

Drug Policy Project

at Reason Foundation

The **Drug Policy Project** at Reason Foundation offers pro-bono consulting to public officials and stakeholders to help them design and implement drug policy reforms for legalized medical cannabis and effective harm reduction policies.



Illinois Draft Legislation to Legalize Marijuana Versus Reason’s Conceptual Framework

The Reason Foundation’s Drug Policy Project has published a Conceptual Framework for State Efforts to Legalize and Regulate Cannabis.¹ The Conceptual Framework is meant to be a guiding document to help lawmakers and regulators in states that have or are considering legalizing marijuana for adult use. It builds on the Seven Principles to Guide a Successful and Well-Regulated Marijuana Market that the Reason Foundation had previously co-authored with Americans for Prosperity.²

This synopsis compares the major provisions of draft legislation in Illinois to legalize marijuana (Senate Bill 7) to recommendations made in Reason’s Conceptual Framework. Senate Bill 7 has features that both coincide with and diverge from the Conceptual Framework. Generally, Senate Bill 7 comports well with Reason’s recommendations for accomplishing social equity objectives and expungement of prior convictions for infractions that would be considered legal following passage of a marijuana legalization statute. However, Senate Bill 7 would also create an overly regulated and restrictive marketplace that substitutes inflexible bureaucratic directive for entrepreneurial judgment and initiative. Below, we examine Senate Bill 7 thematically, beginning with administration and concluding with social equity programs.

Administration:

Reason’s Conceptual Framework recommends state marijuana programs be regulated by a single state agency. This avoids confusion on behalf of applicants or licensees who must otherwise seek approval from multiple authorities and simultaneously allows state officials to develop a specialized expertise in all aspects of marijuana regulation and avoid potential coordination problems across multiple agencies.

¹ Lawrence, Geoffrey and Harrison, Matt, “A Conceptual Framework for State Efforts to Legalize and Regulate Cannabis,” The Reason Foundation, March 1, 2019, <https://reason.org/wp-content/uploads/conceptual-framework-state-efforts-to-legalize-regulate-cannabis.pdf>.

² Moore, Adrian and Jedynek, Erica, “Seven Principles to Guide a Successful and Well-Regulated Marijuana Market,” The Reason Foundation and Americans for Prosperity, <https://mk0xituxemauaaa56cm7.kinstacdn.com/wp-content/uploads/2018/09/7principlesMReform.pdf>.

Reason further recommends that this be a new division in an existing agency (like a bureau of alcohol regulation) to avoid the delays of building an entirely new agency.

The division of authority under Article 5 in SB7 (pp. 19-26) names a half-dozen agencies. Later (pp. 30-32), the Department of Commerce is also charged with managing low-interest cannabis loans. Eight different agencies are authorized to draw funds from the Cannabis Regulation Fund to administer cannabis laws (p. 385). All these functions should be consolidated within the proposed new Illinois Cannabis Regulation Oversight Officer's division at the Department of Financial and Professional Regulation.

Further, the current draft allows only 180 days for each agency involved to promulgate rules to implement SB 7 (p. 271). If eight different agencies (plus the Attorney General's office) are charged with drafting and coordinating a diverse set of overlapping regulations, soliciting public feedback and adhering to open meeting requirements, this timeline may be recklessly aggressive.

Licensing Structure:

SB 7 would cap the available number of **Adult Use Dispensing Licenses** at 75 and apportion them geographically across the state. Of the 75, 47 are apportioned to Chicago (p. 83). By December 21, 2021, up to an additional 110 licenses may be awarded (p. 99) based on Department's analysis of supply versus demand. After January 1, 2022 the Department can change the number of available licenses, up to 500 (p. 101).

Only 30 **cultivation centers** (p. 162) are permitted. Cultivation centers are limited to 100,000 square feet of canopy space (p. 184). By comparison, Nevada has roughly twice as many operational cultivators as dispensaries and imposes no plant-count or canopy-size limitations on cultivators. Still, Nevada has experienced periods of inadequate supply. Cultivation centers are also required to produce as much medical cannabis as they did in the six months before acquiring an adult-use license (p. 168). It is extremely likely that Illinois will experience a shortage of adult-use cannabis products considering these supply constraints. It would be better to impose no canopy-size restraints nor any limitation on the number of cultivation licenses so the market can actively adjust to variations in supply and demand rather than waiting possibly years for state agencies to make additional licenses available.

There is also language alluding to geographic apportionment of cultivation centers and craft growers, although it's unclear what this structure would be; the language could be a legacy of a previous draft where the apportionment was subsequently omitted. There is no reason for any wholesale license type (cultivation, craft grower or processor) to be geographically apportioned. Where the number of dispensary licenses is limited, this approach can make sense by ensuring citizens have retail access within a reasonable distance of their homes. But wholesalers should be free to generate inventory in any part of the state where they can best control costs and attract qualified labor. Their products are simply transported to retail dispensaries that are already geographically apportioned.

The **Early Approval licenses** are a good idea that will accelerate implementation of the act. However, the financial cost of applying for one is enormous. An Early Approval Dispensary License would cost at least \$230,000 (and \$330,000 for a secondary site). If one is received, the licensee still cannot begin selling recreationally until January 1, 2020. Then, the licensee will still need to submit all fees and a full application to receive an Adult Use license. Conditional Adult Use Licenses must be awarded by May 1,

2020 (p. 83), so this may only be a four-month advantage. The initial cost for an Early Approval license should be much closer to the cost of a regular Adult Use license and then it should automatically convert once the Adult Use licenses become available since, presumably, these existing medical licensees have already been vetted extensively.

Early Approval Cultivation licenses would cost more than \$650,000 in total and are good for 18 months, beginning September 1, 2019 (p. 165). This amount is only the cost of acquiring a license and does not consider the costs of building a suitable facility. This is a substantial barrier, particularly for an industry in which entrepreneurs do not have access to traditional sources of capital.

Likewise, **craft grower** licenses are inordinately costly and there are too few available to make up for what will surely be a lack of licensed cultivation space. Only 40 craft grower licenses will be issued by July 1, 2020 (p. 190) although the Department of Agriculture may award up to 60 more by December 2021. The bill draft grants the Department discretion to create more afterward, but creates a hard cap of 150 licenses (p. 192). There is a \$40,000 nonrefundable application fee plus a \$100,000 annual license fee if the applicant is awarded a license (p. 212).

SB 7 allows up to 40 **processor** licenses to be awarded by July 1, 2020 and up to 60 more by December 21, 2021 (p. 214). The application fee is \$5,000 and annual license fee is \$20,000 (p. 232). The language says the licensing authority “shall issue” a license if the applicant receives at least 85% of the available points on its application.

There is no limit to the number of transporter licenses and they must be issued by July 1, 2020. The application fee is \$5,000 (p. 233) and annual license fee is \$10,000 (p. 239). This license type also has “shall issue” language if the applicant receives at least 85% of the available points. All other license types should ideally have a licensing structure closer to this one.

Ownership Restrictions:

A single person cannot have an interest in more than 10 dispensary licenses (p. 99), 3 cultivation centers (p. 184) or 1 craft grower (p. 208). Although provisions like this are important in the context of a limited number of licenses, this is highly restrictive. The limitation should be on “controlling interest” only. On the plus side, language is included to facilitate ownership by public companies (pp. 110-111).

Scoring Criteria:

Applications will be scored using the following criteria, the details of which are left to administrative rule-making (pp. 93-97):

- Floor plan (10 points)
- Employee training plan (10 points)
- Security and recordkeeping (60 points)
- Business plan (65 points)
- Knowledge and experience (30 points)
- Status as Social Equity applicant (25 points)
- bonus points (12) – labor practices, existence of a labor peace agreement, local community report, environmental plan, owner has been an Illinois resident for previous five years, community engagement

Floor plans should not be considered as it will be imprudent for most applicants to secure a lease or purchase a facility until they know they have received a license; licenses should instead be awarded within a jurisdiction and addresses determined later. The other criteria (except for the bonus points) mostly adhere to Reason's Conceptual Framework.

Fines: Why do the maximum fines for violations differ by license type? A cultivation center could face fines of up to \$50,000 but a dispensary would only face fines up to \$10,000 (p. 248).

Taxes: Reason's Conceptual Framework recommends that marijuana excise taxes be levied only at retail and at uniform rates that do not create a cost advantage for black-market suppliers. SB 7 would violate both these principles. First, it imposes a cultivation tax of 7%. The Department of Revenue would be responsible for determining the selling price when a wholesale transaction is not arms-length (p. 289), such as when a licensee is vertically integrated. This means the Department will need to devote resources to determining the fair market value of marijuana, which is a needless exercise that could be avoided by eliminating the wholesale tax.

Retail excise taxes also vary by the type of marijuana product. Cannabis flower containing less than 35% THC is taxed at 10%. Cannabis flower containing more than 35% (this is *extremely* rare) is taxed at 25%. Cannabis-infused products are taxed at 20% (p. 299). The reasons for this delineation are unclear, although it would tend to steer consumers toward smokable flower of lower potency, which is a less healthy method of consumption than edibles and other infused product types. There should be a single, uniform tax rate to avoid tax-induced distortions in the marketplace.

The administration of marijuana taxes is also problematic. All tax payments are required to be made by electronic means (p. 292, 303) even though electronic payment methods are generally unavailable to marijuana businesses. Further, licensees are required to estimate their monthly taxes and pay a prorated amount four times monthly (p. 293, 304). This imposes needless compliance costs on licensees and state tax authorities alike. Taxes should be filed and paid monthly.

Use of Tax Proceeds: All tax proceeds are placed in the Cannabis Regulation Fund. The eight governing agencies can first request a reimbursement of their costs. Then the Attorney General's Office can seek reimbursement. The remaining balance is appropriated as follows (pp. 385 - 387):

- 2% drug prevention,
- 8% law enforcement training,
- 25% to the Restoring Our Communities program,
- 20% substance abuse and mental health,
- 10% budget stabilization fund,
- 35% state general fund

Capitalization Requirement:

Reason has argued against any form of arbitrary capitalization requirement. Typically, an entrepreneur may not be able to line up large amounts of capital on the speculative hope of acquiring a license; capital is more likely to flow to an entrepreneur that has already acquired a license. Yet, SB 7 would require an applicant to have access to \$100,000 in liquid cash at the time of the application (p. 92).

Diversity Requirement:

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Applications must contain diversity plan for ownership, management, employment and contractors (p. 88, 174). License applications should be evaluated purely on the relevant business experience or acumen of the applicant.

Supply-Side Operations:

Generally speaking, licensees should have the freedom to experiment with different operational approaches so long as they meet the intent of marijuana laws and regulations. Instead, SB 7 places needless prohibitions on licensees to restrict their operating freedom, essentially treating licensees as public utilities. Following are some examples:

Procurement limitation: Dispensaries cannot enter into an exclusive agreement with any wholesaler. They must offer “an assortment of products from various cannabis business establishment licenses.” The Department can arbitrarily require greater diversification of product offerings at any time (pp. 125-126). Dispensaries also cannot refuse to do business with any wholesaler. However, there may be valid reasons for entering an exclusive agreement (e.g. discounts on volume) or refusing to do business with someone (e.g. that entity may have past-due debts or a poor reputation from having defaulted on a previous obligation.)

Delivery by dispensaries to customers is prohibited (p. 126). Delivery is an important mechanism to ensure customers have access to safe, regulated marijuana products. It also may reduce customers’ inclination to drive under the influence of cannabis. Most states view deliveries as nothing more than an extension of the dispensary’s point-of-sale system and custody of marijuana product is easily trackable using GPS technology.

Payment. Online payment platforms are prohibited.

Product offerings. Product bundles are prohibited.

Price Discrimination: Cultivators are prohibited from charging higher prices to some retailers than others (p. 183). This also applies to craft growers (p. 206) and processors (p. 226). Price discrimination, whether intentional or not, is a natural feature of markets that helps to regulate supply cycles. In locations that experience a shortage of supply, for instance, dispensaries will offer more money to procure the available supply and restore equilibrium. Price controls defeat this mechanism and could lead to regional price disparities on the retail market.

Inventory control: All states with adult-use marijuana require licensees to participate in a track and trace system. However, SB 7 would also require a daily reconciliation of physical inventory with this system (p. 130). Daily is excessive. This should be a weekly or monthly requirement.

Standard business decisions. Pages 153-156 name a litany of conditions that could lead to revocation of a license. Among them are business decisions that state agencies should not need to adjudicate, such as what constitutes an “insufficient number of employees” or whether a manager’s mental capacities have deteriorated due to age.

Home Grow:

SB7 permits residents to grow five plants per household (p. 37-39). The allowance of home grow is positive, however the limit in other states is typically either six or twelve plants. The provision in SB7

also has some strange language: it keeps referring to a person who is “registered” for a home grow. It’s unclear what kind of registration is required, but there should be no such requirement.

Agent Cards:

Like Nevada and Colorado, SB7 would require all employees or representatives of a licensee to acquire a state-issued agent card before they can begin work (p. 62, 104). This is a type of occupational licensing scheme that makes the labor market less dynamic and creates needless delays for both employers and employees. Nevada, for instance, has operated on a continuous six-month backlog for processing agent card applications. All other states with recreational marijuana somehow maintain a well-regulated market without this provision.

Product Testing:

Licensed labs must be independently accredited and will test for: microbiological contaminants, mycotoxins, pesticides, residual solvents and active ingredients (p. 256). The specific thresholds for these tests are left to administrative rulemaking. This largely conforms to Reason’s Conceptual Framework. However, no specifics are provided on test sample sizes. Further, SB 7 indicates that not all marijuana products need to be tested in order to be sold—there is “if sampled” language indicating that some products at retail may not have been tested.

Advertising:

These restrictions are standard with one exception: Licensees cannot use an image of cannabis a leaf or bud (p. 261). The reason for this is unclear.

Local Government:

Local governments cannot “unreasonably prohibit” home cultivation or use (p. 269). They can govern the time, place, manner and number of establishments, but those regulations cannot be more restrictive than what is imposed by the state (p. 269). SB 7 preempts any regulation by local governments beyond what it explicitly permits, even in cases where the local government is subject to home rule (p. 287). These provisions are all in line with Reason’s Conceptual Framework.

Banking:

There is limited feasible action states can take to facilitate financial services for marijuana businesses because financial institutions, even when chartered at the state level, are predominantly regulated by federal entities. However, states can make it easier for traditional banks to serve marijuana businesses within the reporting parameters established by the U.S. Treasury Department by granting those banks access to background and transaction data for marijuana licensees. This allows banks to perform the know-your-customer and anti-money-laundering checks that are necessary for the financial institution to gain confidence that cash held on deposit is the result of legitimate transactions and not illicit drug trade. Senate Bill 7 would enable exactly this type of information sharing by requiring relevant state agencies to share data about licensees with financial institutions (p. 280).

Expungement:

Carrying a criminal conviction on one’s public record can impede an individual’s ability to gain employment, seek higher education, or perform other productive activities that lead to successful

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rehabilitation. This observation is especially poignant when the conviction is for an action that is no longer even considered criminal. That's why any marijuana legalization effort should incorporate liberal provisions to expunge convictions for low-level possession of marijuana. States have approached this issue with varying degrees of automation. For instance, Oregon requires citizens to apply for expungement and have a court review each individual case in a costly and time-consuming process. California, by contrast, is preparing to automatically expunge all low-level possession charges and will individually review higher-level convictions for possible reclassification or expungement. Senate Bill 7 would closely mirror the preferred approach of California, by requiring automatic expungement of low-level convictions within two years (p. 376).

Social Equity:

Several states have sought to include a social equity component within their marijuana legalization laws as compensation to individuals or communities that have been victims of the War on Drugs. Reason has advised that these policies should be targeted as specifically as possible to those individuals or communities and not applied broadly to groups that may have limited correlation with this victimhood. Massachusetts, for instance, defines communities that have been disproportionately impacted by the War on Drugs as those Census tracts that have experienced extraordinarily high arrest rates for marijuana.

Senate Bill 7 takes two approaches toward social equity. First, it creates a special class of applicant called a "social equity applicant" and awards those applicants additional points on the competitive scoring to receive a license. It also proposes to provide low-interest loans to these applicants to help defray the costs of starting a business. Second, it creates a new program to benefit specific communities through the proceeds of marijuana taxes, called the Restoring Our Communities program (p. 50-59). The Restoring Our Communities program would provide grant funding to community organizations to provide services of social benefit. A similar initiative in California provides mental health support, job training and similar services. One potential shortcoming of the Restoring Our Communities program is that its goals are more nebulous and success toward those goals more difficult to measure. These include addressing the "root causes of violence" or advancing the "social determinants of health." To be sure, these are worthy causes, but exacting accountability from grant recipients to pursue these goals may become challenging.