Cannabis Regulatory Updates for 2023

City Attorneys Department Cannabis Regulation Committee

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LEAGUE OF CALIFORNIA CITIES

CITY ATTORNEYS DEPARTMENT, CANNABIS REGULATION COMMITTEE WHITE PAPER: REGULATORY UPDATES FOR 2023

Introduction

In July 2021, the Bureau of Cannabis Control, California Department of Food and Agriculture, CalCannabis Cultivation Licensing Division, and CDPH's Manufactured Cannabis Safety Branch were consolidated into a single entity, the Department of Cannabis Control (DCC). This consolidation signaled a unified approach to regulating cannabis in California, propelling the passage of numerous regulations designed to streamline the requirements applicable to legal cannabis businesses in the state. As part of this streamlining, DCC has moved existing cannabis regulations to the California Code of Regulations, has resolved conflicts with existing regulations, and has strengthened public protections.[1]

As part of the consolidation process described above, DCC has undertaken the rulemaking process for numerous regulations that have been approved by the Office of Administrative Law, many of which have implications for California cities and local agencies. We believe the following regulations are the most impactful developments that cannabis practitioners in the public sphere should be aware of as the DCC continues to implement new requirements for the legal cannabis industry in California. Accordingly, the most relevant updated DCC regulations are summarized and briefly explained below.

Regulations Summarized

4 Cal. Code Regs. § 15000.3 – Premises Requirements

Section 15000.3 sets forth rules governing a "dual-use" property—one that is shared by both a licensed cannabis business and another use.

[1] See DCC, "State cannabis consolidation", available at: https://cannabis.ca.gov/about-us/consolidation/.

The amended provisions aim to separate the licensed cannabis premises from other uses on the site, subject to certain minimal exceptions. Under the existing provisions, licensed cannabis premises are prohibited from being located such that someone would have to pass through a business that sells alcohol or tobacco, or a private residence, to access the licensed cannabis premises, or vice versa. In other words, the cannabis and non-cannabis uses were required to have means of separate access. Under the amended provisions, licensed cannabis premises are prohibited from including the living areas of a private residence, unless living areas are required to be included in the licensed premises by local regulations. If a local jurisdiction requires living areas of a private residence to be included in the licensed premises, the licensees shall designate these living areas on their premises diagram but cannot conduct any commercial cannabis activity within the designated living areas. However, the various uses can share common use areas, such as bathrooms, breakrooms, hallways, or building entrances.

Further, under the amended regulation, personal cultivation is prohibited within the licensed premises, and all structures within the licensed premises must be "permanent" and not readily moveable, though use of shipping containers as part of the licensed premises is allowed.

This regulation needs to be considered by any local jurisdiction in deciding how to regulate (or prohibit) parcels that contain a commercial cannabis business together with other uses. The Legislature's adoption of SB 6 and AB 2011 in the 2022 Legislative Session make consideration of this regulation all the more important. Under SB 6 and AB 2011, cities are required to allow housing on parcels zoned for retail or office uses, subject to certain requirements. As a consequence, cities will face an increased likelihood of residential uses potentially sharing a parcel with a commercial cannabis business, and will need to consider how Section 15000.3 will affect potential combined residential and cannabis uses on a site.

4 Cal. Code Regs. § 15003 – Owners of Commercial Cannabis Businesses

Section 15003 articulates who is considered an owner of a commercial cannabis business. The definition of owner has evolved significantly over time as state regulatory agencies have consolidated and grappled with implementing the state's licensing system.

The prior version of the regulation simply stated that a person with an aggregate ownership interest of 20 percent or more in the commercial cannabis business was an owner. A recent update clarifies how aggregate ownership is determined, defining *aggregate* to mean:

> [T]he total ownership interest held by a single person through any combination of individually held ownership interests in a commercial cannabis business and ownership interests in an entity that has an ownership interest in the same commercial cannabis business. For example, a person who owns 10 percent of the stock in a commercial cannabis business as an individual shareholder and 100 percent of the stock in an entity that owns 10 percent of the stock in the same commercial cannabis business has a 20 percent aggregate ownership interest in the commercial cannabis business.

Other categories of "owner" have been added, so that now any person who manages, directs, or controls the operation of the commercial cannabis is an owner, including:

- A member of the board of directors of a nonprofit;
- The trustee(s) and all persons who have control of the trust and/or the commercial cannabis business that is held in trust;
- A general partner of a commercial cannabis business organized as a partnership, or a non-member manager or managing member of a commercial cannabis business that is organized as an LLC;
- The chief executive officer, president or their equivalent, or an officer, director, vice president, general manager, or their equivalent; and
- If the business is owned in whole or in part by an entity, and the entity includes individuals who manage, direct, or control the operations of the business, those individuals must also be disclosed as owners.

Finally, another recent update provides for a process whereby, if available evidence indicates that an individual qualifies as an owner, the DCC may notify an applicant or licensee that the individual must either comply with the information submission requirements applicable to the owner or prove to the DCC's satisfaction that the individual is not an owner.

These changes are significant for the state because various reporting obligations and enforcement mechanisms tie into the definition of owner.

These changes are also significant for cities. Under local regulatory ordinances for those cities that have allowed commercial cannabis activity, an applicant for a commercial cannabis license typically must identify each "owner" of a commercial cannabis business. The intended effect of this requirement is to allow cities to determine who holds financial interests in, and controls, cannabis businesses within the city. If a city's local ordinance relies upon the regulatory definition of "owner" provided in section 15003, the city should be aware of this update as it may affect its oversight of cannabis business ownership and control.

Similar to state regulations, most local ordinances have regulations that are directly connected to the definition of "owner," and which may need updating accordingly. Most notably, a city's definition of owner is usually implicated in regulations applicable to initial applications (especially reporting requirements and review for disqualifying conduct) and regulations applicable to transfer applications (most local commercial cannabis permits are valid only as to the licensed owner, and therefore must complete a process similar to an initial application in order to lawfully transfer ownership). Expanding a city's "owner" definition to mirror the state's will help a city to ensure it meets its regulatory goals and receives the same information the DCC is receiving regarding who truly owns and controls a cannabis business.

A beneficial knock-on effect of mirroring Section 15003's definition is a streamlining of state and local regulations that will assist cannabis businesses and applicants with meeting the city's regulatory requirements. These businesses will more easily know the universe of "owners" that will be subject to the city's regulations and not have to parse out where a city's definition may be more restrictive or expansive than the State's.

4 Cal. Code Regs. § 15004.1 – Independence of Testing Laboratories

This regulation expands on Business and Professions Code Section 26053, which exempts cannabis testing laboratories from the general rule that individuals may obtain multiple, varied types of commercial cannabis licenses. Specifically, the Business and Professions Code provides that a person that holds a cannabis testing laboratory license, or has a financial interest in one, may not hold any other type of commercial cannabis license, or employ any individual that is employed by another licensee that does not hold a testing laboratory license.

The new regulation, effective November 7, 2022, further clarifies the above by requiring a testing laboratory to generally "maintain independence" from persons who hold a license or an interest in a commercial cannabis business licensed for an activity other than testing. The regulation then expands on this general requirement of independence by prohibiting common ownership, financial interest-holders, and employees, landlord-tenant relationships, and discounted services or other "preferential treatment" between testing laboratories and other types of license holders.

Cannabis laboratories are integral in ensuring a predictable, safe, and quality product is delivered to consumers who apply, ingest, and inhale the various types of cannabis products on the market. The use of cannabis products can pose serious risks to the consumer, and cannabis testing laboratories reduce that risk by testing cannabis for a variety of factors, including potency, foreign material, heavy metals, mycotoxins, pesticides, residual chemicals, and terpenoids, among others.

Because testing laboratories ensure a safe, quality product is being delivered to consumers, it is essential that cannabis testing laboratories are independent from other types of cannabis licensees, like cultivators and dispensaries. Any simultaneous ownership, monetary interest, or other type of interest in both a cannabis testing laboratory and another type of cannabis license presents an obvious conflict of interest, as it can be extremely costly for cultivators and other licensees to have a product that is not testing well.

For example, an entire batch of cannabis plants may be deemed unsellable as a result of poor testing, and can lead to negative consequences such as lost product, lost profit, and inability to perform contracts. Accordingly, a testing laboratory that maintains an interest in another type of cannabis business could be tempted to avoid the negative consequences of products testing poorly by faking data, misrepresenting the

quality or potency of a product, or otherwise offering unfair "discounts" or kickbacks to their own businesses or interests. This regulation highlights and expands on the various types of interests that a cannabis testing laboratory and other cannabis business may share that could encourage this bad behavior, including common ownership, financial interest-holders, and employees, as well as landlord-tenant relationships.

Ultimately, the Business and Professions Code as well as this regulation prohibit such conduct to maintain the safety of the public and ensure a quality product is delivered to the consumer, which the success of the cannabis industry in California depends on.

4 Cal. Code Regs. § 15005 – Personnel Prohibited from Holding Licenses

Section 15005 prohibits certain state or local government officers and employees from holding a commercial cannabis license or owning a business that does so. Section 15005 applies to state and local office holders and employees who have a duty to enforce the Medicinal and Adult-Use Cannabis Regulation and Safety Act ("MAUCRSA," codified at Business and Professions Code Section 26000 and following) or the penal provisions of any other state cannabis law. It includes those working in any city attorney's office, local police department, sheriff's office, district attorney's office, or for the Department of Justice as a peace officer. It prevents these individuals from holding a cannabis license or having any direct or indirect ownership interest in a business that operates or is conducted under a cannabis license. Section 15005 does not apply to these officers and employees if they hold a cannabis license in the capacity of executor, administrator, or guardian.

Recent changes to the text of Section 15005 are non-substantive. However, it is important for city employees and officials to be periodically reminded of Section 15005's restrictions. In particular, city employees (such as police officers and relevant code enforcement staff that enforce cannabis licensing regulations) and public officers (including both in-house and contract city attorneys) need to ensure their conduct conforms with Section 15005. Section 15005's prohibition on indirect ownership interest should also alert affected employees and officers about the breadth of this prohibition. Section 15005 may therefore affect the business interests of one's spouse, for example, as well as an officer's ability to loan money to a cannabis license holder.

4 Cal. Code Regs. § 15007 – Landowner Approval

As part of its cannabis licensing criteria, the DCC now requires applicants to submit evidence from the owner of the property upon which the licensed premises is to be located that the applicant has the legal right to occupy the property. If the applicant is not the owner of the real property, the applicant must submit a document from the owner or owner's agent that the business has both the right to occupy the property and to use the property for the type of cannabis activity applied for. The applicant must also submit a copy of the rental agreement, as applicable. Where the applicant is also the landowner, the applicant must submit a copy of the deed or title. If the landowner is a trust, the approval for the use must come from the person holding equitable title to the property.

Section 15007 is intended to clarify that the landowner must be actually aware of, and consent to, the specific cannabis use occurring on the property. The DCC's website includes a sample Landowner Consent Form for this purpose.[2] In the future, all license applicants should be aware of the need to file the required landowner consent form and associated documentation.

4 Cal. Code Regs. §§ 15037, 15037.1, 15037.2 – General Record Retention Requirements

Sections 15037, 15037.1, and 15037.2 set out regulations that allow the DCC to provide a safe harbor, under state law, for financial institutions that meet certain criteria. This will allow more banks to conduct cannabis related business, easing some of the financial constraints that banks and commercial operators have faced in the past.

Section 15037 requires licensees to keep and maintain records in connection with the licensed commercial cannabis business for seven years, including financial records required by the California Department of Tax and Fee Administration under Sections 1698 & 4901 of Title 18 of the California Code of

[2] See https://cannabis.ca.gov/wp-content/uploads/sites/2/2021/12/Landowner-Approval-Form_211022.pdf.

Regulations, as well as personnel records with employee information and other related records. Section 15037.1 specifies the process by which a licensee may authorize the DCC to provide information to a financial institution, sets forth what designated information the DCC will release, and clarifies how the licensee may withdraw the authorization for the release of information. Finally, Section 15037.2 specifies the process for a financial institution to request information from the DCC related to a licensee for purposes of facilitating the provision of financial services to that licensee. Such requests must be made in writing, on a form prescribed by the DCC that includes information such as who is requesting the information and the type of financial service to be provided. The requesting institution must also acknowledge that their use of the information will be limited to that which is necessary to provide financial services.

Recent changes in the regulations cited above reflect updated record retention requirements consistent with AB 1525 (a safe harbor under state law for financial institutions that provide services to the cannabis industry and allows cannabis businesses to permit the DCC to share licensee application and regulatory information with financial institutions). This change will aid in ensuring that cannabis businesses are complying with the requirements of AB 1525 relating to the obligation to provide regulatory and financial information to a financial institution for the purpose of facilitating the provision of financial services for the requesting licensee. This change also has the potential to expand funding for cannabis entrepreneurs, as it eliminates the threat of state criminal penalties for financial institutions that deal with cannabis businesses.

4 Cal. Code Regs. § 15402 – Customer Access to the Retail Area

Section 15402 establishes when it is appropriate for customers to obtain access to cannabis retail areas, inclusive of curbside delivery services.

The prior version of the regulation provided that individuals could access the retail area of a cannabis business only upon the retailer or its employee confirming that individual's age and identity pursuant to Section 15404. The regulation also required the licensed retailer or at least one employee to be physically present in the retail area at all times when customers were present, and that all cannabis sales must take place in the retail area except for delivery or drive-through window sales.

A recent update to the regulation adds that if a licensed retailer or microbusiness (as defined in the regulations) is authorized to engage in storefront sales, they may also conduct sales through curbside delivery (businesses authorized to engage *only* in delivery retail sales may not partake in curbside delivery). Procedurally, this means that any cannabis goods purchased by a customer can be delivered to that customer's vehicle, which must be parked immediately outside the licensed retail premises. The delivery must occur under video surveillance, and must otherwise comply with Section 15044(e)'s requirements for recording point-of-sale areas. The employee must still verify the customer's age and identity.

These changes will have minimal effects on cities who regulate cannabis businesses; any businesses already licensed to engage in storefront sales may now also conduct those sales through curbside delivery, without any change in local regulation. The vehicles must be parked directly outside of the business, and transactions will be done under video surveillance with all customers' identities checked, in compliance with current regulations. As long as a city's local ordinance does not expressly prohibit curbside delivery (which would now be inconsistent with state regulations), then no regulatory updates are required at a local level.

4 Cal. Code Regs. § 15407 – Sale of Non-Cannabis Goods

Section 15407 previously specified that a licensed retailer may sell, in addition to cannabis goods, only cannabis accessories and branded merchandise of the licensee (e.g., shirts, hats, water bottles that have logo/license number). Cannabis retailers were also allowed to provide customers with promotional materials.

As amended, Section 154007 now provides more options to licensed cannabis retailers and microbusinesses. Those that are authorized to allow cannabis consumption on site in accordance with the Business and Professions Code may now sell certain prepackaged, non-cannabis-infused, non-alcoholic food and beverages to their clients, as long as the local jurisdiction also allows such sales. This change will now allow a cannabis retailer or microbusiness to potentially expand the types of products and services that are being offered, and improve the quality of the experience for customers who consume cannabis on site. Cities might consider updating their regulations, if desired and not currently addressed, to authorize these types of additional sales of non-cannabis goods on site.

4 Cal. Code Regs. § 15418 – Cannabis Goods Carried During Delivery.

Section 15418 regulates cannabis goods carried by delivery employees of licensed cannabis retailers. Each delivery employee may only make deliveries for one licensed cannabis retailer at a time. Section 15418 also allows a delivery employee to now carry up to $10,000 in cannabis goods in the delivery vehicle, as determined by the current retail price of the goods. Delivery employees may also carry cannabis accessories, branded licensee merchandise, and promotional materials in the delivery vehicle, the value of which is not included in the $10,000 limit for cannabis goods. In addition to delivering for only one licensed retailer at a time, delivery employees must depart and return to the same licensee before taking possession of cannabis goods from any other licensee, and must return to the licensed premises if no new customer delivery requests have been received for 30 minutes. Each delivery employee must depart from the licensed retailer with a full inventory ledger of all cannabis goods in the vehicle, which must be updated after each delivery to reflect the remaining inventory carried by the delivery employee. The delivery ledger and updates by the delivery employee must comply with all track and trace delivery requirements described in Section 15049.3 of the DCC Regulations, and must be entered into the track and trace system no later than the end of the calendar day on which the delivery trip occurred. The delivery employee must also enter each stop into a log and provide the log to the licensed retailer for required records retention.

In addition to track and trace data entry and recordkeeping requirements, deliveries may only be made in response to a customer request. The delivery employee must possess the customer delivery request receipt prior to arrival at the delivery location. Each receipt is required to contain detailed information about the transaction, including tax information, in compliance with Section 15420 of the DCC Regulations. These regulations help ensure deliveries originate from a licensed cannabis retailer, are traceable, and work to discourage strictly mobile retailers.

Finally, to monitor compliance, a delivery employee shall immediately provide the following upon the request of the DCC or a law enforcement officer:

- The delivery inventory ledger during the current delivery trip;
- All delivery request receipts; and
- The log of all stops made by the delivery employee.

The DCC updated Section 15418 twice in 2022, making significant revisions, and again in 2023, to further clarify the track and trace requirements. Effective November 7, 2022, the value limit for cannabis goods carried by a delivery employee was increased from $5,000 to $10,000, and limits on carrying unordered cannabis goods were removed. The updates also clarified the delivery employee's ability to carry cannabis accessories and branded merchandise. In response to public concern regarding increased thefts, robberies, and assaults on delivery drivers, and increased marketing to children, the DCC required safeguards such as secure compartments for cannabis goods and existing marketing and advertising restrictions to remain in place, thereby reducing these risks. In addition, cities retain local control to impose additional or different regulations on commercial, non-medical cannabis deliveries.

With implementation of the delivery track and trace system, which resulted from emergency rulemaking in December 2022, the DCC also amended Section 15418 to remove the requirement that at least one cannabis order must be placed prior to the delivery employee leaving the licensed premises. As the DCC explained, "[t]he added track and trace requirements for delivery proposed in Section 15049.3 will allow for more effective tracking of cannabis goods in delivery vehicles, making this requirement unnecessary."

Violations of Section 15418 are subject to Tier 1 Disciplinary Order Guidelines, meaning that a violator faces a minimum administrative penalty of a stayed state license revocation, a 5 to 15-day state license suspension, a fine, or a combination of suspension and fine. The maximum penalty is state license revocation.

Conclusion

As discussed above, the foregoing regulations are the ones the Cannabis Regulatory Committee considers among the most impactful to California cannabis practitioners in the public sphere, but there have been many other regulations implemented in the last two years as a result of the consolidation and streamlining process. In addition to the regulations identified in this paper, all DCC regulations can be found in Division 19 of Title 4 of the California Code of Regulations (§§ 15000 et seq.) DCC's further proposed changes can be found on their website at https://cannabis.ca.gov/cannabis-laws/rulemaking/.

With the creation of the Unified Cannabis Enforcement Taskforce (UCETF) in 2022, co-chaired by the DCC and the California Department of Fish and Wildlife, the state has increased its cannabis enforcement efforts to specifically address the unlicensed and illegal market. With that shift of enforcement efforts to the illegal cannabis market, we can expect an increasingly robust set of regulations applicable to the legal market as well as the dynamics between legal and illegal markets unfold further.