DAVID C. FRANKEL, ESQ.
LAW OFFICE OF DAVID FRANKEL
david@cannabusiness.guru
770 L Street, Suite 950
Sacramento, CA 95814
(916) 250-0215

November 5, 2018

Lori Ajax, Chief
Bureau of Cannabis Control
2920 Kilgore Road
Rancho Cordova, CA 95670
E-mail: BCC.comments@dca.ca.gov

Re: 15-Day Notice of Modification to Text of Proposed Regulations

Dear Chief Ajax:

This letter is in response to the 15-Day Notice dated October 19, 2018 ("Notice"), concerning proposed modifications to the text of previously noticed regulations.

For the reasons stated below, I believe that the Notice violates the California Administrative Procedure Act at least as to certain proposed changes which are not nonsubstantial or grammatical within the meaning of Gov. Code §11346.8(c). Likewise, 1 CCR §40 provides that:

> changes to the original text of a regulation shall be deemed to be "nonsubstantial," as that term is used in Government Code Section 11346.8, if they clarify ***without materially altering the requirements, rights, responsibilities, conditions, or prescriptions contained in the original text.***" (Emphasis added.)

As described below, some of the modifications contained in the Notice do materially alter the requirements, rights, and responsibilities of licensees and non-licensees. As a result, Gov. Code §11346.8(c) requires a 45 day notice and comment period.

Specifically, proposed new BCC Regulations §§5003, 5004 and 5032(b) constitute major changes having statewide impacts as well as material economic impacts to California

enterprises and individuals and which materially alter requirements, rights and responsibilities of licensees and non-licensees. Therefore, they must be subject to the 45 day notice and comment period required by Gov. Code §11346 *et seq*.

Further, new BCC Regulation §5032(b) exceeds the BCC's authority under MAUCRSA and is invalid on that basis, as further described below. Also, BCC Regulation §5032(b) is not necessary to achieve the purposes of MAUCRSA, is not based on best available evidence and would be onerous and, consequently, violative of B&P Code §26013(c).

In addition, the proposed modifications have a substantial impact on small businesses to the extent that BCC §5032(b) would restrict 'White Labeling' activities between non-licensee brand owners and licensed manufacturers. The failure to include a determination concerning such impacts in the Notice violates 1 CCR §4.

Finally, I am including a comment in response to BCC Regulation §5024.1(b)(2) and the explanatory statement related thereto which purports to clarify that only microbusinesses that are licensed for distribution (in addition to licensed distributors) may transport cannabis. Disallowing cultivators, nurseries, processors and manufacturers from transporting their product is a waste of time and money, is onerous, puts additional financial pressure on and thereby squelches the growth of industry. This clarifies that such remains a problem and should be addressed in future legislation. The undersigned understands that the BCC lacks authority to make any changes to its regulations that would authorize transport by other than those licensed for distribution but would like to see a change implemented by the legislature and requests BCC to seek that legislative change. By imposing minimal additional security on transporting cultivators, nurseries, processors and manufacturers, such as GPS monitoring similar to what is imposed on retail delivery drivers, the agencies and the public would be assured that there would be no adverse impacts on public safety or increased risks of diversion. Such a change would add efficiency to the market and would greatly assist cannabis companies and the entire California cannabis industry.

Specific Comments

Comment 1: The changes from BCC Regulation §5003(b)(6) are substantial.

Specifically, proposed BCC §5003(b)(6)(D)(ii) expands the notion of control in ways that are not contemplated by MAUCRSA and such expansion is not required because the control factors in the first sentence of (b)(6) are clear and effective to ensure all control persons are disclosed and vetted. A person who acquires debt or guaranties the debt of a commercial cannabis business should not be considered an owner based on that fact

alone. There is no basis in the corporate law for making a determination that guaranteeing the debts of a company creates an ownership or control relationship.

We note that neither the CDFA nor the CDPH have acted to expand their respective regulations in this manner. Neither CDFA §8103(a)(4) nor CDPH §40102(a)(4) include the expanded notion of control being proposed by BCC. This further emphasizes that this is a substantial change that requires a 45 day notice and comment period.

Similarly, proposed BCC §5003(b)(6)(D)(iii) expands the notion of control in ways that are not contemplated by MAUCRSA by asserting jurisdiction over persons who are involved with non-plant touching activities such as branding or marketing. Again, there is no basis in the law to make a determination that mere licensing of a brand, together with customary licensor control covenants, would create an ownership or control relationship. Such an expansion is not authorized by MAUCRSA and would be so onerous as to foreclose licensed manufacturers from licensing brands or doing white label manufacturing in California. In any case, such changes are substantial and require a 45 day notice period.

Comment 2: The changes from BCC Regulation §5004(a) are substantial.

Specifically, proposed BCC §5004(a)(1) expands the notion of financial interest in ways that are not contemplated by MAUCRSA and such expansion imposes expensive and burdensome record keeping and reporting requirements in connection with employee profit sharing arrangements. Such arrangements are very common with start up companies and are governed by California and federal law related to corporate and tax treatment thereof. The imposition of additional disclosure for persons participating in employee profit sharing plans imposes such additional burdens on licensed cannabis companies without creating any new benefits. In any case, such changes are substantial and should be subject to a 45 day notice and comment period.

We note that neither the CDFA nor the CDPH have acted to expand their respective regulations in this manner. Neither CDFA §8103(c) nor CDPH §40102(b) include the expanded notion of financial interest being proposed by BCC. This further emphasizes that this is a substantial change that requires a 45 day notice and comment period.

Similarly, proposed BCC §5004(a)(2) expands the notion of financial interest in ways that are not contemplated by MAUCRSA and such expansion will have a chilling impact on landlord/tenant relationships and contracts/leases in California. Virtually every retail and many warehouse leases contain percentage rent clauses. This proposed BCC §5004(a)(2) would lead to renegotiation and, in some cases, termination of existing leases

and make it more difficult for cannabis companies to obtain fair market leases. In any case, such changes are substantial and require a 45 day notice and comment period.

In addition, proposed BCC §5004(a)(3), (a)(4) expand the notion of financial interest in ways that are not contemplated by MAUCRSA and such expansions will have a chilling effect on the ability of cannabis companies to retain consultants, accountants, and attorneys on a cost effective basis. In any case, such changes are substantial and require a 45 day notice and comment period.

Further, proposed BCC §5004(a)(5), (a)(6) expand the notion of financial interest in ways that are not contemplated by MAUCRSA and such expansions will have a chilling effect on the ability of cannabis companies to retain brokers and salespersons where commission based compensation is common. Perhaps, it would be fair to impose background check requirements on brokers and salespersons. In any case, such changes are substantial and require a 45 day notice and comment period.

Comment 3: The changes from BCC Regulation §5004(c) are substantial.

Specifically, proposed BCC §5004(c) expands the notion of financial interest in ways that are not contemplated by MAUCRSA and such expansion will have a chilling impact on the financing of cannabis businesses in California. If a public company invests in a cannabis business, this proposed BCC §5004(c) would lead to the listing of all the individuals owning stock in such public company. It is quite common for persons to hold public company stock in unnamed brokerage accounts which would make it difficult, burdensome and expensive to track through to individuals. This is only one example of the disfunction that will be caused by this proposed regulation. In any case, such changes are substantial and require a 45 day notice and comment period.

Comment 4: The changes from BCC Regulation §5032 are substantial and violate MAUCRSA and Applicable Law.

Specifically, proposed BCC §5032(b) purports to expand the authority of the BCC in ways that are not contemplated by MAUCRSA and such expansion is illegal and invalid. In any case, such changes are substantial and require a 45 day notice and comment period.

The proposed changes in BCC §5032(b) are not authorized by MAUCRSA, namely B&P Code 26012, which divides authority among BCC, CDFA and CDPH and does not authorize BCC to regulate manufacturing. As a result, proposed BCC §5032(b)(2), and (b)(3) are over broad and illegal. Further, such proposed regulation would have a chilling effect and would cause economic harm to small businesses in California.

B&P Code §26013(a) only authorizes each of BCC, CDFA and CDPH to regulate activities respectively within their specific areas which are defined in B&P Code §26012(a). Under B&P Code §26012(a)(1), BCC is authorized to regulate only: microbusinesses, transportation, storage ***unrelated to manufacturing activities*** (emphasis added), distribution, testing and sale of cannabis and cannabis products. Nothing in B&P Code §26012(a) authorizes BCC to regulate manufacturing.

Under B&P Code §26012(a)(2), only CDFA administers cultivation related activities. Under B&P Code §26012(a)(3), only CDPH administers manufacturing related activities.

B&P Code §26001(k) defines "Commercial Cannabis Activity" and names only activities that touch the cannabis plant and/or cannabis products, but not commercial activities ancillary thereto. For example, cultivation is included but the sale of nutrients for plant cultivation is not included. Likewise, manufacturing is included but the licensing of branding to manufacturers is not included.

Therefore, BCC §5032(b)(2) and (b)(3) expands the scope of the BCC's interpretation of "Commercial Cannabis Activity" and constitutes an impermissible amendment to B&P Code §26001(k). Further, by asserting jurisdiction over manufacturing activities, the BCC has impermissibly exceeded its statutory authority. For both reasons, BCC §5032(b) must not be adopted.

The Notice states at p.15:

> The examples include procuring or purchasing cannabis goods from a licensed cultivator or licensed manufacturer, ***manufacturing cannabis goods in accordance with specification of a non-licensee, packaging or labeling cannabis goods under a non-licensee's brand or specifications,*** and distributing cannabis goods for a non-licensee. ***The Bureau has received information that licensees may be engaging in such conduct; therefore, this clarification is necessary to assist licensees with determining what activity is allowed.*** (Emphasis added.)

To the extent that the BCC is referring to white labeling activities, namely: (1) manufacturing cannabis goods in accordance with specification of a non-licensee, and (2) packaging or labeling cannabis goods under a non-licensee's brand or specifications, such activities come within the CDPH definition of "Manufacturing" at CDPH §40100(dd). Therefore, BCC lacks jurisdiction as to those activities. Further, as discused below, nothing in CDPH regulations prohibits a licensed manufacturer from engaging in branding transactions provided all other CDPH regulations are complied with.

Moreover, even if it were within BCC's jurisdiction, the agency may not adopt regulations based on conjecture without publishing supporting documentation. As a result, in order for the BCC to issue a regulation based on conjecture, pursuant to 1 CCR §10, BCC is required to include in the Notice supporting facts, studies, expert opinion, or other information that verify the conjecture. Since the BCC failed to include in the Notice facts, studies, expert opinions or other information that supports the conjecture that licenses ***may*** be engaging in such conduct, together with evidence that such conduct is both within BCC's jurisdiction and in violation of applicable California law, proposed BCC §5032(b)(2) and (b)(3) must fail.

Finally, the undersigned notes that CDPH §40115 requires parties engaged in Manufacturing (as defined in CDPH §40100(dd)) to be licensed but does not require third persons (e.g., trademark owners) to be licensed in order to engage in contractual non-control, non-ownership activities such as trademark licensing or branding agreements with licensed manufacturers. Therefore, white-labeling activities, which are customary in other non-cannabis industries throughout the World and prevalent in California and other cannabis-legal states and countries, would not be in violation of applicable CDPH regulations solely by virtue of such activity. The undersigned believes it would be arbitrary and capricious for the BCC to ban an activity that is permitted under applicable CDPH regulations and which is common in the cannabis industry and non-cannabis industries throughout the World.

In any case, the proposed change to ban white-labeling activity is substantial and must be subject to a 45 day notice and comment period.

On behalf of clients of this firm which include licensed manufacturers engaged in white-label activities in compliance with applicable CDPH regulations, I hereby reserve any and all privileges, rights and remedies, administratively, at law and/or in equity, to challenge and invalidate the above-referenced regulations in a court of competent jurisdiction.

Sincerely,

David C. Frankel