Washington State
Liquor and Cannabis Board

Notice of Permanent Rules

Regarding WAC 314-55-035 – What persons or entities have to qualify for a Marijuana license? (Retitled "Qualifying for a marijuana license")

This concise explanatory statement concerns the Washington State Liquor and Cannabis Board's (WSLCB) adoption of amendments to existing rules regarding WAC 314-55-035 – What persons or entities have to qualify for a marijuana license? (Retitled "Qualifying for a marijuana license")

The Administrative Procedure Act (RCW 34.05.325(6)) requires agencies to complete a concise explanatory statement before filing adopted rules with the Office of the Code Reviser. The concise explanatory statement must be provided to any person upon request, or from whom the WSLCB received comment.

The WSLCB appreciates and encourages your involvement in the rule making process. If you have questions, please contact Kathy Hoffman, Policy and Rules Manager, at (360) 664-1622 or e-mail at rules@lcb.wa.gov.

Background and reasons for adopting these rules

In August 2018, LCB filed a robust CR102 consisting of omnibus rule changes to implement 2017 legislation. Revisions to WAC 314-55-035 were included in the proposal. At the public hearing on October 3, 2018, multiple stakeholders offered feedback, requesting additional, significant revisions to WAC 314-55-035. When the final rule package was presented to the Board in November, 2018, staff excluded WAC 314-55-035 from the adopted rules to allow for additional content development and stakeholder engagement.

In January of 2019, Engrossed Substitute House Bill (ESHB) 1794 was introduced that proposed amendments to RCW 69.50.395 concerning agreements between licensed marijuana businesses and other people and businesses, including royalty and licensing agreements relating to the use of intellectual property. Since there was potential for the substance of the bill to influence revisions being considered regarding WAC 314-55-035, the project was temporarily paused until the end of the legislative session. The bill was approved by the Governor on May 13, 2019, and became effective on July 28, 2019.

The adopted rules are needed to accomplish the following:

- Modernize the section title, redesigns and reorganizes the section structure;

- Modernize language regarding which entities are considered to be true parties of interest;
- Remove the spousal vetting requirement;
- Expand definitions to include, “control,” “financial institution,” “gross profit,” “net profit,” and “revenue;”
- Clarify and expand upon what persons or entities are not considered to be true party(ies) of interest;
- Describe the circumstances under which licensees must continue to disclose funds that will be invested in a licensed marijuana business;
- Incorporate by reference amendments to RCW 69.50.395 regarding disclosure agreements and intellectual property; and
- Establish a new subsection to distinguish the requirements for financiers from that of true party(ies) of interest.

These adopted rule amendments, in addition to adopted modernizing clarifying revisions, support the overarching agency goal of ensuring the highest level of public safety by continually improving regulations in an effort to reflect the current, dynamic regulatory environment.

Rulemaking history for this adopted rule:

CR-101 – filed October 31, 2018 as WSR #18-22-054;
CR 102 – filed June 24, 2020 as WSR #20-14-032.
Public hearing held August 5, 2020.

Public comment received on the rule proposal

The following comments were received as indicated below, and are presented in their native form, including formatting, text and spelling. A response to each comment is provided, along with an indication regarding whether the comment was reflected in the adopted rule.

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1. ***Email received July 20, 2020:***

From John Kingsbury:

“I wish to comment on the rules proposal for true parties of interest. I am working off this copy that is in on the Cannabis Observer drive. I hope it is up to date.

Admittedly, beyond being a citizen who wants my state to work well, I am not a stakeholder in the conventional sense of the term. Like many qualifying cannabis patients, I have

more or less given up on, and dropped out of, the regulated system. Still, I think it is appropriate to qualify why I have an interest and why I am addressing these proposed rules changes.

For a few months, I have been collaborating on researching and writing a true party of interest violation complaint. This project has been slow because it is complicated, has required much research, crosses state lines, might be viewed in terms of law enforcement interest, and honestly is often superceded by more urgent projects. I am sure you can relate to all of that.

My point is that, when I read this rulemaking proposal, I am impressed that it seems to get directly at some of the concerns brought up by the project I am working on. Of note would be addressing the rule that married couples may only hold three or five licenses. Thank you for that.

Investigating landlords. I was very impressed by this provision "if there is a common ownership interest between the applicant or licensee, and the entity that owns the real property, the board may investigate all funds associated with the landlord to determine if a financier relationship exists. The board may also investigate a landlord in situations where a rental payment has been waived or confirmed ."

I guess what I am saying here is "Nice job! "

LCB recourse beyond state boundaries. The project I am working on crosses state lines, as you could predict, and international lines. Those concerns may exceed LCB authority. As you can imagine, I am learning about all sorts of stock offernig rules that I never cared to learn about. But if this rulemaking is about true-parties of interest, and undue influence, and what those entities look like, I hope this rule making will anticipate as much as possible what LCB enforcement of true-party of interest violations look like when they step outside of Washington State boundaries.

Influence by non-true parties of interest. I would also suggest that the term "control" be looked at in terms of "influence". To provide an example of how that works in another context that I know about first hand. A developer in Bellevue, who already owned several other properties in Bellevue, wanted to construct a new project. When that developer applied for financing to build that new project from a bank that had no interest in the other developer's properties, one requirement for obtaining financing for the new project from the new bank was that the new bank could control the rents in the developer's other properties even though the bank had no interest in them.

I feel it is to the point to ask the question: If a party owns the real estate that a licensee sits on, as well as the branding that licensee puts on its packages and markets itself as, can that party really not be a true party interest? In a real sense, that is like saying that McDonalds is not a true party of interest in any of its franchises. That branding and real estate owner

does in fact have a strangle hold on that licensee.

Thank you for the opportunity to comment.

WSLCB response: The WSLCB appreciates this comment, and the demonstration of meaningful, collaborative participation in the rulemaking process. The WSLCB looks forward to your continued partnership on future policy and rule development projects.

Was the comment reflected in the adopted rule? This comment was not reflected in the final rule.

2. ***Email received August 5, 2020:***

From Ezra Eickmeyer:

My association, Producers Northwest, has some significant concerns about the CR 102 regarding TPI rules. As written, we believe that it will lead to significantly more TPI investigations. This would mean more workload for LCB and more compliance costs for businesses. Also, I always like to ask a few key questions about any rule or law – What is the public policy need? What good is this doing for our state?

Our main concerns are listed below. We do not believe this rule change should be implemented as-is and may require a re-submission of the CR102.

Definition of control –

By defining "control" as broadly targeting anyone who can direct company policy, but then leaving employees out of the list of exemptions, it appears that the agency would begin TPI investigations into employees in our businesses. This is not workable for us and provides zero public benefit.

Also, "policy" could mean anything from the daily schedule for watering plants to safety protocols, decisions made up and down the organization chart for each company in unique ways. If this is implemented as-is, licensees would not have clear instruction into what employees they would have to disclose to LCB for vetting. Also, what would the policy be regarding whether a licensee has to wait for the completion of a TPI investigation before hiring a new manager? **Unless this is fixed and clarified, the draft rule change is simply not functional.**

Financiers – US Resident Restriction

While this is less critical than our concern listed above, we do not believe it is important to limit financiers to US residents only. Instead, the focus should be on ensuring that LCB can fully acquire the information it needs for its vetting of financiers regardless of their country of residence.

Note: Mr. Eickmeyer also provided oral testimony reiterating this written comment at the public hearing.

WSLCB response: The WSLCB appreciates this comment, and the demonstration of meaningful, collaborative participation in the rulemaking process. The WSLCB looks forward to your continued partnership on future policy and rule development projects.

With respect to the definition of control: The benefit of a rule must justify its burden. Here, after many months of exhaustive discussion with industry members and their representatives, the WSLCB opted for a less prescriptive definition to plainly, and broadly describe "control" in this context. This definition closely aligns with other states, and in alignment with industry members, WSLCB prefers to encourage

disclosure rather than imposing prescriptive regulations that limit, rather than encourage, compliance. An overly prescriptive definition of "control" may result in a variety of unintended consequences, including but not limited to disproportionate impact on the smallest marijuana businesses, and result in suboptimal outcomes when applied to this specific industry that continues to rapidly evolve. Prescriptive regulations do not support the goals and objectives of chapter 69.50 RCW, and instead may impose special interest solutions on all that benefit a limited number of licensees.

With respect to financiers: Out of state investment *is* allowed in Washington State, However, out of state *ownership* is not allowed consistent with RCW 69.50.331. The suggested revision would require a legislative action, as opposed to a regulatory amendment.

Was the comment reflected in the adopted rule? These comments were not reflected in the final rule.

3. Email received August 5, 2020:

From Lukas Hunter:

I appreciate the opportunity to discuss my concern with the current TPI proposed rules.

In looking at this section of rule I think about feasibility of recognizing true parties of interest as defined in this section. Business continue to grow and change very dynamically, much faster than the change request process can accommodate, and far faster than adding a true party of interest to a license can take. I worry with this current definition of control and the requirement to disclose all those who meet the proposed definition of control. We will be creating a bottleneck in licensing, and further a bottleneck in the ability for businesses to grow and adapt to this ever-changing landscape. At this time, I am urging for further exceptions to allow for non-shareholding members or employees of a licensee, to be exempt of being a true party of interest.

From visiting a vast number of licensees across the state, I believe these rules do not allow for business owners to delegate necessary day to day tasks to mid-level managers and senior staff constituting them as a true party of interest. This limits licensees who are growing and cannot afford to keep their thumb on day to day operational issues that can be handled by proven staff members. This becomes another prohibitive issue putting another barrier on Washington cannabis making it less attractive than others in the country, this is not acceptable as we move towards a future of open interstate commerce.

I also look at this definition of control equating to a vetted true party of interest, and think about the tax on the WSLCB to investigate each and every one of these new true parties of interest. With this proposed language the industry will be looking to add mid-level managers and senior staff to the license as a true party of interest. Not as a shareholder, but as a true party of interest to assure they are not in violation of this chapter. I currently am not aware of a mechanism within the WSLCB to accomplish this. I am familiar with a mechanism for liquor licensing to allow non-entity members to be a true party of interest on a license, but for marijuana a new form of licensure will need to take place, along with a tsunami sized wave of change requests that will hit the WSLCB's door step. This wave of new licensing cases will additionally be met with a WSLCB budget cut of 15% as discussed in yesterday's Caucus meeting. I fear this perfect storm will further result in delays in the licensing process, and further making it prohibitive for owners to delegate day to day operational tasks and further prohibiting owners to explore entrepreneurial opportunities.

In an effort to mitigate this workload and expense, the industry is not ready to face along with what I predict is a workload the WSLCB is not ready to face. Along with the ebb and flow of employees coming and going from a licensed facility who's position duties meet the proposed definition of control, I would encourage the WSLCB to consider changing their criteria of control to something along the lines of, "executive level decision making" focusing on decisions that change the course of where a company is going, and eliminating day to day operational decisions that is covered in the current definition, "independently order or direct the management, managers, or policies of a licensed business".

Note: Mr. Hunter also provided oral testimony reiterating this written comment at the public hearing.

WSLCB response: The WSLCB appreciates this comment, and the demonstration of meaningful, collaborative participation in the rulemaking process. The WSLCB looks forward to your continued partnership on future policy and rule development projects.

With respect to the definition of control: The benefit of a rule must justify its burden. Here, after many months of exhaustive discussion with industry members and their representatives, the WSLCB opted for a less prescriptive definition to plainly, and broadly describe "control" in this context. This definition closely aligns with other states, and in alignment with industry members, WSLCB prefers to encourage disclosure rather than imposing prescriptive regulations that limit, rather than encourage, compliance. An overly prescriptive definition of "control" may result in a variety of unintended consequences, including but not limited to disproportionate impact on the smallest marijuana businesses, and result in suboptimal outcomes when applied to this specific industry that continues to rapidly evolve. Prescriptive regulations do not support the goals and objectives of chapter 69.50 RCW, and instead impose special interest solutions on all that benefit a limited number of licensees.

Was the comment reflected in the adopted rule? These comments were not reflected in the final rule.

4. ***Email received August 5, 2020:***

From Washington CannaBusiness Association:

The Washington CannaBusiness Association (WACA) represents Washington's licensed and regulated cannabis and hemp businesses. As the oldest trade association for cannabis and hemp businesses in the state we are committed to establishing a safe, fully-regulated system that keeps cannabis out of the hands of children. We value our collaborative relationship with the WSLCB and appreciate the opportunity to work together and to provide feedback on the CR-102 WAC 314-55-035 - what persons or entities have to qualify for a marijuana license. We worked with our membership to discuss and develop input on the conceptual draft for your consideration. Our feedback is in the spirit of modernizing Washington's rules in alignment with a rapidly evolving industry, shaped by increasing acceptance and public understanding of legal, regulated cannabis.

Section 1 - True Parties of Interest
WACA recommends restoring the row in this chart to account for ownership structures that include publicly held corporations. The entity listed should be publicly held corporations and the corresponding TPI should be, "All corporate officers and directors (or persons with equivalent title) and shareholders holding more than ten percent." RCW 69.50.339 is explicit that, in the case of shareholders, only the proposed sale of more than 10 percent of the outstanding or issued stock of a corporation must be reported to the WSLCB.

While our state is one of the first to enter regulated adult use cannabis, updated rules should account for various ownership structures to allow Washington to be competitive with expanding markets across the globe. As with other industries in Washington State, publicly held corporations should be allowed to have an ownership interest in cannabis companies. Furthermore, background checks, vetting and the listing of *each* shareholder of a publicly held corporation as a TPI creates an unwieldy and unwarranted procedural burden representing resources that would be more impactful in other areas. WACA also recommends removing the row with "multilevel ownership structures" as this would be captured by the other entities listed in the chart and is therefore unnecessary and repetitive.

Section 2
WACA recommends striking the first line of this section. Although we recognize the intent, there are already rules in place to address concerns regarding married couples exercising control over more licenses than they are allowed to hold as individuals, including the new definition of "control" included in this ruleset. Because no single person could own more than the legal limit of licenses and would not be able to exercise undue influence or control over their spouse's licenses under existing rules, this section is unnecessary. Enforcement mechanisms already exist to regulate such activity without restricting the opportunities of married persons over non-married persons. Again, in an effort to normalize business practices we recommend striking the first line of this section. If the recommendation to strike the first line of this section is declined, we suggest replacing the language

“five retail licenses” and “three producer processor licenses” with a more general reference to the legal ownership limits set by rule and statute. This would account for any future statutory or regulatory changes to the current ownership limits and would limit necessary revisions in the event of a rule change.

Section 4(a) - TPI does not include
The language in Section 4(a) seems out of place. While we agree with clarifying that a landlord or a person receiving payment for a rent is not a TPI, the language goes much further. WACA recommends going back to the original language in 035 that simply states a person receiving payments for rent is not a TPI unless that person exercises control over the business. Licensees already struggle to find rental agreements due to zoning restrictions and liability concerns, this extra level of scrutiny is unnecessary as there are already rules that would allow the WSLCB to intervene should the landlord exert “control” over the business. Finally, the last line of this section related to waived rent should be removed considering all of the recent changes to rental agreements in light of COVID-19.

Section 5(a) - Notifications
WACA recommends adding a subsection in Section 5(a) to clarify that reimbursement of incidental expenses incurred by an employee, owner, or manager within the scope of their duties does not require disclosure.

Section 6(b) - Disclosure agreements and IP
WACA recommends striking Section 6(b) that prohibits producer or processors from entering into an intellectual property agreement with a retailer. While we understand the apprehension related to undue influence and protecting a vertically integrated system, there is already rule language in WAC 314-55-018 that addresses these types of concerns.

WSLCB response: The WSLCB appreciates these comments, and the demonstration of meaningful, collaborative participation in the rulemaking process. The WSLCB looks forward to your continued partnership on future policy and rule development projects.

With respect to Section 1 (adopted WAC 314-55-035(1)): WSLCB removed “All corporate officers and directors (or persons with equivalent title) and shareholders holding more than ten percent” from the table to concentrate the meaning of “true party of interest” on the function, as opposed to the title, or an entity or entities. Removing this specific designation allows the agency to consider position equivalency or legal function rather than concentrating solely on title.

With respect to Section 2 (adopted WAC 314-55-035(2)): The sentence structure was designed to provide clear guidance, and promote consistent rule application regarding the number of licenses and license types in which a married couple are considered true parties of interest. WSLCB finds that removing the first sentence of this section would not support either of these design purposes.

With respect to Section 4(a) (adopted WAC 314-55-035(4)(a)): This specific subsection was added at the request of licensees and industry representatives during the course of the protracted process that resulted in the adopted rules. The subsection was designed to provide clear guidance, and promote consistent rule application regarding who is not considered to be a true party of interest. WSLCB finds that removing this subsection would not support either of these design purposes. As noted in the introduction to the subsection, the list is not exhaustive, allowing the agency some flexibility to adjust as needed in response to rental agreement adjustments or changes that may be related to COVID-19.

With respect to Section 5(a) (adopted WAC 314-55-035(5)(a)): WSCLB does not agree that adding additional specificity, particularly related to “incidental” expenses

when “incidental” is undefined. WSLCB does not currently investigate reimbursement for nominal expenses. Adding an additional sentence will not modify current practice.

With respect to Section 6(b) (adopted WAC 314-55-035(6)(b)): This specific sentence was added at the request of licensees and industry representatives during the course of the protracted process that resulted in the adopted rules, and reflects the intent of ESHB 1794, now codified as RCW 69.50.395. WSLCB does not agree that WAC 314-55-018 fully addresses these concerns.

Was the comment reflected in the adopted rule? These comments were not reflected in the final rule.

5. ***Email received August 5, 2020:***

From Jerry Derevyanny:

“I write on behalf of 7Point Holdings, LLC, a Tier 3 producer/processor (#424481), of which I am the owner, regarding WSR #20-14-032. Specifically, I write regarding my concerns that the proposed rules: (1) continue to impermissibly discriminate against out-of-state owners; (2) further disadvantage Washington cannabis business owners by not allowing public company ownership as evidenced by the removal of public company from the table in draft WAC 314-55-035(1); and (3) needlessly hamstring Washington cannabis businesses.

Discriminating Against Out of State Ownership is Impermissible
For numerous reasons, Washington’s ban on out of state ownership is impermissible. Not least of these reasons is that the United States Supreme Court recently rejected a residency requirement as it related to liquor stores last year in *Tennessee Wine and Spirits Retails Association v. Thomas*. Due to the 21st Amendment, states' powers to regulate commercial goods are at their zenith in the alcohol market– if states cannot discriminate when it comes to liquor, they surely cannot when it comes to cannabis. That cannabis is federally illegal is unimportant in this analysis.

Indeed, when Maine’s cannabis residency requirements were recently challenged, the state declined to “enforce or implement” residency requirements in the future because they were “subject to significant constitutional challenges and [were] not likely to withstand such challenges,” and Maine’s cannabis regulator announced that it intended to affirmatively propose the legislative repeal of the residency requirements in light of their constitutional defects in Maine’s next legislative session. (Source: Maine Office of Marijuana Policy press release, dated May 11, 2020, available at: https://www.maine.gov/dafs/omp/news-events/news/aump-lawsuit-residency-requirement).

The LCB should follow Maine’s lead, or at a minimum prepare for the likely day when Washington’s residency requirement is also invalidated by drafting rules which tell people what the ownership rules *would be* if the residency requirements were overturned. Those “backup” rules should be modeled on modern alcohol TPI rules, which the LCB has implemented regularly for years.

Not Allowing Public Company Ownership Hurts Washington Businesses and Benefits No One
The proposed rules leave no place for public companies in Washington's cannabis industry, which needlessly excludes a large segment of commercial actors from the market. To the extent public companies could pose a concern to the LCB, the LCB's vetting and approval process will expose those concerns. But individuals who do not hold enough shares to influence a public company pose no threat to the public. The LCB should include in TPI rules a reasonable framework for public company ownership, such as the vetting of members of the board, corporate officers, and any shareholders who rules. Public company ownership should be on equal footing with other forms of ownership.

Public company ownership has certain significant advantages: (1) significantly more transparency than private companies so shareholders, concerned citizens, public policy experts, etc., have access to significantly more financial and business information; (2) they are subject to regulation and oversight by other significant regulators (e.g., the SEC, the particular exchange they are traded one, etc.) behavior; and (3) while imperfect, the corporate governance system allows the public to petition the company on critical issues such as diversity, environmental issues, and the like, in a way that is just not possible with private entities.”

WSLCB response: The WSLCB appreciates this comment, and the demonstration of meaningful, collaborative participation in the rulemaking process. The WSLCB looks forward to your continued partnership on future policy and rule development projects.

With respect to out of state ownership and “Public Company Ownership”: Out of state is statutorily prohibited consistent with RCW 69.50.331. The suggested revision would require a legislative action, as opposed to a regulatory amendment.

Was the comment reflected in the adopted rule? This comment was not reflected in the final rule.

Public Hearing, August 5, 2020:

Two attendees provided comment regarding the rule proposal as noted above.

Changes from Proposed Rules (CR-102) to the Rules as Adopted:

There were no changes to the proposed rules.