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Industry Roundtable: Regulation of Cannabis

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What's the difference between hemp, cannabis and CBD? What are the challenges in regulating them? How will this impact businesses, their investments and the Capital Region? Law firm Hodgson Russ and the *Albany Business Review* hosted a discussion to answer these questions and more. Cindy Applebaum, market president and publisher of the *Albany Business Review*, moderated the discussion.



DONNA ABBOTT-VLAHOS

Standing: Patricia Fahy, left, Stephen Halton, Robert McLaughlin and Ariele Doolittle. Seated: John McDonald III, left, Owen Martinetti, Hillary Peckham and Melissa Fleischut.

There is a lot of confusion about hemp, cannabis and CBD.

What is the difference?

Hillary Peckham, COO, Etain LLC Dispensary: Hemp is a form of the cannabis sativa plant. Cannabinoids are the components that make up the cannabis sativa plant. The two major cannabinoids are CBD and THC. THC is the one that's federally illegal, which is what I am regulated for. CBD is now federally legal, and it's the non-psychoactive cannabinoid.

Right now, if they're cultivated for CBD, hemp plants have very high proportions of CBD with very low thresholds of THC. What's legal as a hemp plant, and what can cross state lines, is a hemp plant with less than .3% THC. My plants in the medical cannabis business sometimes have 80%, or the plant material will generally have about 30% THC in it. There are different variations of the same plant, and they're regulated differently based on what components make them up.

How do you clarify the differences for consumers, or those at the government level that are looking to make decisions on the approval process?

Peckham: The way it's being addressed is relatively piecemeal. Essentially, you have industrial hemp, CBD, the medical cannabis program and potentially adult-use cannabis. Having one piece of legislation or one regulating body would be a good way of sorting it out. There also needs to be a significant amount of consumer education.

A lot of what's being sold over the counter, or what you can buy online, is not held to the quality standard that you would expect for any other normal product. Consistency, potency, labeling, testing, and all of those things that you might take for granted with other drugs, are not something that exists in the CBD world.

Patricia Fahy, Assemblywoman, 109th District, New York State Assembly: It's even less regulated than vitamins.

John McDonald, Assemblyman, 108th District, New York State Assembly: There needs to be validation of what each product is. As a pharmacist, I've been evaluating whether we bring CBD oil into our business. People think you're not allowed to have marijuana because it's a Schedule 1 substance. But with the right products and appropriate potencies, oversight and chemical lab space, people are seeing relief that you can't deny, particularly if we're trying to move away from an opioid-dependent society.

Fahy: One of the problems, aside from the lack of information, is that we still haven't fully validated, with just a few exceptions, the medicinal piece of this. While I think CBD has tremendous potential, I have serious concerns about cannabis or marijuana, and thus far oppose legalization. What we're facing is legislation that lumps everything together, as opposed to separating it out.

And because we don't have the research at the federal level to help validate the problem, you're seeing the gas station selling CBD, which may or may not have any CBD in it. There's no quality control.

Does there need to be an organization similar to the state liquor authority to help with oversight?

McDonald: The governor is looking to create the Office of Cannabis to bring medical use and adult use under one umbrella. The SLA is actually a perfect vehicle for it. They're used to regulation and they have their own investigatory process, so they can bring some oversight. We need to make sure the Department of Health is integrated into this process because it's important that we validate purity, particularly of the product.

It's going to happen. It's happening all around the other states and countries, so it's going to happen one way or the other.

Fahy: Yes, parts of this may be inevitable, but you need the feds addressing this as well. I have some real concerns about New York state jumping out ahead on full legalization. I'm all for decriminalization and medicinal expansion of CBD, but full legalization puts us way out in front of the feds without the research and the ability to measure impairment, and the research to really validate parts of this.

Quite frankly, the businesses that have invested millions into the medicinal market are at risk. We've seen in other states where they have been completely undercut because once legalization happens, there's a race to the bottom of the dollars to compete with the illegal market.

Melissa Fleischut, president and CEO, New York State Restaurant Association: From the restaurant association standpoint, we almost never ask for additional regulation on our businesses. However, in this case, what's really important is a coordination of regulations. Not only do you have discrepancies between state and federal law, which the states that have legalized it are dealing with, we are also finding that there are discrepancies between federal agencies right now. One of the things we went through this year as an industry was that the USDA has said CBD is OK, but the FDA has not approved it as an additive to food or drinks.

A lot of restaurants that were starting to sell infused drinks or edible products in New York City had the New York City health department saying, "The FDA hasn't approved this as a food additive or a drink additive, so you can't be including this at this time." There's not a lot of education taking place because the FDA and the USDA don't agree.

We could find ourselves in a similar situation in New York state because Ag & Markets regulates one side of the industry and the health department regulates the other. And the State liquor Authority has to be brought into the conversation. For us, there are a lot of issues as to how alcohol comes into play when people start using. How are we going to coordinate across all those state agencies to get the right answers and the right regulations in place?

Owen Martinetti, CEO Naturae Oils: My business doesn't deal with adult use or medical marijuana. We're strictly on the CBD side with industrial hemp. Our lab has been operating since November, and 99% of everything we produce gets shipped to the West Coast. Currently, there is absolutely no market in New York state for CBD at the scale that we're producing. It's very frustrating, especially after investing lots of money into this project, to see all this material going out of state. The closest place we're shipping to is New Jersey. One of the problems is on the food side. The entire market was cut off with the recent change, and it seems like there's no guidance or an idea put forward yet.

Fahy: Part of that is because we're conflating the issues at the state level. I've heard from some of our members representing the bigger agricultural areas, of the tremendous potential of hemp and CBD. It's all getting conflated, and thereby stymied, while we debate the whole legalization.

Does legalizing cannabis help your business or hurt your business?

Peckham: It depends. The governor's proposal was unclear on where the medical dividers would actually wind up in the adult-use industry. When the proposal initially came out, it stated there would be an auction and bidding between the 10 licensees to enter into the adult-use industry.

As a woman-owned, privately-owned, family-owned company, I could not compete against nine publicly owned companies, and at a minimum, keep my structure. That would put us in significant jeopardy, and the real shame is that a patient would be the one suffering in that instance.

Not allowing medical providers to also sell in the adult-use industry has a few impacts. The first is cost for patients. One of the biggest barriers for people gaining access to the current New York program is that it's very costly. The only way to drive cost down is to be able to produce at scale. And the only way to get people involved in the medical side of things once you have an adult-use industry is to have patients come into our store, become educated, and say, "I could use this for medicinal purposes." Then there would be an economic incentive.

McDonald: These companies that originally started in medical marijuana really have been done an injustice. The rollout was horrific. The Department of Health dragged their heels. I was a co-sponsor of medical marijuana because I know the value it can bring to the table. But what they've gone through in regards to getting their businesses started, the herculean efforts just to actually go through the delivery service, they have more restrictions on delivery service than banks do that deliver millions of dollars.

Fahy: I worry that we're putting politics ahead of policy, and while I agree ultimately we are probably heading there, this is where you do need the feds. We have to have an ability to measure impairment. We are seeing a 6% jump in impairment in the states that have legalized. Every one of those states is

saying they're having a very difficult time because you can only measure impairment after the fact with a blood test. Breathalyzers only measure alcohol. There are safety issues on multiple levels, including on our roads. I also need to note that in the states that have legalized, such as California, the estimates are that 75% to 80% of the market is still the illicit market.

Peckham: There's an opportunity here to look at why the illicit market still exists in California and these other states, and what New York could do to create an infrastructure that combats that.

Most of the product made in Oregon is being shipped out of state, with most of it being shipped to New York because they have an oversupply. Usually, if there's oversupply, they ship it to a state where there is an illicit market because they can get a premium. By having a legal market, you take out the illicit component and there's no need to ship it from Oregon to start with.

Overlicensing is a big problem in those states. Every day on the news, there's a new article about investment in cannabis. It's a huge moneymaker, and it's the green rush, so everybody's inclined to get involved in this industry. In reality, you're dealing with a controlled substance and there isn't a need for thousands and thousands of operators.

Stephen Halton, CEO, CNY Hemp Processing: I went to a meeting in January about hemp, and the Department of Ag & Markets was there. They said there were 330 applicants to grow hemp in New York state. Of those, 290 were for CBD. That's a lot of newbies coming into the industry that think they're going to strike it rich. I don't know how much you can process in a day, but think about 290 people growing 2 or 3 acres. That's a lot of biomass to flood the market. It would be the same scenario as in Oregon, with the over-abundancy of marijuana. The legalization scares me a little bit as far as my business goes.

Imagine if legalization happened and someone decided to grow marijuana near a CBD field. Granted, it should be all female plants that are being grown, so it shouldn't do a cross-pollination, but say something like that happens and then I decide to make a heat pellet for barbecues.

Who's to say that neighborhood kids can't sit outside the exhaust pipe stove and get high from it? I just hope that New York state lawmakers will actually talk to people that are in the industry before making a lot of these laws and guidelines.

Let's say they're going to do a dollar-a-gram tax, just for the grower to process it. That's fine for cannabis because your profit margin's a little bit higher. But a pound of CBD might be \$35 and if you're going to have over \$400 worth of tax on that \$35 pound, there goes the entire CBD market for New York state.

Martinetti: I do a lot of research on California and Oregon and why the illegal markets are still around. It's primarily due to the price versus the underground market, which are the taxes. If you're paying a 45% premium for a legal product and people are already consuming an illegal product at a lower price, why are they going to switch and pay more if they already have a supply chain?

You've got to switch the supply chain and also lower the prices by not overtaxing. I don't have a horse in the fight on the CBD side, and cannabis is just a vertical for us to eventually go into if it comes to New York. But on the subject of a lot of new people coming to the CBD market, we're seeing a lot of people that are making promises to people and a lot of money getting poured into our industry. From 2017, there have been 10 licensed facilities. Only three are actually up and running. I'm not going to name names, but there were promises made to the other people and they invested in farms thinking

that their farm would be taken by those people, and they weren't present when it came time to harvest.

McDonald: The perception that the assembly fully supports it is not truly accurate. The majority of members do, but there are a lot of members from all parts of the state who have varying concerns. There's this thinking that this is going to be a huge windfall for the state of New York, where other states' revenue expectations are falling woefully short. There's this promise to the minority community that we're going to reinvest that money back into the minority community to kind of make up for the Rockefeller drug era. I understand the discussion, but those revenues are going to fall short.

And then all of it is complicated by talk about it being a great opportunity for minority-owned businesses to grow and blossom. The reality is that if you don't think the big tobacco companies aren't looking at this as a huge opportunity, I've got a jewel to sell you. They will come in and squeeze out the small businesses.

Martinetti: In New York, we let in Canopy, a foreign company from Canada, and they're investing 150 times or 100 times more than what any other facility has put into New York. Right off the bat, we've let in a company that could essentially crush the entire market for New York and dominate it just as we're getting started in this industry. How do we protect the farmers and the labs and the mid-tier and the lower tier? There's no way for them to compete.

We're working with farmers providing genetics here in New York, and different protocols of how to grow the plant if it's their first time, and a way to deliver it to our facility in specific forms so we can handle it and process it. As of now, there's not a high education level on this plant and how to grow it. We're receiving products in all different forms and we spend a lot of time refining it so we can even process it. The New York Growers of Cannabis Association is actively trying to put in place some kind of protection for the mid-tier and lower-tier farmers, and how to identify these people.

Now that Canopy is here, there's absolutely no way to compete with a public company that lost \$300 million last year to make \$30 million in revenue.

What is Hodgson Russ hearing from its business clients regarding their concerns about the legalization of cannabis?

Bob McLaughlin, attorney, Hodgson Russ LLP: The clients that we have in this space are concerned about taxes, regulations and where the regulations will wind up. They're also concerned about the ability to not only grow in the state, but then also to distribute in the state. And they're trying to figure out where the legislature is at in all of this.

There's also the issue of illegal opportunities. The Lottery business is an example of what can happen. When the Lottery was passed, part of the initiative was to eliminate illegal bookies. For the first 10 years it was instituted, that didn't happen. Then the Lottery changed the limit so that the prizes on the daily games were under \$600. For the most part, that eliminated those illegal bookies. That is a model that can be used in the cannabis industry as well.

They're also looking at a commission type of structure with the various stakeholders — Ag & Markets, the Department of Health, the SLA. But cannabis has all these multiple different areas. There's medical, recreational, cannabinoids, CBD, hemp. How are we going to regulate that? The concern I had with the initial legislation was that there seemed to be one person that was going to run and operate this whole thing. But there are too many business interests and too many industries, and

clients have a major concern about who's running the show. If it's one person, that's kind of dangerous and not the model that the state should consider.

How do you see this impacting restaurant owners with regard to their workers? Is the New York State Restaurant Association talking to restaurant associations in states that have already implemented legalized cannabis to learn about what's going on there?

Fleischut: I'm part of an organization called the Council of State Restaurant Associations and we meet roughly three times a year. One of our meetings is always focused on government affairs issues, and this has been a topic of conversation. What I found interesting about their feedback was that there have been many days where I have thanked the Lord that we do not have ballot initiatives in the state of New York. They have played a lot into how this has gotten legalized in other states, and they're finding themselves in a position where the public has voted this in and legalized it without the infrastructure and the regulations behind it to implement it. One of them actually used the term "wild, wild west" for the industry and how it's developing in one of the states.

There are overall employment concerns. Our friends in Colorado talked about the idea that any kind of pre-employment screening wasn't realistic. Unemployment is low and a million people nationwide understaff the industry, and so it isn't feasible for the restaurant industry to consider a pre-employment screening. Even when you would find candidates to work in the positions that you need, and cannabis were legalized in the state, you'd be telling them they couldn't do it on their own time and in their own lives outside of work. If you have a policy that they can't be using when they're at work, which you should, how are you going to enforce that? How are you going to look for that?

There's also concern about the flood of opportunity that people see in this industry. As an employer of a large population of low-skilled or under skilled people, are we going to have trouble finding people? What's it going to do to the job market?

Assuming that cannabis is legalized, is there any indication as how it would impact alcohol sales?

Fleischut: I don't have any good data on that from anyone at this point. But there is definite concern that it's going to impact alcohol sales. But there's an opportunity for potential. If you get to a place where you could do something more with CBD, is that an opportunity instead of just a fear of lower alcohol sales?

Martinetti: There should be clear differentiations between CBD or cannabinoids and THC because CBD is a non-psychoactive cannabinoid. Introducing CBD into the food chain as a food additive doesn't have any psychoactive effects. I just need to keep educating people on the clear differences between the cannabinoids because the cannabinoids are what ultimately have these different properties and the medicinal benefits.

We already have one FDA-approved drug, so there's clear evidence and FDA approval of this cannabinoid, but we just don't have that information, or the information we do have is that it's not psychoactive. We have identified THC as psychoactive, but don't let that stagger the growth of the other parts of the plant.

Fahy: That is such a huge part of the problem because it's dominating the debate and the tremendous potential of CBD and hemp is getting overrun.

Martinetti: Stephen's involved in a whole other aspect of an industry that was cut off in the 1960s. As we continue to see legalization, we need to develop a market. But we're completely missing it. There's

no reason why we shouldn't be investing in a plant that can be grown here domestically, instead of importing everything. It can be used for everything from fuels to paper, but we're just not doing it yet. However, we are consuming foreign goods and importing foreign hemp.

Halton: Everyone pitches that hemp has 50,000-plus uses. I have probably a dozen products that I produce already out of hemp. A few more will be released soon. But if hemp has 50,000 uses and CBD is one, why not focus on the 49,999 other uses? I try to work with dairy farmers that are struggling because of poor milk prices. I was farming first, and that's how I got into the hemp industry.

I wanted to grow high-grade, textile-grade fiber. I talked to Department of Ag & Markets and they said there were no processors for it. So, I became a processor and put all this money into fiber, grain and fiber processing. And Ag & Markets said, "Well, that's great, but nobody's growing it," so I went out to work with a lot of these farmers.

I'm on the fence as far as legalization goes. It's not that I'm opposed. I hope that lawmakers really think about these regulations, and I'm really scared for the whole hemp industry.

This year I have 27 growers and over 400 acres growing across New York state. I pitch the whole idea of rotational crop. We pitch industrial hemp a little bit more. People hear about all the money going to CBD, and that they can make \$60,000 an acre. That's great, but you're going to put \$45,000 into each acre, and it's probably the same for medical use.

Peckham: With marijuana, at the federal level and state levels, we're subject to a tax code called 280E, which prohibits us from taking any business deductions except for cost of goods sold. And then you're taxed at a penalty because it's an illicit substance, so we cannot deduct anything, particularly at point of sale. The cost of our employees, cash registers, chairs, things like that, are not deductible business expenses. The taxes that are put on THC-based companies are so enormous that it's really difficult to make money in the industry. At a minimum, I think New York's legislation should have a one-liner that says, "Cannabis businesses in New York state are not subject to 280E tax at the state level," because right now we are. We paid an extra 20% on our New York state taxes because of the 280E penalty.

Martinetti: It's not sustainable.

Are there financing challenges? And are they different based on whether you're a farm, CBD producer or in the cannabis industry?

Arielle Dolittle, attorney, Hodgson Russ LLP: There's more leniency and latitude among, say, the local credit unions versus national banks, but yes, there are many challenges.

Peckham: I was denied a personal mortgage because I'm in a cannabis business. We've been denied by three banks. A lot of what we do is in cash and we can't accept credit cards, so it's very difficult for showing income.

McLaughlin: Beyond that, one of the surprises we recently found is that even if you are able to get a mortgage and try to close, you would not likely be able to get title insurance because you'd be paying your fee from the proceeds of the cannabis business. The title companies, with the exception of one, which is not the greatest one, have all said, "We're out. We're not going to even take care of that." And it really has nothing to do with their insurance. They're just insuring your marketable title, but yet you cannot get that insurance. So, good luck with your dream.

Halton: I went through 23 different insurance companies just to find the policy for mine. And I'm not dealing with CBD or THC. Finding investment on my business was difficult. It wasn't quite a Craigslist ad, but it was pretty close to that. I have several different products and I can't accept credit cards.

Martinetti: We're paying, sometimes, 30% on our loans for maybe six months. We're privately funded. The disadvantage of that is you give away a portion of your company. But from that, we were able to bring in people with different creative backgrounds. We have current NFL players on our project. I would say 90% of all NFL athletes are taking CBD.

Peckham: Or everybody is sort of forced to go public in Canada, which means they're now foreign companies. In November, we were denied an economic state development grant. We applied for a JDA construction loan through the state, at a 4% interest rate. It was at state level, not federal level. But we were denied because we're a cannabis company and the department didn't think that they could keep up with the guidelines.

There's never been an issue collecting my excise tax or my state tax, but this was apparently beyond their capacity. And so without having those kind of mechanisms for funding, in particular if you're looking at a small business, like here with adult use, it's going to be very difficult to keep those small businesses from not getting eaten up by larger ones. There's no reason I should have been denied that loan.