

A COMPREHENSIVE CANNABIS PROGRAM FOR NEW YORK STATE: THE SECOND ACT

Hemp & Medical Cannabis Alert
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On January 21, 2020, as part of his 2021 Executive Budget, New York State Governor Cuomo released his proposed Cannabis Regulation and Taxation Act (CRTA)—his vision of a regulated cannabis market in New York State and second bite at the apple. In the 2019 New York State legislative session, which runs from January through June of each year, comprehensive cannabis legislation failed to garner enough support to pass as part of the budget or as standalone legislation. The current version of the bill includes more detail than the prior year's, no doubt benefiting from a year's worth of additional consideration and discussion among the Governor's office and legislature. This year's proposed legislation also reflects that New York's time remaining on the sidelines of adult-use cannabis was well-used to learn from the challenges and shortcomings of other adult-use programs in the country.

The Program

The legislation calls for the creation of the Office of Cannabis Management (the OCM). Where previously it was to be its own standalone agency, the OCM is now proposed to be within the Division of Alcohol Beverage Control. Similarly, the OCM previously was to be run by a single Executive Director, who would have exercised unprecedented authority over a cannabis program; now the OCM will be overseen by an Executive Director and a separate board, consisting of a chairperson and four members, all selected by the Governor. The Executive Director would be charged with setting the standards for, and otherwise administering the program, and the board would be tasked with approving certain actions and promulgating the rules and regulations to effectuate the program.

The proposed legislation comprehensively sets out the broad requirements and minimum standards of the program, but leaves the details to rules and regulations to be promulgated by the OCM. Moreover, New York's cannabis program would consist of three branches: medical, adult-use and hemp. The OCM would exercise significant control over each market, including, but not limited to, setting minimum mark-ups and maximum prices for products; setting maximum doses and concentration of products; setting a cap on the production or sales of certain licensees; dictating form and contents of labels and types of packaging; permissible advertising; regulating hours of operation; after consultation with other state

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agencies setting rules for the energy and environmental requirements of grow facilities and approving the size and location of any type of registered facility.

Notably, and for adult-use of marijuana, the Governor's proposal would allow any county, or any city with a population of 100,000 or more, to adopt a local law by majority vote to prohibit any or all license types or activities within their borders. However, perhaps learning from the lessons of California—with its unnavigable patchwork of state, county and local laws governing cannabis—New York State counties, towns, cities and villages would be preempted from adopting rules, regulations or ordinances pertaining to the operation or licensure of registered organizations, adult-use cannabis licenses or cannabinoid hemp licenses. The Governor's proposal provides that those municipalities may adopt local laws pertaining to the hours of operations, but even those cannot be “unreasonably impracticable” to the licensees' operations. This provision will no doubt be the subject of significant discussion and negotiation in this year's legislative session.

Registered Organizations and Medical Marijuana

The law would require the OCM to register at least 10 Registered Organizations that manufacture medical marijuana. Each Registered Organization would be permitted to operate no more than four dispensing sites under its license. The OCM would have the authority to determine the geographic locations of those sites, to assure that the spread satisfies the needs of the program and the patients.

The proposed legislation would also provide OCM with the authority to grant some, or all, of the Registered Organizations, currently registered with the Department of Health (DOH), the ability to grow, process, distribute and sell adult-use cannabis products. Just as with the previous proposal, those Registered Organizations would be permitted to vertically integrate their business and would not be subject to the prohibition of adult-use cultivators, processors and/or distributors having a financial stake in a retail dispensary. However, in participating in the adult-use market, those Registered Organizations would be required to abide by the same rules, regulations and fees as would be applicable to adult-use licensees for the specific license activity. Where the prior proposed legislation would have previously given the existing Registered Organizations the right of first refusal for those adult-use licenses, the new proposed law would require the OCM to establish a competitive bidding process, including an auction, to determine which Registered Organizations get the privilege of access to the adult-use market under the current license. Alternatively, any Registered Organization that is not awarded the privilege may separately apply for a license under the adult-use program, subject to all the same limitations as any other applicant.

Likely under the auspices of public safety and assuring that cannabis is not diverted into the black market, the proposed law allows only certified patients to grow their own cannabis at home for medical use. The law presently prohibits home cultivation for recreational adult-use. And in addition to limiting the plant count, and subject to additional future rules and regulations, the proposed law sets certain minimum requirements that a patient must abide by in order to cultivate at home, which will likely make it difficult for the average patient to do so. For example, each home cultivation set-up is subject to approval by the OCM and must include features like sufficient security and “odor mitigation equipment.”

Protections afforded certified patients under the current DOH medical program against adverse employment action (being terminated or not being hired due to a positive drug test) are carried over from the 2019 proposed legislation. However, where the previous version of the CRTA extended those protections to adult-use consumers, the current version does not.

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Employers would be allowed to have drug testing policies in place and to take adverse employment action based on a violation of that policy by adult-use consumers. In light of New York City's prohibition against such action, however, this provision will no doubt be the topic of negotiation this legislative session.

Adult-Use Licenses

This year's proposed legislation describes, at a minimum, seven classes of adult-use licenses: cultivator; processor; cooperative; distributor; retail dispensary; on-site consumption and microbusiness cultivator. The board of the OCM would have the authority to create any other type of license it deems appropriate. The law allows for partial vertical integration of adult-use activities, with conditions, and prohibits full vertical integration. These categories of licenses are largely carry-overs from the first version of the CRTA, and are defined as follows:

- *Cultivators* (planting, growing, cloning, harvesting, drying, curing, grading and trimming) are required to obtain a separate license for each facility. Under a cultivation license, the licensee is permitted to undertake certain minimal processing activities without need of obtaining a separate processor license. Cultivators may apply for and obtain one processor and one distributor license; however, licensees must obtain all three. For example, a cultivator cannot hold a distributor license without also obtaining a processor license. Like all other classes of adult-use licenses, cultivators are prohibited from holding a retail dispensary license.
- *Processors* (blending, infusing, packing, labeling, branding, making or preparing cannabis products) are limited to one license per licensee, but may operate and perform processing activities at multiple locations under one license. Processors will not be allowed to engage in any other business at its processing premises. Licensees may also hold cultivator and distributor licenses.
- *Distributor* licensees are permitted to obtain adult-use cannabis and cannabis products from processors, microbusiness cultivators, adult-use cooperative or registered organizations and sell those products to retail dispensaries. A separate license would be required for each facility.
- *Cooperative* licenses allow the licensees to grow, process and sell cannabis at licensed premises to licensed distributors and/or retail dispensaries. Cooperative licensees cannot sell products directly to a consumer. As the name suggests, these operations are to be run as Cooperatives, and the law requires that they be operated in accordance with the Seven Cooperative Principles published by the International Cooperative Alliance.
- For *retail dispensary* operations, a separate license would have to be obtained for each facility or location. Registered Organizations would be permitted to apply to sell adult-use recreational products at their existing locations previously registered with the DOH. retail dispensary licensees would be prohibited from holding, or otherwise having an interest in, any other class of license or licensee. Retail locations shall not be within 500 feet of a school or 200 feet of a church or place of worship.
- Retail dispensary licensees may also apply for an *on-site consumption* license. However, as the national permitting landscape for such licenses is only now maturing—e.g., California and Colorado are just beginning to issue such licenses—OCM would likely issue such licenses only after New York State's program is well underway.
- *Microbusiness* cultivator licenses permit the cultivation, processing and distribution of cannabis under a single license. However, the OCM may set an annual cap regarding the total amounts of those license activities.

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The proposed law would also afford certain preferences in the licensing processes to minority and women-owned businesses, disadvantaged farmers as well as social and economic equality plan participants. These would include: the opportunity to have their application expedited; priority or exclusive access to certain classes or categories of license; priority access to certain markets; reduction or deferral of certain fees and access to low- or no-interest loans.

Further, the OCM would have the authority to prohibit the transfer of licenses or may prescribe criteria under which it will allow limited transfers of licenses or changes of ownership. If the OCM decides to permit this, any such changes or transfers would be required to be made during the application process or no later than two years after the approved applicant begins to undertake its licensed activities. After such period of time, transfers will be prohibited.

Hemp

We previously reported on the details of the modified hemp bill that was passed by the legislature, and signed by Governor Cuomo into law, in our July and December 2019, alerts. The hemp legislation is currently scheduled to become effective in March 2020. If the CRTA passes in its current form, the hemp bill will be repealed and the CRTA will govern the production of hemp products, effective January 1, 2021.

The CRTA provides for a hemp processor license, which is required to process CBD or hemp extract for human consumption. A licensee is permitted to also process and extract hemp products not for human consumption on the same premises. Existing holders of Research Partnership Agreements under the Pilot Program shall be awarded a license under the new program.

The pending hemp bill requires retailers, wholesalers and distributors of CBD to obtain permits authorizing them to sell hemp extract products. Under the proposed version of the CRTA, anyone selling CBD products to consumers in final form must obtain a cannabinoid hemp retailer license. A separate license is required for each facility for processing or retail, but an applicant can submit one application for multiple locations. These licenses are non-transferrable without consent of the OCM. OCM will also have authority over the final packaging and labeling requirements for such products.

Taxes

Aside from recognizing popular opinion, a significant reason for any state to legalize adult-use recreational cannabis is the financial windfall afforded by taxing the products. The Governor's proposed CRTA assures that New York State profits from the program.

Medical Marijuana: The proposed law provides that an excise tax would be levied on all medical marijuana, at a rate of 7% of a Registered Organization's gross receipts. Registered Organizations would be prohibited from passing the cost of that tax on to the end consumer as an extra charge or line-item on an invoice or bill. A separate two-tiered tax structure is provided for adult-use products.

Adult-use non-medical cannabis: Under the proposal, everyone in the supply chain would need to register with both the OCM and the New York Tax Department. An application fee of \$600 would be imposed to receive the tax registration and suppliers would need to reapply every two years.

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Cultivators would be subject to one of three new taxes as follows: \$1 per dry-weight gram of flower; \$0.25 per dry-weight gram of trim and \$0.14 per gram of wet cannabis (whole plants weighed within two hours of harvesting). Such taxes would accrue at the time of sale or transfer by the cultivator and would be paid by the registered person to whom the product is sold. Microbusinesses, cooperatives, or Registered Organizations that exercise their option to partially or completely vertically integrate under their respective licenses would become liable for the cultivator taxes.

Sales to **registered retail dispensaries** would be subject to a **state tax of 20%** of the sale price. An additional **local tax of 2%** would apply. On the other hand, the proposal would amend the Tax Law to exempt adult-use cannabis products from both the state and local sales tax.

By comparison, Colorado imposes a 15% excise tax on retail cannabis products upon the first sale or transfer from a cultivator or processor to a retail dispensary. And its medical marijuana is not subject to an excise tax. New for the year 2020, California adjusted its tax scheme. California applies a 15% excise tax and recently adjusted the incidence of the excise tax from the retailer to the distributor, and now the distributor collects from the retailer an amount of excise tax determined by the wholesale price and a government-set mark-up factor. For its cultivators, California applies a similar three category tax as proposed in the CRTA. Retail sales in Oregon are taxed at a rate of 17% of the retail price, plus a possible local tax of up to 3% if approved by local voters. There is no tax on the sale of medical marijuana to certified patients. In Massachusetts, retail sales are taxed at a combined rate of 17% (sales tax of 6.25% and an excise tax of 10.75%), plus a possible local tax of up to 3%, and medical marijuana is tax-free.

While negotiation regarding the outlines of New York State's regulated cannabis industry will certainly continue through the budget process (which finishes by April 1, 2020), and perhaps beyond as standalone legislation through the end of the legislative session in June 2020, the Governor's proposal provides industry participants and others a clear outline of a program that is likely to be approved in New York State before the end of the second quarter of this year.

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