



**STATE OF NEVADA
DEPARTMENT OF TAXATION**

Web Site: <https://tax.nv.gov>

1550 College Parkway, Suite 115
Carson City, Nevada 89706-7937

Phone: (775) 684-2000 Fax: (775) 684-2020

RENO OFFICE
4800 Kietzke Lane
Building L, Suite 235
Reno, Nevada 89502
Phone: (775) 687-9999
Fax: (775) 688-1303

BRIAN SANDOVAL
Governor

JAMES DEVOLLD
Chair, Nevada Tax Commission

DEONNE E. CONTINE
Executive Director

LAS VEGAS OFFICE

Grant Sawyer Office Building, Suite 1300
555 E. Washington Avenue

Las Vegas, Nevada 89101

Phone: (702) 486-2300 Fax: (702) 486-2373

HENDERSON OFFICE

2550 Paseo Verde Parkway, Suite 180
Henderson, Nevada 89074

Phone: (702) 486-2300

Fax: (702) 486-3377

RETAIL MARIJUANA DISTRIBUTOR INSUFFICIENCY DETERMINATION

The Department of Taxation (“Department”) held a meeting on August 10, 2017, to accept information from the public necessary for the Department to determine whether issuing licenses under NRS 453D.210(3) only to licensed alcohol distributors will result in an insufficient number of marijuana distributors to service Nevada’s retail marijuana market. Based on the information gathered by the Department and the information presented during the meeting, the Department determined that limiting the marijuana distributor licenses exclusively to licensed alcohol distributors had resulted in an insufficient number of marijuana distributors and that the insufficiency would not be remedied by the applications currently pending with the Department. In order to ensure an adequate number of distributors for the retail marijuana market, the Department will accept applications from both licensed alcohol distributors and from other entities that have been transporting medical marijuana and will issue distributor licenses to those applicants who are in good standing with all applicable license requirements and who meet the criteria to operate as marijuana distributors.

PROCEDURAL BACKGROUND

Through initiative petition, Nevada legalized the sale and private use of marijuana by adults over the age of 21 (“retail marijuana”) beginning July 1, 2017. The provisions of the initiative petition were codified at NRS 453D. The initiative specifies that licensed distributors will transport retail marijuana between marijuana cultivation facilities, testing facilities, manufacturing facilities, and retail stores. NRS 453D.030(10). For the first 18 months after July 1, 2017, “the Department shall issue licenses for marijuana distributors pursuant to this chapter only to persons holding a wholesale dealer license

pursuant to chapter 369 of NRS, unless the Department determines that an insufficient number of marijuana distributors will result from this limitation.” NRS 453D.210(3).

Effective May 8, 2017, the Department adopted temporary regulations to govern the licensure of distributors during the first 18 months of retail marijuana sales. NRS 453D.200, LCB File No. T002-17 Section 14. The regulations specified that the Department would accept distributor applications from persons holding liquor wholesaler dealer licenses issued under NRS Chapter 369. And, in order to prepare for the contingency contemplated in NRS 453D.210(3) of an insufficient number of NRS Chapter 369 wholesaler licensee applicants, the Department also accepted applications from establishments that had been transporting medical marijuana. The Department could then ensure an adequate number of licensed retail marijuana distributors when retail sales began on July 1. The deadline for submission of those applications was May 31, 2017. LCB File No. T002-17 Section 15. After the May 31 deadline, the Department could then make the determination regarding the sufficiency of the number of licensees if the licensees were limited to NRS Chapter 369 wholesaler licensees.

The temporary regulation was challenged by the Independent Alcohol Distributors of Nevada (“IADON”), a non-profit corporation purportedly representing alcohol wholesalers, who asked a Nevada District Court to prevent the Department from issuing distributor licenses to anyone other than NRS Chapter 369 wholesaler licensees. On June 20, the Court ordered that the Department could not issue marijuana distributor licenses to other than NRS Chapter 369 wholesaler licensees until the Department made additional rules for the process to determine an insufficient number of marijuana distributors. In compliance with this order, the Department adopted an Emergency Regulation on July 13, 2017, that specified the criteria the Department would use to make the determination, the timeline for distribution of surveys to the industry and alcohol wholesalers, required that the determination would be made in a meeting that was noticed to the public, and provided that the decision would be appealable to the Nevada Tax Commission. The validity of the Emergency Regulation was established by order of the District Court on July 27, 2017.

INFORMATION FROM SURVEYS

In mid-July, the Department sent surveys to marijuana retailers, producers, and cultivators seeking information to help the Department determine the demand for retail marijuana and how well that demand was being met by the current number of retail marijuana distributors. 65 recipients initially responded and the Department received subsequent information from a majority of the 53 retail marijuana licensees. The retail establishments reported that they required at least 9 to 11 deliveries of products per week, relied on at least 7 to 9 suppliers for the products they stocked in their stores, and needed deliveries between 12 hours and 5 days after placing orders. On average, they expected their businesses to grow 35% in the next 6 months. The retailers provided comments that indicated that distribution provided at that time was slow in comparison to the demand for product at the stores and in comparison to the delivery of medical marijuana. One retailer indicated that conversations with liquor companies showed that those companies did not understand, and were not seeking to understand, the needs of the marijuana market. Specifically, the marijuana establishments need the product to be delivered frequently and sometimes on short notice. The alcohol distributors' business model is to charge penalties for those deliveries and would increase the cost of the product dramatically.

The Department also emailed surveys to 61 licensed liquor wholesalers seeking information on their current and future intent to provide retail marijuana distribution, their status of preparation for that endeavor, and their estimated capacity to provide distribution services to the retail marijuana industry. The Department sent the surveys to the email addresses the licensees had provided to the Department. The Department received responses from 17 licensed liquor wholesalers. Of those who responded, 4 are currently licensed as marijuana distributors, 3 have applications pending, 6 indicated they may submit applications in the future, 4 said they would not apply, 1 did not indicate intent either way. Two of the respondents licensed as marijuana distributors claimed to have a greater number of inspected vehicles than the Department had actually inspected. One of the pending applicants made a similar claim for more vehicles than it has allowed the Department to inspect.

INFORMATION FROM AUGUST 10, 2017, MEETING

On August 7, 2017, the Department properly issued notice that it would hold a meeting on August 10, 2017, to accept information from interested persons and entities to assist the Department in making a determination of whether issuing licenses under NRS 453D.210(3) only to licensed alcohol distributors will result in an insufficient number of marijuana distributors to service Nevada's retail marijuana market. Nearly 50 people attended the meeting in Las Vegas and a dozen attended in Carson City. There was no way to determine the number of people who attended by telephone.

As of the date of the meeting, only 9 applications have been received from licensed liquor wholesalers since the application became available in May 2017, 16 vehicles have been inspected by the Department, and 16 marijuana distributor agent cards have been issued (agent cards are required of all employees and contractors of a marijuana establishment). Of those distributor applications, some were licensed medical marijuana establishments that obtained their liquor wholesale dealer licenses solely to secure a retail marijuana distributor license. Six distributors are licensed, but only one is operating.

Department staff has been tracking and studying the retail marijuana market since this process began. Kile Porter, Economist for the Department, is knowledgeable with regard to the Colorado retail marijuana market and its tax structure. Colorado's data is relevant for predictions for Nevada's market because the tax structure is similar and both states started with medical marijuana industries before moving to retail marijuana. Mr. Porter presented economic analysis of Colorado's market which shows that tax revenues from retail marijuana sales in Colorado have increased 5% on average each month since 2014. He anticipates that the growth in Nevada may even outpace Colorado because Nevada's revenue from its tourist market is nearly twice that of Colorado's. Mr. Porter concluded that in order for Nevada's legal marijuana market to compete with and keep buyers from using the black market, those companies need to be able to compete both on price and on selection. When there is inadequate supply and variety, the prices of legal marijuana increase and licensed retailers do not have the products demanded by their customers. Both situations drive consumers to the black market.

Joe Brezny and Matt Griffin, both of whom were involved in drafting and sponsoring the initiative petition, offered testimony regarding how licensed alcohol distributors fit in the retail marijuana scheme. Early in the initiative process, they contacted the licensed alcohol distributors in order to make political friends who would help them get the initiative petition enacted. But the distributors were never intended to be a separate tier of the retail marijuana system and were not envisioned as independent third parties who served as checks on that system. The retail marijuana system was always intended to allow for vertical integration, and the inevitability that it would have self-distribution was written into the initiative. Testing laboratories serve as the independent third parties in the medical marijuana program and that structure was repeated in the initiative. The language in NRS 453D.210(3) was drafted to give the Department complete discretion to license people other than licensed alcohol distributors if the number of licensed alcohol distributors was insufficient to serve the market.

Blackbird, an agent of Crooked Wine, the only licensed marijuana distributor that is fully operational, began business in mid-2015 as a delivery and software solutions provider for medical marijuana establishments. It wanted to serve the same role in the retail marijuana market. In early July, Blackbird entered into an operating agreement with Crooked Wine, an alcohol distributor that obtained a marijuana distribution license. Currently, Blackbird has 30 employees, which is 5 times as many as they required for medical marijuana services. Blackbird owns 12 vehicles (10 inspected) and has purchased 10 more vehicles. Blackbird currently services 99 wholesalers and makes 100-150 deliveries each day. On behalf of Blackbird, Timothy Conder admitted that they are too busy to offer the level of service they would like to provide to their clients. Mr. Conder firmly stated that based on his work in the medical marijuana industry and his knowledge of the adult-use market today, a single distributor is insufficient and at least 5 more distributors of his size, with the ability to scale up rapidly, are required to support the industry at the level that it is performing and to accommodate predicted growth.

When the members of the public added their testimony to the record, only 4 licensed alcohol distributors spoke in favor keeping the retail marijuana licenses exclusive to the licensed alcohol

distributors. Those individuals spoke vaguely of the rapid process for putting the retail marijuana market into place and argued that the question of whether there were sufficient distributors was premature. They asked for more time and data gathering before that determination was made by the Department. One business, Focus Distribution LLC, which has not yet received its marijuana distributor license, announced a new alliance with a licensed alcohol distributor, Palidin LLC, for marijuana distribution starting the week of August 14. They promised 200-240 deliveries per day. However, as of the date of the meeting, Palidin had only had 1 truck inspected by the Department. Mr. Hagemeyer, attorney for Mighty Sun West, testified regarding the business of liquor distribution activities and of the capabilities of 3 other unnamed distributors he had spoken with. No specifics were provided regarding Mighty Sun West's preparation for distribution of retail marijuana. As of the date of the meeting, the Department had only inspected 1 truck for Mighty Sun West. Many marijuana retailers testified that they rely on Blackbird for product deliveries but none mentioned Palidin, Mighty Sun West, or Focus. The attorney for the IADON testified, but provided no additional information regarding the ability of liquor wholesalers to exclusively serve the marijuana retailers.

The remainder of the testimony, from approximately 25 people, was in favor of the proposition that the liquor wholesalers were an insufficient number of distributors to service the retail marijuana market. Those testifying were representing liquor wholesalers, cultivation, production, and retail store marijuana establishments. Some pointed out the inefficiency of having a third-party distribution system as compared to the medical marijuana system, while others expressed that they did not have an interest in maintaining a delivery fleet but needed access to a fair and timely delivery service. This testimony was consistent with the comments the Department had received in survey questions. They distinguished traditional alcohol distribution system from the point-to-point transportation required by the marijuana industry. They calculated that this difference doubled the transportation costs to marijuana enterprises. One retailer provided a copy of a fee proposal he has received from a licensed distributor for 17% of the retail price and another testified to a 10% fee.

There was agreement that the marijuana market was not performing to its full capacity because there was insufficient distribution to ensure supply that could meet the current demand of the market. They anticipate growth as more licensees phase in their multiple licenses, more municipalities allow retail marijuana, production facilities increase production, and consumer demand continues to grow. This testimony was consistent with the economic analysis done by the Department's Economist.

The retailers reported they need deliveries 7 days a week, 8 to 10 times a day. Currently in many cases, deliveries take 7 to 14 days. The retailers who were able to maintain an adequate supply for the first few weeks of sales did so because they front-loaded their facilities. In other words, they transported marijuana to their dispensaries and held it in inventory under their medical license in anticipation of the July 1, 2017, retail start date. Now that the product amassed in advance has been sold out in many cases, they struggle to keep stock on their shelves. Vertically integrated locations need internal deliveries, between 3 and 5 each week, and they could not get those deliveries made either, even when the cultivation, production, and retail store are physically located in the same building. Retail stores in outlying areas reported that they cannot get deliveries to their locations. The variety of products being offered has declined as much as 65% due to the inability to have products picked up and delivered by distributors.

The retailers reported the security risks created by insufficient distribution: large amounts of product on the premises because they have to order more at a time to try to keep the shelves stocked; large amounts of cash on the business premises because of the long wait time between pick up; and delivery drivers who will not wait for verification of inventory to invoice, thus creating an opportunity for diversion of product into the black market. Additionally, distribution delays have increased retail store overhead, interrupted their compliance with regulation, and driven sales down 20-30% because they simply cannot meet demand.

DETERMINATION

The Department must make the determination whether the exclusive licensing of liquor wholesalers as marijuana distributors will result in an insufficient number of distributors based on a preponderance of the evidence. This preponderance is a requirement that more than 50% of the evidence points to a given conclusion and is based on the more convincing evidence and its probable truth or accuracy, not on the amount of evidence.

The testimony of the industry regarding their unmet distribution needs is credible. These businesses are struggling without a robust distribution system. Cultivators and producers have product sitting for days waiting to be delivered to stores while the quality of the product degrades. Retailers do not have the products their customers desire, products that are legal and should be available to them.

The data the Department collected from both marijuana enterprises and liquor wholesalers shows that the distributors who are currently licensed and those who have currently applied cannot, on their own, serve the market because they are too small and under-resourced. Liquor distributors have not brought online sufficient services to meet the needs of the industry: frequent deliveries, specific handling of product, growth in the market, and widespread geographic locations. The Department's economist illustrated how the increased prices and reduced supply that result from insufficient distribution can push consumers to the black market. Finally, it is clear that only a few liquor wholesalers want to limit these licenses to liquor wholesalers only.

After considering all of the evidence gathered by the Department and presented by the public during the meeting, a preponderance of the evidence supports the Department's determination that limiting marijuana distribution licenses to only liquor wholesalers will result, and has in fact resulted, in an insufficient number of distributors for the retail marijuana market. Issuing distribution licenses to a broader pool of applicants than just liquor wholesalers will facilitate a robust marijuana market, prevent inflation of market prices, decrease the possibility of diversion of product and customers to the black market, and provide consumers with a broad selection of products. The Department will immediately

open distribution licensing to both liquor wholesalers and to other applicants identified in the Department's Regulation T002-17 and who meet the requirements for licensure as retail marijuana distributors contained therein.

Dated this 15th day of August, 2017.

Deonne E. Contine

Deonne E. Contine, Executive Director
Nevada Department of Taxation

APPEAL RIGHTS

Licensed liquor wholesalers who disagree with the Department's determination may appeal this decision to the Nevada Tax Commission provided that a notice of appeal is filed within 30 days after the date of this determination.

Although notice of the appeal need not be in any particular format, it must be in writing, must clearly state the desire to appeal the Department's determination, and must be filed with the executive staff of the Department of Taxation within 30 days after the date of service of this determination. In this regard, you are advised to mail or personally deliver any notice of appeal to the attention of:

Tina Padovano, Executive Assistant
Nevada Department of Taxation
1550 College Parkway, Suite 115
Carson City, Nevada 89706

This determination will become final 30 days from the date above unless a notice of appeal is filed within those 30 days.

All the above general information is provided to you as a matter of courtesy only. You, or your counsel, should ascertain with more particularity your legal rights and obligations with regard to this determination and any appeal of determination.