructure their companies to now be for-profit?

Purpose of the Hearing

In light of the Governor's proposal and continued attention to the draft regulations on cannabis, the committee is seeking an update on the status of cannabis licensure, regulation, legalization, and the process for amending existing law. This is especially timely since many of the regulatory structures of AUMA are designed to parallel the regulatory structure of MCRSA.

MCRSA and AUMA direct the state to begin issuing cannabis licenses for both medical and recreation beginning on January 1, 2018. Entities operating in accordance with other state and local laws are expected to continue to do so until such time as their licenses are approved or denied under the new licensing scheme.

MCRSA established a new comprehensive licensing and regulatory scheme for MC, and AUMA makes use of much of that structure. While the legislation itself established many requirements to comply with the law, even more is left to the implementing agencies, including DFA, DPH, and the newly-established Bureau under DCA, which are tasked with administering MCRSA and AUMA. In addition to the challenges of creating a brand new regulatory body, other hurdles exist such as adopting regulations to address complex issues that cover a wide breadth of issues,

including but not limited to, minimum potency for cannabis, pesticide regulation, child-proof packaging, labeling and advertising, and establishing requirements that licensees must meet in order to obtain licensure by January 1, 2018. Licensing authorities and other state and local boards and agencies will also be responsible for enforcing MCRSA and AUMA in order to ensure that participants are compliant and the public and the environment are protected.

As the state moves forward with the regulation of both medical and non-medical cannabis, stakeholders are requesting a streamlined regulatory structure of cannabis activities across both medical and non-medical. This hearing is intended to evaluate next steps the licensing authorities and Legislature must take to implement the law.