

Making Sense of New York's Revised Proposed Recreational Cannabis Regulations

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By Alex Malyshev. Published in the *New York Law Journal*

More than two years ago, New York passed the Marijuana Regulation and Taxation Act (MRTA) to much fanfare. The rocky rollout of the program by the New York Office of Cannabis Management (OCM), including the challenges to its conditional adult-use retail dispensary (CAURD) program, and the complaints being voiced by cultivators (who are sitting on thousands of pounds of cannabis they cannot legally sell because only a handful of dispensaries have opened so far), received a lot of press over the last year.

The CUARD program is the centerpiece of the "Seeding Opportunity Initiative," which was meant to allow those individuals impacted by the war on drugs to be the first to open recreational dispensaries in New York. It came under fire from existing medical operators, culminating in a lawsuit filed by the Coalition for Access to Regulated & Safe Cannabis (CARSC) accusing the regulator of exceeding its authority in creating the CUARD program, and allowing the illicit market to take root during the past two years and, from the point of view of the medical operators, improperly preventing them from entering the recreational market. In a preview of its revised regulations, the OCM has attempted to address some of these concerns.

Medical Operators

As previously covered, one of the CARSC plaintiffs' chief complaints in their March 16 lawsuit, were that the CUARD program improperly delayed their entry into the recreational cannabis space, and the regulator was generally hostile to them. Although it is an open question whether the apparent requirement of Article 4 of the MRTA (applicable to adult-use cannabis) that applications be open to all eligible applicants at the same time truly covered the medical operations (who are licensed under Article 3 of the MRTA), the proposed regulations provide a timeline for them entering the market as early as this year. Unsurprisingly this drew rebukes from those representing CUARD licenses, who fear that the much better capitalized medical operators would be too hard to compete against for these nascent operators.

The MRTA allows registered organizations (RODs), as the state's 10 medical operators are known, to operate up to eight medical dispensaries each. With respect to adult-use cannabis, the MRTA envisions them being able to co-locate up to three of those dispensaries for both medical and adult-use sales, with the first dispensary being opened after Dec, 29, and the second and third stores after June 29, 2024. For this privilege, the registered organizations will be required to pay up to \$20 million in fees that are meant to support New York's Social & Economic Equity plan. See Section 120.4(b)(11) (ROD licensing fees) ("A ROD licensee shall pay a license fee of \$175,000 in addition to the fee associated with a Tier 5 adult-use cultivation canopy as set forth in paragraph (2) of subdivision (b) of this section, as well as a one-time special licensing fee of \$20 million."). The "special" fee is based on a schedule that makes \$5 million due at the time of the license for the first dispensary being granted, and another \$5 million within 180 days of the second location being co-located. As one would expect, representatives of these registered organizations have called the fees excessive.

Formalizing New York's Move to a Two-Tier System and Tweaking True Party in Interest Regulations

When originally passed, it was expected that the MRTA would usher in a three-tier system to adult-use cannabis, where cultivation, processing/distribution, and retail, would be separated (much like the alcohol model). This is in contrast to vertically integrated model that prevailed in the medical cannabis space. However, as regulations have evolved, it has become clear that the OCM really views adult-use cannabis as a two-tier industry: supply-side (consisting of cultivation, processing, distribution, and certain other limited licenses), and retail (comprised dispensaries and lounges). This was first reflected in the conditional licenses granted for the CUARD program, where cultivators were allowed to conduct some limited processing, and would be allowed to apply for additional processing licenses in the future.

This concept also flows into New York's proposed regulation of "true parties of interest" (or TPIs) —investors over a certain threshold who receive the economic benefits of the license holder— which are subject to these cross-ownership restrictions even if one of the businesses in which they invest is in another state. Specifically, under the proposed regulations, a TPI is an individual who has an arrangement under which they would receive the greater of 10% of gross revenues, 50% of net revenues, or \$250,000.00, from a license holder. See Section 118.1(a)(105) (true party of interest). The threshold was increased from \$100,000.00 to \$250,000.00 after the comment period on the regulations. Under the proposed regulations TPIs would be precluded from holding an interest in a New York dispensary if they had an interest in a supply-side business in another state.

Tweaking Licensing

The proposed rules include some other tweaks to licenses, meant to deal with some of the tough economics and logistics of the nascent industry. The first of these is the establishment of "application periods" (as opposed to the previous system of rolling applications). See Section 120.1(b),

Second is the concept of a "provisional" license, which would be a form of pre-approval for those licensees who have not secured space for their locations (but have otherwise satisfied all of the conditions precedent for getting a license). See Section 120.2(b). Although provisional licenses don't allow one to operate a cannabis business, they create a twelve month window during which a location can be secured, resulting in final approval. See Section 120.9(c). This is meant to solve the "chicken or the egg" problem for licensees who don't happen to own eligible (and desirable) real estate and so would otherwise be unable to satisfy the MRTA's requirement that an applicant have a site secured for the duration of the license period. This is a very expensive proposition at the pre-investment phase (as an applicant is unlikely to attract investors prior to receiving regulatory approval in a competitive market). This is analogous to the model OCM adopted as part of the CUARD program, where the requirement to have a site secured at the time of application was eliminated.

The proposed regulations also create the concept of a "limited retail consumption facility," which is distinct from "on-site consumption" lounges (e.g., the cannabis equivalents of bars). See Section 118.1(60) (limited retail); 123.9(e). This would allow retail locations to set aside an area where cannabis can be consumed. These areas cannot be used to consume cannabis that is rolled, packed, or otherwise prepared by retail staff, and cannot have a separate entry fee. It is conceivable that this concept (much like the CUARD license) will be challenged by competitors operating consumption lounges or neighbors in court, as the MRTA makes clear that the holders of retail licenses (e.g., dispensary) cannot hold an on-site consumption (e.g., lounge) license.

Conclusion

The proposed regulations remain a work in progress, but it is apparent that OCM has listened to the input it received for its original proposed rules. Even though such changes will clearly not make everyone happy, it appears that New York is finally inching its way towards a wider adult-use industry.

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