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MEMORANDUM

TO: Steve Linder and Interested Parties

FROM: R. Lance Boldrey

RE: Observations On Draft Kansas Legislation

DATE: April 15, 2022

INTRODUCTION

You have asked us to review the draft Kansas Medical Marijuana Regulation Act ("MMRA"), and offer comments based on lessons learned in the fourteen years since we originally co-drafted the Michigan Medical Marihuana Act, which passed by ballot initiative at the November 2008 election. Given the federal enforcement stance at the time, the MMMA was intentionally vague, eschewing a regulated marketplace in favor of a system where caregivers and patients would be the growers, and there would be no expressly authorized commercial activity.

Later, after playing a significant part in developing the regulations for Illinois' original medical marijuana framework, we were intimately involved in drafting and securing legislative passage of the Michigan Medical Marihuana Facilities Licensing Act ("MMFLA"). The MMFLA introduced a licensed and regulated system, and we took on a lead industry role in working with Michigan's regulators to craft the administrative rules for the Act. After activists won passage of a 2018 ballot initiative authorizing adult-use marijuana, the Michigan Regulation and Taxation of Marijuana Act ("MRTMA"), we reprised our role of playing a central part in developing regulations.

Today, we represent over 150 cannabis companies and investors, with a focus on larger more capitalized industry participants. Our clients include the Michigan Cannabis Manufacturers Association, a select group of less than a dozen companies who have invested north of a billion dollars in the State, and other well-financed groups. Although we do represent some clients whose principals came from the "legacy" market, our clients are all highly compliance-focused and undergo background investigations by our firm before we will provide them with services. As a consequence, we currently maintain a 100% success rate in state licensing applications for the four and a half years since Michigan began accepting applications.

We understand the policy considerations to be taken into account in a medical legalization statute, and recognize that policy objectives of Kansas legislators are bound to differ in some regards from the decisions embodied in Michigan law. (We assume, however, that primary objectives include limiting the existing illicit market and protecting patient health and safety.) Our intent in providing our reflections on the MMRA is to share insight into the likely ramifications of decisions reflected within the draft bill, some of which will not be readily apparent. Below, we have separated our commentary topically on what in our opinion are the most important considerations, and then close with observations on more minor technical issues.

ANALYSIS

Capping Licenses and Deciding Among Competing Applications

- Ramifications of the proposed prohibition on capping licenses: promotes free market, but will also lead to excess capacity and rapid price deflation that can incentivize producers into diversion (a much larger issue in states that permit outdoor grows). The Legislature, of course, could always amend this in the future.

- Local Control: counties can opt out of retail, but query whether local zoning can be applicable. (We did not review all the cross-references to other statutes concerning counties.) If so, this can easily yield an unintended limited license environment, e.g., a required separation distance between marijuana uses would force a choice when two businesses apply for adjacent properties. Who would make a selection and how? (Competitive processes are facially appealing, but lead to lawsuits and delay.)

Ownership Qualifications

- Limits on out-of-state ownership: this will lead to lawsuits and possible delay in program implementation because a number of federal courts have found residency restrictions to violate the dormant commerce clause. (In *Gonzales v Raich*, 545 U.S.1 (2005), the U.S. Supreme Court found that the commerce clause applies even to purely intrastate marijuana activity.)

- Prohibition on publicly traded companies: we assume that this is also intended to favor local ownership, and perhaps reflects a belief that out-of-state companies will care less about compliance and local impacts.

- Ramifications: while there are valid state interests for each of the above limitations, it should also be understood that they will impede investment and box out those with the most experience in operating in a regulated marijuana market. Additionally, publicly traded entities have additional incentives to maintain compliance and often operate far more professionally given fiduciary obligations to shareholders and the oversight of a securities market. (While the public companies in this space are listed on Canadian exchanges, most are controlled by Americans.)

- History of compliance with the MMRA is a required factor. What about history of compliance with other regulatory statutes?

- Backgrounding "each owner" sounds good at the outset, but most states move away from this quickly and limit backgrounding to those over a certain percentage ownership or who exercise any control over the business. Even without publicly-traded companies, anticipate that there will be LLC's and corporations with many passive members or shareholders.

Fees and Economics

- Fee levels: we recognize that the fees in the MMRA are maximums, but those caps are extraordinarily high. With fees being dedicated to regulation of the industry, fees as high as those permitted would incentivize the creation of a massive and over-reaching regulatory body, particularly in a "big government" administration.

    - Even at a quarter of the maximum per square foot of grow area fee, cultivators may not be economically viable. Extreme fees could potentially be off-set by maintaining high prices, but doing that means the illicit market will flourish.

    - Many states have no or very low fees for laboratories, which require large capital costs. Labs need to be licensed prior to validating their equipment and earning accreditation, because they typically need to demonstrate proficiency in testing actual marijuana.

    - Retail licenses are quite expensive, especially when Section 280E of the Internal Revenue Code makes even high volume, high revenue facilities barely profitable.

- No state excise tax: this is unique among states that do not also have an adult-use market. Taxes that are split with local units of government, law enforcement, etc. can generate greater support or muted opposition from interest groups that will lobby on the bill.

- Business expenses: Section 280E of the Internal Revenue Code prohibits marijuana businesses from deducting any business expenses. Costs of Goods Sold reduce income, so businesses like cultivators whose expenditures are almost all for manufacturing a product are not heavily impacted by 280E. But 280E causes retail outlets to pay effective federal tax rates in the 70's, 80's and even higher. The State may wish to consider at least allowing businesses to deduct expenses on any state taxes.

- Prohibition on any revenue sharing (21(h)): may want to consider loosening to allow approved licensing agreements. Many popular and efficacious products are not manufactured by their owners, but instead have their technology and brands licensed to the state-licensed businesses.

Limits on Forms of Marijuana and Means of Administration

- Forms of THC: the definition of "tetrahydrocannabinol" as the "primary psychoactive cannabinoid" suggests that this means Delta-9 THC, and excludes other cannabinoids. Many states are awash in products that contain Delta-8 THC and now other variants. There is a strong argument that such products are "industrial hemp" under federal law (although the DEA disagrees) and we have witnessed a proliferation of unregulated, untested Delta-8 products marketed to all ages and affiliated with brands such as Snoop Dog. A number of states now ban Delta-8 products. Michigan was the first to bring it within the definition of marijuana and subject it to state regulation and control, which may be a path to consider.

- Prohibition on Smoking or Vaporization: depending on intent, the definition of vaporization may be far too narrow. As drafted, "vaporization" only pertains to use of an e-cigarette, defined as a "battery powered device" and probably only one that uses cartridges or oil distillate. There are many ways to vaporize marijuana or various forms of marijuana concentrate (shatter, butter, wax) that would not fit within this definition. Electronic nails or tabletop "Volcanoes" that plug in and "dab rigs," where a consumer uses a torch, are very common.

- There are no "equivalency" definitions to equate 3 ounces of flower to tinctures, edibles, dissolvable powder, etc., and no THC content limits on anything other than flower.

Operational Issues

- There are some important items not addressed in the draft bill, which will have to be resolved by the regulatory agency unless the Legislature wishes to address them now.

    - "Co-location": will a licensee be allowed to have cultivation, processing, and retail all at the same facility?

    - Can licensees have multiple licenses?

    - Can cultivation licenses be "stacked" at one location? 50,000 square feet is the limit for grow space, but can someone create a cultivation campus with multiple buildings with 50,000 SF grow space each?

    - Will outdoor cultivation be allowed? It is the least expensive entry into the market, but even with security cameras and seed-to-sale tracking is rife with opportunities for diversion or for bringing illicit marijuana into the market. Section 22(a) implies that outdoor is prohibited, but we recommend making this explicit ("only within a building").

- It is unclear whether licenses can be issued prior to construction and inspection of a facility. The security plan requirements are laudable (but should mandate back-up power supply), but other common operational requirements are missing (e.g., standards for processors).

- The rules to be promulgated with respect to labs appear to be limited to a standard notice-and-comment rulemaking process. Allowing for emergency rules for every aspect of this interest is important and we would recommend it be specifically allowed unless such a process is inherently permissible under Kansas administrative law. Lab-related rules should also prohibit lab-shopping.

Enforcement Issues

- It appears homegrows by patients are not permitted, but if that is not absolutely crystal clear, it will be left to the courts to decide.

- Fines and penalties for first offenses seem low, while subsequent offenses would ordinarily be subject to higher fines.

- Some tracking of caregiver to patient transfers would be wise.

- Inclusion of chronic pain will lead to many people in their 20's using this condition (especially with low patient fees).

- Defining "30 day supply" is challenging. Is this from the framework of a hypothetical ordinary patient? An inexperienced consumer will not need much, while a 30-day supply for a daily consumer can a large quantity. Higher limits equals more diversion.

- Labels (section 28(b)) should also include confirmation of compliance testing and the name of the lab. Making test results available via a QR Code that pulls up the Certificate of Analysis would be valuable.

- Is armed security allowed?

- Financial institution regulation and cooperation: this is good, although as-written would take a bank out of the safe harbor if a licensee customer failed to comply with state law—even if the bank had no reason to be aware. Some helpful ideas for banking:

    - Require compliance with FinCEN guidance, and have marijuana-related SAR's sent to the State as well.

    - Allow bank access to seed-to-sale system so they can better monitor customer compliance, and allow access to application materials to allow meaningful due

diligence. (While a bank can and will ask a potential customer for a copy of their application, they need to be able to validate that with the State.)

Other Technical Issues

- In 46(b) and the sections pertaining to workers comp, discrimination, etc., we believe there may be some inconsistencies. Employers should be able to prohibit conduct outside of the workplace since there is no equivalent of a blood test to ascertain if someone is intoxicated. (Nanogram thresholds such as that on p. 92 are meaningless. A regular consumer could be sober yet over the threshold, while an inexperienced consumer could be high as a kite and under it.)

- Section 50(a)(1) would prohibit someone from traveling even with a topical in a locked container. Is this intended?

- The medical board would be prohibited from taking adverse licensing action against a doctor for advising patients or themselves being a patient or caregiver. This should be extended to other professions, especially lawyers and accountants whose services are critical for compliance. Performing services under the influence should be prohibited (especially in the midwife section).

CONCLUSION

All in all, the MMRA draft is a thorough and well-considered bill. It is not possible to understand all of the ramifications until after a bill is enacted and takes effect, and the industry begins to develop. We would be pleased to provide further analysis as and if Kansas moves forward with this effort.