

California Adopts Emergency Cannabis Regulations for Licensing Beginning on January 1, 2018

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by Jason Brenkert

On November 16, 2017, California published the long awaited rules and regulations to implement voter approved Proposition 64, the Adult Use of Cannabis Act of 2016, which legalized adult use of cannabis in the State of California. The California Legislature passed and the Governor signed into law the Medicinal and Adult-Use Cannabis Regulation and Safety Act (MAUCRSA), which creates the general framework for the regulation of both commercial medicinal and adult-use (recreational) cannabis. Under MAUCRSA, the California cannabis industry is regulated by three state agencies: Bureau of Cannabis Control (distribution, testing, retail and microbusiness), Department of Food and Agriculture (cultivation), Department of Public Health (manufacturing). Each of these state agencies established new regulations under an “emergency” rule-making process for commercial medicinal and adult-use (recreational) cannabis industries. The “emergency” regulations will be followed by a formal rule making process beginning next year.

The published “emergency” regulations, a total of 276 pages, apply to medicinal and adult-use cannabis and consist of California Code of Regulations, Title 16, Division 42, Bureau of Cannabis Control (115 pages); California Code of Regulations, Title 3, Division 8, Cannabis Cultivation (62 pages); and California Code of Regulations, Title 17, Division 1, Chapter 13, Manufactured Cannabis Safety (97 pages)(collectively, the “Regulations”). The Regulations provide the rules and regulations that commercial cannabis businesses must comply with by January 1, 2018, when California is scheduled to begin issuing temporary cannabis permits. Formal rule making will follow.

Summary of Regulations

The Bureau of Cannabis Control (BCC) regulates the distribution, testing, retail sales and microbusinesses of commercial cannabis in California under the MAUCRSA and adopted emergency regulations under California Code of Regulations, Title 16, Division 42, Bureau of Cannabis Control.

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Related Capabilities

- Cannabis
- Capital Markets
- Food, Beverage & Agribusiness

Some highlights under the BCC Regulations:

Temporary Permits

- In December 2017, California will begin accepting on-line applications for temporary business permits.
- Priority application review will be provided for annual license applicants that were in operation under the Compassionate Use Act prior to September 1, 2016. To be eligible for priority review, an applicant must be able to demonstrate that the business was in operation and in good standing with the local jurisdiction.
- Temporary permits will be good for four months (120 days) for cannabis businesses, which may be extended for two 90-day extensions (only if the temporary licensee has applied for an annual license).
- There is no fee for temporary permits.
- Businesses receiving temporary permits will be required to provide documentation in support of a permanent cannabis license, including security plans, insurance bonds, business formation documents and for the state to complete applicant reviews and background checks.
- Cannabis business will need local approval for conducting commercial cannabis activities, which must be demonstrated to receive a temporary permit.
- The State will contact local jurisdictions to verify applicant information and provide the jurisdiction at least 10 days to respond before issuing a license. The State will presume local compliance if the local jurisdiction has not responded in 60 days.
- Beginning January 1, an email notification will be issued from the State confirming that a temporary permit has been approved.

Transitional Rules

- The State has adopted a six-month grace period (until July 1, 2018) for licensed businesses to:
 - Sell products in their inventory (with specified labeling) that do not comply with Regulation (testing and labeling) guidelines.
 - Sell non-child-resistant products that are placed in child-resistant packaging at the time of sale.
 - Package dry flower for retail sales.
 - Work with other licensed businesses without worrying about whether their permits are for medical and recreational activities.
- Temporary licensees will not be required to use the state's track-and-trace system but will need to complete manifests and other paperwork to keep track of cannabis products.

A-License and M-License

- A license holder must hold an A-license to engage in adult use commercial cannabis activity, and an M-license to engage in medical cannabis activity.
- It is unclear whether an A-license can be used for a medical dispensary or a business would require separate A and M licenses.
- Testing labs may test cannabis goods for both types of licenses.

License Fees

- Annual cannabis license fees are based on a sliding scale ranging from \$800 to \$120,000 based on activity and revenues.

License Type	Operation (\$ Million Max. Per License)	Fee Per License
Self-Distribution	Greater than \$2m to \$8m	\$2,000
Distributor Transport Only	Up to \$2m	\$800
	Greater than \$2m to \$8m	\$2,500
Retailer	Up to \$500k	\$4,000
	Greater than \$500k to \$1.5m	\$12,000
	Greater than \$1.5m to \$4.5m	\$36,000
	Greater than \$4.5m	\$72,000
Microbusiness	Up to \$500k	\$5,000
	Greater than \$500k to \$1.5m	\$15,000
	Greater than \$1.5m to \$4.5m	\$42,000
	Greater than \$4.5m	\$120,000
Testing Laboratory	Up to \$50m	\$20,000
	Greater than \$50m to \$500m	\$45,000
	Greater than 500m	\$90,000

- Cannabis license fees for event organizers are determined by the number of planned events.

License Type	Planned Operations(Number of	Fee Per License
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	Operations)	
Event Organizer	1-10 Events Annually	\$5,000
	Greater than 10 Events Annually	\$10,000

- Cannabis application license fees are:
 - \$1,000 for Annual License Application
 - \$1,000 for Cannabis Event Organizer
 - \$1,000 for Temporary Cannabis Event License
 - \$500 for Physical Premise Modification

Ownership

- The state Bureau of Cannabis Control (BCC) says “owners” must submit fingerprints (via the Department of Justice’s Live Scan service) and background information including any past criminal convictions.
- The BCC defines an “owner” as:
 - any person who holds an aggregate of 20% or more ownership interest in the person applying for a license or a licensee (except interest held solely as a security interest, lien or encumbrance);
 - the Chief Executive Officer;
 - any member of the board of directors; and
 - any person participating in the direction, control, or management of the person applying for a license, including any of the following:
 - partner of a commercial cannabis business that is organized as a partnership.
 - member of a limited liability company of a commercial cannabis business that is organized as a limited liability company; and
 - officer or director of a commercial cannabis business that is organized as a corporation.
- Individuals that are employed by the State of California or district attorney’s offices and law enforcement agencies are prohibited from holding a license when the duties of their employment have to do with enforcement of cannabis regulations.

Financial Interests

- “Financial interests” mean an investment into a commercial cannabis business, a loan provided to a commercial cannabis business, or any other equity interest in a commercial cannabis business.
- The license application must disclose the holders of “financial interests” in a commercial cannabis business, including the name, birthdate, and government issued identification type and number for all individuals that have a financial interest in a commercial cannabis business, but are not subject to the same requirements as “owners” (i.e., background checks and fingerprints).
- The following holders of financial interests are not required to be listed: (a) a bank or

financial institution whose interest constitutes a loan; (b) individuals whose only financial interest in the commercial cannabis business is through an interest in a diversified mutual fund, blind trust, or similar instrument; (c) individuals whose only financial interest is a security interest, lien, or encumbrance on property that will be used by the commercial cannabis business; and (d) individuals who hold a share of stock that is less than 5 percent of the total shares in a publicly traded company.

Site Location

- An application must include a copy of the lease agreement, property title, or deed indicating a right to occupy the property.
- Cannabis business will need local approval for conducting commercial cannabis activities, which must be demonstrated to receive a permit.
- Property diagram is required to be submitted with the application.

Labor and Employment

License applicants with more than 20 employees must attest that they have entered into a labor peace agreement (which employer agrees not to resist organizing attempts by its workers), and provide a copy to the Bureau of Cannabis Control. If no such agreement exists, the license applicant will have to provide a notarized statement indicating that the company will enter into a labor peace agreement.

Surety Bond

License applicants must obtain a surety bond of \$5,000, payable to the State as obligee, to ensure payment of cost incurred for the destruction of cannabis product necessitated by violation of the MAUCRSA or Regulations.

Retail Operations

- Adult-use cannabis sales are limited to adults 21 years and over.
- Cannabis businesses cannot be located within 600 feet of schools (K-12 school, day care center, or youth center) in existence when the license issued.
- Cannabis stores must close by 10:00 p.m.
- Cannabis businesses must have 24-hour surveillance.
- Annual licensees will need to complete a training and register for the track-and-trace system.
- Adult-use customers can buy up to 28.5 grams (one ounce) of non-concentrated cannabis, eight grams of concentrate and six immature plants.
- Medical patients can buy or receive eight ounces of cannabis or, if a valid physician's recommendation contains a different amount, medical patients can purchase an amount consistent with the doctor's recommendation.
- Only medical cannabis patients or their caregivers will be permitted to receive free cannabis products or samples.
- Delivery is permitted by a delivery employee of a licensed retailer.

- Businesses may not sell both alcohol and cannabis.
- Businesses will be able to apply for a special license to host cannabis events, such as festivals at fairgrounds.
- Advertising is permitted in outlets where at least 71.6 percent of the audience “is reasonably expected to be 21 years of age or older.” Online advertising requires visitors to confirm age compliance.
- Cannabis window displays are prohibited and interior displays must not be visible to the outside public.
- Cannabis products must be tested for cannabinoids (THC, CBD, and others), foreign material, heavy metals, microbial impurities, mycotoxins, moisture content and water activity, residual pesticides, residual solvents and processing chemicals, and terpenoids.
- Cannabis products must be in child-resistant packaging.

Distribution

- Only a licensed distributor may transport cannabis.
- Cannabis may only be stored on a licensed premises. A distributor must (1) ensure cannabis goods are properly stored, handled, packaged, and tested; (2) ensure distributors keep and maintain records that are adequate to effectively track and trace the cannabis goods, thereby assuring that cannabis goods are safe for use by the consumer prior to distribution for retail sale; and (3) ensure cannabis goods are transported in a safe and secure manner.
- Distributors must maintain commercial general liability insurance in an amount no less than \$2,000,000 and in an amount no less than \$1,000,000 for each loss.
- Transportation of cannabis goods requires that the cannabis goods are not visible or identifiable during transport, that the cannabis goods are only transported by vehicle, requiring the cannabis goods to be in a secure locked box within the interior of the vehicle, requiring the vehicle to be attended at all times in residential neighborhoods, and requiring all transport vehicles to be equipped with alarm systems.
- Only persons 21 years or older may be in a Distributor’s vehicle transporting cannabis.

Cannabis Manufacturing and Products The California Department of Public Health (CDPH) is responsible for regulation of manufacturing of cannabis and adopted regulations under California Code of Regulations, Title 17, Division 1, Chapter 13, Manufactured Cannabis Safety. These Regulations are administered through the Manufacture Cannabis Safety Branch of the CDPH.

- Manufacturing licenses are subject to the same or similar requirements related to temporary licenses, local approval, site location, ownership, criminal background checks, Labor Peace Agreement, bonding requirements and documentation requirements.
- Manufacturing licenses (A-License and M-Licenses) fall under four license types:
 - Type 7: Extraction using volatile solvents (butane, hexane, pentane).
 - Type 6: Extraction using non-volatile solvents or mechanical method (food-grade butter, oil, water, ethanol or carbon dioxide).

- Type N: Infusions (using pre-extracted oils to create edibles, beverages, capsules, vape cartridges, tinctures or topicals).
- Type P: Packaging and labeling only.
- Product Processing and Packaging:
 - All cannabis products must contain a state mandated warning label and the CDPH-issued universal symbol.
 - Cannabis products must be tested for cannabinoids (THC, CBD, and others), foreign material, heavy metals, microbial impurities, mycotoxins, moisture content and water activity, residual pesticides, residual solvents and processing chemicals, and terpenoids.
 - All edibles must be tested for serving consistency: uniform concentrations (THC, CBD) across the product.
 - Cannabis products can only be “additionally processed for remediation” and retested twice.
 - Edible products may not be in shapes that may appeal to children – no human beings, animals, insects, or fruit shapes.
 - Edible products must be produced in serving sizes that have no more than 10 milligrams of THC and no more than 100 milligrams of THC for the total package.
 - Non-edible cannabis products (concentrates, topicals, tinctures, extracts, etc.) separate limits based on medical (up to 2,000 mg of THC per package) or Adult-use products (up to 1,000 mg of THC per package).
 - Products cannot be infused with nicotine or alcohol or have added caffeine.
 - Potentially-hazardous foods, such as meat and seafood, and other products requiring refrigeration, are prohibited for sale as cannabis products.
- Manufacturing Practices and Controls:
 - Licensees must have written procedures for inventory control, quality control, transportation, security and cannabis waste disposal. Descriptions of these procedures or Standard Operating Procedures (SOPs) must be submitted with the annual license application. Cannabis waste cannot be sold, must be placed in a secured area and be disposed of according to applicable waste management laws.
 - Good manufacturing practices must be followed to ensure production occurs in a sanitary and hazard-free environment, cannabis products are contaminant free and THC levels are consistent throughout the product and within required limits.
 - Extractions using CO2 or a volatile solvent must be conducted using a closed-loop system, certified by a California-licensed engineer. Volatile, hydrocarbon-based solvents must have at least 99% purity. Finally, volatile solvent, CO2 and ethanol extractions must be certified by the local fire code official.
- Application processing fee of \$1,000 per application (non-refundable).
- Annual cannabis manufacturing license fees are based on a sliding scale ranging from \$2,000 to \$75,000 based on gross revenues of the licensed premises.

Tier	Premises Gross Revenue	Fee Per License
Tier I	Less than \$100k	\$2,000
Tier II	Greater than \$100,001 to	\$7,500

	\$500k	
Tier III	Greater than \$500,001 to \$1.5m	\$15,000
Tier IV	Greater than \$1,500,001 to \$3m	\$25,000
Tier V	Greater than \$3,000,001 to \$5m	\$35,000
Tier VI	Greater than \$5,000,001 to \$10m	\$50,000
Tier VII	Greater than \$10m	\$75,000

- Applications for temporary and annual commercial cannabis manufacturing licenses are anticipated to be available in December 2017.
- Additional (stricter) rules for testing are expected to be developed. An additional license type (Type S) is being developed to permit shared facility space.
- A useful fact sheet is available at:
<https://www.cdph.ca.gov/Programs/CEH/DFDCS/CDPH%20Document%20Library/EmergencyRegulationsFactSheet.pdf>

Cannabis Cultivation

The California Department of Food and Agriculture adopted regulations under California Code of Regulations, Title 3, Division 8, Cannabis Cultivation, regulating the cultivation of commercial cannabis.

- Cultivation licenses are subject to the same or similar requirements related to temporary licenses, local approval, site location, ownership, criminal background checks, Labor Peace Agreement, bonding requirements and documentation requirements.
- Cultivation of cannabis fall under three categories (regulated by the California Department of Food and Agriculture):
 - Cultivators: Numerous license types for commercial cultivators, ranging from specialty cottage to medium-sized grows.
 - Nurseries: Cultivation of cannabis solely as a nursery, including cloning and seed propagation.
 - Processors: A site that conducts only trimming, drying, curing, grading, or

packaging of cannabis and nonmanufactured cannabis products.

- Application fees are non-refundable and range between \$135 to \$8,655 depending on the type of licensed facility.
- Applications for temporary and annual commercial cannabis cultivation licenses are anticipated to be available in December 2017 via CDFA's CalCannabis Cultivation Licensing website at cannabis.cdca.ca.gov
- A useful application checklist is available at:
https://static.cdca.ca.gov/MCCP/document/CalCannabis%20Annual%20License%20Checklist_web_11.20.17.pdf

Testing Laboratories

All cannabis goods must meet certain health and safety standards before they can be sold to consumers. To ensure that cannabis goods meet those standards, a representative sample of the cannabis goods must be tested by a licensed testing laboratory. The Regulations provide the minimum laboratory-operation requirements, which would include requirements such as sampling procedures, personnel qualifications, standard operating procedures, and recordkeeping requirements. These proposed regulations would set forth action levels, threshold values that provide the criterion for determining whether a cannabis goods sample passes or fails an analytical test, that the Bureau considers to be both protective of public health and achievable by the cannabis industry. The Regulations provide specific testing requirements such as proof of ISO/IEC 17025 accreditation, and requirements for obtaining a provisional license if an applicant meets all requirements for licensure apart from the ISO/IEC 17025 accreditation.

Microbusiness

A microbusiness license allows a licensee to conduct multiple commercial cannabis activities under one license. A microbusiness licensee is permitted to: cultivate cannabis on area less than 10,000 square feet; act as a licensed distributor; manufacture cannabis as a Level 1 manufacturer; and/or sell cannabis as a retailer. The Regulations would clarify that an applicant may engage in at least three of the four activities: cultivation, manufacturing, distribution, and/or retail sale. The Regulations would specify the information that must be provided in the application depending on the commercial cannabis activities the licensee intends to engage in. A microbusiness licensee must comply with all the rules and requirements promulgated for each commercial cannabis activity the licensee intends to engage in.

Unanswered Questions

The Regulations leave some uncertainty for cannabis business that may be subject to future releases, regulations, rules and interpretation. These questions include:

- **When will applicants be able to submit applications for temporary or annual licenses?**
Applications for temporary and annual commercial cannabis manufacturing licenses

are anticipated to be available in December 2017.

- **When will temporary licenses be issued?**

Beginning January 1, 2018, an email notification will be issued from the State confirming that a temporary license has been approved. Priority application review will be provided for annual licenses applicants that were in operation under the Compassionate Use Act prior to September 1, 2016. To be eligible for priority review, an applicant must be able to demonstrate that the business was in operation and in good standing with the local jurisdiction.

- **Is foreign ownership restricted?**

The Regulations do not expressly limit foreign ownership or contain residency requirements. The persons prohibited from holding licenses include individuals that are employed by the State of California or district attorney's offices and law enforcement agencies are prohibited from holding a license when the duties of their employment have to do with enforcement of cannabis Regulations.

- **Can a public company hold a license?**

The Regulations require as part of the license application process that persons who own a "financial interest" in a commercial cannabis business to submit personal information. A "financial interest" means an investment into a commercial cannabis business, a loan provided to a commercial cannabis business, or any other equity interest in a commercial cannabis business. Disclosure of ownership and financial interests requires the disclosure of the person's name, birthdate, and government issued identification type and number for all individuals that have a financial interest in a commercial cannabis business; however, "individuals who hold a share of stock that is less than 5 percent of the total shares in a publicly traded company" are not required to be listed in the application. This exclusion suggests that a publicly traded company could apply for a cannabis license.

- **How would a public company address the ownership and financial interest reporting requirements?**

The Regulations require as part of the license application process that "owners" submit personal information and be subject to criminal background checks and persons who own a "financial interest" in a commercial cannabis business to submit personal information. "Owners" include the CEO, directors, any person who holds an aggregate of 20% or more ownership interest in the licensee and person participating in the direction, control, or management of the licensee (including partners of a partnership, members of an LLC and officers and directors of a corporation). It is unclear how far up the corporate structure an applicant would need to go for the purposes of determining ownership or financial interests. A public company that serves as a holding company for a licensee may be required to submit personal information for its 5% beneficial owners and 20% beneficial owners may also be subject to background checks.

- **Have the Regulations addressed federal law or banking related challenges?**

The Regulations are silent on the implications of federal law on the cannabis industry or how cannabis companies can bank.

General Information

General information about the California cannabis industry can be found at the California Cannabis Portal at <https://cannabis.ca.gov/>

Each of the state agencies have posted useful information on their websites to guide cannabis businesses through the Regulations and licensing process:

- Bureau of Cannabis Control at <http://www.bcc.ca.gov/>

- Department of Food and Agriculture at <http://cannabis.cdfa.ca.gov/>
- Department of Public Health at <https://www.cdph.ca.gov/mcsb>

Federal Law Warning

The United States federal government regulates drugs through the Controlled Substances Act (21 U.S.C. § 811), which places controlled substances, including cannabis, in a schedule. Cannabis is classified as a Schedule I drug. A Schedule I controlled substance is defined as a substance that has no currently accepted medical use in the United States, a lack of safety for use under medical supervision and a high potential for abuse. The Department of Justice defines Schedule 1 controlled substances as “the most dangerous drugs of all the drug schedules with potentially severe psychological or physical dependence.” The United States Federal Drug Administration has not approved the sale of marijuana for any medical application. State laws regulating Cannabis are in direct conflict with the federal Controlled Substances Act, which makes cannabis use and possession federally illegal.

About Dorsey & Whitney LLP

Dorsey & Whitney LLP is an international law firm with offices throughout the United States, Canada, Europe and Asia with expertise assisting U.S. based cannabis companies with their legal needs.

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