

# BUDGET NARRATIVE

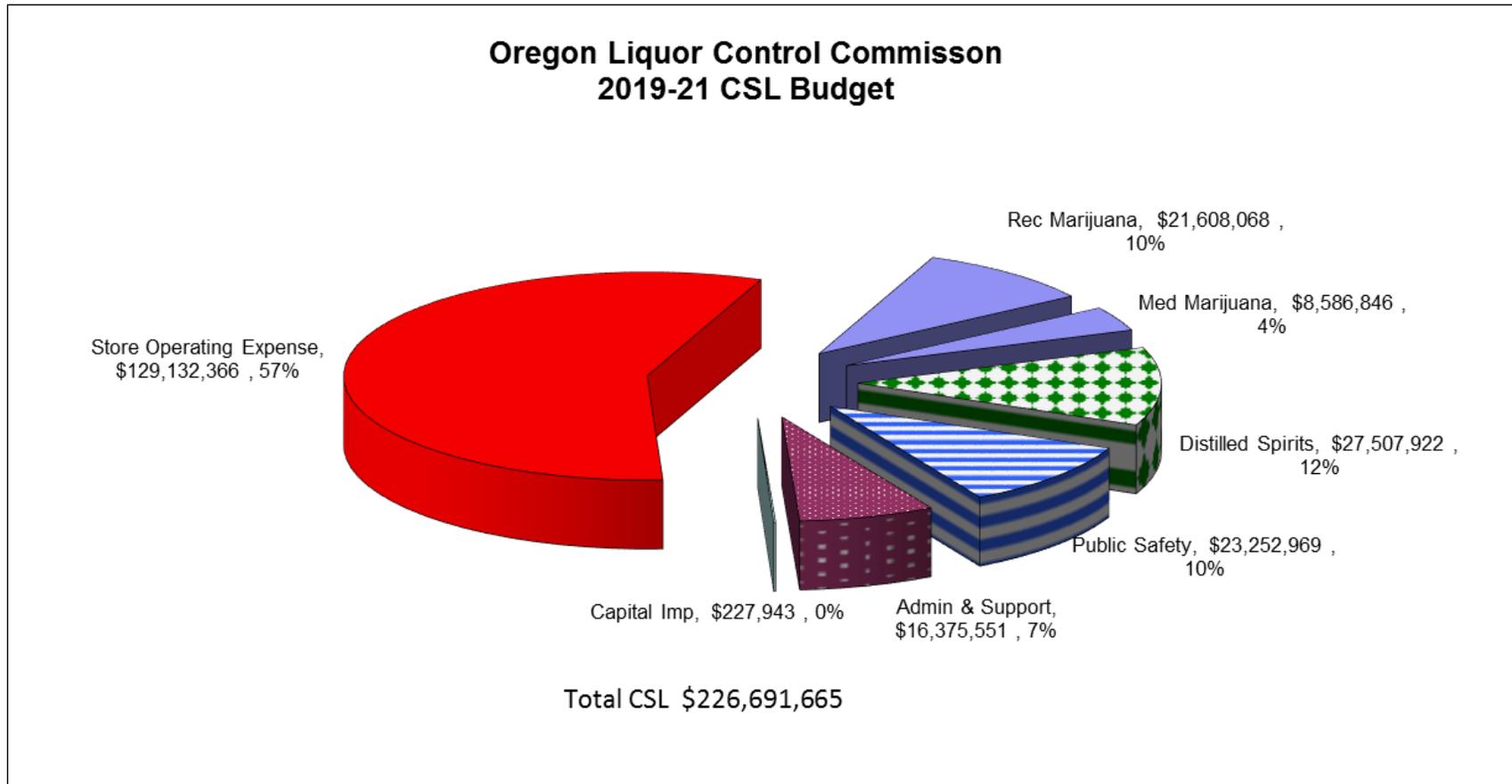
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## OREGON LIQUOR CONTROL COMMISSION

### 2019-21 BUDGET

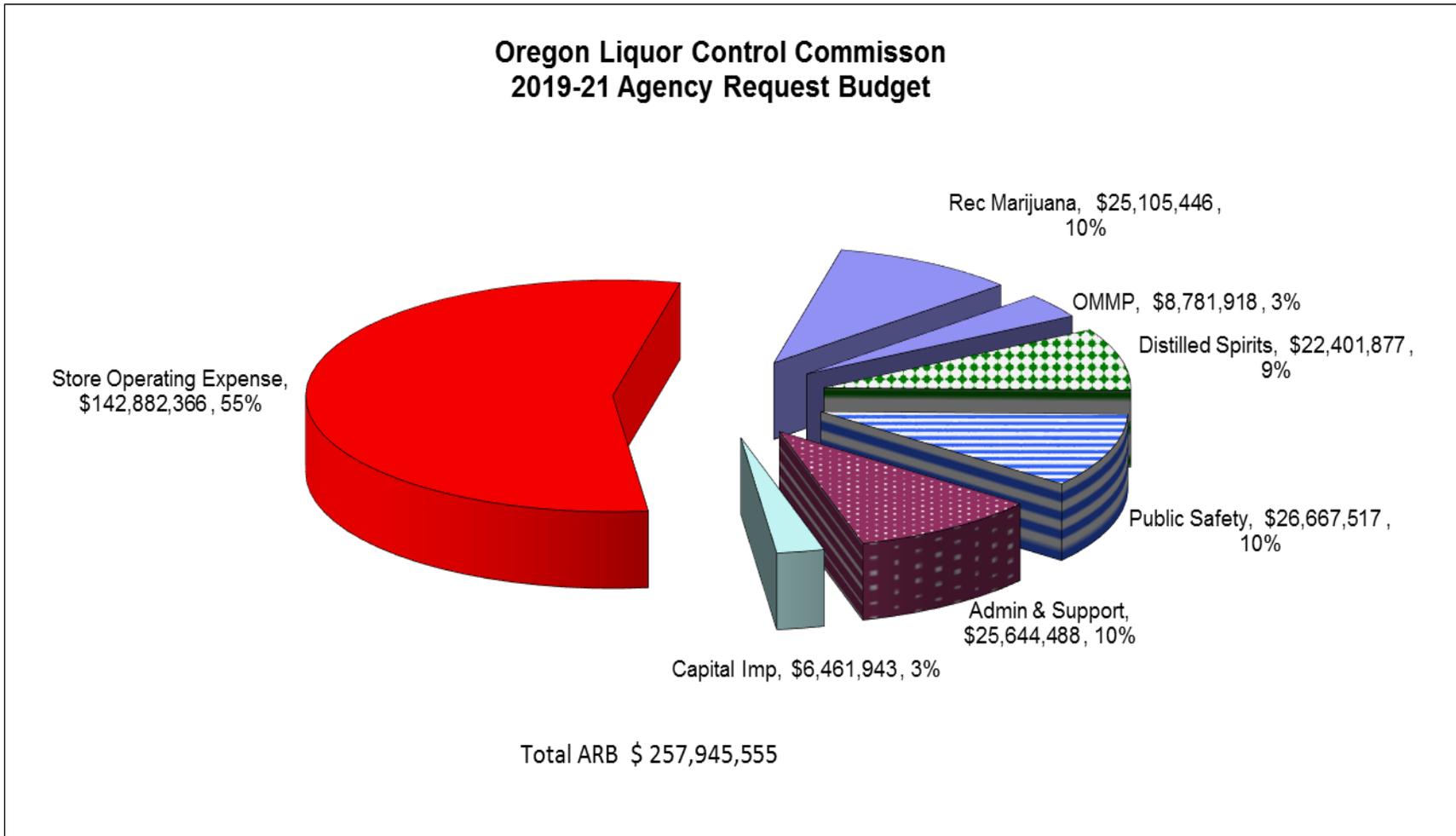
### AGENCY SUMMARY

#### A. BUDGET SUMMARY GRAPHICS



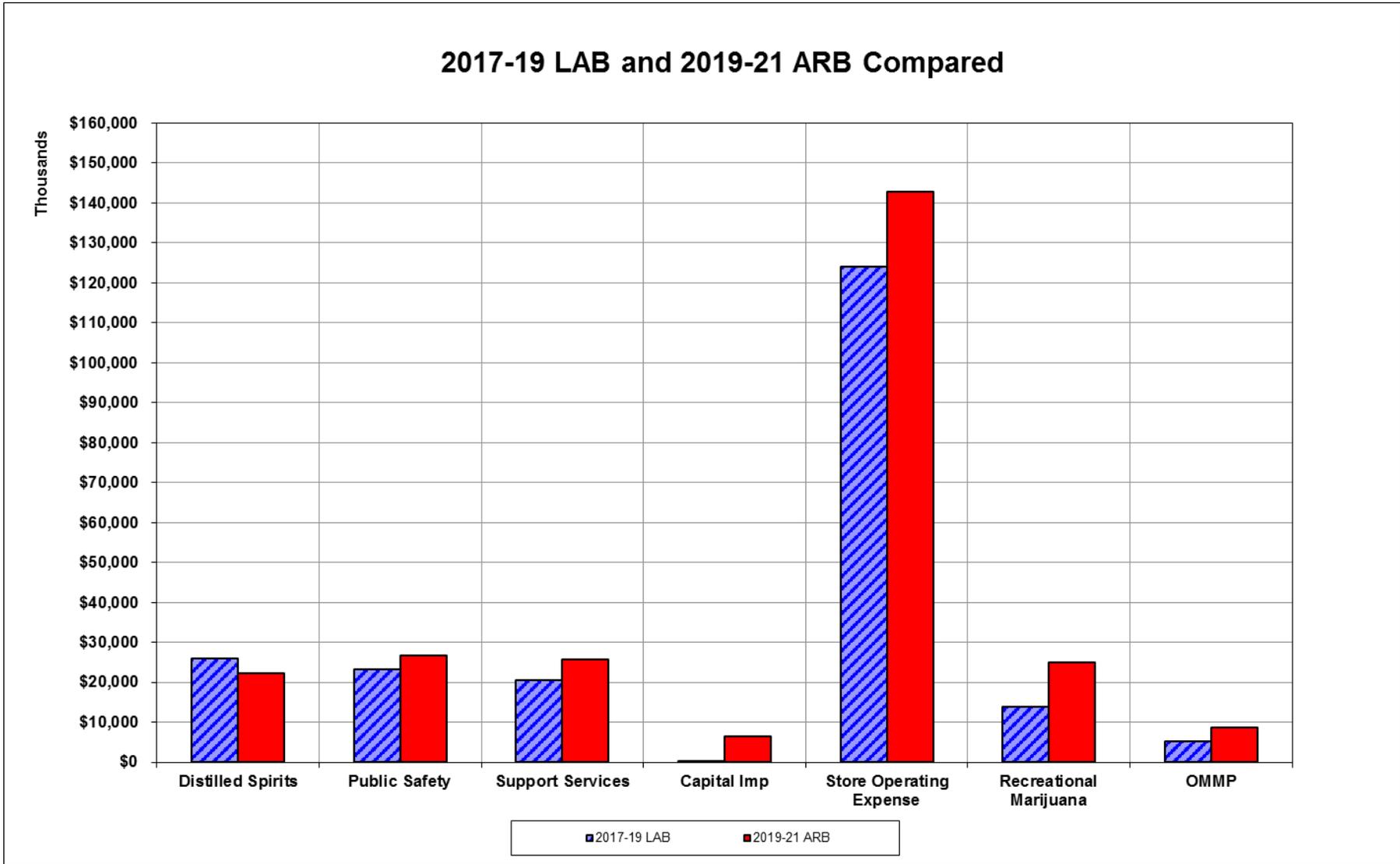
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## BUDGET SUMMARY GRAPHICS Continued:



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## **B. MISSION STATEMENT AND STATUTORY AUTHORITY**

The mission of the Oregon Liquor Control Commission (OLCC) is to support businesses, public safety, and community livability through education and the enforcement of liquor and marijuana laws. This mission has been adapted to incorporate the addition of recreational marijuana licensing, tracking, and compliance, OMMP tracking and inspections, and hemp tracking to the agency's portfolio. The OLCC values managing the alcoholic beverage and marijuana control systems intelligently, ensuring that any growth or change is socially responsible, responsive to citizens' needs, and encourages the development of all Oregon industry.

The OLCC administers Oregon's Liquor Control Act and Cannabis Regulation. The agency's alcohol and marijuana authority is derived from Oregon Revised Statutes Chapters 471, Alcoholic Liquor Generally; 473, Wine, Cider and Malt Beverage Privilege Tax; 474, Trade Practices Related to Malt Beverages; 459A.700 to 740, Beverages Containers, the Bottle Bill; 475B Cannabis Regulation, and Administrative Rules Chapter 845.

**During the 2017 Regular Session the Legislature passed several bills that impacts agency operations including:**

### Alcohol Policy Legislation

- HB 2089 - Vermouth Sales in Exclusive Stores
- HB 2150 - Electronic Privilege Tax
- HB 2159 - Cider Definition
- HB 2160 - Brew Pub Locations
- HB 2779 - Treasury Public Funds
- SB 677 - Cider Businesses
- SB 1044 - Alcohol Systems Clean Up

### Recreational, Medical Marijuana, and Hemp Legislation

- HB 2198 - Medical Marijuana Governance
- SB 56 - Marijuana Systems Clean Up
- SB 302 - The Control and Regulation of Marijuana Act
- SB 319 - Siting of Marijuana Establishments near Schools
- SB 863 - Marijuana Consumer Privacy
- SB 1015 - Industrial Hemp Processing
- SB 1057 - Marijuana Tracking and Regulation

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## Policy Legislation Applied to Both Alcohol and Marijuana

- SB 303 - Minors in Possession of Alcohol or Marijuana

## Bottle Bill Policy Legislation

- HB 2746 - Compliance Dates for Labeling

## Tobacco Policy Legislation

- SB 754 - Increases Minimum Age for Purchasing

## Budget and Tax Distribution Legislation

- HB 2197 - Tribal Tax Rebates
- HB 3470 - Statutory Changes to support 2017-19 Legislative Adopted Budget (Marijuana Tax Distribution, Borrowing from Liquor Fund)
- HB 5006 - Emergency Board Allocation and 2017-19 Budget Adjustments
- HB 5019 - OLCC Budget 2017-19
- SB 5508 - Limitation Increase for 2015-17
- SB 5529 - Oregon Marijuana Account, Lottery, and Criminal Fine Allocations
- SB 5545 - Ratifies Marijuana Fees

**During the 2018 Short Session the Legislature passed several bills that impact agency operations including:**

## Recreational, Medical Marijuana, and Hemp Legislation

- HB 4089 - Hemp Legislation
- SB 1544 - Medical Marijuana, Hemp and Illegal Marijuana Market Enforcement Grant Program

## Budget and Tax Distribution Legislation

- HB 4163 - Moves Marijuana Civil Penalties collected to General Fund
- HB 5201 - OLCC Budget Additions
- HB 5202 - Hemp and Marijuana Fees

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## C. AGENCY STRATEGIC BUSINESS PLANS

The agency's long-term strategies focus on the state's long-term vision and outcomes, specifically: A Thriving Oregon Economy; Excellence in State Government; and Safer, Healthier Communities. The agency utilizes the governing principles of supporting economic development, public safety, accountability, transparency, customer service, and stewardship of state resources to guide agency operations and services that will enhance its long-term strategic directions for the public services it provides. The following discussion outlines strategic considerations utilized by the agency in its continuing efforts to evolve the alcohol licensing and enforcement program while building and implementing marijuana licensing and enforcement programs, creating a seamless, streamlined organization. Key initiatives include evolving Oregon's recreational marijuana program, implementing medical marijuana and hemp tracking, providing support for the Oregon Bottle Bill, and modernizing Oregon's alcohol program.

### Agency Overview

#### *Core Functions*

- Centrally purchase, warehouse and distribute bottled distilled spirits to OLCC-appointed retail agents
- License and regulate alcohol licensees and alcohol server permittees
- Administer Bottle Bill
- *New* License and regulate OLCC marijuana licensees and marijuana worker permittees
- *New* Track and inspect OHA medical growers who grow for more than two cardholders, OHA processors and dispensaries
- *New* Track hemp processed and sold to OLCC licensees

#### *Third largest generator of public funds*

- 2019-21 estimates \$594.5 million in liquor revenue distributed to general fund, cities and counties
- *New* 2019-21 estimates \$202.1 million in marijuana tax revenue distributed to schools, cities, counties and health programs (Office of Economic Analysis)

#### *Funding Sources*

- OLCC marijuana program and hemp tracking is funded by marijuana and hemp license fees
- OLCC tracking of OHA medical marijuana program is funded by OHA fees and marijuana tax proceeds
- OLCC alcohol program is funded by license fees, sales of distilled spirits, and beer and wine tax revenue

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The following discussion outlines the challenges the agency faces in its efforts to build an infrastructure to match the agency as it is today.

## **Challenge: Agency Characterized by 4 Years of Growth and Change**

### *Staff and Leadership Changes*

- 230 positions prior to legalization of recreational marijuana, in 2019-21 expected to exceed 370
- Of the 304 employees prior to the 2018 session, 94 were new to the agency and 81 moved to a new position within the agency
- Recruiting and onboarding, existing employees have added roles and responsibilities, continual training required for both marijuana and alcohol

### *Implementing 2015, 2016, 2017 and 2018 Statutory Changes*

- *New* license types, new privileges
- *New* Rulemaking (draft, rules advisory committee, board approval)
- *New* Online Marijuana License system, Online Worker Permit System, Cannabis Tracking System, Alcohol Permit System,
- *New* Electronic Privilege Tax System
- *New* process and procedure development

### *Marijuana license and enforcement activity exceeds estimates*

- Initial estimate 1,200 applications, now 4,422
- Initial estimate 800 licensees, now 1,986
- Initial estimate 4,000 marijuana worker permits, now 31,000
- *New* Applicant and licensee training and education
- *New* 5.7 million visits to marijuana website, 91,000 subscribers to Gov Delivery

### *Retail Alcohol Expansion*

- Marketing and outreach completed in four of five regions
- 37 retail stores appointed, 18 opened, 13 in process of opening, and 6 withdrawn; new stores generated \$27 million in sales
- 89 retail distillery tasting rooms opened after 2009 legislation which allowed sales
- Sales are expected to increase by \$134 million from 2017-19 biennium, volume of cases distributed in 2019-21 are expected to increase by 2.5% per year.

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## Strategic Approach to Challenges

### *Creating a culture of accountability for change*

The leadership of OLCC continues to work on updating the agency's strategies for the future. As commissioners, the executive director and division directors in key positions introduce fresh approaches to the work of the agency, there is both excitement and stress present within the agency as a dedicated, knowledgeable and seasoned staff work to enable new ideas and change.

The OLCC has a culture that prides itself on its service, expertise, transparency, and integrity. It is both the producer of public services and a provider of public safety and that integrated responsibility is reflected across the breadth of the organization. Integration of these dual responsibilities remains one of the most vital elements of an OLCC plan for the future.

It is a key agency objective to harness the richness of its considerable human capital talent and knowledge to advance a culture of accountability for change and productivity. The agency believes it has strong competencies within its staff and throughout its divisions that will enable it to accomplish this result.

### *Facilitating the contribution of businesses to sustain community growth throughout Oregon*

The business of the OLCC takes place in communities throughout Oregon. The OLCC's liquor agents and licensees sell and produce revenue from within the community, likewise Oregon's manufacturing industry and servers throughout the state earn their livings and income when local businesses thrive. In addition, the OLCC's management of liquor sales and beer and wine privilege taxes produces the third largest source of revenue for the State of Oregon; its revenue stream is directly and indirectly returned to services within communities through allocations to the general fund, cities, counties and mental health programs. The OLCC's marijuana program is self-funded through license fees. OLCC licensees grow, process, and sell useable marijuana and processed products in retail outlets throughout the state. Tax revenue from retail sales are expected to grow as this industry becomes established in Oregon. While the Oregon Department of Revenue collects and distributes marijuana taxes, the OLCC has a substantial role in auditing data and financial transactions through the agency's Cannabis Tracking System. With these two programs, the OLCC makes a positive contribution to Oregon's economic development and community livability by developing rules and regulations that support business growth and protect public safety.

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## *Creating new means to advance public health and safety through prevention and community engagement*

The OLCC has duties to oversee the safe operations of its licensed alcohol and marijuana facilities and to ensure compliance. A continuing major focus of the agency for the long-term includes its fundamental work to prevent sales to minors. The OLCC is not satisfied by the rate of non-sales to minors; the rate of minor decoy compliance (percent of operations that did not result in a sale) for alcohol reached a high of 84% in 2013 but went down to 81% in 2015. The rate of successful minor decoy operations at alcohol licensees is lower than at marijuana licensees'. The agency will take steps in 2019-21 to address this discrepancy and improve overall compliance rates. Minor decoy operations were one of the first proactive compliance actions the agency conducted at recreationally licensed marijuana retailers in December 2017 and due to the concerning amount of sales to state sanctioned minor decoys, in January 2018 the Commission escalated the penalty schedule for marijuana sales to a minor. After the first couple of visits, the word getting out in the industry, and the increase in penalties, the sale rate decreased to 10% with a successful no sale rate of 90%. Bend has visited all but one of their licensed retailers and has maintained a 100% no sale rate. To close the gap and eliminate sales to minors the OLCC pursues four primary strategies: 1) Increase the number of decoy operations, 2) Expand upon the agencies general prevention communication strategy by providing increased community-level communications when non-sales to minors are faltering or not improving so community and licensee-based awareness is heightened, 3) Increase licensee education, and 4) Consider the implementation of heightened fines for violations if the rate of non-sales to minors fails to improve over time.

Another central focus of the OLCC is to reduce the incidents in alcohol and marijuana sales to visibly intoxicated persons. This fundamental interest of the OLCC is primarily pursued through the general structure of rules, training and enforcement. The agency utilizes a primary strategy of training licensees, alcohol and worker permit holders, and servers, to reduce the incidents of sales and service to visibly intoxicated people. Such incidents are considered when a community identifies concerns and the agency is approving or renewing license applications for the sale of alcohol or marijuana.

## *Opening communications as a means to place the agency closer to Oregon customers and to advance all other agency strategies*

The OLCC sees improved communication strategies as a fundamental need to support its duties to keep the public safe, licensees in compliance, and the business of OLCC productive. The OLCC sees a future in which it will affirmatively support Oregon's development through active policies and communication with the greater alcoholic beverage and marijuana industry and its stakeholders across the state. Over the coming years the OLCC will work to establish renewed and new regular communication channels with a host of its constituencies. There is both a critical need for improvement and considerable opportunity to effectively move forward in opening lines of communication. As the organization grows, internal communications have become more critical in the agency's efforts to integrate, train, and onboard new employees and those new to their positions. Both alcohol and marijuana rules, processes, and procedures are shifting to streamline processes and reflect new learning.

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The OLCC has a strong commitment to education and transparency. The OLCC has a broad scope of communication needs within Oregon. This begins with establishing the means to communicate with licensees, permittees, agents, and employees on a regular basis. The OLCC responsibilities cover the entire state and combined operations of the agency cover 19 to 20 hours on most days. This broad community responsibility should be matched by strong community level communications – OLCC strategies for the future include bolstering responsiveness and capability to engage local communities and employees at the policy, process and operational levels.

## *Agency Process Improvement Efforts*

Process improvements have been a high priority for OLCC for several biennia, including streamlining and technological and automation improvements for the Public Safety Services Program and Distilled Spirits Programs. The focus on system improvement is particularly prevalent as the agency works to integrate the Marijuana Program responsibilities throughout the organization. Rather than creating a completely separate stand-alone program with redundant services, the agency integrated central office support for marijuana throughout the organization. A proportional share of management services and staff are allocated to marijuana and paid through marijuana funds, and now with the addition of OMMP tracking responsibilities, a proportional share will be paid through, marijuana tax funds. Integrating these services creates efficiencies, as systems, such as finance and purchasing, are already in place. Agency leadership including managers of key divisions, have responsibility for managing both alcohol and marijuana staff. This creates efficiencies and consistency throughout the agency. The integration, while positive, continues to create stresses as new needs are identified, departments are rearranged, desks are moved, and job responsibilities are realigned. The changes, focus on interdepartmental project teams, and agency improvement efforts have energized staff, resulting in a high degree of problem solving efforts to create processes that benefit stakeholders and the public.

The extraordinary heavy lift to improve processes in 2017-19 will continue over the next two years. The agency has eight legacy and stand-alone information technology systems, three new online systems, and needs to develop additional electronic systems to replace manual processes. Data for the legacy systems has to be input manually and information has to be extracted manually. Moving forward key issues are replacing aging agency core technology systems, contract and vendor management, connection of disparate agency IT programs, business process change management, addressing data storage capacity issues, and disaster recovery. The ability to coordinate IT projects and strategically move forward, particularly for an emerging organization with multiple needs, is very different from more static organizations with limited change. To be successful the agency is proposing a budget strategy that works within the timelines of legislative approval and regulatory oversight and at the same time allows the agency to develop the technology in a timely manner. All of these activities represent a major retooling of the agency to achieve long-term goals for high performance service delivery to support commerce and revenues generated for the state over the next ten years.

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## *Agency Two Year Plan*

### **Build agency infrastructure to match how the agency works today**

#### *Information Technology Systems*

- Invest in technology to protect core agency functions of distilled spirits distribution, finance, licensing and cannabis tracking
  - Secure appropriate levels of staffing to ensure continuation of agency operations
  - Provide near and long-term redundancy for disaster recovery
  - Replace unsupported legacy software
  - Replace unsupported hardware
  - Select and manage technology solutions for new agency mandates
  - Set aside limitation for investment in IT projects and hardware and release by E-board as project stage gate approvals are received
- Redesign work processes to eliminate manual processes, reliance on excel spreadsheets, and duplicate data entry
  - Connect data from disparate systems
  - Add administrative functionality to software
  - Utilize data to inform business intelligence and decision making
- License and vendor selection, evaluation, and oversight
  - License inventory and management
  - Vendor contract selection, assessments and realignment
  - Manage Stage Gate and contracting processes

#### *Capital Construction and Space Planning*

- Complete final phase of agency roof project (asset management)
- Identify options to accommodate growth in licensing, enforcement, and distribution including space utilization of headquarters and lease options
- Develop a capital investment plan to maximize operations and investments over the next decade

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## *Administration*

- Manage current and continue growth of the agency responsibilities through reclasses of existing personnel and selective hiring
- Strengthen relationships with stakeholders and lawmakers to manage changing alcohol and marijuana environment

## *Internal communications*

- Provide staff development and training to ensure consistency between divisions in charge of licensing, public safety and the OLCC sanction processes to provide for consistent practices and high levels of accurate technical support regardless of which field or regional office provides the service.
- Refine data and measures of progress on desired outcomes
- Build agency intranet to improve employee productivity

## *External communications*

- Increase outreach to licensees on law and rule changes
- Prepare licensees, permittees, and retail agents for the challenges of successful compliance through the establishment of opportunities for engagement and trainings.
- Prioritize public access and transparency to information about OLCC licensing and enforcement activities and ensure robust information is available through the agency's web and social media presence.
- Implement agency internet redesign required by DAS

## **Preserve and build state revenue**

### *Financial Services*

- Create efficiencies in tax collection, business support services and payment
  - Replace unsupported liquor store auditor equipment and software
  - Implement online privilege tax system
  - Increase data analysis and dissemination for making business decisions
- Grow revenue through license fees to support program needs and increase revenue for state, cities and counties

### *Retail Services*

- Target retail market expansion to support customers, revenue growth and stability
- Automate data analysis and dissemination to improve profitability
- Simplify agent compensation formula

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- Establish distinct compensation formula for Oregon Distillery Agents
- Improve automation of entire chain of logistics from the manufacturers marketplace, to warehouse and shipping of inventory to retail sales transactions

## *Distilled Spirits Program*

- Optimize staffing levels to meet current distribution demand
- Acquire key equipment to support daily operations
- Increase data analysis and dissemination to improve warehouse efficiency

## **Enhance livable communities through regulation, licensing, and enforcement/compliance**

### *Regulation*

- Adapt policies and rules to match statutory changes and evolving alcohol and marijuana markets
- Collaborate with other state agencies and industry stakeholders to refine existing rules
- Adapt and innovate regulations to embrace digital commerce for alcohol transactions
- Innovate with alcohol agents approaches to e-commerce for home delivery
- Ensure the OLCC system services increase access to medical marijuana products for OMMP cardholders

### *Licensing*

- Increase licensee outreach and education to increase rule understanding and compliance
- Adopt, refine or replace automated process to replace manual systems, administrative process and duplicate data entry
- Refine the Cannabis Tracking System for all recreational marijuana licensees, OMMP and hemp tracking programs
- Minimize alcohol and marijuana licensing application, permittee, and renewal backlog

### *Enforcement/Compliance*

- Ensure public health and safety via administrative enforcement actions
- Cooperate with law enforcement agencies with the prosecution of illicit commercial marijuana offenses in Oregon
- Operate a law enforcement only call center to answer questions, direct resources and provide real time investigation assistance
- Implement OHA medical marijuana tracking through CTS and provide onsite inspections
- Continue a vigorous minor decoy operation program

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- Increase inspectors and proactive inspections of marijuana licenses including more data driven specific inspections targeting diversion
- Target “pay to play” and other nefarious market place activities to ensure a level and fair market for alcohol

## *OLCC Agency Programs*

The Oregon Liquor Control Commission wholesales, distributes and contracts retail agents to sell all distilled spirits; contracts with Oregon Distillery licenses to sell their products in distillery tasting rooms, regulates all individuals and businesses that manufacture, wholesale, retail, import, export or serve alcoholic beverage to ensure compliance with state liquor laws; regulates all individuals or business that produce, process, wholesale, sell, research, or test marijuana; tracks OHA medical marijuana in the Cannabis Tracking System; tracks hemp in the Cannabis Tracking System; educates and trains liquor and marijuana licensees, alcohol server and marijuana worker permittees, the public and other groups; investigates and takes compliance action when necessary against those who violate liquor and marijuana laws; provides due process in contested cases; and provides revenues for cities, counties and the state General Fund. The OLCC also has responsibilities for the bottle bill and approves redemption centers and ensure retailers meet their obligations for redemption of redeemable containers. It fulfills these functions in ways that encourage the development of Oregon industries.

A seven-member, citizen board of Commissioners administers the Liquor Control Act and Cannabis regulation. The OLCC carries out its mission through five operational program units: Distilled Spirits, Public Safety, Administration/Support Services, Marijuana, and OMMP Tracking. The Marijuana and OMMP Tracking Programs pays for employees in their respective programs and a proportional share of agency management and expenses. Additionally, the Store Operating Expenses Program fund contains dollars for the OLCC to pay independent, contracted liquor store agents for their services operating liquor stores. The Capital Improvement Program fund contains dollars to support the infrastructure of the Milwaukie office complex, including two warehouses and grounds owned by the OLCC. The OLCC’s alcohol programs are funded through OLCC-generated revenue, such as from the sale of bottled distilled spirits, collection of privilege taxes on beer and wine, and from liquor license and permit fees and fines. The OLCC’s Marijuana Program is funded through marijuana licensee and marijuana worker permit fees and fines. The OLCC’s OMMP Tracking Program is funded through marijuana tax proceeds. In 2019-21, the agency will focus on adding capability and capacity, particularly building core technology and FTE, to support operations in both the alcohol and marijuana programs, including distilled spirits retail expansion, movement to online systems, effective use of agency facilities and IT infrastructure, enforcement and minor control goals, licensing efficiency, timely response to public records requests, and internal communications.

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## ***Distilled Spirits Program***

## ***Program 001***

The Distilled Spirits Program enables the socially responsible availability of distilled spirits in Oregon. It is a vital part of Oregon's hospitality and tourism economy and supports the manufacturing and distribution networks for beer, wine, ciders and distilled spirits. Oregon's liquor system promotes public safety and livable communities, and generates revenue by making alcohol available in a managed environment. The program makes distilled spirits available for sale by the bottle through liquor stores run by independent, contracted business people (liquor agents), appointed by the liquor Commissioners in a competitive process that balances customer service, access and revenue generation. The program regulates legal and responsible sales through the liquor stores. In addition, distilled liquor is available for sale in distillery tasting room outlets. The Distilled Spirits Program comprises the Wholesale Operations' Distribution Center, the Purchasing Division, and the Retail Services Division. The program centrally purchases, warehouses, and distributes distilled spirits to Oregon's liquor stores. It oversees the liquor agents. Under this system, the OLCC can provide a varied and balanced inventory of distilled spirit brands to the public. Customers throughout the state have a world class choice of distilled spirits available in their communities or within a reasonable distance from them at consistent prices. Through oversight of retail operations, the program ensures responsible sales in the liquor stores. Liquor agents and their customers, distillers and their representatives, and licensees purchasing spirits from liquor stores are key stakeholders of this program and serve as its partners.

### *Program focus for 2019-21:*

- Align oversight of distillery agent contracts with statutory obligations
- Target expansion of retail outlets to support customers, revenue growth and stability. Following a general statewide expansion focused on market development and consumer access in 2017-19, the OLCC will limit expansion to targeted opportunities to generate revenue and to foster unique marketplace innovations.
- Increase data analysis and dissemination to improve profitability
- Foster increased agent participation in system governance
- Open increased channels of agent communication, education and input from the hospitality and tourism sectors
- Communication and education about retail premises violations
- Publish consumer magazine to support statewide liquor and hospitality sales and service.

## ***Public Safety Services Program***

## ***Program 002***

The Public Safety Services Program protects the public safety, supports livable communities and enables economic development through the administration and enforcement of liquor and marijuana laws. The program regulates the manufacture, distribution and sale of alcoholic beverages, the production, manufacture, wholesale, testing, research, retailing, and tracking of marijuana, and more recently the tracking of OMMP medical marijuana and hemp. It builds partnerships with local law enforcement, moderation groups and

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licensees. The program comprises four divisions: License Services Division, Public Safety Division, Alcohol (& Marijuana) Education Division and Administrative Policy and Process Services Division.

The Public Safety Services Program works to license only qualified people and businesses to sell alcohol and marijuana and to ensure their compliance with liquor and marijuana laws. Program staff work extensively with licensees to help them understand and comply with the laws that govern them; training and educating them in processes and laws is OLCC's first strategy to gaining liquor and marijuana law compliance. Staff also works with neighborhood, civic and business groups, the general public, schools and local governments to educate them about liquor and marijuana laws and to gain their perspective on a variety of issues. Additionally, the program ensures that people who sell or serve alcohol or work in the marijuana industry take the mandatory education course to obtain their permits, and that the curriculum is effective, accurate and reflects current laws and policies. The hospitality industry (including restaurants, taverns and other businesses selling and serving alcohol at the retail level); beer and wine wholesalers and distributors; the alcoholic beverage industry, licensees of recreational marijuana, and OMMP registrants and hemp growers subject to tracking are customers of this program. Neighborhoods, communities, local law enforcement, moderation groups and local government also have interest in this program and serve as its partners.

## *Program focus for 2019-21:*

- Ensure public health and safety via administrative enforcement actions
- Collaborate with federal, state and local law enforcement to protect Oregon's legal recreational marijuana market
- Cooperate with law enforcement agencies on the prosecution of illicit commercial marijuana offenses in Oregon
- Operate a law enforcement only call center to answer questions, direct resources and provide real time investigation assistance
- Implement OMMP medical marijuana and Hemp tracking through CTS and provide onsite inspections
- Continue a vigorous minor decoy operation program
- Provide greater management controls to achieve coordination of field offices activities and compliance outcomes
- Increase accountability through consistent records management
- Increase licensee outreach and education to increase rule understanding and compliance
- Replace manual systems and minimize duplicate data entry with automated processes
- Minimize license application, renewal, and permittee backlog
- Refine process for sanctioning minor and major marijuana administrative violations

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## *Administration and Support Services Program      Program 003*

The Administration and Support Services Program (usually called the *Support Services Program* for ease) provides the infrastructure to fulfill the liquor commission policy direction, and for OLCC programs to provide services to its customers and stakeholders. The program provides a means to communicate and collaborate with external stakeholders. It provides the OLCC with an internal infrastructure to create and implement organizational structure; ensure accountability and stewardship; and provide the tools and supplies for an efficient and safe workplace. Functions include setting and implementing policy, providing public information, internal and external communications, hiring staff, providing fiscal accountability and recordkeeping, administering privilege tax collection, providing information technology services, stewardship of facilities, business continuity, internal auditing, staff training, labor relations, commodity purchasing, personal property control, building and equipment leasing, motor pool management, physical plant and building maintenance, mailroom services, and central supplies. OLCC's internal users of these services are the program's customers. Additionally, external stakeholders are customers -- including legislators, local governments, law enforcement, the alcohol and marijuana industries and the hospitality industry. The media is also a customer of this program.

### *Program focus for 2019-21:*

- Invest in technology to protect core agency functions of distilled spirits distribution, finance, licensing and cannabis tracking
- Redesign work processes to eliminate manual processes, reliance on excel spreadsheets, and duplicate data entry
- Utilize data to inform business intelligence, policy analysis, and decision making
- Scope future capital investments and return on potential investments for continuity of operations
- Build agency intranet to improve employee productivity
- Increase communication with all constituencies

## *Store Operating Expenses Program      Program 005*

The OLCC contracts with individual and private business people, to operate exclusive and nonexclusive liquor stores and distillery tasting rooms around the state to make distilled spirits available in a managed and socially responsible manner. These independent contractors (called *liquor agents*) receive funds from which they pay all store expenses, including rent, utilities, store fixtures, remodeling, moving and staffing expenses. From the net, they fund their own salary and any benefits or retirement savings. The Store Operating Expenses Program fund contains the dollars the OLCC distributes to liquor agents to operate the stores and a commission for sales in distillery tasting room outlets. Both the shopping public and business people with licenses to sell distilled spirits by the drink are customers of the liquor stores. The shopping public are customers of the distillery tasting rooms.

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## *Program focus for 2019-21:*

- Simplify compensation for retail liquor agents
- Establish distinct compensation formula for Oregon Distillery Agents
- Review retail contracts, classifications, and compensation to stimulate an increased quality in retail business appointments, store quality improvements, business practices, and stable growth in revenue
- Provide annual training for agents and their staff to better overall business practices and knowledge about liquor products, and
- Facilitate regular communications with the agents about liquor industry trends and data that can positively impact agent store operation.

## ***Capital Improvements Program***

## ***Program 088***

Through OLCC's Capital Improvements Program, the agency provides effective stewardship of OLCC-owned building and grounds. The OLCC owns its Milwaukie office and warehouse complex, which includes the distribution center for all bottled distilled liquor. The distribution center comprises two warehouse facilities. The entire campus houses approximately 248 employees; 80 employees are located in eleven different leased field offices. Each biennium, the OLCC completes regular maintenance and repairs per its ten-year plan, and completes major projects as provided for by the Legislatively Adopted Budget.

## *Program focus for 2019-21:*

- Complete final phase of warehouse roof project
- Implement the Agency's capital improvement program
- Develop a capital investment plan to maximize operations and investments over the next decade

## ***Marijuana Regulation Program***

## ***Program 004***

In November 2014, Oregon voters approved Ballot Measure 91, which legalized the sale and use of recreational marijuana in Oregon; tasking the OLCC with regulation. Subsequent legislation in 2015 and 2016 further defined and expanded the scope of regulation, including the addition of license types, and allowing medical products to be produced, processed, and sold through the OLCC system. This responsibility resulted in an added focus of the OLCC, requiring adoption in a very short timeframe to adopt marijuana regulations relating to growers, wholesalers, processors, retailers, laboratories, marijuana worker permits, and research certificates. In 2015-17 the focus in this program was on hiring and training staff, agency integration, interagency coordination (OHA, Department of Agriculture, Department of Revenue), creation of processes and procedures, licensee education and licensing. A major undertaking was the development and implementation of online systems including the Cannabis Tracking System, License Application System, Packaging & Label Approval System, and Marijuana Server Permit Education and Application System. The Program was responsible

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for staffing the Cannabis Best Practices Environmental Task Force and producing a DUII report for the legislature. In 2017 and 2018 the marijuana program was again impacted by multiple changes in statute which added responsibilities for consumer privacy, hemp processing, marijuana tracking and regulation, hemp tracking and OMMP registrant tracking, and labeling. Changes in statute resulted in the need to modify the agency's electronic systems, hire and train additional staff, policies, procedures and rules and significant outreach to existing licensees and applicants.

In 2019-21, the program focus will continue on agency integration, interagency integration, enforcement, rulemaking, licensee education, licensing, compliance, and the production and analysis of data from the Cannabis Tracking System to aid in auditing of tax collections in conjunction with the Department of Revenue and compliance activities. Processes and procedures will be refined as statutes and rules change and as the program gains experience. Adaptability, transparency and public and industry engagement will be key to the development of this new industry, public safety, and community livability.

With significant changes in the medical production of marijuana, the OLCC must work to ensure access to marijuana for medical conditions for which use is considered beneficial as supported by medical evidence with some positive benefit of treatment such as: cancer and use in the treatment of associated nausea, pain associated with glaucoma, veterans with post-traumatic stress disorder or PTSD, use for seizures in children and adults, and for the reduction of opioid use for pain management under a physician's care.

The OLCC works closely with its partner agencies to administer this program:

- Oregon Health Authority (Oregon Medical Marijuana Program regulation, testing standards, ORELAP certification, label requirements, THC concentration limits)
- Oregon Department of Revenue (taxation, audit)
- Oregon Department of Agriculture (certification of kitchen and weight scales, pesticide use)
- Oregon Department of Water Resources (regulatory authority of water use in Oregon)

The marijuana program is funded solely from marijuana licensee fees and fines, paying for marijuana program expenses and personnel including its proportional share of agency-wide shared management, support staff, and expenses. The Department of Revenue collects and distributes marijuana taxes.

*Program focus for 2019-21:*

- Continue integration of marijuana enforcement activities with Public Safety Services Program
- Continue integration of marijuana licensing activities with Public Safety Services Program
- Coordinate government to government policy issues
- Refine and streamline marijuana rules, policies and procedures

# BUDGET NARRATIVE

- Identify needed technical statute changes and work with the legislature to achieve them in 2019
- Provide for ongoing data reporting
- Ensure the recreational system is servicing medical patients and their unique needs

***OMMP Tracking Program***

***Program 006***

OLCC’s Medical Marijuana Tracking Program results from the passage of SB 1057 (2018) which requires that OMMP medical marijuana growers, producers, and retailers to be tracked by OLCC’s cannabis tracking system. OLCC was given the responsibility to administer the tracking and to perform inspections to assure that OMMP marijuana is properly accounted for. Violations are reported to OHA for enforcement.

*Program focus for 2019-21:*

- Continued hiring and onboarding of staff
- Refinement of policies and procedures
- Implementing OMMP tracking program
- Continued registrant education and outreach
- Analysis of Cannabis Tracing System data
- Performing registrant inspections

***2019-21 Agency Request Budget:***

<b>OLCC Program</b>	<b>2019-21 Agent Request Budget Other Funds</b>	<b>2019-21 Agency Request Budget Positions</b>	<b>2019-21 Agency Request Budget FTE</b>
<b>Distilled Spirits</b>	\$ 22,401,877	79.00	79.00
<b>Public Safety Services</b>	\$ 26,667,517	118.00	116.00
<b>Administration &amp; Support</b>	\$ 25,664,488	80.00	80.00
<b>Store Operating Expenses</b>	\$ 142,882,366	0.00	0
<b>Capital Improvements</b>	\$ 6,461,943	0.00	0
<b>Recreational Marijuana</b>	\$ 25,105,446	71.00	71.00
<b>Medical Marijuana - OMMP</b>	\$ 8,781,918	23.00	23.00
<b>TOTALS</b>	\$ 257,945,555	371.00	369.00

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**Oregon Liquor Control Commission is Focused on Business Success and Creating a Fair Marketplace:** The OLCC role is to create and enforce responsive and well-defined regulations that support business innovation, create fair markets, and provide education and enforcement services that keep communities and people safe. The plethora of complex policy and regulatory issues in the alcohol and marijuana environmental sections, described below, will challenge the agency in 2019-21. E-Commerce, trade practices, retail expansion, and agent compensation discussions are likely to dominate the policy landscape for alcohol. Implementation of recreational marijuana, OMMP marijuana, and hemp programs will continue to generate significant policy and regulatory work as the agency works to maintain a legal cannabis market, expand services to meet the needs of medical marijuana cardholders, prevent diversion from the legal market, and keep marijuana out of the hands of children. Market consolidation and licensing complexities combined with data analysis will continue to fuel the growth in need for technology and staff.

## ***Alcohol Environmental Factors:***

### ***OLCC's Sales Produce Major Revenue for State and Local Services***

**Alcohol Sales Are a Significant Revenue Producer for Oregon's State and Local Government Programs.** During the 2019-21 biennium, the Governor's budget estimates OLCC will collect \$1.5 billion in revenue from four primary areas: 94.5% of the agency's revenue comes from sales of distilled spirits, 3% from collection of wine and beer tax and 1% from liquor license fees and 1.5% from marijuana license fees; \$1.45 billion will come from alcohol sales, license fees and fines. A total of \$594.5 million is the estimated distribution to state and local government programs – a critical resource for education, health, and public safety.

### ***Oregon Market Driven by Competition and Consumer Choice***

**Distilled Spirits in Oregon are Capturing Higher Market Share of Alcohol Sales:** Oregon's spirits market is competitive, filled with a selection of consumer choices and generally matching or exceeding national trends for premium product sales. Over the last several years, the Distilled Spirits Council of the U.S. (DISCUS) has observed that per capita consumption of all alcoholic beverage types combined has remained flat nationally but has risen in Oregon since 1995, and distilled spirits has captured more of the alcoholic beverage market share in Oregon. This shift continues in Oregon and across the nation. Distillers' increased national marketing and advertising has led to greater consumption of spirits. Distillers' premium and super-premium spirits in American whiskey and Tequila has driven much of the recent growth in distilled spirits.

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**Oregon Consumers Choosing Premium Brands Among a World Class Offering of Products:** Distilled spirits customers’ preference for premium brands continues to increase since a recession-driven shift to less expensive items. In 2017, over 4,100 different products were available to consumers and sold through the Oregon liquor system. The warehouse regularly stocks 2,000 items and in 2017 the agency filled 22,314 special orders for 2,100 additional items. The special-order process is particularly important to small Oregon Distillers as it provides a unique to Oregon distribution channel that enables these distillers to build brand recognition.

**Oregonians Choose Craft Products Produced in Oregon:** Oregonians support local products in the marketplace. Oregon craft distillers contribute to state revenue growth and are an important source of product diversity in Oregon’s market. Oregon spirits account for 13% of annual liquor sales in the state, making them an important factor both to state revenue and distributions to local governments. The OLCC system provides important access to the entire statewide market for craft distillers’ offerings distributed statewide through the OLCC warehouse. This is an important market advantage compared to other states. The OLCC recently reduced cost for small distillers by allowing them to serve local markets without first shipping to the Portland warehouse, thereby creating new efficiencies for getting local products to local markets.

## ***Oregon Sales of Spirits Continues to Grow***

It is important to be aware of the economic, business, regulatory, and other environmental factors that affect sales. A major issue facing the OLCC’s distilled spirits program is how to manage resources and gain efficiencies to keep pace with the changing, growing marketplace within the state budget framework. The OLCC has applied several strategies to this challenge and sales performance shows the strategies’ success.

The national and Oregon distilled spirits sales trends that evolved in the last two biennia have continued to grow and retail prices for distilled spirits continue to increase modestly. Distilled spirits sales in Oregon are affected by demographic and market forces similar to those in the national environment. Oregon case sales will continue to increase in 2019-21. The OLCC expects a growth rate of 2.5% percent per year in case sales during the 2019-21 biennium. In 2009-11, people were “buying down”; that is, buying less expensive brands than in the recent past. Since 2014, OLCC has seen the average price per bottle increase from \$16.56 to \$17.24. For 2019-21, the agency is projecting an annual sales growth rate of 5.4 percent using econometric forecast models tying sales to population growth.

**Sales of Spirits in Oregon Reflect National Sales Trends:** Sales of distilled spirits in Oregon reflect sales patterns on a national level. Domestic whiskeys are the sales leaders followed by vodkas. The major brands are the biggest sellers with about 400 products accounting for over 75% of the sales revenue. During FY 2017, over 4,100 different products were sold through the Oregon liquor system. Oregon-based spirits account for 13% of annual liquor sales in the state making them an important factor both to state revenue and local communities.

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**Liquor Sales Recover after Great Recession but Percentage of Consumer Sales Still Higher than Licensee Sales:** Before the Great Recession (starting in 2008), liquor sales revenue had increased at an average rate of 7% during the previous decade. After the recession began, the liquor sales revenue declined to an average annual increase rate of 2%. Over the past five years, liquor sales have resumed a 5% annual growth rate. The volume of liquor as represented by case sales, which had increased at an average annual rate of 5% during the previous decade, went to almost 0% after the recession. The implementation of the 50¢ surcharge helped maintain positive revenue growth after the recession while volume growth was negligible. Since the economic recovery, case sales have resumed at an annual average increase of 2.5%.

During the Great Recession the share of liquor sales to consumers increased relative to on-premises sales at licensed establishments. The percent of sales to licensees dropped from 29% in 2007 (prior to the recession) to 24% in 2013 and has not recovered, indicating that the increases in liquor sales have been driven by consumers rather than bars and restaurants. Liquor sales growth for licensees (bars and restaurants) went negative in 2009 and 2010 as many businesses were affected by the Great Recession but has since recovered showing average annual increases of 3.0% since 2013.

**Factors Influencing Oregon Sales:** The OLCC carefully watches trends and factors that influence the market within the state. One development is the dramatic and enduring positive affect the State of Washington’s liquor privatization has had on boarder sales. A new development is a federal government tax break for distillers.

**Washington Privatization Continues to Boost Sales in Oregon:** A ballot initiative changed the Washington liquor system in 2012. The combined effect of revenue replacement fees along with private wholesaler and retailer markups raised liquor prices about 30% over pre-privatization levels and created a significant differential with Oregon liquor prices. The impact to Oregon was that liquor stores along the Washington state line saw an average increase of 34% in sales, which has been maintained. Oregon liquor stores do not track out-of-state purchases, so it is not possible to know exactly how much revenue was generated as a result of the Washington privatization. A comparison of before and after sales for stores near the Washington state line suggests, however, that as much as \$15 million in additional revenue may have been added annually to Oregon sales.

**Craft Beverage Modernization Act Cuts Federal Excise Taxes:** The Craft Beverage Modernization Act was part of the 2017 Federal Tax Cuts and Jobs Creation Act passed in December 2017. It included the first reduction in federal alcohol excise taxes since the Civil War. The federal excise tax on distilled spirits was reduced from \$13.50 per proof gallon (one gallon that is 50% alcohol) to \$2.70 per proof gallon for the first 100,000 proof gallons, \$13.34 up to 22,130,000 proof gallons and \$13.50 for production above 22,130,000.

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This represents an 80% decline in federal excise tax for smaller distilled spirits producers and a decline in excise taxes of between \$1.1-\$4.6 million for large producers and importers of distilled spirits. This is in addition to lower corporate income tax rates that large distillers will enjoy from other provisions of the tax. One major industry player experienced a 1.7% decline in effective tax rate for FY 2018 and anticipates a further 7% drop for FY 2019.

At an average price per bottle of \$17.84, the excise tax decrease for a small producer represents about 20% of the total cost to OLCC of an average 750 ml bottle of 80 proof liquor. Analysis of 2017 bottle prices compared to 2018 bottle prices indicate no systematic reduction in producer prices has been passed on to OLCC and Oregon consumers, either from smaller craft producers or major vendors. However, notable capital investment in storage facilities to age bourbon and whiskey suggests that this reduction is fueling capital investments in meeting future demand for both large and small producers.

## *Commission Leadership Creates a Culture of Accountability for Change*

OLCC Commissioners and agency leadership continues to focus on creating a culture of accountability for change throughout the organization. A key focus is aligning rules, regulations, and enforcement, and utilizing education to increase compliance in order to both protect public safety and support the success of businesses, the creation of jobs throughout Oregon, and the expansion of the retail footprint. This requires enhanced efforts to reach out to the local agencies and state partners to work on community-based solutions.

***Balancing Convenience and Economic Development with Public Safety:*** In the 2019-21 biennium, the agency will continue retail expansion efforts to increase customer convenience and promote economic development through the creation of new businesses. Expansion efforts have led to discussion on whether the number of outlets selling distilled spirits is adequate to meet demand and if not how many more outlets can the state open without heightening public health concerns related to over consumption of alcohol. The challenge of balancing convenience, economic development and public safety has always been a critical mission of the agency. Growing the agency's capacity to communicate directly with communities and licensees that sell and serve alcohol and expanding the capacity to inspect and enforce its regulations in the field are primary tools to achieve a balance between its responsibilities and achieve greater safety in communities.

While the sale of liquor generates state revenue and fuels a strong hospitality and entertainment economy that is important to citizens and tourism, alcohol has high societal health and safety costs. Other public health services have the primary responsibility of addressing the negative effects of over consumption and law enforcement in every community deals with the associated violence and traffic deaths related to alcohol. The OLCC sees expansion of its enforcement capabilities as vital to keeping communities and people safe through education and regulation of the sale and service of alcohol. Communication and partnership about central issues and problems caused by alcohol are part of accountability for change and the OLCC's role to help achieve it.

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**Underage Drinking Continues to Be a Serious Problem:** Underage drinking continues to be a serious problem across the nation, and in Oregon, though the country has been able to affect a downward trend in recent years. The OLCC's number one public safety priority is preventing underage drinking. The OLCC realizes it cannot adequately address the problem alone but can be a major part of the solution by ensuring alcohol is not available to minors from licensed premises.

The Public Safety Services Program works in partnership with a variety of entities to increase communication between agencies and the public. The program staff have been active with the Governor's Advisory Committee on DUII, the Governor's Alcohol and Drug Policy Committee; National Liquor Law Enforcement Association; Oregon Chief of Police Association; Office of Mental Health and Addiction Services Department; Oregon Lottery, local law enforcement agencies, State Police, and city and county government agencies.

Currently the Public Safety Services Program has over 14,000 retail businesses such as restaurants or convenience stores that serve or sell alcohol directly to the public. In addition to working with licensees, Public Safety Services staff oversees more than 165,000 alcohol service permit holders. The Education Division of the Public Safety Services Program administers a mandatory clerk-training course, a voluntary seller training course, and the Responsible Vendor Program. The staff also designs and develops special educational projects focused on youth which are distributed through print and social media.

One of the primary tools of the Commission in its work to support public safety is expansion of its ability to communicate directly to communities and licensees that serve communities. The OLCC believes that it can improve community safety by using data to keep communities aware of growth in alcohol related sales and service problems locally. Communication coupled with an ability to complete inspections and necessary enforcement is a central combination for the agency in meeting its responsibilities to keep people safe.

**A Mission to Match its Responsibilities:** The Commission and agency worked with all its employees to define its agency wide understanding of the responsibilities and services it provides to the state. This was important defining work for establishing a new culture of responsibility for how all employees and leadership carry out their jobs on behalf of the citizens of Oregon and the Commission. This mission took into account new responsibilities for marijuana and recognized the broad responsibilities of the agency; this contrasted with its old prohibition era alcohol mission focused on regulation of just sales and service. It is simple and to the point. The laws of Oregon detail OLCC's responsibilities. Interestingly the agency mission statement does not focus on generating revenue, the calling out of any regulation, or other specific responsibility of law. This mission is notable for its focus on service to the success of the economy and people. For the employees of OLCC, it defines our purpose.

**Mission of the OLCC:** Support businesses, public safety and community livability through education and the enforcement of liquor and marijuana laws

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**Minimizing the Impact of Retail Expansion on Existing Liquor Agents:** The Commission’s concern for balancing the expansion of liquor outlets with the impact on existing businesses is a direct example of its commitment to be accountable for change. The Commission considered the potential negative impact on existing liquor stores in their deliberations for the appointment of new stores. First, the Commission provided existing agents opportunity to participate in the expansion process and some existing agents were successful applicants along with newly created liquor business operators that were welcomed into the system through appointment by the Commission. The 18 expansion stores generated \$27.0 million in additional sales; however, there was a reduction of \$5.4 million in nearby stores. This resulted in a \$21.6 million net sales gain within all market areas. The Commission is pleased with the results and will continue to monitor sales trends, share them with agents and the legislature, and incorporate the findings into future location selections.

## ***Adapting to Innovations in Commerce, Customer Expectations and Creating Fair Markets***

**E-Commerce transactions involving Beer, Wine, and Cider:** Consumer demand for access to goods and services through online tools that provide both convenience and variety is skyrocketing. Consumers are interested in including alcohol items in their orders when purchasing groceries or meals for home-delivery. Businesses that own and operate e-commerce tools like apps and websites are stepping up to meet consumer demand for home delivery. Many of these market actors would like to facilitate alcohol transactions and provide alcohol delivery as a part of their services. The operators are using a variety of applications and web-based tools to facilitate online alcohol transactions in other parts of the country and they would like to do so in Oregon. However, most do not hold liquor licenses in Oregon. Because the OLCC provides a retail system for the sale of distilled spirits, these digital operators are focused on facilitating alcohol transactions involving malt beverages, wine, and cider and asking the OLCC for guidance how they can provide alcohol transaction facilitation and delivery services in Oregon. Oregon law allows liquor licensees to deliver beer, wine and cider to consumers in certain circumstances. OLCC has worked proactively with stakeholders to fit their delivery models into the existing legal framework. However, some companies that utilize private contractors may not be able to adapt their business models to existing state requirements.

This is a new and exciting area of regulation for the OLCC and the Oregon marketplace, but the existing statutory framework defining conduct qualifying as a “sale” of alcohol in Oregon is written broadly and may preclude some of these e-commerce actors from facilitating legal alcohol transactions in Oregon, without a license. A primary goal of many of the e-commerce actors seeking to operate here is to connect existing retailers that hold liquor licenses in Oregon with Oregon consumers through their apps and web-based tools. In some cases, the method for connecting the licensees with the consumers presents issues for the e-commerce actors under the current statutory scheme.

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In Oregon, a business that “sells” alcohol must have a liquor license and the current licensing structure set by state statute does not include a license option that would fit the needs of all e-commerce businesses. This frustrates some participants who would benefit from the alcohol transaction services that could be provided by these e-commerce tools. Importantly, it frustrates liquor licensed businesses that would like to use third-party apps and websites to manage orders, payment and delivery to customers that are demanding the service. Digital operators are anxious to receive this guidance so they can determine whether it is feasible for them to legally enter the Oregon market to provide alcohol transaction services under the existing statutory framework. While the OLCC could consider rules modifications to work on the edges of this larger commerce issue, it does not have the ability to work around the central prohibitions of state law related to sales without a license. The legislature could work with interested parties and regulators to fashion a solution to the issue. Possible options include modifying the statutory definition of “sale”, designing a new license-type, or defining a set of criteria to use to distinguish and allow these types of businesses to enter the alcohol stream of commerce.

**E-Commerce for Spirits:** App and web-based alcohol shopping for beer, wine, and cider will be present in the Oregon market and, depending on state regulation, will provide varying degrees of service to customers and businesses. This creates unique challenges for OLCC given its responsibility to oversee sales of spirits in this changing consumer environment. Customer’s expectations are important in private business, to OLCC businesses, and the independent agents that sell spirits. Business growth and relevancy is driven by the ability to provide innovative products that reach customers conveniently. Customer convenience continues to be one of the reasons for the expansion of the OLCC agent store system in both traditional and non-traditional outlets.

The spirits market and OLCC retail stores are not insulated from the strong consumer trend of shopping from home and home delivery. Today, shoppers across the globe are purchasing products online for delivery to their homes or to pre-order products for one stop pick-up. The internet offers widespread variety and its use is disrupting traditional brick and mortar retail businesses. As the exclusive provider of spirits in Oregon in an alcohol control state, the OLCC regulated system may need to adapt its distribution system to preserve revenue and meet consumer expectations by including e-commerce as a consumer choice in addition to shopping in independent agent liquor stores. Over the past decade the stock of OLCC outlets through private agents is increasingly catering to customer preferences and experiences. Tremendous investment in store improvements have been made in the last three years with changing policies of the OLCC and greater confidence in its stability as an institution; In 2018 the OLCC was recognized as the best-of-the-best for retail innovation among its peer states by *Stateways* magazine. The legislature has invested in its operations and facilities in order to serve the state consumer into the future. All of this is in recognition of the tremendous asset the OLCC is as a revenue producer for the state. As a state with an overall limited tax and revenue base, state-controlled liquor distribution is likely to remain a central feature of Oregon’s liquor future.

These e-marketing platforms have various business models and work to comply with prohibited activities in federal and state law. OLCC is in position over the next two years to explore, with the independent agents that sell liquor and the legislature, its future with respect to online ordering and delivery of spirits to the home. It is an important and delicate discussion for shaping the desirability of

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the system for customers and to preserve market share and revenue generation. Financial transactions and visualization of inventories on an app or website defies existing technical and legal applications of concepts such as financial assistance, advertising, sales, and soliciting related to the sale and service of alcohol. These online services also blend the careful separation in law between the three-regulatory tiers. Retailers, distributors, and manufacturers are only allowed to engage in specific activities, yet services on apps and websites sometimes look like an amalgamation of all three tiers without careful examination of how they are structured, how payments are technically made, who actually makes a sale, fills an order, or makes a delivery.

The agency is up to the task of creating actionable options for the public, Commission, and legislature to consider. The OLCC must work with its agents to make sure that any system design is synergistic with agent's sales of liquor and that full verification that a legal adult is accepting the spirits at the home occurs. There are a variety of system designs that could ensure age verification and that compensation from the online system includes agents in the revenue stream of delivery to the home.

***Trade Practice Regulation:*** Post prohibition alcohol law and regulation created a three-tiered system that does not allow one area of business to engage in other areas of business. The three tiers are the manufacturers that make the distilled liquor, wholesalers that distribute distilled liquor, and retailers that sell distilled liquor. Statutes were put in place to control the monopolization of the industry by manufactures and wholesalers of alcohol and to address issues of historical corruption and criminal association within the industry. Other than the separation of the tiers, one of the most significant controls placed on industry was to prohibited financial assistance between the three tiers; this prohibition was put in place to create level planning field.

Many states are mired in deep historical corruption and competition to gain market advantage in the liquor business. Oregon does not have that history, nor has it had a reputation of being a “pay-to-play” market. But nationwide the Alcohol Taxation and Tobacco Bureau (TTB) that regulates liquor on behalf of the federal government has engaged in a renewed enforcement focus on trade practices. The OLCC does not have a reason to believe trade practice violations are prevalent but it does believe that now is the time to work with the industry to ensure a professional ethic and level playing field for all the business that work in the Oregon marketplace. Even through there are no documented violations in recent years in Oregon, the OLCC has detected an increased level of concern about this practice in its discussions with a number of licensees, brokers, and manufacturers that sell, market and make spirits. Unfair and unethical trade practices skew competition and it is the job of the OLCC to ensure a level playing field.

OLCC is taking action to get in front of the “pay-to-play” issue with strong support from its industry partners. The agency's strategy is to enlist the industry itself in communicating the need to play by the rules. It will encourage communication about the importance of providing the agency information and tips when trade practice violations occur or are suspected. Prohibited activities include action such as solicitation of sales, providing financial incentives, or the giving of gifts and gratuities such as gifts of professional soccer or basketball tickets, televisions, displays, cash for providing shelf space or to carry a brand, or vacations.

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## *Serving a Growing Swath of the Oregon Economy and Jobs*

The OLCC serves a business and consumer sector that reaches every corner of Oregon. The agency's licensees fuel a hospitality and entertainment industry that creates jobs and business opportunities throughout Oregon, including rural Oregon where jobs are often scarce. Oregon's craft distilleries along with wineries, who produce top tier wines of international note, and craft beer brewers that produce an incredible array of products are fueling Oregon's reputation for tourism and unique dining. These businesses often utilize Oregon grown agricultural products in their businesses, from the grapes of the Willamette Valley and Southern Oregon, across the wheat fields of Eastern Oregon, to the hops grown along the pathway of the Willamette River. The focus on craft processes and Oregon grown products creates a lure and special vibrancy in bars and restaurants throughout the state. This creates an important cluster of the economy that supports jobs and economic opportunity in urban and rural Oregon as well as enjoyment for Oregonians and visitors that come to experience Oregon's natural craft products, and to enjoy the hospitality of the businesses that welcome them.

**Oregon Beer, Wine, and Distillery Manufacturers Compete for Market Share:** Oregon's alcoholic beverage manufacturers compete for businesses in Oregon communities, statewide, and in national and international markets. Across the spectrum of beverages, Oregon manufacturers produce many high-quality products and exclusive alcoholic beverage experiences. This is an industry that thrives on innovation and the OLCC works with manufacturers to enable the introduction of new and creative offerings in this sector.

**Oregon Liquor Stores Serve the Oregon Consumer, Oregon's craft markets, and the entire hospitality economy:** Agent liquor stores play a vital role in providing services to Oregon's hospitality industry, through the sales of Oregon's craft products and high-quality products from national and international manufacturers. Agent stores deliver a diverse selection of distilled spirits to bars and restaurants, many of whom differentiate themselves by focusing on locally sourced craft cocktail preparations for their patrons. Through annual OLCC agent trainings, agents have gained insights into the products from master distillers and sales experts. Increasingly, agents are making major investments to improve the shopping environment for Oregon customers, and their knowledge about their community places these small businesses in a unique position to be promoters of the cultural aspects of Oregon's thriving hospitality and entertainment businesses. Agent's knowledge of product selection serves their customers well and subsequently increases their earnings and profits. They know their customers, and their sales have generated billions of dollars to fund state, county and city services over the decades.

The OLCC recognizes the importance of agents as the engine of liquor sales which create state revenue. It's to OLCC's and the state's advantage to ensure the system of stores is profitable for hard working retailers. It is also important that compensation is fair and recognizes the independence of these small business contract agents who assume both the opportunity and responsibilities of liquor sales in Oregon.

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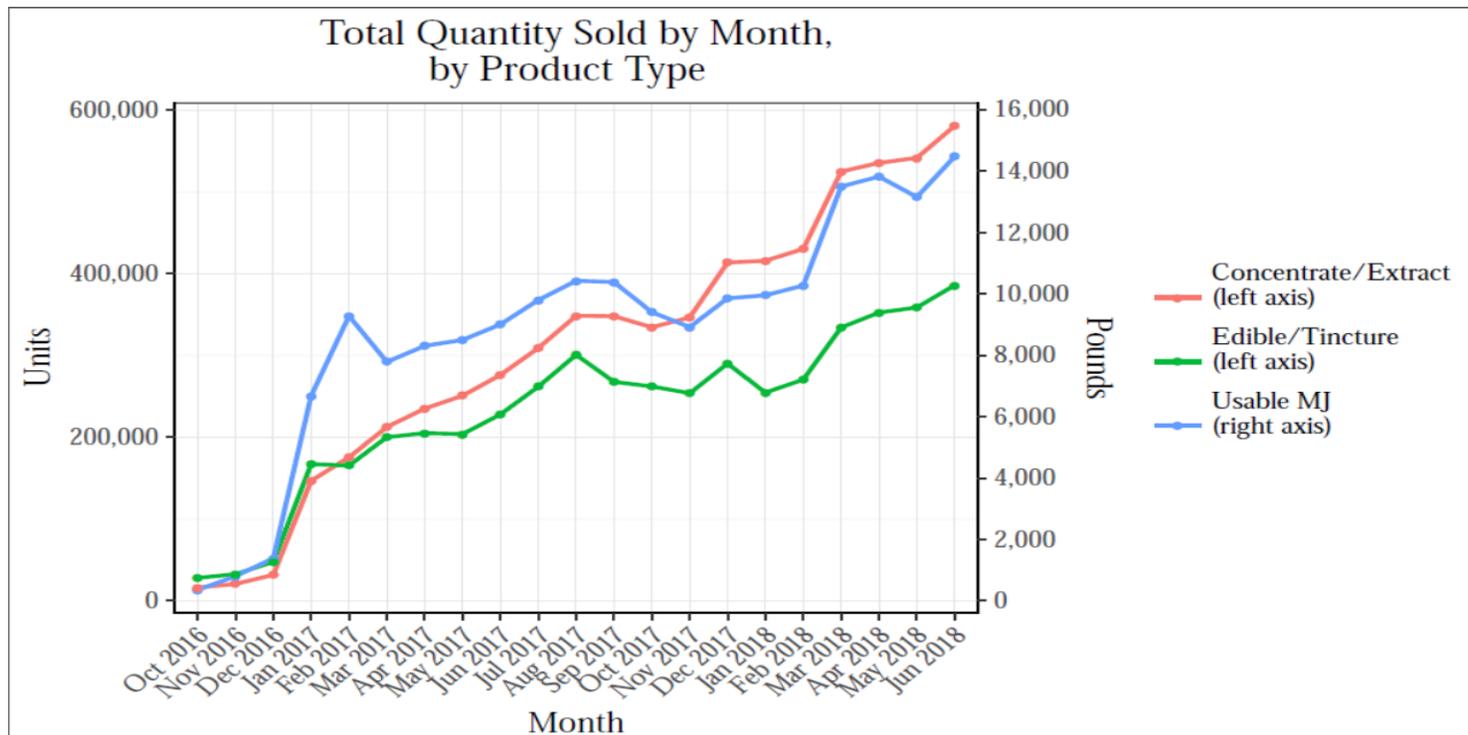
## *Marijuana Environmental Factors:*

### *Oregon Successfully Establishes a Legal Cannabis Market for Oregonians*

Oregon was well poised to establish a comprehensive consumer market for cannabis after the passage of Measure 91. Oregon’s legal regulatory system is providing a growing selection of innovative product choices for customers. Sales of marijuana have generated \$173.1 million in tax dollars for public services since the program’s inception. Marijuana sales are expected to generate \$202 million in tax collections for the 2019-21 biennium.

### *Oregonians have access to a wide variety of superior products at low retail prices*

Oregon now has a robust supply chain in place — growers, testing labs, processors, wholesalers and retail licensees are linked together through the Cannabis Tracking System to efficiently move supplies of tested products to the Oregon consumer. This development, and superior quality control in the legal system, is creating the conditions to fully displace old illegal market alternatives within Oregon.



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Legal consumer access was the central outcome sought by Ballot Measure 91 and that central aim of policy has largely been achieved. The earned revenue streams from fees and taxes will be more than sufficient to evolve second generation systems and introduce additional controls to improve regulatory efficiency. Cannabis clearly is a growing and important sector of the Oregon economy fueling the creation of jobs and tax revenue for government services at the state and local level.

## *Annual Sales of Retail Cannabis Nearly Match Spirit Sales in Oregon*

The growth of Oregon's market has been rapid. A comparison of the annual retail sales of cannabis products shows that these sales nearly match sales of spirits in Oregon. Annual retail sales of marijuana were \$588.0 million in 2017 and this compares to total annual retail sales of distilled spirits of \$626.1 million in the same year. The rise of the marijuana market has been nothing short of dramatic.

**Revenue Generation Comparison:** Through the end of the current biennium, Oregon's 17% sales tax on marijuana has generated \$206.7 million in revenue. This compares to the revenue generated from alcohol distilled spirits sales and licensing of \$544.0 million. These revenues combined with the proceeds from a 3% local cannabis tax directs millions of dollars to local government budgets. Many cities and counties continue to exercise their ability to prohibit marijuana businesses within their boundaries, but most jurisdictions that allow sales have chosen to take advantage of their ability to impose the maximum local sales tax of 3%.

## *Expanding Services to Meet the Needs of Medical Marijuana Cardholders*

Oregon's recreational market is becoming a full-service supplier as the legislature allowed retailers to produce and sell higher dosage, medical grade products to OMMP patients and caregivers. Additionally, OMMP patients and caregivers do not pay tax on any marijuana items purchased at OLCC retailers. The OLCC system is medical patient friendly. Currently approximately 13% of retail sales are made to medical cardholders.

**Creating a Patient Friendly OLCC System:** With significant regulatory changes in the oversight of Oregon's medical grow system many OMMP patients may lose or have already lost their existing relationships with a medical grower. Almost all OMMP medical dispensaries have converted to OLCC retail marijuana stores that sell both recreational and tax free medical grade marijuana products. For medical cardholders the OLCC system is becoming a viable and growing alternative for access to medical products. Improving access for medical cardholders presents an opportunity to serve patients that have found cannabis effective for relieving their medical conditions. Serving OMMP cardholders is an important objective for the OLCC system and increasing sales of cannabis to medical cardholders will be the primary signal that efforts to improve access are working.

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***Refining Medical Use:*** Oregon’s newly created Cannabis Commission is charged with making recommendations on a framework for future governance of OMMP. As recommendations come forward, the OLCC will tailor its rules to facilitate patient access to medical products useful for treating or managing certain health conditions. As well, the OLCC is prepared to make changes to help a defined population of low-income patients gain access to medical grade products through a system of not-for-profit retail distribution or administration of programs that provide for subsidized access. Supporting low income patients is not explicitly addressed in the current OLCC market, however, the OLCC continues to search for opportunities to improve patient access.

***Responding to Research and Trends for Medical Marijuana:*** The consideration of policy options would certainly be aided by research and medical evidence of effectiveness. There remains a lack of research in the U.S. but there is a growing consensus that for certain medical conditions marijuana is beneficial. Oregon is an ideal position to be a leader in the area of research when federal constraints give way.

***Exploring Medical Cannabis Use:*** Across states, and certainly within states that sell recreational marijuana, an older cohort of the population has been identified as one of the groups experimenting with marijuana for its benefits and value to their health issues. This is but one group that has a growing interest and curiosity about the potential medical benefits of cannabis.

For some time now there has been a growing list of medical use conditions associated with cannabis and evidence that medical cannabis use might be beneficial for patients with these conditions; however, more research is needed. Some of the conditions and treatment use that are finding acceptance include: cancer and treatment related nausea; seizures in children; Post Traumatic Stress Disorder (PTSD) in veterans; opioid use reduction under a physician’s care, a substitute for pain and chronic discomfort associated with a wide variety of diseases and conditions; insomnia and eating disorders; and generally as a muscle relaxant. While some medical properties are associated with Delta 9 Tetrahydrocannabinol (THC), which is the chemical or cannabinoid associated with euphoria, non-psychoactive cannabidiol or CBD oils and extracts are widely touted for healing properties. It is CBDs derived from hemp that are used in the production of Charlotte’s Web that has been popularized for its reported success in reducing chronic seizures in children.

All of this interest and use of marijuana for medical treatments confirms that the focus on the medical properties of cannabis will continue. For the OLCC system to be an effective provider of marijuana products to the public, it will have to closely monitor developments in the medical use of marijuana and look to medical experts and the Oregon Cannabis Commission to evolve its relationship to serve medical cardholders.

## ***Leading the Nation and the World in Best Practices and Protecting Children***

Oregon is a worldwide leader in product testing and has in place rigorous pesticide tests to protect marijuana consumers. Learning from Colorado and Washington’s early experiences, Oregon set in place nation-leading best practices for product labeling and packaging — Oregon pre-approves all packaging and labels designs before they are placed on products.

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**Cannabis Tracking:** The Cannabis Tracking System (CTS) creates strong consumer protections from tainted products and the systems' product identification features allows the rapid traceability of tainted products and initiation of recalls. Oregon's tracking system provider, Franwell, is the national leader for provision of marijuana tracking services to recreational states through its Metrc platform. With all the changes in state law over three legislative sessions, Oregon is driving innovation and improvements for this tracking system out of necessity and other states are benefiting from that work. While the practices of tracking marijuana are new, Oregon is a leader in what might be described as state-of-the-art imperfection. Even with its imperfections, Oregon's Cannabis Tracking System is a powerful tool for achieving regulatory compliance and in the next two years, the OLCC will be able to exploit its robust capabilities.

**Protecting Children:** Oregon has in place measures to protect children and minors under age 21 from accessing marijuana products that are dangerous for them. From the development of universal marijuana product warning symbols to requirements that packaging and advertising not be attractive to children, the Oregon system has in place state-of-the-art practices used to protect children from dangerous products. This includes many products that must leave stores in child resistant packaging and units of recreational product dosages are generally lower than other states. The OLCC has also prohibited certain marijuana strain names from appearing on package labels that, in general, are misleading, contain other illicit drug references, or are named after cartoon characters or otherwise appeal to minors. As well, Oregon has strong enforcement protocols and penalties in place to enforce sales to minors. Marijuana tax dollars have been used by OHA to support prevention education to children about consequences of marijuana use at an early age. Oregon has not seen a dramatic change in reported marijuana usage by children, though at least one recent study has seen a spike in an older adolescent age group and several studies are indicating that legalization has changed attitudes adolescent have about the safety of marijuana use. These are issues which public health official are monitoring closely and these professionals are in the best position to represent research to policy makers.

**Advancing Laboratory Testing and Oversight:** Oregon put in place a nation leading regime of product testing standards for laboratories. In this system there is no tolerance for pesticide detection. As innovative as Oregon's work is in this area, the management of testing and the ability to provide meaningful oversight is very challenging. In this area there is a need for additional policy development and oversight of highly technical procedures and regulations. The OLCC issues licenses to marijuana testing laboratories and oversees their reporting of test results. The agency also works with partner agencies to investigate complaints about test falsification and other potential violations. Regulation of labs and the establishment of testing protocols and lab certification is a shared responsibility between the Oregon Health Authority, ORELAP certification standards, the Oregon Department of Agriculture and the OLCC. Until expertise and resources are developed, a regular inspection and auditing protocol for labs will not be available. In the meantime, potential violations will be investigated as complaints are reported to OLCC and its partners. The OLCC is in position to self-fund its responsibilities with fees. Partner agencies are typically financed through the General Fund and do not have great flexibility to dedicate staff to this mission. To date, these agencies have not received funding from the Marijuana Administrative Fund which would be a natural consideration for policy makers seeking to align the expenses of regulating marijuana with the revenues generated through taxation.

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## *Growing Pains and a Predictable Market Shakeout*

Oregon is far from done with dealing with all the complexities of regulating marijuana. While consumers enjoy a plethora of cannabis products the amount of supply in the legal system and intense retail competition is leading to reduced prices. Competition and lower profits are economically squeezing both cannabis producers and retailers. Indicative of this is the dramatic price drop of a gram of usable marijuana; the October 2016 average price per gram of usable marijuana was \$9.73 but dropped to \$4.62 per gram June 2018. On the retail side, there are reportedly more licensed marijuana retailers than Starbucks locations in Oregon. Though Oregon's open market system has benefited consumers, the flood of businesses within is making profitability a challenge.

**Market Consolidation:** Oregon's market response to the low pricing structure is leading to industry realignment. For companies that are being pressured by Oregon's highly competitive market, well capitalized new business interests represent an opportunity for some licensees to recover cost by selling their businesses. Consolidation and ownership churn is expected to continue given the state of the industry. This activity impacts the focus and priorities for OLCC enforcement and licensing. The agency is seeing an increasing number of failing businesses that are working with OLCC to legally dispose of cannabis and properly relinquish their licenses. In other cases, failing businesses often end up with serious charges of basic violations and through the administrative process agree to relinquish their license through settlement rather than proceed to a hearings process.

**Licensing Complexities Driven by Consolidation:** The agency recently announced that it would not be processing new license applications because it needed to focus on renewing licenses for existing licensees that are requesting complicated ownership changes and physical changes to facilities. Approving these renewals is necessary for continued operation as the issuance of renewals generate the fees needed to fund OLCC operations. Renewals are taking roughly 80% of the time of approving original applications and though the agency would like to streamline the renewal process, new ownerships require additional owner and investor background checks and investigation. The agency's marijuana renewal processes not working well to address current circumstances. This burgeoning and unexpected workload is causing the OLCC concerns because licensees can continue to operate while renewals and ownership changes are being reviewed, just as is true with liquor licenses, however, this presents a vulnerability for potential system abuses and the agency's experts are considering options that can be implemented to reduce the risks identified.

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***In spite of Market Distress Demand for New Licenses Remains Strong***

The following table shows the status of issued and new license applications as of July 15, 2018:

	License Active	Approved Not Paid	Surrendered	New Applications	Grand Total
<b>Laboratory</b>	22	1	4	16	43
<b>Processor</b>	182	0	9	414	605
<b>Producer</b>	1064	10	77	1293	2444
<b>Retailer</b>	573	4	42	351	970
<b>Wholesaler</b>	126	3	7	220	356
<b>Research</b>	0	0	0	4	4
<b>Grand Total</b>	1967	18	139	2298	4422

**Helping Failing Businesses Exit Licensing:** As welcoming as Oregon’s system has been to new market entrants, OLCC is positioning to be as helpful and timely as possible in assisting licensees that are exiting the market. Oregon’s regulatory response in a business shakeout environment is two-fold, the agency’s first goal is to be in the position to help business unwind in a legal manner — for example, by prioritizing business ownership and investor changes to help stabilize existing businesses. The second is to work to make sure failing businesses’ products are properly sold out, transferred or destroyed.

**Marijuana Supply:** The rapid growth of businesses in this sector are producing a lot of marijuana. In response, the Oregon market is consolidating to match production to consumer sales and consumption. This is leading to a debate over the necessity for additional supply and license controls. In many respects this is a classic free market debate. The essential question of this emergent debate is whether the government needs to impose additional controls to match supply to consumption in Oregon or will business failures and consolidation balance supply to consumption more efficiently. Secondly, if over production is warehoused and stored by licensees, are controls and reporting systems strong enough to ensure it remains in the legal system.

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In general, many officials in law enforcement and as well as industry stakeholders have expressed support for limits for marijuana licenses or perhaps a legislatively imposed moratorium. However, this view is far from universal. There are other people and industry members who believe limits will be too high to be effective, that taking action now would be unfair or, that limits would go against the open nature of Oregon's system which is successfully providing the opportunity for industry participants to "go legal." The OLCC will be carefully compiling and analyzing its data to inform this growing debate about the need for additional controls.

***Marijuana Supply Report:*** The OLCC will be producing a supply and sales study for the 2019 Legislature that will quantify supply produced within the OLCC system, describe quantities of finished products and their sales to consumers. It will also detail inventories of marijuana that are in the supply chain of OLCC licensees. Additionally, it will seek to identify any consumer ready products, like storable cannabis extracts, that are being stored longer-term, to account for unsold product that is being held by licensees. It will also seek to quantify documented waste and destruction. Ideally the study will provide useful analysis to contrast supply with consumption research for Oregon. All of this will provide a window of data to inform policy makers and citizens with an interest in regulation of marijuana supply. This study will not account for supplies of OMMP grower produced marijuana or transfers to patients that occurred prior to July 1, 2018 and it will not make estimates of production in Oregon that is taking place at illegal, non-state licensed grows.

## ***Enforcement Landscape is Changing for Legal and Illegal Marijuana Businesses***

From the perspective of federal authorities, and specifically Oregon's US Attorney, when marijuana is sold illegally in interstate commerce there is no distinction as to its origins; recreational, medical and unregulated markets are all complicit. And in spite of a national cannabis debate between states and the federal government, there is no clear guidelines on how to bridge the gap between the federal objective of stopping interstate diversion and Oregon's statutes that guide OLCC's licensing and compliance operations. Oregon's U.S. Attorney has a great deal of authority to shape the federal relationship with the state. Through the U.S. Attorney for Oregon's statements, actions and setting of priorities, Oregon officials are confident that legal grows operating within the rules of the state are not a target priority for the U.S. Attorney's Office in Oregon. This aligns with the leadership and advocacy the Governor has provided to support the small businesses that are operating in compliance with Oregon law. The OLCC is appreciative of the coordination and investigative work of federal, county and city law enforcement that are helping the OLCC cleanup bad actor licensees who slide over the line and engage in criminal activity.

***Oregon's Action to Curtail Diversion and Account for Production:*** Preventing marijuana diversion and trafficking outside of the state is a top priority and any Oregon licensee or worker permit holder that removes products from a premises for sale outside of OLCC's system will lose their licenses and permits and potentially be subject to criminal prosecution. Investments in communications will continue to aid in the agency's public safety efforts. The entirety of the OLCC policies and procedures for education, licensing, tracking, compliance inspections and enforcement of violations are all designed to ensure legally produced marijuana remains within the

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legal system. All of this work is critical to preventing diversion. A major policy change by the 2017 legislature demonstrates Oregon's commitment to confront the issue of preventing diversion by state authorized growers of medical marijuana. While the state's medical grow system has consistently been identified as a major source of diversion, it is important to not paint with too broad a brush. Some medical marijuana growers have focused on the legitimate activity of producing marijuana for patients, however, a history of system abusers and bad actors have historically operated within this system to fuel Oregon's out of state diversion reputation. As a result of these concerns, the Oregon Legislature took significant action to reform the system.

**Tracking Medical Grows is a Major Milestone for Marijuana Regulation in Oregon:** Oregon faced a considerable hurdle of transitioning growers that were largely unregulated in the state's OMMP marijuana system into the highly regulated OLCC recreational system. The robust historical and culturally imbedded industry of outdoor growers within OMMP present unique challenges. With an extraordinarily inclusive process of rules development, and legislative changes, many decades-long growers moved out of the OHA system and into the recreational system in 2016 and 2017. Yet, many thousands of growers remained in Oregon's existing OMMP medical grow system. Though it is impossible to determine the quantity and number of operations involved, it is generally accepted by marijuana industry members and law enforcement that a good number of OMMP growers were illegally selling exported marijuana to lucrative out-of-state markets. While this conclusion is generally accepted, there is a contentious debate about how much diversion has been taking place and by whom. Attribution of diversion is really difficult because Oregon still has a number of growers that simply grow and export illegally. Regardless of the level of OMMP growers' actual responsibility for problem of diversion, the Oregon Legislature took action to provide for more regulation and transparency for production of marijuana within the OMMP system. Legislative concern about diversion and potential federal intervention in its newly passed recreational program prompted the state to take bipartisan action to place new requirements on the OHA Oregon Medical Marijuana Program registrants that grow marijuana for OMMP patients.

As of July 1, 2018, many OMMP growers and registrants, are required to be tracked by the Cannabis Tracking System (CTS) and are subject to inspection by OLCC Medical Marijuana Inspectors. This will allow the state to account for all marijuana legally produced in Oregon except for registrants who grow for two or fewer patients. Though the transition is still underway, Oregon now has a system in place that is constantly tracking all medical grows who grow for more than two cardholders, the sharing of product with patients from those grows and the legal sales of up to 20 pounds of product into the OLCC recreational system. All OLCC grower product has been tracked since inception of the program. This is a major development for the control of diversion outside of Oregon as more and more marijuana growers come under ubiquitous regulation and tracking of marijuana. Regional law enforcement studies about diversion, the OLCC supply report, and other private estimates on legal and illegal production in Oregon will continue to differ widely through the next year. Nevertheless, the step the state is taking to bring these grows under meaningful tracking is a significant step to combating illegal diversion, ensuring that marijuana products are not leaking out of the state system. Provided Oregon continues to invest in inspections and oversight for program compliance and that federal, state and local prosecutions of illegal activity are a priority, this step by Oregon creates the

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conditions to align the interests of legal growers, regulators and law enforcement on a shared aim of eliminating illegal operations.

It is still a tenuous transition, but Oregon policy makers, its emerging legal industry and citizens have taken perhaps the most definitive step in the country to combat illegal production and to support the emerging high-quality controlled legal system. This creates a system “proving-up” that industry members hope will open doors to controlled and legal access to broader medical markets across America and the world.

On this course Oregon has the opportunity to reduce a history of illegal diversion and create a new national and worldwide reputation for its marijuana production acumen within a legally regulated framework.

## *Enforcing Against Criminal Activity*

The regulated and legal system of marijuana production will not thrive and grow without a concurrent effort of strong enforcement against illegal marijuana operations. These growers are competitors with the legal market; their activities diminish tax revenue generated by the legal system. As important for Oregon’s industry, the persistence of the illegal export of marijuana impedes advancing industry members’ hope for opportunities for interstate commerce. These opportunities include controlled and legal export to states that have recently legalized medical marijuana programs. These policy direction debates will take place within the federal government, individual states and here in Oregon. Many of these policy considerations are beyond the scope of OLCC’s responsibilities, however, all of these dynamics point to the importance of strong enforcement against illegal grows and activities. The legal system’s growth and success is tied to the creation of a level playing field for the businesses that participate in it.

**Depending on Strong Coordination with Law Enforcement Partners:** Today, the OLCC relies upon federal, state, and local law enforcement to pursue criminal activity related to its licensees as the OLCC only has administrative enforcement powers over its licensees and their transportation of product in Oregon. This is likely a proper relationship for the OLCC to be effective in its administrative responsibilities; however, this division of responsibilities requires strong avenues of coordination between administrative agencies and criminal law enforcement agencies. The following are some of the ways OLCC works with and provides and receives services and cooperation from law enforcement:

- Based on investigations or informant information, the OLCC communicates with law enforcement on criminal matters that are beyond OLCC jurisdiction.
- Law enforcement often informs OLCC about licenses that are being investigated criminally. At law enforcements’ discretion they may share evidence with OLCC in order to allow the agency to consider taking appropriate action against the license. Depending on the case and circumstances, OLCC can use shared evidence to stop operations through the immediate suspension of the license.

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- OLCC cooperates, coordinates with, and seeks the assistance of law enforcement to the extent it is legally possible.
- OLCC operates a law enforcement call center to provide law enforcement information about licensees, transportation manifests, or data related to the production, transfer and sale of marijuana.
- In Southern Oregon, the new OLCC office will house Oregon State Police officers with responsibility for pursuing marijuana crimes.
- The OLCC provides training and education for law enforcement about the marijuana regulatory structure.
- OLCC Inspector training and curriculum development takes place through the Oregon Department of Public Safety Standards and Training (DPSST).
- The OLCC seeks input and direct participation from Law Enforcement about OLCC policy.

Over the next two years the OLCC will work to establish stronger ties and protocols for coordination with law enforcement. To date, when the OLCC has needed assistance, law enforcement agencies across Oregon have responded. However local prosecution of criminal marijuana offenses and the priority placed on responding to theft and robbery reports from licensees could be characterized as variable. For some time now, rural Oregon law enforcement has faced financial issues requiring them to prioritize their overall responsibilities to protect public safety in their communities. This prioritization is likely as it should be given the need to prioritize resources, however, the state has and will look to fill gaps in implementing a coordinated overall marijuana policy in order to stabilize the legal marijuana system in Oregon.

Oregon State Police is one of the most important partners in achieving the aims of OLCC and the legal system. OSP receives some marijuana tax dollars to focus on criminal activity related to marijuana and there is opportunity to provide a net increase in resources to OSP to assist with an overall statewide policy to control marijuana. In 2017 the legislature took an important step by tapping the marijuana administrative fund to fund both OLCC medical grow inspectors and to distribute grants to local jurisdictions by the Criminal Justice Commission; the OLCC was instrumental in identifying this priority and is appreciative to the legislature for taking this needed action. All of these efforts, beyond the scope of OLCC's specific responsibilities, help to create a stable legal system and support the success of Oregon's regulated marijuana production. The OLCC intends to continue work for a comprehensive approach to the control of marijuana diversion statewide.

## ***Achieving Regulatory Compliance through Comprehensive Rules and Sanctions, Education, Analysis and Inspections***

The OLCC is continually assessing and modifying the regulatory framework to ensure that public safety is maintained. Although the US Attorney General rescinded the Cole Memorandum, the memo's guidelines continue to provide an important framework for regulatory guardrails that allow the cannabis industry to function and diminish the prospect of illegal activity.

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**Refining an Efficient System of Compliance:** The OLCC’s top priority is to ensure the regulated market – whether OLCC licensees or OMMP registrants –are following Oregon’s laws and rules. The industry itself wants a fair and level playing field and consistent application of agency rules. Most OLCC licensees are focused on success within the legal framework that they have gone through considerable effort to join. Most have responded positively to education as the agency and industry have launched into this new and dynamic relationship. For these licensees the OLCC has worked hard to create a system of education, warnings, standard fines for violations and an ability to settle more serious failures when the violations are not wanton and when the activities do not indicate systemic diversion. The agency is working to refine its charging practices and refine sanctions to give licensees remedial opportunities to get operations on track while not tolerating diversion and failures to prevent access to marijuana by minors.

**Improving Rules to Protect Public Safety and Provide for Efficient Implementation:** The OLCC will be reviewing all of its rules with respect to implementation of marijuana and hemp laws. This is an opportunity to eliminate processes that are not working for the OLCC or industry; and it is an opportunity to improve overall compliance to achieve public safety. Between the fall of 2018 and early 2019, the OLCC will engage in rule making procedures to refine laws based on OLCC’s and industry’s learnings. Across several areas, procedures that were transferred into marijuana rules from the agencies alcohol rules will be revised to ensure that rules work given the unique nature of regulating marijuana.

**General Rule Making:** The OLCC will open its suite of marijuana rules for revision. In this process errors will be corrected, rules will be refined to create efficiencies for licensing and inspections, and new provisions will be created based on the agency’s learnings over the past two years of implementation. The OLCC will conduct a separate rule making process for hemp in order to implement recent legislation. The OLCC may have business needs to accelerate adoption of specific areas of rulemaking focuses. Selected issues for OLCC rule making include:

**Diversion and Product Tracking:** The OLCC has identified three primary issues for refinement in this area, all issues being worked on in this section are commonly raised by law enforcement and the industry as potential points for diversion which is why the OLCC is targeting these specific areas of regulation for improvement.

- **Harvest Notice:** The first is simply to require a notice of harvest by outdoor growers in order to facilitate inspections of harvest practices as it is within this crucial timeframe that the opportunity for diversion is high.
- **Post-Harvest Drying:** The OLCC feels it is important to examine the practices associated with drying marijuana and requirements that licenses have to meet in reporting weight loss as harvested marijuana is dried and prepared for sale.
- **Waste Disposal:** The OLCC, law enforcement, and licenses have identified the current waste rules as needing revision. The OLCC will be pulling together a workgroup prior to rule making to devise practical controls for operators to implement while providing greater accountability and oversight of waste disposal methods.

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**BHO Extracting:** The OLCC is very concerned about the proper inspection of equipment and the quality and consistency of life safety inspections statewide. This is a dangerous process and one inspected, licensed facility had an explosion with serious injury to an employee. Beyond this the OLCC rule is flawed technically. The OLCC has been working with the State Fire Marshall, OSHA, Oregon Building Codes Division and industry experts to improve overall inspections. This is complicated by the fact that there are not national standards for cannabis extraction; however, there are significant improvements that will be implemented to meet the current need for better inspections prior to licensure.

**Renewal Process:** The current OLCC license renewal process is based on alcohol licensing experience, but it is not working well given the demand for marijuana renewals and concurrent changes being sought for ownership interests and physical premises changes. The OLCC will seek a more efficient way to provide for license renewals and OLCC fee payments. This work will have to tie into major improvements of the electronic licensing system and its 2.0 generation.

**Hemp Regulation:** New laws surrounding OLCC regulatory responsibilities for hemp require agency rule making. The OLCC is likely to open a separate rule making process for this task. Regulating hemp in conjunction with marijuana is confounding to the hemp market and creates complexities within overall requirements of OLCC rules.

***Changing Expectations and Culture:*** The rapid issuance of licenses to build the market combined with a rather open-ended system of registration and historical expectations carried forward from an OMMP program that was never designed for accountability leaves OLCC with a lot of work to do to ensure licensees are professionalizing operations sufficient to maintain compliance. It is inevitable that a faction of OLCC licensees will attempt to manipulate the protection provided by their license as a cover to engage in diversion. Even operators that came into the system with the best of intentions may be vulnerable to the lure of established criminal influences that organize the illegal export of marijuana to lucrative markets across the county. Colorado and Washington have experienced this and Oregon will as well. The job of the OLCC over the next two years is to separate the new licensees that comply with regulations from those who are willing to risk their license and investments for returns from illegal diversion.

***Building Towards Systemic Enforcement:*** It has taken time to create rules that match three legislative sessions of major law changes. Building up staff, the development of rules, and creating the IT systems and procedures to implement the rules has consistently lagged behind the overwhelming workload of starting-up a new industry. Until 2017, most of the focus of OLCC was on licensing a vast number of marijuana business and finalizing rules. For most of this time, enforcement was complaint based and reactive. Early on, alcohol program licensing and compliance staff were drawn upon to match the urgency of establishing the regulated marijuana market. With approval of the 2017-19 budget, the OLCC had the necessary permissions to move forward and hired additional staff for enforcement. At the same time, the OLCC gained major new responsibilities for tracking of medical growers.

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**Compliance and Good Enforcement Begins with Licensing and Renewals:** Enforcement begins with having a good licensing process that preforms criminal background checks, vets investors and ownerships, and examines the premises of the marijuana licensee. Annual licensing renewal is another important checkpoint for public safety oversight of the industry. Since the inception of the program OLCC has continuously adjusted and revised details and procedures surrounding licensing to ensure that reviews are accurate, efficient and complete. Although initial licensing automation will work for the new program, changes in laws, rules, procedures and volume of activities has exposed the limitations of the initial licensing system. Perhaps the highest priority for the agency is to fully revamp licensing and move on to a next generation system. This is a mission critical issue for the agency, for its effective review of licenses, and to effectively managing persistent demand for complex license changes surrounding ownerships and the physical site.

**Establishing Inspection Protocols and Training Inspectors:** It was not until 2018 that the integration of marijuana enforcement into public safety compliance really took hold. While there are more resources necessary to complete this process, OLCC has established a management structure that is integrated within the Public Safety Division and in regional field offices. OLCC has made progress on training staff and developing field procedures for enforcement inspections of each license type. Early in 2018 the agency ran multiple minor decoy operations in each region of the state, it has inspected retail locations, and now has a full suite of procedures for inspections. The agency educates licensees through regular contact and regulatory bulletins prior to the initiation of a new inspection protocol so they understand what inspectors will be looking for and understand what is necessary to be compliant.

**Capitalizing on the Use of Data Analytics to Set Inspection Priorities:** Oregon's Cannabis Tracking System (CTS - Metrc) is populated with dynamic daily data detailing the condition of grows and the movement of marijuana through the supply chain. Some of the information tracked includes: status of individual plants, quantities of marijuana flower being dried, bulk packages of marijuana that are tested, lab results associated with packages, manifest for transportation to processors, wholesalers and retailers, daily sales of marijuana sold to recreational and medical customers by quantity and units, and taxed and tax-free sales. All of these data points reflect a fraction of the streams of data in the CTS. As retail sales came on line, the OLCC created a team to monitor daily sales and to investigate sales patterns that were unusual, or sales of quantities of marijuana that were above the legal limits for personal possession of marijuana products.

Until 2018, only one person monitored the system and coordinated with Metrc on a regular basis. A great amount of time went into constant modifications of the system to tailor it to new state laws and the rules of the OLCC. Other than the initial oversight on sales, the data was only analyzed to make changes to the system and when there were complaints about specific marijuana operations. In these specific cases, CTS was used to analyze operations and to provide inspectors with reported inventory data. These specific data investigations proved useful and many violations and data entry mistakes were discovered through episodic reviews. On many occasions enforcement and the policy team identified specific requests that were satisfied by a single analyst's work. Given the limited trained inspectors the agency had at that time, and the focus on licensing, the OLCC did not have resources to pursue all suspicious activities. While CTS was being put to good use, the agency lacked resources for enforcement inspections

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needed to investigate the issues flagged in system and also lacked resources for policy making needs related to findings. *OLCC's usage of CTS to date represents a gross underutilization of the system's capacity to provide information about compliance and more importantly as a means to detect non-compliance.*

In 2017 the Oregon Legislative Assembly funded additional personnel to analyze CTS data. This was done in part to ensure that there was additional capacity in place to oversee data related to the OLCC's new responsibilities for tracking medical grow sites under the OMMP system. By mid-2018, after the hiring of management staff and technical staff, OLCC oversight of tracking for medical grows was in place. This capacity gain helps the OLCC to more fully employ the power of the CTS system, however, it is still inadequate given the agency's commitment to the vision of robust use of CTS.

**Creating a Specialized Unit Focused on Analytics and Data:** The OLCC has developed plans to create a full compliance unit and team of analysts charged with bringing the initial vision of the tracking system to life. The CTS is at the heart of creating a comprehensive approach of using data to create a system of violation prevention, deterrence and detection through the automated and manual identification of data anomalies in the CTS. Central to the system is the ability to flag activities for warnings and violation tickets followed by inspectors in the field who inspect or survey licensee activities. Utilizing basic algorithms and programing, the regular production of data reports will unleash the tremendous value of the data reported into the CTS system.

The specialized unit will generate a suite of regular and specific reports that will be used by OLCC management to set field inspection and oversight priorities. The reports will be constructed to combine intelligence from the system about multiple data anomalies to focus OLCC inspections on high-risk licensees that are generating variations outside their own statistics for operation and in comparison, to the universe of licensees. As an example, the system may detect unusual discrepancies between wet weight and dried product, combined with multiple changes in waste data, and strange reporting of travel manifest data. Any one of these issues may not be overly concerning on its own but examining the pattern of relationships certainly could reveal larger issues. The CTS is self-reported data and may be inaccurate, just like someone entering business data into a ledger. The critical part of the overall compliance regime is that OLCC licensees are accountable for their data entries into the CTS and that those entries match physical inventory upon inspection. Inspections are ultimately necessary to verify compliance and this is true of almost all known regulatory systems — someone has to look specifically at the case to determine its merits. This is why having adequately trained inspectors will be an ongoing focus of OLCC into the future.

However, not all data needs to be verified on the ground. The OLCC rules contain timing requirements and steps that must be followed sequentially. The rules also dictate transaction limits such as for the sale of retail products. In these prescriptive data cases, programing can be created by the unit to issue automated warnings to prevent mistakes or to

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highlight failures that have happened. In some cases, the agency may be able to issue tickets based solely on reported data for both single event issues or after multiple warnings about the same issue.

Lastly, this unit will be responsible for analyzing video data for inspectors. This data is stored on site at marijuana operations and is an important source of evidence of violations. By creating capacity in this unit, analysts will create efficiencies by freeing inspector time so they can do inspections. As well, the CTS analysts will be in the best position to crosswalk taped activity with reported data in CTS.

Through its current budget request, and with the continuing work of existing personnel, the OLCC will develop and fully employ the use of CTS data in regulating marijuana licensees. This system is at the heart of OLCC's goals for mitigating diversion and for holding licensees accountable for the responsibilities of their license.

***Capacity to Inspect and Verify Compliance:*** In the end, the Oregon regulatory system depends on highly-trained field personnel to work directly with licensees across all the complexities of each license type. OLCC inspectors assigned to marijuana are trained specially for work with marijuana licensees and they are certified by the Department of Public Safety Standards and Training (DPSST) where the agency sponsors an annual training academy. Modifications to training for inspectors taking on the new OLCC responsibilities of inspecting OMMP grows will reflect the fact that inspectors within this program may be accessing grow sites located at a residence.

The entirety of OLCC's success with compliance relies on a regime of inspections that are at least annual, that may be random, or that may be ubiquitous enough that the licensed community believes OLCC is likely to inspect their operations. Especially at this nascent stage of system development, and with the cultural change the OLCC system represents, it is critical that licensees take the regulation seriously — meaning the agency must urgently focus on inspecting operations in the field. With over 1,900 licenses and in year three of the program, now is the time to roll forward into systematic enforcement of regulatory requirements. Prior to 2018 the OLCC only responded to the investigation of complaints. In early 2018 the OLCC engaged retailers through statewide minor decoy missions — and received lackluster results. As a result, OLCC increased the penalties for a violation of sales to a minor. These operations resulted in much better compliance. This will be the case across a variety of different issues associated with different license types.

To a great extent the deterrence and prevention mission is a numbers equation. As OLCC increases its regulatory presence, licensees will become more vigilant. In the current biennium recreational program inspectors were funded at a ratio of 100 licenses to 1 inspector, the agency believes this ratio is too low and is recommending a ratio of 75 to 1 for the next two years. For the medical inspectors, the ratio is anticipated to be 1 in 150 when the program is fully operational. OMMP inspectors do not have the same licensing inspection responsibilities of inspectors on the recreational side. They will spend the majority of their time educating registrants on regulations, use of the Cannabis Tracking System, and compliance investigations.

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Hiring inspectors has been a challenge, but a new software program is speeding up intensive background checks the agency performs prior to hiring. Although background checks are rigorous and many candidates do not make it through this process, the OLCC believes it is critically important that all new inspectors are thoroughly vetted. The agency has a staffing plan to match the new ratios. Hiring in Southern Oregon has recently been difficult and the OLCC has had trouble recruiting qualified candidates. This is troublesome as Southern Oregon has the most licensees of any region in the state, and many of these licensees are outdoor growers who are a focus of the agency with respect to diversion issues. If this problem persists the agency has a plan to reorganize the coverage area of the Eugene office and may establish new boundaries for the regions to facilitate coverage in the South.

While OLCC inspectors' number one mission is to seek out diversion they are also trained to provide education to growers and to work with them to ensure compliance and success in the regulated system. Inspectors are responsible for using their judgment in issuing violations. However, many businesses are not routinely meeting obligations and frequently licensee's lack of diligence is earning them serious violations which carry the potential of license revocation. When diversion evidence is not a factor, these cases are often settled. Perhaps the most common tickets written relate to lack of camera coverage and the ability of licensees to retrieve back-up video for OLCC inspectors. The rules of the OLCC penalize licensee with the maximum sanctions because of the public interest of control in operations

## *Other Important Issues Concerning Marijuana Regulation*

**Considering Social Consumption:** Measure 91 prohibited public consumption when passed by voters and this prohibition remains in place. The prohibition of public consumption, combined with the requirements of Oregon's Indoor Clean Air Act, make licensed social consumption venues virtually impossible and leaves private property and residences the legal options for consumption. Understandably the industry will push for policy changes to allow for social consumption in order to shore up its economic viability. Product innovation, cannabis tourism (similar to wine tasting) and flexible business models will continue to challenge the OLCC's licensing and compliance capacity. While social consumption has been considered and debated in all states where recreational marijuana is legal, no state has completed licensing of social consumption venues. On-premises consumption of marijuana presents a set of regulatory challenges that are discreet from other license types. For example, states must consider patron intoxication, neighborhood livability issues and employee exposure to second-hand smoke. While the regulatory debate about providing legal premises for social consumption is high-centered by competing values in the law, the lack of controlled options has not stopped increasingly cavalier illegal public consumption. Oregon, like elsewhere, will continue to struggle with the societal and social conflicts surrounding regulation of social consumption.

**Regulating Hemp:** As the OLCC's cannabis regulating responsibilities are increasing, the legislature also tasked the agency to extend its oversight of industrial hemp within OLCC license system. Hemp is often touted for the use of its seeds and stalks for making rope, fabric and other products, however, much of the hemp grow today is destined for processing consumable CBD

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products. CBD, or cannabidiol, is a non-psychoactive compound found in industrial hemp and some marijuana cultivars. CBD is widely believed to have medicinal value. The state faces another balancing act with CBD because the US Drug Enforcement Agency has classified CBDs as a Schedule I drug when used for human consumption, the same classification as marijuana. The US farm bill currently under consideration may change this designation, but that legislation has not yet been adopted.

At the same time, non-CBD hemp products are perfectly legal for export nationally and internationally. Hemp hearts, or the shelled seed of the hemp plant, are a food product touted for its nutrition. Hemp oil made from the seeds of hemp is also sold as food product or ingredient in topical lotions and creams. Topical creams containing CBDs are also common.

Today, hemp growers and handlers registered by the Oregon Department of Agriculture can transfer hemp items to OLCC licensees under certain conditions. Any hemp items transferred to OLCC licensees must be entered into the Cannabis Tracking System and must be accompanied by a system-generated transportation manifest. Hemp growers and handlers pay fees to participate in CTS and bring hemp items into the OLCC system. Marijuana licensees who are endorsed to receive hemp also pay a fee. Hemp itself is not taxed when sold; however, if hemp is mixed with marijuana the product becomes a marijuana item and is taxable from that point forward. The hemp industry itself worked very hard to gain access to the OLCC market. Until legislation passed, the OLCC was legally limited to only regulating marijuana. While hemp products had been available at OLCC retail locations, but the agency was working to phase them out due to the inability to track these items in CTS. Timely legislation preserved hemp products availability at OLCC locations and ensured that these products were tracked when received.

Hemp and marijuana plants are nearly identical. The plants are both cannabis plants with hemp being low in psychoactive Tetrahydrocannabinol or THC; the chemical or cannabinoid associated with euphoria. Regulating hemp grows and products while trying to distinguish these plants and its products from marijuana is a confounding regulatory task. Legal hemp is required to be field tested to ensure it is below its 0.3% THC level.

With the growing reputation of CBD's medicinal value, both hemp growers and marijuana growers compete for this desirable product market. However, marijuana growers are at a disadvantage in that grows of hemp are much larger and do not bear the added security cost of cameras or the burden of comprehensive CTS tagging, recording of harvest weights, packaging and other detailed data recording steps and operational requirements for producing marijuana. However, hemp entering the OLCC system will have to be tested just as if it was a marijuana product. OLCC marijuana licensees may also hold a hemp license and grow hemp, but the operations must be separate. No hemp is allowed on a marijuana producers licensed premises. Given the current competitive environment within the state's legal marijuana market, many OLCC growers are turning to hemp as another source of income and this will undoubtedly create many opportunities for regulatory confusion.

Marijuana and hemp are both cannabis plants and products made from them can be easily confused in the field. This can be confounding to law enforcement, neighbors and public officials. Raw hemp, and the products made from it look very much like marijuana and marijuana products. OLCC licensees who transport marijuana items must carry a travel manifest and law

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enforcement can call OLCC and verify the manifest. This requirement also applies to hemp that is transported to or from an OLCC licensee. However, the manifest and tracking requirements do not apply to hemp items sold outside the OLCC license system. Hemp items are commonly sold at unlicensed locations such as farmers market and in interstate commerce. This inconsistency creates a clear opportunity for nefarious actors to use hemp operations as cover for illegal commerce in marijuana.

There are no easy regulatory answers as the state balances the creation of a safe high-quality consumer market for marijuana with a largely unregulated market for hemp. One issue not to be lost in this policy discussion is that unlike marijuana, hemp is not taxed. The state is likely to expend considerable resources working to balance the issues raised by parallel but inconsistent regulations for hemp and marijuana production; there are no clear or easy answers here for policy makers.

**Banking:** Cannabis businesses have limited banking options due to federal banking restrictions and the flow of funds and cash generated by the cannabis industry creates a public safety issue. Oregon has followed the lead of other legal cannabis states in working with state-chartered banks and credit unions to address this issue. As provided under House Bill 4094, enacted during the 2016 legislative session, the OLCC has entered into agreements with three credit unions that are banking the cannabis industry. The OLCC provides CTS data to these financial institutions for compliance auditing in order to provide these institutions with the information they need to service marijuana accounts.

**Coordination with other States:** OLCC will continue to work with other state regulators to share best practices and codify regulations as this industry steps towards emerging into a national market. Oregon and the OLCC remain aware of our pioneer status in the regulation of marijuana. Oregon’s reputation for having thoughtfully built out the regulatory framework for marijuana and the knowledge and experience gained is important to other states, and the OLCC actively shares its regulations and experiences with new regulators.

**Mixing Marijuana and Alcohol:** Since the passage of Ballot Measure 91 the Commission has been clear with its licenses that THC and alcohol do not mix. The OLCC has communicated its expectations in numerous forums, including through its “What’s Legal” campaign about legal consumption. OLCC has also adopted rules that prohibit the co-location of alcohol and marijuana licenses and prohibits the consumption of marijuana on any licensed premises. Also, in place are vigorous controls for alcohol license special events that are held in conjunction with marijuana events in Oregon. Careful controls are in place to clearly separate the license alcohol activity from the event surrounding it. Again, no marijuana use is permitted.

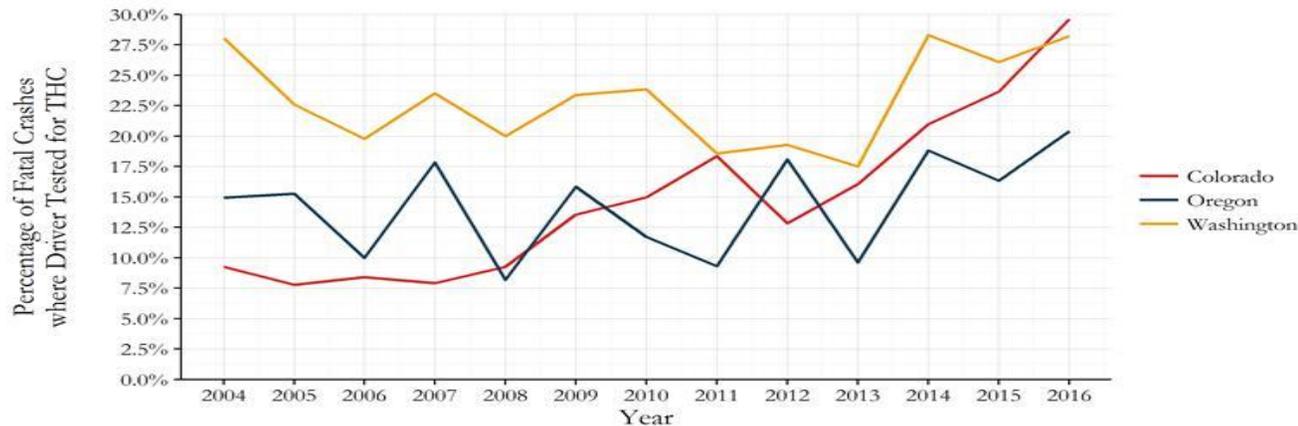
Alcohol and marijuana are certainly a deadly combination for driving. At the outset, it is important to understand that there is no drug test for THC that measures impairment and the detection of marijuana is not a sign of impairment, law enforcement uses field sobriety test to make arrests for drugged driving. However, there is convincing research that mixing alcohol and marijuana results in increased impairment when compared to consuming the substances alone. This combination — in excess — results in greater impairment, less control and greater danger while driving. Alcohol related traffic fatalities are consistently a significant cause of all

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traffic fatalities. A new development is that drug screens are being conducted for all traffic fatalities in Oregon. A battery of tests are done to detect the presence of marijuana and other drugs when someone dies from a traffic accident. Marijuana as the sole drug detected represents about half of all fatalities in which drugs were detected and, when fatalities involved other drugs and marijuana, the relationship of marijuana to total fatalities involving drugs increases. This may be due to the fact that marijuana is detectable in the user's system for longer than other drugs. In Oregon the total annual traffic fatality deaths in 2016 in which the drug screen detected THC totals 25. Importantly, this number includes passengers as well as drivers. It is difficult to identify trends with only one year of data on this drug screening of people who have died in traffic accidents. Certainly, such data will be important to closely watch.

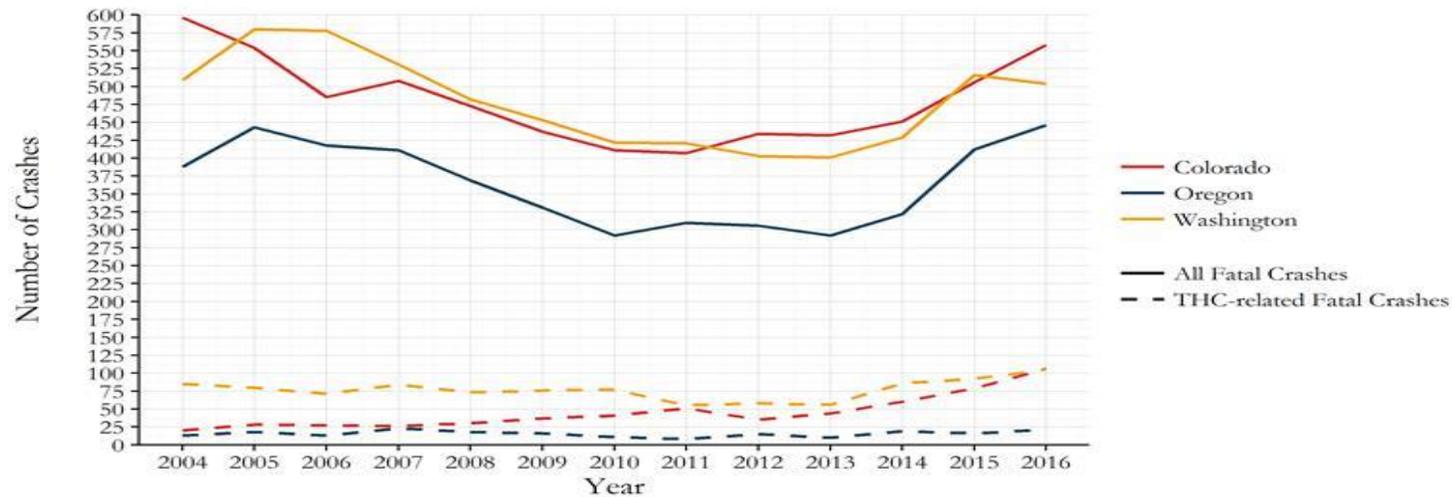
## NHTSA's 2016 DUII Traffic Fatality Data (FARS)

THC-Intoxicated Drivers  
as Percentage of Fatal Crashes where Driver Tested for THC,  
2004 – 2016



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Fatal Crashes by State,  
2004 – 2016



**Marijuana Infused Beverages:** As more states have legalized marijuana, there has been an increasing interest in marijuana-infused beverages. In Oregon and other states, these beverages cannot legally contain alcohol. However, anecdotal observations show unregulated production of cannabis infused alcohol has existed for some time and is likely to continue despite its illegality. In addition to THC infused beverages, CBD-infused beverages have grown in popularity. The Alcohol and Tobacco Tax and Trade Bureau (TTB) grants federal approval for spirits and other categories of alcoholic beverage that contain hemp seed oil or other inert hemp ingredients. However, TTB will not approve any alcohol beverage that contains CBD or THC.

Despite TTB prohibition, industry innovation in this area is going to occur. Several large manufacturers of alcoholic beverages have either become shareholders or formed other business alliances with marijuana companies with an interest in producing marijuana beverages —Heineken, Constellations Brands, Blue Moon, and Molson-Coors is reportedly looking into the concept. Innovators in this area are positioning to sell non-alcoholic beer and wine products as regulated marijuana products by removing alcohol and replacing it with THC. Oregon manufacturers also have an interest in these type of products or those that include CBDs. Certainly this has interesting implications for the OLCC that regulates marijuana and alcohol in Oregon and that oversees the sale of spirits. It also has interesting implications for health professionals captured in a July 23, 2018 Forbes news story that headline, “Cannabis Beer Could Save Drinkers from Cirrhosis of the Liver.” Cirrhosis of the liver kills about 3.3 million people world wide. This is one of

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many examples about the changing public policy issues being driven by the legalization of cannabis. The OLCC will continue to monitor these many developing issues to fulfill its responsibility to Oregonians to carefully regulate the cannabis market.

## C: Agency Initiatives in the 2019-21 Budget

The 2019-21 Legislatively Adopted Budget includes the following policy option packages for OLCC. These option packages, if approved, enable OLCC to address issues arising from the agency's aging core technology systems, the expansion of the agency's mission to regulate marijuana, the addition of OMMP marijuana and hemp tracking, the expansion of the alcohol system, to prevent the sale of alcohol and marijuana to youth.

### Information Services

**Package No. 301, 7 FTE, \$7,956,685**

Requests staff and funding to support the critical IT needs of the agency. The package requests funding to add one data base architect, two technical project managers, one quality assurance and automation developer, one businesses systems analysts, and three systems developers, replacement of outdated network equipment, and funding for future software development projects for alcohol warehouse management, licensing and financial management and marijuana licensing, enforcement and supply chain tracking.

### Distilled Spirits Shipping Capacity and Service Package

**Package No. 102, 11 FTE, \$2,243,955**

Addresses need for management, logistics and account functions. It requests funding authority for a Distilled Spirits Program Manager, four liquor distribution equipment operators, six liquor distribution workers and temporary workforce funding for seasonal labor needs.

### Liquor License Fee Increase For Revenue Generation

**Package No. 203, 0 FTE, \$9,172,403\***

Raises funding for much needed upgrades in infrastructure and information technology and offset the use of other liquor funds that can be distributed to the state, cities and counties. \*Raises revenue

### Roof Repairs and Replacement to Main Warehouse

**Package No. 304, 0 FTE, \$6,234,000\***

Requests funding for the final phase of the roofing project. The estimates include \$3.3 million for roof repair, \$1.0 million for required earthquake remediation, and \$1.9 million for a 45% contingency. \*Includes earthquake mitigation and 45% contingency.

### Public Safety Statewide Dispatch Services

**Package No. 205, 0 FTE, \$1,072,596**

Requests funding to continue the cost of maintaining the Oregon State Police dispatch services for OLCC's Inspectors in the field.

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## **Licensing Staff Fulfillment**

**Package No. 206, 7 FTE, \$1,334,998**

Requests funding for staffing services for efficient licensing and permitting, an increase in demand for public records and effective management in licensing. This package requests funding for one limited duration double fill of a metro area Event Licensing Specialist AS1 position, one Principal Executive Manager D for alcohol licensing, one Principal Executive Manager B for license process, one Operations and Policy Analyst 2 for public records, 3 Office Specialists 2s for alcohol service permits and a reclass for the Director of Licensing from a Principal Executive manager E to a Principal Executive Manager F.

## **Public Safety Enforcement Staff Fulfillment**

**Package No. 207, 2 FTE, \$811,140**

Requests funding for the addition of two Liquor Regulatory Specialists, one for the Salem office and another for Eugene.

## **Marijuana Program Enhancement**

**Package No. 408, 12 FTE, \$2,492,613**

Requests funding for staff including 8 marijuana regulatory specialists to ensure regulatory compliance, 1 laboratory compliance specialist to focus on laboratory compliance, protocol and regulation, 3 office specialists 2s to utilize the information stored on video to enforce compliance and prevent or detect diversion, as well as funding for continuing strategic and tactical communications support related to marijuana, reclassification of positions to reflect actual duties, and increasing annual marijuana license fees by \$100 to accommodate the increase in program expense if all the proposed policy option packages for recreational marijuana are approved.

## **Regulatory Specialist Reclass**

**Package No. 209, 0 FTE, \$656,774**

Requests differential funding for Regulatory Specialists to implement findings by DAS Classification and Compensation unit in a compensation study of the liquor and marijuana regulatory class positions.

## **Financial Services Staff Fulfillment**

**Package No. 310, 310 FTE, \$556,290**

Requests funding to support the ongoing retail expansion and distillery agent growth. The package adds two accountant 2s for distillery agent auditing, one accounting technician 3 for distillery agent tracking, one accounting technician 2 for retail expansion, and new equipment and software for store auditors.

## **Administration and Communication Outreach – Sr. Policy Advisor and Digital Infrastructure**

**Package No. 311, 2.00 FTE, \$755,962**

Requests funding for one senior policy advisor to evolve rules for complex policy and regulatory discussions related to the changing alcohol, marijuana, medical marijuana, hemp and bottle bill regulations. The person in this position will work directly with key agency staff, industry, and customer partners to shape options for alcohol and marijuana policy. As the agency's policy expert, this person will report at the Director level of the OLCC and service the response to policy requests from the director, commission, Governor's Office and Legislature across all areas of agency responsibility. This package also includes consulting services to build an agency intranet, one public affairs specialist to manage the agency intranet and assist in the management of the agency's internet as well as the required

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transition to the DAS required updated internet format in 2020, consulting funds for alcohol stakeholder education and communication, and to reclass a grounds maintenance worker to a Facility Energy Tech 2, better reflecting the actual duties of the position which has changed.

## **Move Agency Bank Cards**

**Package No. 112, 0 FTE, \$7,350,000\***

Keeps the responsibility for contracting for merchant services with the state but transitions the responsibility for credit card fees to the agents. Agents are made whole by shifting the state's allocation for credit card fees to agent compensation. \*Transfers 2<sup>nd</sup> fiscal year funds from Bank Card Costs in Distilled Spirits Program to Store Operating Expense (agents compensation).

## **Increase Licensee Comp Rates**

**Package No. 113, 0 FTE, \$6,400,000**

Requests funding to raise the rate that liquor agents are compensated for licensee sales to the same rate of compensation for consumer sales.

## **Distillery Agent Compensation Enhancement**

**Package No. 114, 0 FTE, \$1,441,000**

Creates a separate limitation for distillery tasting room agents and requests funding to raise distillery agent's overall compensation rate.

## **Bottle Bill Regulation and Funding**

**Package No. 215, 1 FTE, \$94,317**

Requests funding for one administrative specialist 1 to perform duties related to the expansion of the Bottle Bill, public information and compliance.

## **LEGISLATIVE CONCEPTS**

### **Agency Concept 84500-001 - Fees for Alcohol Licensing**

The generation of revenue in Oregon from alcohol is heavily weighted toward the markup for distilled spirits. Oregon is one of the highest states in the country generating revenue from spirits and one of the lowest in the country in generating revenue from license fees. Revenue from distilled spirits subsidize the agency's licensing, renewal and enforcement activities for over 15,000 alcohol licensees and 9,000 special event licenses. Doubling annual license fees and adding a fee for the temporary annual use of license will provide additional funding to provide services to licensees including online licensing and renewal systems, training, education, enforcement, increased communication and IT services to help licensees comply with the law.

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## **Agency Concept 84500-002-Redemption Center Fee**

The refund value for empty beverage containers increased from 5 cents to 10 cents on April 1, 2017 and the types of beverages included in the Bottle Bill greatly expanded on January 1, 2018. These changes increased interest in redeeming containers, which in turn created a major increase in the number of questions and complaints from impacted stores and the public about the Bottle Bill, which are currently fielded by the agency's one Bottle Bill Compliance Specialist. This leaves little time for performance of higher level compliance and oversight functions. A \$3,000 annual registration fee for each redemption center will support the funding of an AS1 position to assist the Bottle Bill Compliance Specialist in performing duties related to Bottle Bill public information and compliance.

## **Agency Concept 84500-003 – Marijuana Fee Conditional Letter of Authority**

The OLCC's recreational marijuana program is funded solely by licensing and renewal fees, however renewal fees are not realized until the application has been approved. In situations where an existing business applies for renewal shortly before their renewal date, or has a particularly complicated renewal application due to changes in business structure or operations, the applicant, agency and local government need additional time after the renewal date to process the application. In these cases the agency issues a Conditional Letter of Authority to allow the business to continue to operate. The agency collects the license fee, however, it cannot expend those funds unless and until the license is approved, even though the licensee is operating and OLCC staff are doing the work. This has created a problem because some licensees are seemingly "gaming" the system, requesting a Conditional Letter of Authority, and then withdrawing their renewal application after harvest and profits are made. In addition, if an agency proposes to deny a license, the licensee can continue to operate without paying a fee. Under this proposal, if a licensee uses their license privileges under a Conditional Letter of Authority (i.e. into a new license year while a renewal is pending), and then later want to surrender their license, the license fee is not refundable.

## **Agency Concept 84500-004 License Server Fee**

The statute requires accounting for the \$2.60 annual server permit fees from licensees and \$13 server permit fee from server permittees is cumbersome and can be streamlined as the costs of the server permit program and alcohol education program are covered by allowed fees under ORS 471.375(2) and other agency alcohol revenues. The agency proposes eliminating the fees outlined in ORS 471.542 (6) and the required accounting in ORS 471.375 (2).

## **Agency Concept 84500-05 – Electronic Verification of ID**

Lack of banking access is a significant problem facing Oregon's legal marijuana industry. One of the primary concerns is ensuring that marijuana businesses are adhering to state law and federal policy. For example, guidance from the Federal Financial Crime Enforcement Network states that financial institutions that service MRBs must ensure that they are not selling to minors. In addition, Oregon law imposes daily purchase and possession limits on marijuana transactions. These limitations are easily circumvented by the practice of "smurfing" whereby a consumer makes multiple purchases from multiple retailers in the same day or the practice of

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“looping” whereby a consumer makes multiple purchases from a single retailer in the same day. Electronic methods of preventing sales to minors by validating ID and the prevention of “smurfing” and “looping” are available; however, the use of electronic methods to provide this service may be prohibited under Oregon law. Oregon law provides that “A marijuana retailer may not transfer any information that may be used to identify a consumer to any other person.” For banks, these types of electronic solutions represent a critical layer of assurance that MRBs are fulfilling their legal obligations and are participating in a process that makes legal marijuana businesses more attractive as potential customers. Amending Section 47B.220 (4) to clarify when and how electronic vendors can be used for age verification and to prevent “smurfing” and “looping” would provide clarity and direction to marijuana businesses in the use of electronic verification equipment and software, and potentially increase the ability of marijuana businesses to secure banking services.

## **D. CRITERIA FOR 2019-17 BUDGET DEVELOPMENT**

OLCC administers the Liquor Control Act and Cannabis Regulation to ensure social responsibility in liquor and marijuana regulation. In doing so, its functions of providing for the retail sales of alcohol, licensing and efficient collection of taxes, and licensing and sales of marijuana (taxes are collected and distributed by the Oregon Department of Revenue), supports the Oregon economy, business investment, employment and vital public services. It is within this legal framework that the OLCC is responsive to citizens’ needs, for public health and safety and engagement on matters of civic and consumer concern. Through and within this framework the OLCC finds its processes and means to meet the challenges of the changing marketplace of the 21<sup>st</sup> century.

The OLCC’s long-term plan is to manage growth within its values and mission. The OLCC actively is planning how to be responsive to the changing demographics and marketplace, while promoting responsible alcohol and marijuana sales and encouraging the development of all Oregon industry and consumer sensitive retail markets.

The OLCC is engaging responsible growth by prioritizing public safety, embracing economic opportunity, and safeguarding its ability to produce revenue to support public programs vital to Oregonians:

- By continuing to create and strengthen partnerships with local law enforcement, moderation groups and others, the OLCC can make well-informed policy decisions and resource allocations to protect the public,
- By reinforcing its commitment to establishing a positive business environment within its overall regulatory structure, the OLCC sets the tone for a sustainable and productive business climate, and
- By prioritizing investments which enhance overall productivity, the OLCC can deliver on expectations that its business operation generate revenue for state, county, and city public services.

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The OLCC recognizes that as the environment changes, OLCC and its stakeholders will benefit from the OLCC's responsiveness to changes. OLCC seeks to use the most modern technology it can afford, to improve services and help business people get into business and employ others. It seeks to transition to modern web-based services which provide greater flexibility, use state technology resources, and create more ease for the user.

The future of Oregon depends on its ability to strategically invest in human capital and infrastructure to facilitate the growth of business and jobs, and to contribute to a positive business climate. The OLCC licenses, permits, and approves people to manufacture, sell and serve alcohol when they meet certain criteria. In addition, the OLCC licenses growers, processors, wholesalers, retailers, laboratories and researchers and issues marijuana worker permits. Licensees in both programs must consistently comply with the law to keep the privilege, so Oregon's communities can be safe. The OLCC needs a certain level of resources to manage growth and regulate the industry responsibly. In order to keep barriers at a minimum and provide good service levels, the agency also focuses on streamlining and automating processes as much as possible. This also is consistent with the priority to reduce barriers for business, including regulatory barriers.

The OLCC budget proposal focuses on its charge to safeguard state assets and provide responsible stewardship for the continued sale and service of alcohol along with its new responsibility for regulating the sales of recreational marijuana. The proposals are primarily focused on adding capability and capacity, particularly FTE, to support operations in both the alcohol and marijuana programs, in order to support distilled spirits retail expansion, movement to online systems, effective use of agency facilities and IT infrastructure, adequate staff to support minor control goals and growth in both licensing and compliance, and timely responding to public records request.

## *Major criteria for 2019-21 budget development*

All budget proposals align with the long-term strategies the OLCC is working toward:

1. Creating a culture of accountability for change,
2. Facilitating the contribution of businesses to sustain community growth throughout Oregon,
3. Creating new means to advance public health and safety through prevention and community engagement, and
4. Opening communications as a means to place the agency closer to Oregon customers and to advance all other agency strategies.

The focus for the establishment of priorities across the agency includes criteria that supports measured progress toward achieving the strategic plans of the OLCC:

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- Safeguard state assets and provide responsible stewardship and return on investments
- Invest in the productivity of the workforce and their professional growth and development to improve agency productivity
- Replace OLCC’s aging core technology to integrate systems and respond to the growing responsibilities of the agency intelligently,
- Streamline and automate processes for applicants, license and permit holders, and administrative staff
- Invest in the capacity to meet potential customer demand for distilled spirits and secure forecasted revenue necessary to support public services,
- Collaborate with law enforcement to enhance public safety and community livability
- Enhance economic development through licensee education to achieve greater compliance and secure safety through prevention
- Increase partnership and communication with business, community, public safety and other partners.

*The OLCC used the following criteria to develop its policy option packages for 2019-21 and their priority ranking:*

1. Does it increase revenue for state services?
2. Does it create efficiency savings within the agency and improve customer service?
3. Does it provide resources to adequately educate and visit licensees in order to increase compliance, reduce sales to minors, and enhance community livability?
4. Does it adequately reflect the growing workload and responsibilities within the agency?

## **E. PERFORMANCE MEASUREMENT**

Annual Performance Progress Report (APPR) documents appear in the “Special Reports” section.

## **F. MAJOR INFORMATION TECHNOLOGY PROJECTS**

The OLCC is in process of finalizing a Request for Proposal for the OLCC Privilege Tax Project mandated by HB 2150 in the 2017 legislative session.