Market Structure Permitted Interaction Group Report - Act 169 (2021) Dual Use Cannabis Task Force

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Agenda

01. Vertical vs. Horizontal

02. Licensing

03. Licensing Restrictions

04. Overseeing Authority

05. Additional Recommendations

Market Group Objectives

1. Create a license structure that will limit the legacy and gray market by offering effective on-ramps into the regulated and licensed adult use program.
2. Determine what should be retained from the existing medical program structure and carried over into the adult use program, especially regarding home grow and cooperatives.
3. Envision an effective licensing structure for an inclusive industry that provides opportunities for local business owners and facilitates innovation and industry growth.
4. Minimize over-saturation and under-provision of cannabis in the market (noting that this cannot be eliminated, and prices are likely to fall substantially as the market develops).
5. Design a financing structure for the regulating authority that will eventually lead the regulating authority to be self-sufficient and not reliant on government funding (general fund appropriations).
6. Recommend regulations in concert with the above goals that facilitate a profitable, sustainable, environmentally friendly, and regulated market that reduces youth access
7. Operating assumption: Hawaii will need a comprehensive regulatory scheme to survive federal legalization

If something's worth doing...

Its worth doing right.

Vertical vs. Horizontal - Recommendation

Given the examples of other states and in accordance with the stated goals for Hawaii included at the beginning and throughout this report, a horizontal licensing structure, with the option for a single licensee to obtain more than one type of license, is the recommended strategy for Hawaii's adult-use market.

- No adult-use market currently requires vertical integration.
- All adult-use markets use horizontal licensing structures.
- A few adult-use states outright ban vertically integrated businesses.
- Some adult-use states allow participants to obtain more than one type of license. This would provide a path to integrate current dispensaries into the system.

Vertical vs. Horizontal

Benefits of a Horizontal Licensing Structure

- Less expensive for business entrants—encouraging innovation; a diverse, resilient industry; legacy market participation; and social equity.
- More businesses = more product diversity
- Diverse license types = more fine-tuned licenses and enforcement
- More business promotes specialization, competition, and cost savings

Licensing - Recommendation

Any comprehensive licensing scheme for a successful cannabis industry must include licenses for the following cannabis-touching activities:

- Cultivation (commercial and individual)
- Manufacturing/Processing
- Distribution
- Delivery
- Testing
- Transportation
- Retail
- On-Site Consumption

Licenses should be “stackable”, i.e., so long as the requirements for a particular license type are met, there should be no limit on how many different types of licenses that a licensee might acquire.

There should be a numerical limit on how many licenses of a particular type that a licensee might acquire to prevent monopolization of the market and discourage multi-state operators.

“The whole is often greater than the sum of its parts.”

What follows is a proposed *system*, not a series of individual recommendations.

If something seems incomplete, it has not been addressed yet.

Cultivation License Regulations - Recommendation

Hawaii will require a flexible licensing structure with different levels of cost and regulation for different sized grow operations.

To the extent that cannabis is legalized in Hawaii, the following restrictions should not be stronger than the laws and restrictions that currently govern alcohol breweries, distilleries, distributors, and retail locations.

Our proposal is to put the provision of cannabis cultivation licenses on a sliding cannabis license fee scale to promote small, local growers.

Cultivation License Regulations

All Cultivation Licensees

- Can sell seeds/clones to other cultivation licensees and retail licensees
- Sell cannabis directly to retail licensees or consign their cannabis through retail licensees
- Must test cannabis to meet state health standards prior to any sale to consumers
- Submit an audit along with every license renewal (the scope of the audit will vary by licensee size)
- Grow outdoors and/or indoors in accordance with other health, agricultural, or state/county building/zoning codes
- Commercial cultivation licensees can only sell to other licensed cannabis businesses
- “Sq. ft. under cultivation” does not include on site processing facilities.

Cultivation License Regulations

Home Grow

- Limited to twenty (20) plants
- Definition of “plant” should match the current definition as applied to current medical dispensaries under the Hawaii Revised Statutes and administrative rules.
- Default right of all adults over 21 years of age under decriminalization/de-scheduling/legalization
- Any individual can gift, barter, or trade cannabis grown personally if they can prove the transaction was noncommercial in nature
- Any individual can sell their individually grown cannabis to any licensed participant in the cannabis industry.
- Any individual can sell their individually grown cannabis directly to consumers if they obtain a cultivation license and test/label the product in accordance with state regulations
- All individuals growing plans are subject to random inspections by the regulating authority to ensure compliance (chiefly in response to third-party reports)
- No testing requirements unless the individual intends to sell the product
- Must comply with all rules and regulations governing the grow site including covenants, AOAO rules, and state and county rules and regulations

Cultivation License Regulations

Commercial Grow

20+ to 499 sq. ft. under cultivation

- A cultivation license is required. Approval of a cultivation license requires:
  - Proposal of square footage to be covered by the license
  - Location of the cultivation
  - Self-Certification of compliance with all local/state/county rules and regulations
  - Payment of scaled licensing fee
- Renewal of a cultivation license requires the licensee to:
  - Report the square footage covered by the license
  - Report the location of the cultivation
  - Recertify compliance with local/state/county rules and compliant security plan
  - Submit evidence of business operation and tax data
  - Pay the scaled license renewal fee
- Sites are subject to random audits/inspections by the regulatory authority
- Grow must be permanent/non-mobile

Cultivation License Regulations

Commercial Grow

500 to 999 sq. ft. under cultivation

- A cultivation license is required. Approval of a cultivation license requires:
  - Proposal of square footage to be covered by the license
  - Location of the cultivation
  - Self-Certification of compliance with all local/state/county rules and regulations
  - Payment of scaled licensing fee
- Renewal of a cultivation license requires the licensee to:
  - Report the square footage covered by the license
  - Report the location of the cultivation
  - Recertify compliance with local/state/county rules and compliant security plan
  - Submit evidence of business operation and tax data
  - Pay the scaled license renewal fee
- Sites are subject to random audits/inspections by the regulatory authority
- Grow must be permanent/non-mobile

Cultivation License Regulations

Commercial Grow

1,000 to 4,999 sq. ft. under cultivation

- A cultivation license is required. Approval of a cultivation license requires:
  - Proposal of square footage to be covered by the license
  - Location of the cultivation
  - Self-Certification of compliance with all local/state/county rules and regulations
  - Payment of scaled licensing fee
- Renewal of a cultivation license requires the licensee to:
  - Report the square footage covered by the license
  - Report the location of the cultivation
  - Recertify compliance with local/state/county rules and compliant security plan
  - Submit evidence of business operation and tax data
  - Pay the scaled license renewal fee
- Sites are subject to random audits/inspections by the regulatory authority
- Grow must be permanent/non-mobile

Cultivation License Regulations

Commercial Grow

5,000 to 9,999 sq. ft. under cultivation

- A cultivation license is required. Approval of a cultivation license requires:
  - Proposal of square footage to be covered by the license
  - Location of the cultivation
  - Approved plan for compliance with all local/state/county rules and regulations
  - Approved compliant security plan
  - Payment of scaled licensing fee
- Renewal of a cultivation license requires the licensee to:
  - Report the square footage covered by the license
  - Report the location of the cultivation
  - Provide evidence of compliance with local/state/county rules and compliant security plan
  - Provide evidence of compliant security plan
  - Pay the scaled licensing fee
  - Submit evidence of business operation and tax data
- Subject to random inspections by the regulatory authority
- Grow must be permanent/non-mobile

Cultivation License Regulations

Commercial Grow

10,000+ sq. ft. under cultivation

- A cultivation license is required. Approval of a cultivation license requires:
  - Proposal of square footage to be covered by the license
  - Location of the cultivation
  - Approved plan for compliance with all local/state/county rules and regulations
  - Approved compliant security plan
  - Payment of scaled licensing fee
- Renewal of a cultivation license requires the licensee to:
  - Report the square footage covered by the license
  - Report the location of the cultivation
  - Provide evidence of compliance with local/state/county rules and compliant security plan
  - Provide evidence of compliant security plan
  - Pay the scaled licensing fee
  - Submit evidence of business operation and tax data
- Subject to random inspections by the regulatory authority
- Grow must be permanent/non-mobile

Cultivation License Regulations

Hemp Only Cultivation License

- Must only grow hemp
- No regulations in addition to current USDA regulations
- Can sell product in accordance with current USDA regulations
- Any product that meets the definition of cannabis rather than hemp and is produced and intended for use in any consumable must be sold and delivered immediately to a licensed cultivator or disposed of immediately. Repeat instances of said production will obligate the hemp cultivator to obtain a cannabis cultivation license.
- Any hemp cultivator can accept cannabis waste from any cannabis market participant for use in non-consumable products (such as rope, plastic, building materials, etc…)

Cultivation License Regulations

Cooperatives

- Any group of cultivation licensees who's cumulative, licensed square footage under cultivation is less than 5,000 square feet may obtain a cooperative license
- All coop members must individually abide by the requirements of their relevant cultivation licenses
- All coop members can sell directly to legal consumers on a single chosen member's agricultural, commercial, or industrial zoned land
- All sales to an end user must meet the regulatory authority's established testing and packaging requirements

Plant-touching Business Licenses - Recommendation

The state should establish a licensing process similar to that established for cultivation licenses for the following businesses:

- Manufacturing/Processing
- Distribution
- Delivery
- Testing
- Transportation
- Retail Dispensary
- On-site Consumption

All consumer sales must be tested and packaged appropriately.

Testing is not required for licensee-to-licensee sales of any sort.

The regulating authority should investigate the feasibility of requiring a seed-to-sale tracking system.

The regulatory authority should have the authority to investigate and license additional business activities in response to market actor requests.

Plant-touching Business Licenses - Regulations

Manufacturing/ Processing

- This license covers any transformative activity to a product between cultivation of the raw cannabis and packaging of the product for retail – including extraction, rolling, cooking, etc…
- Licensees can accept detritus from all other market participants for processing
- Licensees can transport their own products.
- Obtaining/renewing a license will require:
  - Approved safety standard operating procedures
  - Approved manufacturing standards
  - (For renewal) Submit evidence of business operation and tax data
  - Demonstrated compliance with state/county building, zoning, other codes and permits as condition of license/renewal
  - Payment of license/renewal fee
- All licensees are subject to random inspections

Plant-touching Business Licenses - Regulations

Distribution

- This license covers the sale directly to retail locations of raw or packaged products bought from cultivation licensees or manufacturing/processor licensees by the distributor.
- Licensees can transport their own products.
- Obtaining/renewing a license will require:
  - Approved safety standard operating procedures
  - (For renewal) Submit evidence of business operation and tax data
  - Demonstrated compliance with state/county building, zoning, other codes and permits as condition of license/renewal
  - Payment of license/renewal fee
- All licensees are subject to random inspections

Plant-touching Business Licenses - Regulations

Delivery

- This license covers the delivery of products directly from retail locations to consumers, subject to transportation limits on the amount transported at any one time.
- This license can be restricted to social equity applicants as defined by the regulatory authority
- Obtaining/renewing a license will require:
  - (For renewal) Submit evidence of business operation and tax data
  - Payment of license/renewal fee
- All licensees are subject to random inspections

Plant-touching Business Licenses - Regulations

Testing

- Testing facilities should be licensed in accordance with current licensing requirements

Plant-touching Business Licenses - Regulations

Transportation

- This license covers business-to-business transportation of large amounts of cannabis.
- Licensees can transport any amount of products at a time
- Obtaining/renewing a license will require:
  - (For renewal) Submit evidence of business operation and tax data
  - Payment of license/renewal fee
- All licensees are subject to random inspections

Plant-touching Business Licenses - Regulations

Retail Dispensary

- This license provides a single brick-and-mortar retail location that may market and sell cannabis products directly to consumers.
- Licensees can transport the products.
- Obtaining/renewing a license will require:
  - Approved safety standard operating procedures
  - (For renewal) Submit evidence of business operation, tax data, and an inventory audit
  - Demonstrated compliance with state/county building, zoning, other codes and permits as condition of license/renewal
  - Payment of license/renewal fee
  - Demonstrated compliance with all current restrictions on retail location sites
- All licensees are subject to random inspections
- Whether medical/adult-use licenses are included together in a single location or require separate licenses will be determined by the Medical Use Group

Plant-touching Business Licenses - Regulations

On-Site Consumption

- This license can only be obtained as an add-on to a retail license for an additional fee. Each on-site consumption license will correspond to a single retail license and provide for a single brick and mortar location for on-site consumption that is physically united with the associated retail location.
- All retail licensee/renewal or requirements apply
- Every on-site consumption location requires a cold dark room and certified CPR on premises at all times
- The regulatory authority can enact other provisions to ensure consumer safety

Plant-touching Business Licenses - Regulations

License Pricing

- Our proposal is to put the provision of cannabis cultivation licenses on a sliding license fee scale by size of operation.
- Cultivators can choose how much to cultivate and how much to pay as a license fee each year in response to efficient market forces.
- This will help control cannabis cultivation business entrance and exits, cannabis prices, and privilege small local growers over large, multi-state operators.
- Other business license fees (including hemp cultivation and cooperative licenses) can be set per license type.
- The regulatory authority should have authority to set license prices for all license types and may consider requiring application fees.

Plant-touching Business Licenses - Regulations

License Pricing Example

Home Grow – Max 20 plants

- No license required

Commercial Grow – 20+ plants up to 499 square feet under cultivation

- 0 sq. ft. to 499 sq. ft.
- Scale linearly by number of sq. ft. at a rate of $1.00 to 1 sq. ft. from $500 to $1,000

Commercial Grow – 500 to 999 square feet under cultivation

- 500 sq. ft. to 999 sq. ft.
- Scale linearly by number of sq. ft. at a rate of $3.00 to 1 sq. ft. from $1,000 to $2,500

Commercial Grow – 1,000 to 4,999 square feet under cultivation

- 1,000 sq. ft. to 4,999 sq. ft.
- Scale linearly by number of sq. ft. at a rate of $4.00 to 1 sq. ft. from $2,500 to $18,500

Commercial Grow – 5,000 to 9,999 square feet under cultivation

- 5,000 sq. ft. to 9,999 sq. ft.
- Scale linearly by number of sq. ft. at a rate of $6.00 to 1 sq. ft. from $30,000 to $60,000

Commercial Grow – 10,000+ square feet under cultivation

- Scale linearly by number of sq. ft. at a rate of $10.00 to 1 sq. ft., i.e. $10,000 per 1,000 sq ft for any facility over 10,000 sq. ft.

License Structure – Concerns and Recommendations

Over or Under Supply

State-level monitoring of market variables such as quantities of cannabis produced or sold (aggregate and per capita), timeliness of license approvals, and oversight of county time/place/manner restrictions is strongly encouraged and license fees can be adjusted to compensate.

Prior Criminal Records of Licensees

Defer to Social Equity Group

Foreign and Interstate Investors

- Adopt a disclosure requirement similar to that recently adopted in Oklahoma that would require applicants to attest to the identity of any foreign financial interest.
- Explore options for managing interstate involvement including:

  (1) Scaling license fees to encourage small growers rather than large growers, discouraging outside investment;

  (2) Enforcement of higher import/export restrictions on cannabis, similar to current agricultural inspection/regulations;

  (3) joining an interstate commerce pact; and

  (4) pursuing alternative methods of encouraging local ownership in cannabis businesses.

License Structure – Concerns and Recommendations

Financial Integrity of Licensee Requirements

- The regulating authority should set scalable, minimum capitalization requirements depending on the type of license and size of cultivation (with exceptions to facilitate the entry of small local business owners).
- Replace the audit requirement (HRS 329D-23) with required submittals of evidence of business operations and tax data for license renewal.

Pre-license Site Inspection Requirements

- The application process should include a physical inspection of site by the regulatory authority in a manner similar to the procedure set forth in the state's liquor law.
- Consideration should be given to provide checklists to assist applicants in meeting the requirements of the physical inspections.
- Pre-site physical inspections should not be required for cultivation licenses under 500 sq ft or for delivery licenses.
- Technical assistance should be provided to social equity applicants in navigating the pre-inspection process.
- Given the long-application time for county building permits and associated cost to carry the property for several months or more, pre-site inspections should happen prior to the purchase or lease of a property to determine compliance with license requirements.

Overseeing Authority & Scope of Legalization - Recommendation

For a vibrant, effective, local industry to emerge that supplants the legacy market and brings current legacy participants into the legal market, the decriminalization/descheduling/ legalization of cannabis should be substantial, and all further enforcement should be handled directly and solely by the regulating authority as a civil matter in the same matter as the Department of Taxation regulates failure to pay taxes and tax evasion.

To the extent that failure to obtain a license might result in criminal liability, such liability should only be enforceable upon referral of the matter to the State Attorney General.

The legislature should make every effort to ensure the new regulatory scheme places as much control of all enforcement of cannabis specific regulations – legal and illegal activities – inside the regulatory authority.

The more agencies and overlapping jurisdictions exhibit authority over the cannabis specific regulations, the more regulatory costs will increase, to the detriment of the legal market.

Regulatory Authority – Operating Board

- Creating a smaller operating board (no more than five individuals) that is supported by a larger advisory board will provide for greater market and enforcement efficiency.
- A larger deliberative board may face vacancy and quorum issues and decision-making would be unwieldy.
- An authoritative body would have the powers and duties to regulate and control its adult-use cannabis program with a well-defined mission statement outlining its governance similar to Nevada, Michigan, California, and Alaska.
- The regulatory authority should have discretion to manage every aspect of the cannabis program within the confines of the authorizing statutes, and it should be independent either within or separate from all current agencies, authorities, boards, or commissions

Regulatory Authority – Advisory Board - Make-up

- **The Advisory Board should include members with background in tax, health, agriculture, law, licensing, and economic development. For instance:**
  - Department of Health Director - Medical and Environmental Divisions or designee
  - Department of Agriculture Director - or designee
  - Department of Business, Economic Development and Tourism Director - or designee
  - Department of Taxation Director - or designee
  - Department of Commerce and Consumer Affairs Director - or designee
  - Department of Public Safety Director - or designee
  - Attorney General or designee
  - Health Care provider
  - Patient advocate
  - Person with knowledge in the field of criminal justice reform
  - 1 - 3 people actively engaged in the cannabis industry
  - 1 - 2 laypersons

Regulatory Authority – Advisory Board Duties

- Recommending clear, consistent standards for licensure by promoting the highest level of public health and safety
- Keeping licensees, stakeholders, and the public informed and engaged in the Board's/Commission's mission
- Recommending clearly defined incentives and preferences for small business
- Providing accurate and timely data from member's agencies for the Regulatory Authority to make data driven decisions

Regulatory Authority – Transition Period

- The transition period between the legalization of cannabis and the setup of the regulatory agency and implementation of the licensing scheme will likely take a number of months if not over a year during which the market will operate with little oversight.
- The Market Group recommends that any enabling legislation include sufficient resources to effect a timely and orderly transition to a dual use system, including but not limited to personnel and operating funds, interim authority to address transitional changes to the market, and authority to temporarily augment existing resources with external contracts.

Labeling Requirements

- In addition to “Made in Hawaii” labeling requirements, and for the protection of Hawaii grown cannabis and genetics, the Hawaii Department of Agriculture’s “Seals of Quality” program should strongly be considered for the cannabis industry. This is particularly so in the future when Hawaii grown adult-use cannabis become eligible for export.
- The state should explore additional options for protecting and promoting the Hawaii brand as it relates to cannabis

Questions?