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FROM THE DESK OF:
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PARTNER

January 15, 2018

Members of the Nevada Tax Commission
c/o Mr. James Devolld
Chairperson, Nevada Tax Commission
1550 College Parkway, Ste. 115
Via Hand Delivery
Via Email: jdevolld@tax.state.nv.us
jim.devolld@lpins.net
Via Facsimile: 702-486-2373
Via Facsimile: 775-684-2020

Re: Opposition to Certain Provisions of LCB File No. R092-17
Our Client: For Fairness in the Cannabis Industry, LLC
Our File No.: 2118-001

Dear Mr. Devolld and Members of the Nevada Tax Commission,

Our firm represents For Fairness in the Cannabis Industry, LLC ("FFCI"), a group of cannabis industry business owners (and other interested parties) who want to make certain the issuance of new retail licenses is fair, impartial and transparent. For the reasons set forth in this letter, FFCI urges the Nevada Tax Commission/Department of Taxation (the "Department") to further revise LCB File No. R092-17 (the "Proposed Regulation"), before implementing the same.

I. THE PROPOSED REGULATION IS NOT IMPARTIAL.

By way of Ballot Question 2 in the 2016 election, Nevada voters directed the Department to utilize "an impartial and numerically scored competitive bidding process" to determine which applicants would be issued a license. However, Sections 76 to 80 of the Proposed Regulation do not employ an impartial process. Instead, for the reasons discussed below, the Proposed Regulation exhibits a significant bias in favor of existing retail licensees, to the detriment of other marijuana establishments (i.e., cultivation and production licensees).

A. Amount of Taxes Paid Unfairly Disadvantages Cultivation and Production Licensees.

Subsection 12 of Section 78 of the Proposed Regulation requires, as part of the application process, that an applicant for a marijuana establishment license submit, "[e]vidence of the amount of taxes paid or other beneficial financial contributions made, to this State or its political subdivisions within the last 5 years by the applicant or the person who are proposed to be owners, officers or board members of the proposed marijuana establishment." This requirement is repeated in Section 80(1)(f), and the Department is required to use this criterion (and others) to "rank the applications."

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When licenses for marijuana establishments were initially issued, it made sense to consider “the taxes paid or other beneficial financial contributions” of owners, officers and board members of the marijuana establishments, because there was no historical data to draw from. However, given the growth in the marijuana industry in Nevada and the taxes already paid by existing license holders, considering the “taxes...or other beneficial contributions” of “owners, officers or board members” only serves to reward the applicants with the wealthiest owners, officers or board members.

Instead, the Proposed Regulation (especially Section 78, which grants a preference for existing marijuana establishments) should only look to the taxes and other beneficial contributions made in the name of the **APPLICANT** for licensure, and not the owners, officers and/or board members of such entities.

In addition to the preference given to those “owners, officers or board members” who make substantial beneficial contributions and/or pay higher taxes, the Proposed Regulation is partial to retail marijuana establishments, to the detriment of other marijuana establishments. By way of an illustrative example, if a cultivator or production licensee sell \$100 of marijuana/marijuana product to a retail licensee, the cultivation/production licensee will pay an excise tax of \$15. As a conservative estimate, the retail licensee would likely sell that same marijuana/marijuana product for ~\$200. Accordingly, the retail licensee would pay an excise tax of \$20, plus sales tax of \$16.20 (at the current rate of 8.1%). Stated differently, a cultivation or production licensee will pay a total of \$15 of taxes on wholesale sales, while a retail licensee will pay a total of \$36.20 for the very same product. Given this structure (wholesale vs. retail) and how and when taxes are collected and paid, a cultivation or production licensee can never compete with the holder of a current retail license with respect to the amount of taxes paid.

Because of this inequity, we believe the Proposed Regulation should be crafted to consider, not just financial contributions to the State of Nevada and its political subdivisions, but also the amount of capital that an applicant has invested in its operations to stimulate Nevada’s economy. As the Department is certainly aware, the costs to construct and operate a retail establishment pale in comparison the costs to construct and operate a compliant cultivation or production facility.¹

FFCI is hopeful the Department will follow the charge of Nevada voters and employ a fair, impartial and transparent process for the allocation of new retail licenses, rather than simply empower current retailers to further control the market (discussed *infra*).

¹ Members of FFCI have collectively invested millions of dollars to construct and operate their cultivation/production facilities.

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B. The Proposed Regulation Considers Only Experience in the “Type” of Marijuana License Sought, Not Experience with Other Types of Marijuana Establishments.

Section 80(1)(h) of the Proposed Regulation demonstrates a bias in favor of current retail license holders. In ranking applicants, this Section permits the Department to consider, among other things, “[t]he experience of key personnel that the applicant intends to employ in operating the type of marijuana establishment for which the applicant seeks a license.” In other words, if a cultivation or production licensee is applying for a retail license, the Department will disregard the applicant’s experience in Nevada in operating compliant production or cultivation facilities because such experience is not germane to the operation of a retail marijuana establishment. This blatant bias in favor of retail licensees does not comport with the charge of Nevada voters – to employ a fair, impartial and transparent method to issue new licenses.

Rather than limiting this criterion to the “type of marijuana establishment,” the Department should consider “the experience of key personnel ...in operating any marijuana establishment in this State.” This minor revision will greatly balance the perceived bias in favor of current retail licensees, and authorize the Department to consider the merits of an applicant’s experience operating any type of marijuana establishment in Nevada, and not just retail dispensaries.

C. The Application Factors Should Be Weighted at the Time the Proposed Regulation is Adopted, Not Left to Arbitrary, Unfettered Criteria Presented at some Later Time.

Section 76(2) of the Proposed Regulation contemplates that “[w]hen the Department issues a request for applications pursuant to this section, the Department will include in the request the point values that will be allocated to each applicable portion of the application.” Additionally, throughout the Proposed Regulation, the Department is empowered to consider “any other criteria the Department determines to be relevant.” *See, e.g.*, Section 78(1)(l). As written, however, there is no indication of what “other criteria” the Department may consider, nor is there a limit on the weight the Department may give to such additional criteria.

While some latitude is certainly understandable and acceptable to consider relevant factors at the time a request for applications is issued, such discretion should not be unlimited. Instead, FFCI strongly urges the Department to revise the Proposed Regulation to indicate the minimum and maximum weights that will be considered in evaluation of the various criteria on an application. By way of example, the Proposed Regulation could be revised with language that a certain criterion (i.e., experience in the marijuana industry) would be weighted at least X percent (X%), but no more than Y percent (Y%). This clarification would considerably reduce the ambiguities in the Proposed Regulation.

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D. Recommended Changes.

As currently presented, the Proposed Regulation do not meet the charge of Nevada's voters, because they do not provide for the impartial evaluation of applications for licensure. By considering taxes and other financial contributions of an applicant (and a host of its owners, officers, directors, employees, etc.), the Proposed Regulation benefits existing retail license holders, and those well-heeled and well-connected individuals. To rectify this perceived impropriety, the Department should consider the taxes, contributions, and capital investments of the *applicant* only. Furthermore, an applicant for a retail license should not be penalized for possessing a cultivation or production license. Instead, the Department should employ a fairer criterion, specifically, an applicant's experience with ANY Nevada marijuana license (cultivation, production or retail), and not further grant a bias to existing retail licensees. Finally, the Department should indicate the relative weights of the various factors it will or may consider before the Proposed Regulation is adopted, not at some future time without the benefit of public comment and participation in the process. FFCI echoes the Nevada voters who approved Question 2, and calls upon the Department to utilize an impartial and fair process to allocate additional retail licenses.

II. THE PROPOSED REGULATION ENCOURAGES (RATHER THAN INHIBITS) MONOPOLISTIC PRACTICES.

While the Proposed Regulation marginally attempts to inhibit monopolistic practices, because many sections of the Proposed Regulation are vague and ambiguous we believe they will lead to and not prevent monopolistic practices.

A. *The Proposed Regulation is Vague and Ambiguous.*

Section 80(5) of the Proposed Regulation provides (with emphasis added):

To prevent monopolistic practices, the Department will ensure, in a county whose population is 100,000 or more, that the Department does not issue, to any person, group of persons or entity, the greater of

- (a) One license to operate a retail marijuana store; or
- (b) More than 10 percent of the licenses for retail marijuana stores allocable in the county.

While FFCI believes the objective of this provision is noble, the language of subpart (b), as presented, is problematic. Will the Department limit a current retail license holder to 10 percent of the OVERALL number of retail marijuana stores in a given county, or 10 percent of the then-available retail marijuana store licenses?

FFCI encourages the Department to clarify this language so that the cannabis industry and Nevada citizens have a better understanding of how the Department intends to enforce its mandate to prevent monopolistic practices regarding marijuana establishments.

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B. The Proposed Regulation does not Address Inconsistent Vertical Integration, which Threatens the Market.

One of FFCI's primary concerns is that the Proposed Regulation encourages (rather than deters) monopolization of sales channels in the marijuana industry. With very few exceptions, substantially all retail license holders also own and operate cultivation facilities. Because the initial costs to build a storefront dispensary are substantially lower than the cost to build a compliant cultivation or production facility, most retail license holders constructed their dispensaries, and began purchasing marijuana products wholesale from other cultivation and production licensees.

However, as many of these retail establishments realized profits, they have since constructed their own cultivation facilities and, in large part, have ceased buying marijuana products from unrelated marijuana establishments. This "vertical integration" means that retail license holders control the sales channels, and threaten to freeze out unrelated or unaffiliated cultivation and production license holders. Nothing in the Proposed Regulation checks the ability of such vertically integrated retail license holders from impairing other unrelated production/cultivation licensees from competing in the marketplace.

There are currently 88 active cultivation licenses statewide, and only 58 retail dispensary licenses. Such retail dispensary licenses are not distributed evenly. In fact, some licensees control as many as five of the currently issued retail dispensary licenses. The Proposed Regulation would allow this small syndicate of vertically integrated marijuana establishments to put more than 30 non-vertically integrated marijuana establishments at risk. Because there is no limit to the number of marijuana plants allowed with a cultivation license, vertically integrated operators will soon have no reason to make wholesale purchases from independent/unrelated cultivation or production licensees.

To combat the monopolization of the marijuana industry, most states with legal marijuana take substantial measures to prevent license holders from controlling all sales channels in ways detrimental to the overall market. By way of example, when an applicant in Arizona or Florida is issued a marijuana establishment license, such licensees are permitted to operate cultivation, production and dispensaries under one license. On the other end of the spectrum, Washington and Oregon licensed marijuana establishments can operate either a cultivation/production facility, or a dispensary, but (unlike Nevada) cannot operate both. Colorado takes a different approach, requiring vertically integrated dispensaries to purchase at least thirty percent (30%) of their inventory from a cultivator they do not own, operate or control.

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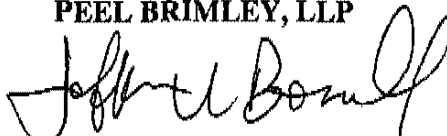
Nevada is the only known state that allows some licensees to be vertically integrated while others are not. The Proposed Regulation does not address the very real concerns of vertical integration and the consequences of such unchecked monopolization of the marijuana industry. FFCI respectfully requests that the Proposed Regulations be revised to address these concerns. FFCI proposes that all marijuana establishments in good standing be considered for at least one retail license, before existing retailers are allocated even more retail licenses.

III. Conclusion.

FFCI urges the Department to further revise the Proposed Regulation to comport with the charge given by Nevada voters. The Proposed Regulation should provide for the impartial evaluation and award of marijuana establishment licenses, and not simply rubber-stamp the application of current retail license holders. Should the Department proceed with these unfair and biased Proposed Regulations, it is highly likely that the current trend of vertical-integration will further consolidate the marijuana industry in Nevada to the detriment of the industry and Nevada's citizens. FFCI and its members stand ready and willing to work with the Department to revise the Proposed Regulation, to bring it into conformance with the scope and directives of Question 2, and to promote a fair and level playing field for marijuana establishments.

Should you have any questions, please do not hesitate to contact the undersigned.

Respectfully,
PEEL BRIMLEY, LLP



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