Recommendations on New Jersey Draft Cannabis Regulation Bill

We think that overall the draft bill circulated in September (S 2703 Amendments, September 12, 2018) is a significant improvement and represents a positive step forward for legalizing and regulating adult use of marijuana in New Jersey. It has many good aspects for establishing functioning and sensible marijuana markets in the state.

However, specific provisions in the bill risk damaging unintended consequences. Despite the excellent work overall, these provisions will undermine the overall implementation process, making success far less likely, resulting in black market diversion and administrative inefficiency. Most importantly, the conditional license requirements as reflected in the draft amendments severely restricts market entry at a crucial time in the legal transition. Even more concerning, it shifts the risk of the early-stage industry (including strict products liability, personnel and payroll – not to mention federal liability) to low and middle-income New Jersey residents.

Some elements of the draft amendments embody approaches that do not reflect best practices and lessons learned from other states that have legalized marijuana. Below we highlight and discuss those elements in two groups: crucial items that will have significant impact if done wrong, and optimization items where changes can help improve outcomes.

I. Crucial Items

1. Sec 11.g. states that "any consultant or other person under contract for services to the commission shall be deemed to be a special State employee, except that the restrictions of section 4 of P.L.1981, c.142 (C.52:13D-17.2) shall not apply to such person. Such person and any corporation, firm, or partnership in which the person has an interest or by which the person is employed shall not represent any person or party other than the commission." **This would seem to require that any consultant or contractor to the cannabis regulatory commission may have not have any other clients**. This is astonishingly restrictive and will ensure that the commission is not able to get the best consultants or contractors for necessary tasks. This section should be eliminated or dramatically revised to address only identified conflicts of interest.
2. Sec 16.a states "The commission shall adopt rules and regulations, pursuant to (this bill) which shall be consistent with the intent of (this bill). Such regulations shall not prohibit the operation of cannabis establishments, either expressly or through regulations that make their operation unreasonably impracticable. [From Sec.3, "Unreasonably impracticable" means that the measures necessary to comply with the regulations require such a high investment of risk, money, time, or any other resource or asset that the operation of a cannabis establishment is not worthy of being carried out in practice by a reasonably prudent businessperson.]. The intent of this section is crucial. **Explicitly requiring**

regulations show how they advance the intent of this law is important to prevent mission creep.

a. The term "unreasonably impracticable" is clunky and obscure. We suggest that the modifier "unreasonably" is not necessary since impracticable means "impossible in practice to do or carry out." As clarified by the definition in Sec. 3, the word impracticable does the job.

b. Model language appropriate to add to this section is "Such regulations shall also be based on the best available evidence, and not unreasonably restrict licensees from using alternative methods or procedures to comply with the same statutory requirements." This language would focus the commission on evidence-based matters and require rules allow licensees to achieve the clearly stated goals by means they find most effective, requiring regulations then to focus on goals and outcomes rather than process where possible. This language was included in California's marijuana legalization bill as a guide to its regulatory bureau.

3. **Sec 16.a.8.e requires occupational licensing for workers in cannabis businesses**. As a report by the Obama Administration Departments of Treasury and Labor and Council of Economic Advisors stated in its 2015 report on occupational licenses, "by making it harder to enter a profession, licensing can also reduce employment opportunities and lower wages for excluded workers, and increase costs for consumers." New Jersey does not require occupational licenses for liquor store workers and it makes no sense to require them for cannabis workers. The law lays out requirements owners of and workers in cannabis businesses must obey that are clear and enforceable and that is all that is needed. Model language that would achieve the broad goal of this section without the problems is "Require cannabis licensees to provide workers with training on compliance with relevant regulations of their work." The cannabis industry will certainly produce training materials to help its members train new workers and remain in compliance with the law as do many other regulated industries.

4. Sec 16.8.g states "Set appropriate dosage, potency, and serving size limits for cannabis and other cannabis products, provided that a standardized serving of cannabis shall be no more than 10 milligrams of active THC and no individual edible retail product unit for sale shall contain more than 100 milligrams of active THC and that cannabis and cannabis product packaging prevent children from access." The last part is already addressed elsewhere in the bill. What is the evidence-based basis for a 10mg THC limit per serving or a total of 100mg THC limit per packaged product? **This seems a completely arbitrary set of numbers and is the kind of matter better determined by the regulators than by the legislation**. This section should simply direct the commission to "Set appropriate dosage, potency, and serving size limits for cannabis and other cannabis products."

5. Likewise, Sec 16.8.i states "Require that, if it is impracticable to clearly demark every standardized serving of cannabis or to make each standardized serving easily separable in an edible cannabis product, the product shall contain no more than 10 milligrams of active THC per unit of sale." This has the same problems as item 5 above and this section should simply direct the commission to "Set THC potency requirements for products in which it

is impracticable to clearly demark every standardized serving of cannabis or to make each standardized serving easily separable."

6. **Sec 16.d.9. sets advertising restrictions that are arbitrary, full of strict numbers on audience that are either not based on adequate evidence and/or are impracticable**. This is an area where the legislation should set the goals and leave the standards and practices up to the commission to establish. Model language is "Restrict advertising of cannabis items and cannabis paraphernalia in ways that target or are designed to appeal to individuals under the legal age to purchase." States such as Washington and Colorado have been experimenting with different approaches to regulating advertising that the commission can examine and learn from in setting rules to meet this clear goal.

7. **Sec 16 establishes an open number of licenses for cannabis businesses. This is the right approach**. Other states have failed to find a sound basis for any specific limits or allocation, so they tend to be arbitrary and fuel lawsuits. Moreover, it is the nature of markets that supply is a dynamic thing, adjusting with costs, market conditions, and demand, all things that are difficult to measure and constantly change so that an agency trying to measure them is perpetually using point estimates that no longer reflect reality by the time they are being used.

8. **Sec. 18 Establishes a state excise tax on cannabis products of 10% plus allows local governments to levy an excise tax of up to 2%. This is a very reasonable provision**. There is not a lot of hard data analysis yet on the effects of various tax levels on cannabis markets. But we can observe that substantially higher combined sales and excise taxes on cannabis products in other states continue to fuel black market sales. A *crucial* goal of legalizing is replacing black markets with legal markets and setting tax levels too high can shatter that goal. At the proposed level, state and local governments will be collecting about 18 cents for every dollar of cannabis products sold in the state, which promises to be a substantial sum and is already more than is collected for the sale of most other products in the state.

9. This law establishes "conditional licenses" which are licenses the commission may issue to allow a licensee to begin operations while some elements of the application process and evaluation are still underway. The conditional license can be revoked if that process is not completed, or replaced with an annual license once the process is done. Sec 20.(2) provides rules for conditional licenses and includes in (a) "and ensure that at least 10 percent of the total licenses issued for each class of marijuana establishment are conditional licenses." While establishing conditional licenses to make allow licensees to begin operating when application requirements are met but the process is not fully complete makes sense, we can see no reason to establish a numerical requirement. **What purpose is served by there always being a certain percentage of total licenses that are conditional? Moreover, we are concerned this requirement could create problems by requiring some annual licenses be denied to make room for a 10% quota of conditional ones**. The 10% requirement should be removed.

10. **Sec 20.2.iv. requires as part of the application process "proof that each person with any financial interest in the proposed cannabis establishment has, for the immediately preceding taxable year, an adjusted gross income of no more than $200,000 or not more than $400,000** if filing jointly with another, or has, at any time in the past five taxable

years, received federal or State financial assistance;" This means no one who has had a high income may invest in or own a cannabis establishment. Nor can anyone who has managed to pull themselves up from dire financial straits that required public assistance but now is in a position to own or invest in a cannabis business. This is an absurd requirement that serves no public policy purpose. Income levels have no bearing on one's ability to invest in or own a cannabis business and does not bear on the other licensing requirements. Licensing requirements should be confined to items that ensure compliance and protection of public health, not arbitrary attacks on certain income levels. This requirement should be removed.

11. **Sec 20.3.c requires all applicants to have a signed labor peace agreement with a bona fide labor organization**. This does not in any way advance the purpose of this legislation to advance public health and minimize harms to New Jersey communities and families. Applicants are free to have labor peace agreements or be unionized if that serves their goals, and that is well and good. But some may prefer different business models that fully meet the state's goals for legalized markets and should be allowed to do so. Indeed, it is likely that well-funded and large applicants would find it easier, if no more desireable, to comply with a labor peace agreement requirement than will small local entrepreneurs. **Requiring labor peace agreements is a special interest provision that will make it costlier and more difficult for applicants. That in turn will squeeze out some of the smallest applicants, raise prices, limit competition, and perpetuate black markets and the harms they bring to communities and families**. This subsection should be eliminated.

12. Sec 20.3.d establishes a point system for helping to determine who is allocated a license. This appears to be left over from earlier versions that proposed a cap on the number of licenses and anticipated a need to choose a limited number from the pool of qualified applicants and so the section sets out a system to rank them. **An open license system that sets criteria for applicants and gives a license to any applicant that meets those conditions is more fair and economically sensible and is what this law currently establishes**. So there is no longer a need for this point system and its criteria. This subsection should be removed.

13. **Sec 20.3.f. requires that 10% of all licenses in each class be for microbusinesses**. Creating a micro business license is a very good idea as it allows small entrepreneurs with limited scope who are thus easier to vet and for whom many requirements of larger establishments don't apply to have a simpler licensing process. However, **the 10% requirement is arbitrary—there is not economic or policy basis for 10% being the right number**. In some locations and types of licenses market conditions may provide for many more than that, and in locations and conditions many less. A quota imposes an inflexibility that will not allow the commission to issue micro business licenses based on supply and demand, which may well wind up restricting regular annual licenses and disrupt the replacement of black markets with legal ones. The 10% quota should removed. Model language to include to encourage micro business is "The commission shall encourage micro business applicants and provide information and assistance designed to facilitate the application process for micro business applicants."

14. **Sec 22. Requires the commission to determine the demand for cannabis products in the state and limit the grow canopy accordingly. No state has successfully estimated**

the total demand in its market, nor the grow canopy that supports it. Nor can they. Demand is not a point estimate, a number that is fixed for a year, or even a day. It is a dynamic outcome of a complex process that rapidly changes in response to things like new products, prices, competition, marketing, etc. Between the grow canopy and the amount available in the market are many natural conditions (storms, dry weather, wet weather, etc.), market conditions (gas prices, legalization in neighboring jurisdictions, changes in federal law, etc.) as well as other factors such as shift in tastes from smokable flower to vaping liquids or vice versa. The federal government's own survey of drug use (the Substance Abuse and Mental Health Services Administration annual report) has long conceded that the stigma associated with unlawful drug use results in statistically significant intentional underreporting. While state legalization has reduced this stigma to some degree for cannabis, it still exists, thus making modelling market demand at this early stage is a statistical, behavioral, economic and practical impossibility. Making regulatory decisions on product availability contingent on this arbitrary, capricious and unjustifiable estimate, would only compound the error. This section sets up the commission and the New Jersey cannabis market for failure and disruptions that will only encourage continued black market production. This section should be removed.

15. **Sec 26 establishes requirements for workers in cannabis business. This section is astonishingly onerous and imposes all manner or requirements that do not apply to liquor store workers. There is no reason for such restrictions and they advance no public purpose but only serve to raise costs and perpetuate black markets**. Subsection d allows the creation of occupational licensing for workers, again a bad idea that hurts the workers the most. Subsection e requires background checks for all workers—again this is not required for liquor store workers nor does it make sense for all workers in highly supervised and regulated cannabis businesses. The exception may be in subsection h governing delivery workers who have to act in accordance with the law and make many judgement calls on whether customers and conditions of a deliver comply with the law while acting somewhat independently while out make deliveries. This section should be simplified to impose no more restrictions on cannabis workers than are imposed on liquor industry workers.

16. **Sec 26.3.h.15 and 16 and 17 imposes requirements on deliveries of cannabis products that are micromanagement and do not serve any purpose of protecting public health**. These matters should not be established in law and the commission has the scope to impose similar regulations on deliver should they prove to be necessary.

17. **Section 27.a. bans vertical integration (ownership of growing, wholesale and retail or a combination of those) in the state cannabis industry for an initial 18-month period and confining licensees to one facility of each type thereafter**. U.S. history is replete with attempts to limit vertical integration and the immediate development by markets off ways to get around them. **These limits don't work and never have, they only serve to distort the market, reduce transparency of those who actually do invest in or own which facilities, and reduce efficiency in the industry**. Sometimes vertical integration reflects consumer demand—they want the efficient and consistent product it provides. Think Starbucks. But there remains plenty of competition. They way to combat market concentration is not to try to limit it from the top, but to foster competition from the bottom. This law allows for entry by new competitors, including micro businesses and even

encourages them. This is the best way to ensure multiple providers at all level of the market. The limits on vertical integration after the initial 18-month period should be removed.

18. **Sec 49.2.k. bans the sale of other products in cannabis stores. There is no evidence-based reason, public health purpose, or even common sense reason for this restriction**. What possible harm could come of cannabis stores selling snack, drinks, cigarettes, tshirts, or what have you just as liquor stores do? This is simply designed to limit competition for convenience stores and the like and should be removed.

II. Improvement Points

1. Sec 8.b. requires the commission to established initial rules that must be replaced by permanent rules after one year. Colorado in particular has found the process of getting the regulations right to be an iterative process and is still making adjustments to its rules as needed. The commission should be encouraged to take a similar approach. Model language that should be added is "The commission shall revise rules and regulations as needed to meet the intent of this law based on evidence and changes in the market."
2. Sec 8 requires the commission to biannually report to the Governor and Legislature certain information. We suggest adding a few items to be reported: data on arrests for driving under the influence as well as stops; metrics on market participants in addition to number of licenses issued since the last report such as total licenses off each type, how many micro business licensees, data on renewals and failure to renew licenses to show how much success and failure is happening in the market, data on prices for a representative set of products to indicate competition and market growth, data on enforcement actions by the commission and outcomes of them, summary of changes made to rules and regulations since the last report and why those changes were made.
3. Setting licensing goals for the commission for minorities, women and disabled veterans of 25% is a productive way to focus the commission on ensuring there are no unusual barriers to these groups fully participating in the market.
4. Sec 18.i.1. Seems to ban the use of lands designated for agricultural use for growing cannabis. Not allowing the owners of agricultural lands to make the most productive use of their land that is still agriculture is extremely restrictive. Restricting those lands to agricultural use is already quite restrictive, no micromanaging what crops they can grow is going too far. This restriction should be removed.
5. Sec 18.i.2. Prevents the issuance of a license to recipients of economic development incentives. Care should be taken to ensure clarity as to what this restriction applies. It wouldn't make sense to limit applicants who are in redevelopment zones or TIF districts, for example.
6. Secs 23 and 24 require processors and wholesalers to report electric and water use. This is not relevant to the purpose of this law nor is it germane to public health or is required of other businesses. This is a special interest provision that should be removed.
7. Sec 28.e does not allow possession of cannabis in certain facilities, including hospitals. This should be modified to remove hospitals. First of all, hospitals are capable of regulating themselves what is permitted in their facilities as they already do. Second, some visits to

hospitals are involuntary or unexpected, as in emergency transport of victims to emergency rooms. As it stands with this subsection, anyone with legal possession of cannabis on their person who, say, has a heart attack and is transported to the hospital and then is found to have cannabis on them would be in violation of the law.

8. Sec31.a states "The provisions of P.L. , c. (C.) (pending before the Legislature as this bill) shall not be construed: a. To amend or affect in any way any State or federal law pertaining to employment matters." Since Sec 28 is entirely about amending state law pertaining to employment matters, this language needs adjusting.
9. Sec 50.4.c. Bans consumption of cannabis at higher education facilities in the state. As with local governments, the state should leave this determination up to the higher education institutions in the state. They can determine their own restrictions on legal consumption in compliance with state laws. That is far more likely to be effective in shaping consumption on campuses to avoid use by minors than is a blanket statewide ban which will be widely ignored as the current total illegality of cannabis consumption is widely ignored on campuses.

For More Information

Dr. Adrian Moore

Vice President, Reason

Adrian.moore@reason.org