

Preparing for Phase 2: Securing Dispensary and Grower/Processor Permits

On March 22, the Pennsylvania Department of Health (the department) announced it will begin accepting applications for medical marijuana dispensary and grower/processor permits as early as April. During this second round, the department will issue 13 additional permits to grow and process medical marijuana, and 23 dispensary permits. Completed applications must be postmarked no later than May 17.

By **Peter Murphy and Daniel Clearfield** | April 25, 2018

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Applying for a state license to dispense or cultivate marijuana is an expensive and labor-intensive process. Typically, experienced cannabis operators have a significant advantage over those seeking their first license. Regulators are more likely to approve applicants with well-defined standard operating procedures that govern all aspects of cultivation, processing and dispensing. Moreover, those currently operating legal cannabis businesses have likely invested heavily in their security and anti-diversion systems, which are critical in protecting plants, products and the proceeds from marijuana sales. Finally, experienced applicants, and their lawyers, will be familiar with the dynamic environment in which laws and regulations are drafted and implemented through a fog of competing interests and agency priorities.

Today's largest legal cannabis operators have quickly evolved into a national network of nimble and hungry entrepreneurs. When new cannabis licenses become available, they invest time and money to evaluate the new market and weigh the costs of competing for a limited number of cultivation and dispensary licenses. Questions abound. Will marijuana flower be permitted? According to BDS Analytics, marijuana flower currently makes up over 50 percent of all legal marijuana sales in Colorado, Washington and Oregon, according to ArcView Market Research, "The State of Legal Marijuana Markets," 5th Ed. (2017) pg. 67. If sales are restricted to cannabis concentrates, does the law include a mechanism to expand the types of cannabis products that will be allowed for sale? Is there a residency requirement for prospective licensees? Will the law give existing medical marijuana businesses preferential treatment?

The answers to these questions, and many more, will directly affect the value of licenses and the strategies used by applicants to enter emerging state markets.

Before embarking on this costly and competitive process, potential applicants should be aware of all risks, including the potential for federal prosecution given cannabis's status as a Schedule I controlled substance under the Controlled Substances Act. Seeking professional guidance in the form of cannabis consultants and attorneys can reduce risk and increase the likelihood of obtaining a license; but, it is by no means a guarantee of success.

A complete examination of the complexities and potential pitfalls involved in applying and securing a license to cultivate and dispense cannabis under state law is well beyond the scope of this article. However, the list below offers guidance to would-be applicants in five critical areas that are often overlooked, but could be the difference between a winning and losing application.

Local Support

The need for local support for an emerging cannabis business cannot be overstated. Marijuana legalization continues to be a polarizing issue across the country. Residents of some U.S. cities, towns and communities remain opposed to any relaxing of existing state or federal marijuana laws. In some states, proposed marijuana legislation will specifically allow individual municipalities to outright ban the cultivation and sale of cannabis regardless of state law that legalizes such activity. In Colorado, the first state to legalize recreational cannabis sales, 176 of its 272 municipalities do not allow marijuana sales

(http://www.nj.com/news/index.ssf/2017/11/marijuana_legalization_would_me
Pennsylvania, municipalities cannot outright ban medical cannabis

establishments, but many have enacted specific land use and zoning ordinances that regulate where medical cannabis can be grown, processed and dispensed to patients.

Thus, even where cannabis cultivation and sale are permitted, cannabis businesses may be restricted to a limited number of sites due to local zoning and use restrictions. Before committing to a specific property to be converted into a cannabis business, applicants should be absolutely certain that the business will have the support of the local community and the site will satisfy all state and local regulations.

To enhance local support, prospective applicants should build relationships with local officials and community leaders in the municipalities in which they seek to operate. Through collaboration with local partners, applicants can assess a community's receptiveness or resistance to a prospective cannabis business and determine whether the project will face opposition in becoming operational. In Pennsylvania, several medical marijuana dispensaries that were awarded permits by the commonwealth were forced to relocate their facilities due to local opposition to the proposed use (<http://philadelphia.cbslocal.com/2017/09/01/mt-airy-medical-marijuana-dispensary-allowed-to-relocate/>).

Real Estate

Most state cannabis programs require applicants to identify, and demonstrate control over, real estate that will serve as the applicant's cultivation or dispensary location. Accordingly, success in state cannabis licensing is dependent upon finding and securing one or more properties that satisfy state and local regulations.

In Pennsylvania, permits may only be issued for the specific location identified in the application by name and address and are only valid for that location, see 28 Pa. Code Section 1141.25. Additionally, Pennsylvania prohibits locations occupying land or facilities owned by the United States or the Commonwealth to be used for medical marijuana purposes. Personal residences or any other location where law enforcement or government agents would have limited access are also prohibited and will result in an automatic denial if included in the application. Pennsylvania awarded points to cultivation applicants that identified a location in a financially distressed municipality. Twenty-five percent of successful cultivation applicants identified a location in a financially distressed municipality, revealing how real estate can be a significant factor in permit determinations.

Regarding the facility itself, Pennsylvania requires the applicant to demonstrate it has the authority to use the facility for, at minimum, the term of the permit. This may be accomplished via possession of clear legal title to the property, an option to purchase or a fully executed, unexpired lease for the proposed facility that includes the consent of the owner to the use of the location as a medical marijuana facility, see, 28 Pa. Code Section 1141.29(b)(3) (i)-(iii). Additionally, applicants are required to submit to-scale plans and specifications for the interior of the facility as well as plot plans, renovation plans or architect's drawings for any element of the facility not yet in existence at the time the application is submitted.

In the months leading up to licensing, applicants can expect fierce competition for qualifying real estate. The most sophisticated applicants will use outside professionals and attorneys to quickly identify properties that satisfy the state requirements and negotiate contracts to purchase or lease the properties as potential cultivation or dispensary sites.

When evaluating real estate to be used as a potential cultivation or dispensary site, applicants should view the property through the eyes of the regulator. Does the property satisfy all the criteria set forth under state law and agency regulations? Does it have any built-in features that enhance the physical security of the building? Some existing properties are ideal for conversion into cannabis dispensaries.

Are there any restrictions in the lease or deed that would prohibit the use of the property for cultivating or dispensing cannabis? In Pennsylvania, an applicant won a license to operate a medical marijuana dispensary in a former Chi-Chi's restaurant. However, the shopping complex owner who sold the property to Chi-Chi's in 1991 has since sought to block the use arguing a deed restriction forbidding "a drugstore" would strictly prohibit a medical cannabis dispensary. The dispute is currently pending in federal court.

Building a Winning Team

An application for a cannabis dispensary or cultivation license is only as strong as its component parts. In awarding cannabis licenses, state agencies seek to avoid risk and will understandably favor applicants with a proven track record of operating cannabis businesses in tightly regulated environments.

In states with existing medical cannabis programs, this manifests in a preference for medical marijuana providers currently operating within the state. Currently, draft legislation in both New Jersey and Delaware include provisions that would give existing medical marijuana operators priority in licensing should the state legalize adult-use cannabis cultivation and sale. No doubt there will be challenges to these provisions; but, should they become law, it will give licensed medical marijuana businesses a significant advantage over first-time applicants.

Applicants without experience in the cannabis industry are thus left with two options: partner with an existing cannabis business that can provide the technical knowledge necessary to secure a license and operate the business; or independently build a team with experience in related fields that would be directly applicable to operating the business. Related experience could include knowledge of the following industries: security, law enforcement, pharmaceutical manufacturing, pharmacy, horticulture, alcohol licensing and gaming.

Both options require careful vetting of the proposed members of the team to ensure they have no criminal history that would prohibit them from participating in the proposed cannabis business.

In Pennsylvania, in addition to a current curriculum vitae for proposed members of the applicant's team, as well as financial backers or partners, each team member is required to submit a criminal history records check performed by the Pennsylvania State Police certifying, chiefly, that the individual has not been convicted of a criminal offense relating to the sale or possession of illegal drugs, narcotics or other controlled substances, see, 28 Pa. Code Section 1141.29(b)(6) All members of the team will be fingerprinted and subject to a federal criminal history search performed by the FBI. Additionally, each principal or operator of the applicant must submit a personal affidavit stating whether they have ever been convicted of any non-summary criminal offense.

Diversity

Diversity is a cornerstone to a successful cannabis business. It is undisputed that changing demographics affect Pennsylvania businesses and the state's economy. To be successful and maintain a competitive advantage, all businesses must draw on their most important resource —the skills of its

workforce. Prospective applicants should be aware of the role workforce diversity plays in breeding innovation and creativity and enhancing the business's understanding of its customers and industry partners.

Diversity is also critically important to state regulators when awarding licenses to dispense and cultivate cannabis. In Pennsylvania, all applicants for medical marijuana permits were required to submit a diversity plan that accounted for 10 percent of the applicant's overall score (100 out of 1,000 points). Diversity can be demonstrated in a number of ways, such as: diverse ownership of the business, hiring of diverse workforce, or contracting with diverse businesses for goods and services.

To promote diversity, prospective applicants should actively seek out minority, women, veteran, disabled and other historically under-represented groups to provide opportunities for them to seek employment, contracts or bid on providing goods and services. Prospective applicants should formalize their internal diversity goals and designate a Director of Diversity to oversee the business's diversity initiatives and implement its Diversity Plan. Regulators will expect applicants to take affirmative action to help correct the patterns and effects of employment discrimination on the basis of race, color, religious creed, ancestry, age, sex, national origin or nonjob-related disability.

Money

Cannabis businesses often struggle to obtain loans and open traditional bank accounts because cannabis production, processing and sale is still illegal at the federal level. Under the Currency and Foreign Transactions Reporting Act of 1970 (the Bank Secrecy Act or BSA), all U.S. financial institutions must report to the federal government any suspected illegal activity (<http://kind.financial/the-bank-secrecy-act-bsa/>) which would include any transaction associated with a cannabis business. These reports must be filed even though the business is operating legitimately under state law. Many banks refuse to offer financial

services to the legal cannabis industry given the risk of violating federal law. While it is getting easier for some cannabis businesses to access traditional banking tools, the legal marijuana market remains cash-heavy (https://www.huffingtonpost.com/entry/why-its-getting-easier-for-marijuana-companies-to-us_5a28015de4b0cd6fb5ee8bb7).

In the absence of banks, cannabis entrepreneurs must often rely on private equity to raise the start-up capital needed to carry the business through licensing and, if awarded a license, becoming operational.

Pennsylvania requires each grower/processor applicant to provide an affidavit stating the applicant possesses at least \$2million in capital, with a minimum of \$500,000 of the affirmed amount on deposit with one or more financial institutions. Dispensary applicants must also submit an affidavit, but only certifying the applicant has a minimum of \$150,000 on deposit.

Raising capital requires careful vetting of potential investors and creditors to ensure they satisfy state requirements applicable to cannabis financial backers. Does the potential investor offer expertise or specialized knowledge of the cannabis industry that can strengthen an application for a dispensary or cultivation license? Will the investor be involved in the management of the business? Has the business properly documented the unique risks, terms and timing of all outside investments, including the risk of federal prosecution given cannabis' status as a Schedule I controlled substance under federal law?

While some high net worth applicants may be able to self-fund a new cannabis venture, most will need to seek money elsewhere. There are currently a handful of venture capital and investment funds that specifically target the cannabis industry, such as Privateer Holdings, Tuatara Capital, MedMen Capital and Casa Verde, which is partially owned by rapper/entrepreneur Snoop Dogg. These firms help cannabis businesses by connecting them with private investors interested in the industry

<https://www.forbes.com/sites/julieweed/2017/09/09/funding-options-for-cannabusiness-expanding/#6466cdb67cf3>). Regardless of the source of financing, prospective cannabis licensees must carefully evaluate the financial and corporate structure of the proposed business to ensure it complies with state law and meets the company's strategic objectives.

The questions and considerations raised above represent a mere sampling of the issues that arise when applying for a license to dispense or cultivate cannabis under state law.

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