Building a Sustainable Model for Regulated Cannabis in Vermont

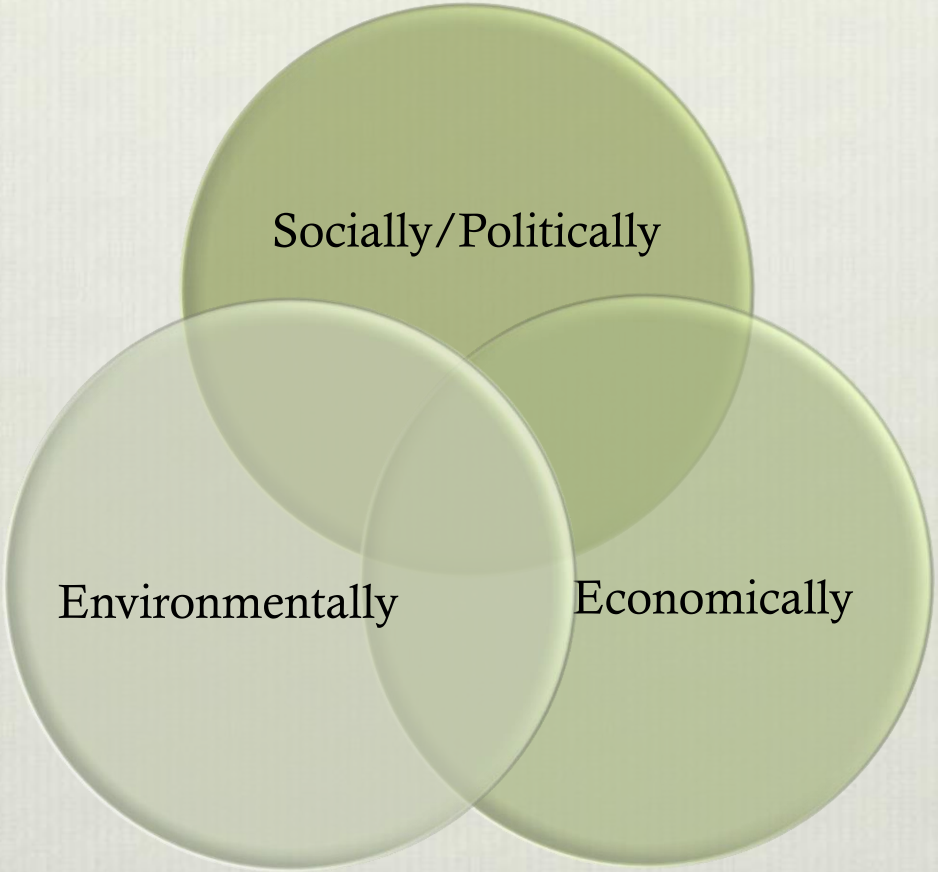
Dave Silberman, Esq.

dave@davesilberman.com

Goals:

- A regulated system for cultivation and sale of cannabis that is:
  - ✓ Sustainable
  - ✓ Appropriately Scaled
  - ✓ Inclusive
- Driving out the illegal drug dealers
- Collecting sufficient tax revenues

Sustainable



Scaled for Vermont

- Structure should provide alternatives *alongside* retail sales (e.g., CSA's, co-ops), rather than a one-size-fits-all approach;

- Licensees should produce sufficient product to meet demand (RAND: 33,000 – 55,000 lbs./yr);

- Market power should be in the hands of consumers and communities, not distant investors;

- Cannabis businesses should not be too big to regulate.

What Kind of Activity Do We Want to Encourage?

How Can We Effectively Encourage It?

Encourage Smaller & Outdoor Cultivation

Small

- Fragmented cultivation market reduces producers' pricing power.
- Reduce incentives to use harmful pesticides
  - Recent CO recalls have come from industrial-scale grows.
- Bring current clandestine growers into the regulated market.
  - Deprives the underground market of a major source of current supply

Outdoor

- Outdoor growth requires less energy and fertilizer than indoors
- Warehouses have negative impact on the scenic landscape
- Reduce pressure on warehouse availability/rents for other industries that need them, as has happened in CO

Preferred Cultivation Models

#1: Grow-Your-Own

- *Non-commercial* cultivation for *personal* use – no sales
- 2-3 plants per household
  - Sufficient, without feeding “gray market”
- Serves as a “bridge” to retail sales while regulations are written
  - Immediate legal alternative to black market
- Pressure retailers to compete on price, quality and customer service.

Preferred Cultivation Models (cont'd)

#2: Co-Operative Grows (Grow-Ops?)

- Effectively, hire someone to grow "your" plants for you
  - Harvest *belongs* to members, not *sold* to them
- Cap on # of members/plants – 50 people/100 plants?
- No sales to non-members, unless Co-Op obtains a separate retail license
- Sell "excess" harvest to medical dispensaries and licensed retailers

Preferred Cultivation Models (cont'd)

#3: Small-Scale "Craft" Growers

- 500 ft^2 plots
  - Production likely in 30-50 lbs/yr range outdoors
- Focused regulatory oversight: seed-to-sale tracking
- Sales only to medical dispensaries and licensed wholesalers and retailers
  - Direct consumer sales should require separate retail license & greater regulatory oversight

- Large-scale grows will be needed to meet market demand, but shouldn't be the default

Encouraging “Craft” Growers

- Lower fees for small/outdoor growers
  - \$500 fee for 500 ft^2 outdoor-only permit
  - Outdoor grows yield 1/3 the crop of equally-sized indoor grows – benchmark @ \$3/ft^2
- Expedited application process
  - Commensurate with smaller scale & lower risk profiles
    - No need for a comprehensive energy plan, for example
- Make licenses widely available

“Too Big To Regulate”?

- Encourage competition by generally prohibiting ownership of multiple licenses.
  - No more than 10% ownership of 2nd+ licensed business of same type, including through affiliates.
- Allow licensed retailer to also have a *single* manufacturing and *single* cultivation license.
  - Tax and cost efficiency.
  - Similar to current medical model.
- No self-certification - testing labs should be independent of their clients

Local Ownership & Control

- Require 51% Vermont ownership
  - Consider additional requirement that ~5-10% ownership resides in town or county where the business is based
  - Outside minority investors with prior experience in CO and WA can help Vermonters avoid early mistakes.
- CEO and CFO should be Vermont residents
- Majority of corporate board should be Vermont residents
- Extend background checks to all officers, directors, and 10% shareholders
- Apply these requirements to both the holding company and licensed entity/management company

Local Ownership & Control (cont'd)

- 100% in-state ownership requirement will hurt Vermont businesses, and most likely is unconstitutional
  - Cannabis businesses can't get bank financing
  - Gives undue leverage to in-state financiers
  - Harsh terms will drive the exact financiers-first business mentality that we want to avoid.
- "Dormant" Commerce Clause 2-prong analysis of laws that facially discriminate against out-of-state persons:
  - Prong 1: Compelling state interest? YES
    - Distant ownership and shareholder-first mentality are harmful to community interests
    - Local ownership will take other stakeholder interests into account, be more socially responsible.
  - Prong 2: Is 100% the least restrictive means to achieve? NO

About Those Background Checks…

- Allow people previously convicted of non-violent drug offenses to participate in the system, both as owners and employees.
- Well-documented disparate impact from systemic biases means minorities would otherwise be disproportionately blocked from the regulated system
- Cole Memo requires excluding violent felons & organized crime, not small-time local growers who would bring valuable industry knowledge and don’t pose an actual danger to society.

Taxation

&

Local Revenue Sharing

Taxation – Traditional Retail

- A two-tier tax system would give the state more flexibility in combatting the parallel illegal market and managing demand.
- 10% Retail Sales Tax
- 25% Wholesale Tax (roughly equivalent to 15% sales tax)
  - Unlike sales tax, wholesale taxes are included in the stated retail price.
    - Once illegal market is weakened, higher wholesale taxes can be used to moderate use, more effectively than sales tax.
  - Mechanism for market responsiveness if high rates are driving consumers to illegal dealers:
    - Empower regulator to adjust rate within a statutory "band" (e.g., 10-25%).
    - In CO, tax department applies a statutorily-fixed rate to an adjusted market-average price every 6 months to calculate an effective per-pound wholesale tax.
  - Tax average market price for below-market sales to affiliates
- Tax "floor" ($/oz) to protect against sharp price drops

Taxation – Alternative Distribution Models

- Co-Ops: retail tax model doesn't translate
- Transfer tax at harvest
  - $50 per ounce would be equivalent to ~15% sales tax
- Some co-op members may not want entire share of harvest:
  - Excess could be sold to licensed wholesalers, retailers, or medical dispensaries
    - Impose wholesale tax on those sales
  - Retail tax on sales to non-members, if separately licensed

Municipal Costs and Benefits

- Cities and towns will bear some of the burden, and so rightfully should receive some of the revenues.

- Municipalities should have power to ban retail establishments.

- Giving municipalities incentives to participate will help ensure geographic dispersion.

- Two ways to give municipalities their fair share:
  - Revenue Sharing
    - CO gives towns 15% of sales tax collections, distributed based on each town's share of state-wide sales.
    - If a town decides to bar all cannabis businesses, that town should not receive benefits.
  - Local Option Tax
    - An additional local sales tax of up to 2.5% should not materially impact goal of driving out the illegal market.
    - Can be separate from "regular" local option tax

Thank You!

Dave Silberman is a corporate attorney in Middlebury, with 15 years' experience advising founders, executives and financiers of private and public companies in a wide range of industries, including medical devices, financial services, pharmaceuticals, education and logistics, at every stage of corporate existence, from formation to sale. Mr. Silberman earned a B.A., *cum laude*, in Economics from Rutgers University in 1998, and a J.D., *cum laude*, from the Columbia University School of Law in 2001, where he was a John M. Olin Law and Economics Fellow and a Harlan Fiske Stone Scholar. This presentation is provided in Mr. Silberman's personal capacity, and not as a representative of any client.