



2019

**Recreational Marijuana
SB 218 Legislative Report**

Oregon Liquor Control Commission

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Executive Summary

Oregonians approved Measure 91 in November 2014, legalizing adult-use recreational marijuana in Oregon. Measure 91 established, and subsequent legislation maintained, the philosophy of a free market within the regulated recreational system in order to encourage producers and consumers to transition early from the illegal market. The legislature did not limit the number of licenses in general, and established lower barriers to entry than other states. Oregon does not have a residency requirement for investment or ownership of licensed businesses, licensing fees are comparatively low, and there are no limits to the number or type of licenses one individual or business can acquire.

The Oregon Liquor Control Commission (OLCC) is the agency responsible for regulating recreational marijuana businesses in Oregon. Since 2016, when OLCC first began issuing licenses to recreational producers, laboratories, processors, wholesalers and retailers, the demand for licenses of all types has increased year after year. By early 2018, OLCC's ability to keep pace with processing new applications while servicing existing licensees began to significantly lag. OLCC deployed multiple strategies in an effort to catch up, including formally pausing the acceptance of new applications in June 2018. However, by that point the number of submitted recreational marijuana producer applications was already considerably higher than other license types, and specific market dynamics hampered OLCC's ability to make meaningful headway on the pending applications for all license types.

With growing concern regarding oversupply and out-of-state diversion continuing to increase, Governor Kate Brown introduced Senate Bill 218 in the 2019 regular legislative session in an effort to curb marijuana production. SB 218 proposed to place a moratorium on new producer licenses until January 2022. SB 218 passed (with amendments) and Governor Brown signed it into law on June 17, 2019. *See* 2019 Oregon Laws, Chapter 419.

SB 218 requires OLCC to submit a report each year to the legislature regarding the bill's impact on the industry and the status on the reduction of the backlog of producer applications. Because the bill took effect just a few months ago, and since most of the agency's work to implement its provisions have recently occurred and remain ongoing, there is limited data available for this initial report to fully analyze its impacts. Therefore this report will primarily focus on describing historical recreational marijuana licensing trends and data,

Key Findings

- Between January, 2016 and the date SB 218 was signed into law, OLCC had received 3,034 producer applications, an average of 72 application per month.
- As of December 12, 2019, OLCC is processing producer applications received on or after February 17, 2018. 511 producer applications are awaiting assignment for investigation. 142 are currently assigned to investigators at varying stages of processing.
- Between April 29, 2016 and December 1, 2019, OLCC issued 1,387 recreational producer licenses.
- OLCC recreational producers harvested more than 5.7 million pounds (2,600 metric tons) of wet, untrimmed marijuana between January 1, 2019 and November 30, 2019.
- OLCC is in the process of implementing some additional measures (including rules and process changes) to further streamline the assignment of applications and issuance of licenses.

and outline the steps OLCC has or is taking to implement SB 218's provisions and to reduce the overall backlog of pending licensing actions.

OLCC anticipates having more information available to fully analyze SB 218's impacts on the industry prior to preparing the next legislative report, which is due by December 31, 2020.

To obtain a paper copy of this report contact the Oregon Liquor Control Commission's Recreational Marijuana program at marijuana@oregon.gov.

Published online at <https://marijuana.oregon.gov> under the "Government Resources" header.

Introduction

Per SB 218 (2019 Oregon Laws, Chapter 419), the Oregon Liquor Control Commission (OLCC) is required to submit an annual report to an interim committee of the Legislative Assembly related to economic development by December 31st of each calendar year regarding the effects of the bill on the marijuana industry.

Given that much of the work to implement SB 218 has been recent or is anticipated, at this time there is little data available to analyze the bill's short and long-term effects on Oregon's recreational marijuana industry. Therefore this report will primarily focus on: 1) the volume of applications and pending licensing actions since legalization; 2) strategies the agency is employing to reduce the backlog of licensing actions; and 3) the projected developments in backlog reduction and licensing timelines during 2020, as a result of implementing of these strategies.

License Types

This report will reference the five primary types of recreational marijuana licenses:¹

- 1) **Producers.** Recreational producers cultivate and harvest marijuana plants within their licensed premises.
- 2) **Processors.** Recreational processors remove cannabinoids from harvested marijuana through either mechanical or chemical separation processes. Processors may also create other products using concentrated cannabinoids.
- 3) **Wholesalers.** Recreational wholesalers can purchase, store, transport, and sell marijuana items from any other license types.
- 4) **Retailers.** Recreational retailers can sell marijuana items to consumers.
- 5) **Laboratories.** Laboratories sample and test marijuana items for specific pesticides, residual solvents, potency, and possible microbial growth.

Licensing Trends

Historical

Recreational marijuana was legalized in Oregon by passage of Measure 91 in the November 2014 general election. Shortly thereafter, during the 2015 regular session, the legislature made numerous substantive changes to the original measure; in June 2015 Oregon Revised Statutes Chapter 475B *et seq.* became the governing statutory framework for both recreational and medical cannabis in the state. OLCC is the agency responsible for licensing and regulating the production and sales of recreational marijuana in Oregon under ORS Chapter 475B.

During 2015 the OLCC focused on developing the initial framework for recreational marijuana licensing and compliance requirements:

- Creating and adopting comprehensive administrative rules;
- Developing and implementing online application and product tracking systems; and
- Hiring and training new staff for the marijuana program.

¹ Oregon also allows research certificates, but at the time of preparing this report no applicants have met the qualifications for or completed the steps required to obtain a research certificate.

The first set of administrative rules were adopted in December 2015, and on January 4, 2016 OLCC began accepting applications for all recreational marijuana license types as required by statute.

During 2016, OLCC concentrated on establishing a fledgling but functioning recreational market by the end of the year, with operating licenses at each level of the supply chain.² To meet this goal the OLCC prioritized its limited resources on processing applications along the supply chain (i.e. focusing on producers and laboratories during the earlier part of the year, then processors and wholesalers mid-year, and finally retailers towards the end of 2016 as early start recreational sales at Oregon Health Authority dispensaries ended). OLCC issued the first eight (8) Producer licenses in April 2016, and by the end of 2016 had issued over 700 licenses of all types.

Original estimates for the number of recreational marijuana licenses that would be applied for and issued by the OLCC during the first two (2) years of the program were between 800 to 1,000. These estimates were based on data from the only two states preceding Oregon with legalized recreational marijuana at that point: Washington and Colorado. Several factors made Oregon unique, however: first, the state had a long-established medical marijuana program, and second, the long-term scope of statewide demand for a recreational market and transition from the medical system was unknown. Even as demand for licenses quickly outpaced original estimates, it was also apparent early on that consumer interest in the recreational system may be higher than anticipated; this meant determining the ultimate size of the market as a whole, and sustainable equilibrium between the number of issued licenses and consumer demands, very unclear.

OLCC applied the same general approach to issuing recreational marijuana licenses in 2017 – focusing earlier in the year on licensing new producers and laboratories (and in particular outdoor producers due to the limited outdoor growing season in Oregon), and then again prioritizing applications through the rest of the supply chain. However, the volume of new applications being submitted did not subside. By mid-2017 the agency had issued more than 1,300 licenses, and by the end of 2017 OLCC had approved almost 1,700 licenses.

Moving into 2018(as shown in **Figure 1** and **Figure 2**) the number of applications received by the OLCC continued climbing at a steady rate. Correspondingly, the increasing rate of issued licenses meant that OLCC licensing staff began facing a growing body of additional work: renewing existing licenses and approving critical changes, required in statute or rule, to licensed businesses. As a result a sizable backlog of applications began to develop.

² This critical goal was due to the impending December 31, 2016 sunset of the “Early Start” program: a legislative allowance for existing medical dispensaries to sell limited products and quantities to recreational customers.

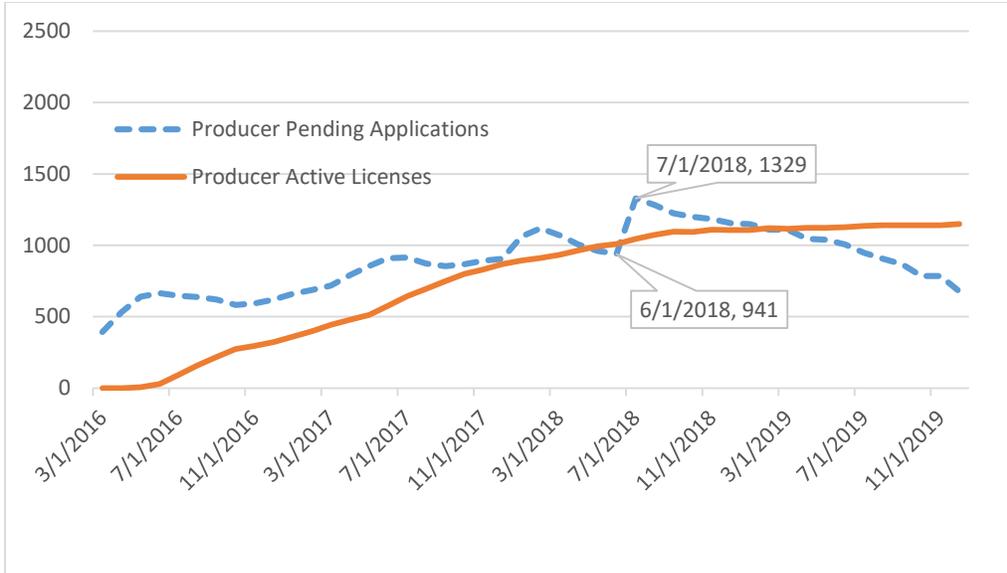


Figure 1: *Producer licenses and applications by month*

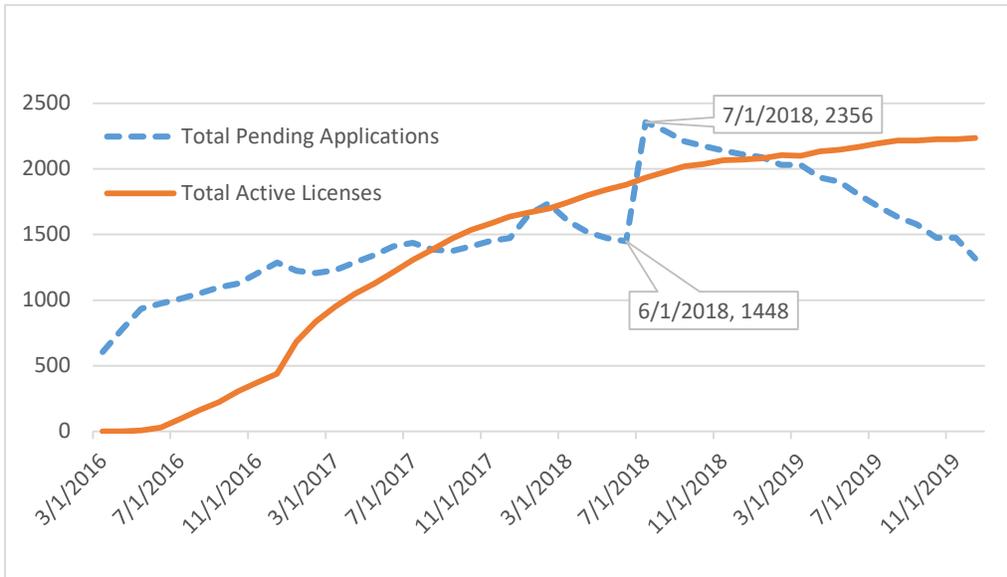


Figure 2: *All licenses and applications by month*

A few additional factors led to this as well: first, OLCC had previously utilized extra staff from other business units across the agency to assist in processing the unanticipated volume of applications, but by early 2018 those additional resources needed to either resume normal duties or begin focusing on marijuana compliance work. Additionally, by early 2018 a noticeable increase in the volume of time-sensitive change requests for existing licensees was occurring. This development coincided with a period of time in which the still young and developing recreational market was entering a very volatile state of change; following a bountiful 2017 harvest the volume of marijuana in the legal system was extremely high, and wholesale prices for flower dropped significantly. Businesses that were not prepared for these fluctuations began to struggle, and a period of rapid consolidation and market instability followed.

The result for OLCC was a critical need for existing licensees to quickly receive regulatory approval for changes in order to stay in business. This included changes in ownership, location, privileges, premises, and financial interest structures (many of which have a layered complexity).

Administrative Pause

As concerns regarding oversupply of marijuana in Oregon increased and market prices continued to fall, it became clear that OLCC needed to prioritize the handling of regulatory approvals for existing licensees over new applications. In early June 2018, the agency issued a formal announcement that it would “pause” processing new applications received after June 15, 2018. At that time, OLCC had issued over 1,900 licenses, and had a backlog of almost 1,300 additional applications waiting to be processed.

A high volume of new applications flooded the agency just prior to the June 15th deadline (over 1,000 new applications of all types), an action which was generally expected; however, the subsequent commodification of submitted applications themselves was not. OLCC had, to this point, liberally allowed applicants to make changes to their applications prior to, and up to the point of issuing a license; applicants began using this flexibility to “buy” and “sell” applications for their “spot in line.” The absence of IT processing systems means most of the work needed to accommodate changing an application must be done manually by staff. The rise in this new phenomenon further decreased OLCC’s ability to make headway on the backlog of pending applications. In addition because much of this work was unanticipated, OLCC’s existing fees do not capture most of the cost to complete these licensee requested changes.

Production and Sales Data

Although demand for marijuana items continues to increase within the OLCC recreational market, supply – in the form of both wet weight harvests and inventory levels – also continues to increase year-over-year.

The 2019 outdoor harvest season was the largest since recreational licensure began in 2016 (**Figure 3**). Between January 1 and November 30, 2019, OLCC producers harvested more than 5.7 million pounds (approximately 2,600 metric tons) of wet weight. This represents a 16% increase over the same time period in 2018.

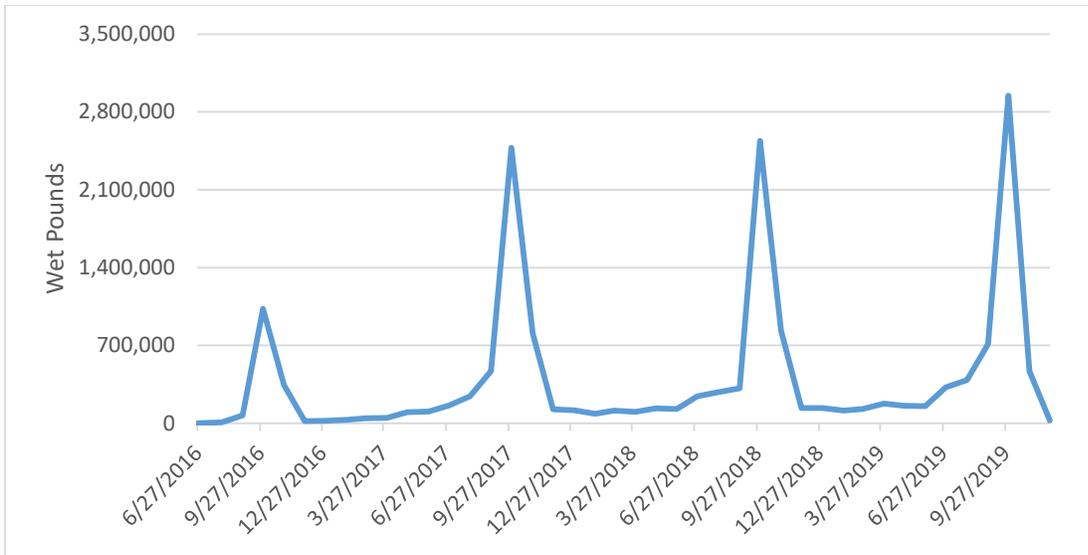


Figure 3: Wet weight harvested by month

Demand increased at a much greater rate than harvested weight in 2019 – the quantity sold of usable marijuana increased by approximately 25% and extracts, concentrates, edibles, and tinctures collectively rose approximately 50% (**Figure 4**). A larger increase in annual demand that exceeded the annual (harvested wet weight) supply would seem to indicate that the gap between supply and demand is closing. However, the proportionately greater shift in demand towards extracts and concentrates means that demand is shifting towards more shelf-stable products where the inventory levels have built up over time. In other words, even though demand is increasing significantly it may still be consuming prior years’ supply of extracts and concentrates and more time is needed to reduce “back stock” of inventories.

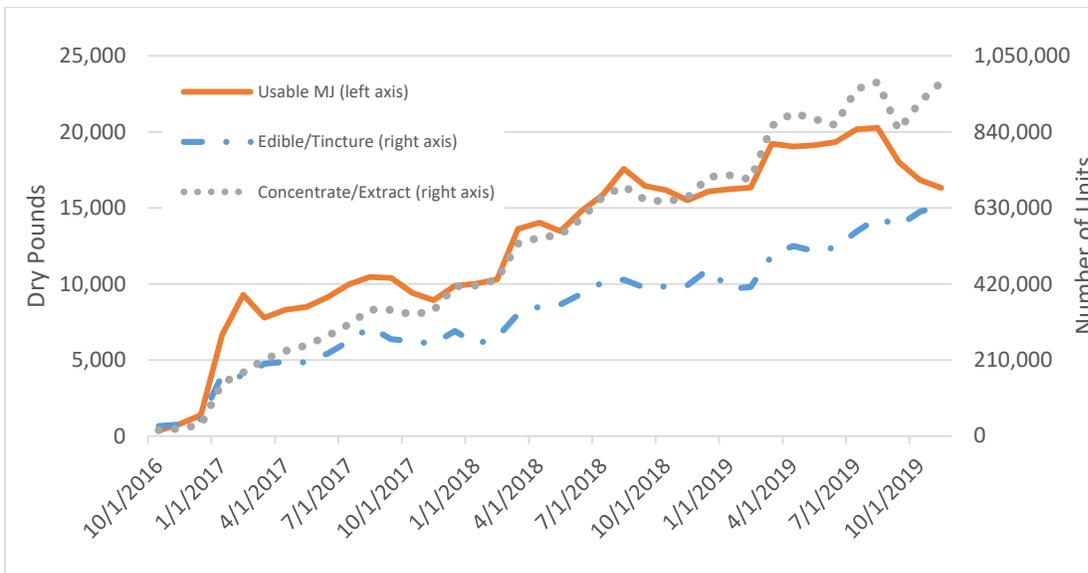


Figure 4: Quantity sold by product category and month

In fact, inventory levels for all categories also continues to either rise (in the case of edibles and tinctures) or remain steady (in the case of usable marijuana and extracts/concentrates) despite an increase in demand (**Figure 5** and **Figure 6**). The stability of extracts and concentrates in particular indicates that shelf-stable stocks continue to be built up, as input (usable marijuana) prices remain relatively low. Even in the case of usable marijuana, the quantity on hand at licensed premises on December 1, 2019 was higher than the amount on hand on December 1, 2017.

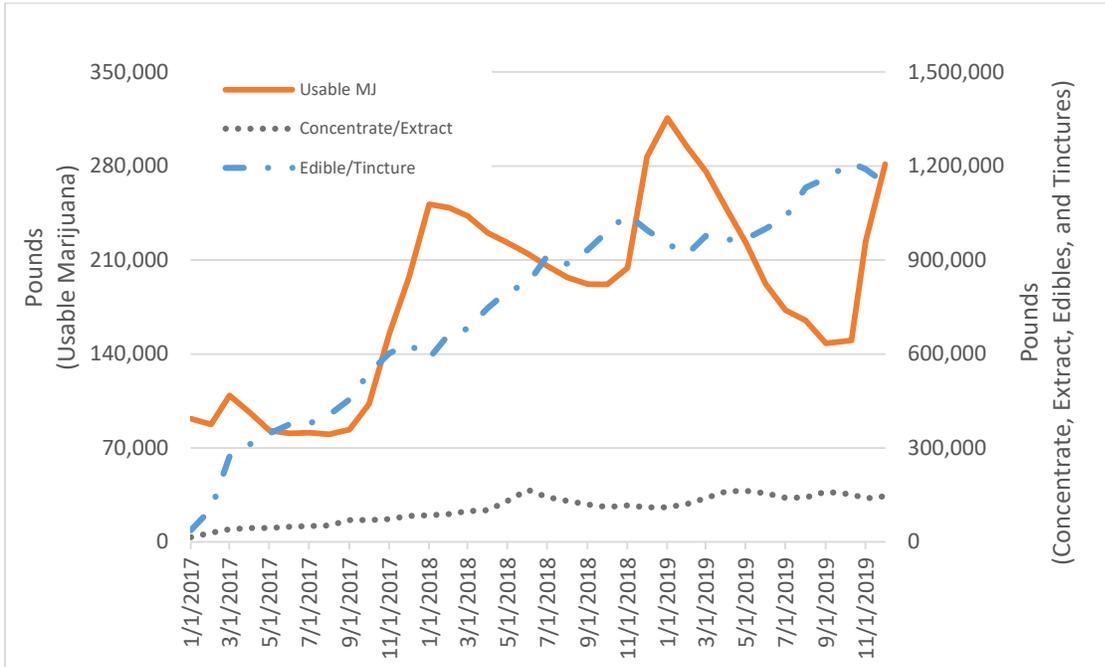


Figure 5: Quantity in inventory by product and month

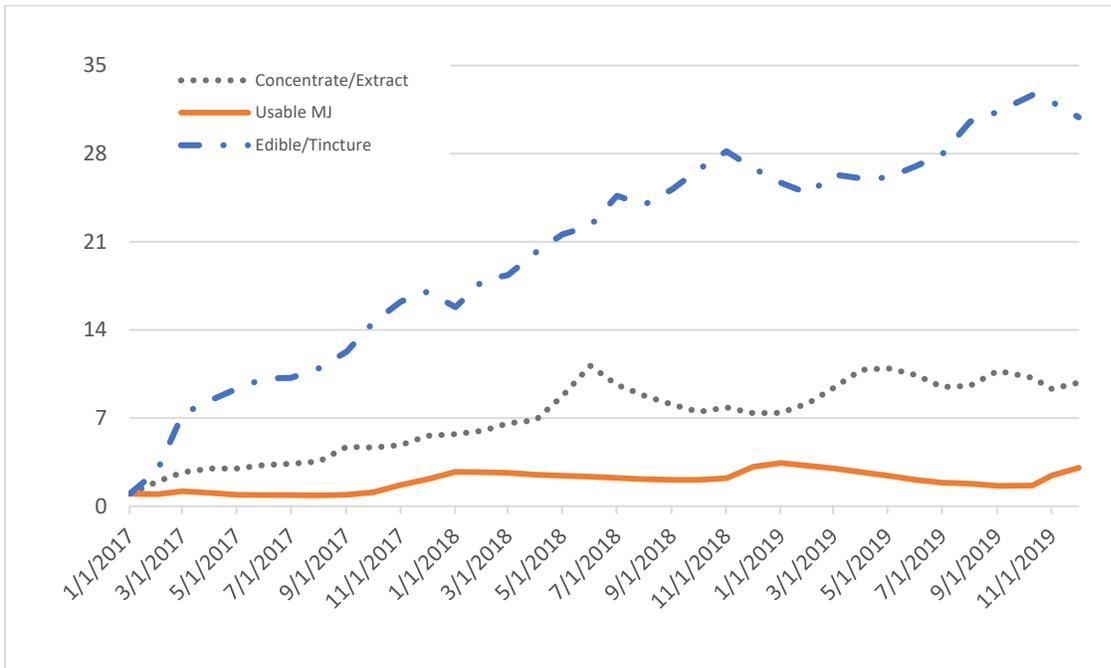


Figure 6: Percent increase in inventory by category and month, from January 1, 2017

Wholesale prices per pound of usable marijuana increased considerably beginning in spring and summer 2019, almost doubling from approximately \$650 in April 2019 to \$1,200 in November 2019 (**Figure 7**). This is favorable news for producers when compared to wholesale prices during last year’s harvest, and likely relieves some price pressure. However, wholesale prices remain 25% lower than at the same point in 2017 and wholesale prices typically begin declining as outdoor harvested material begins to be sold in December of the harvest year and January of the following year. It remains to be seen what the 2020 price trend will be, and that will be determined by individual business decisions over the coming months. For example, whether outdoor producers sell early to processors or retain stock to sell to retailers throughout the year.

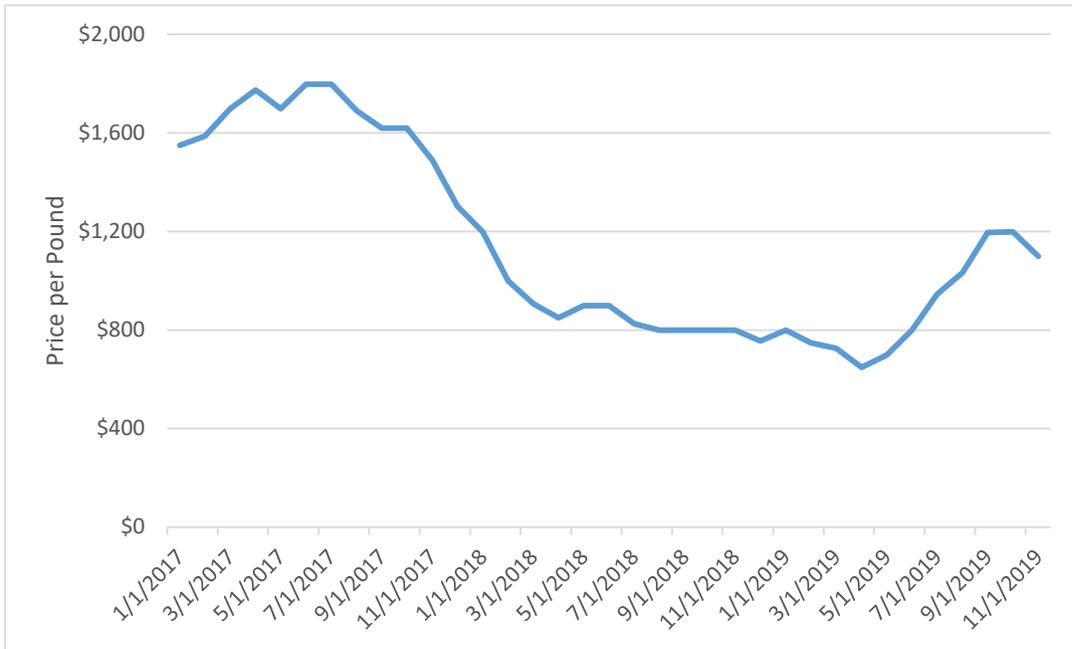


Figure 7: Median wholesale price, usable marijuana

Despite significant increases in wholesale prices, the retail price of usable marijuana remains low, increasing only 16% between June and November (from \$3.00 to \$3.50 median price per gram, **Figure 8**). If prices remain low that will continue to boost demand within the recreational market. However, a lower retail sales price and a higher wholesale price will increase price pressures on retailers.

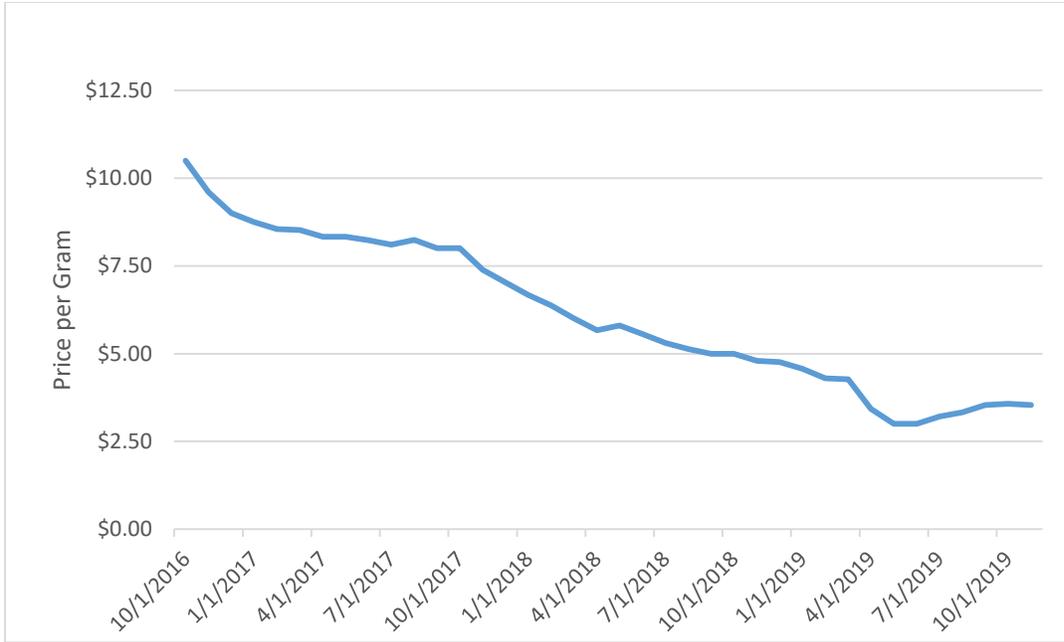


Figure 8: Median retail price, usable marijuana

Based on an analysis of data from September 2018 to August 2019 (**Figure 9**), approximately 50% of the usable marijuana harvested in that time period has been either sold to consumers as usable marijuana or processed into secondary or tertiary products (e.g. concentrates, extracts, edibles, etc.); 30% has been rendered unusable and wasted out; and 20% remains in licensees’ inventory. This report is only an analysis of usable marijuana (and does not take into account waste/spoilage, “stocking up” of secondary and tertiary items, or sales of those products). Even excluding waste (which may be due at least in part to “unsellable” material that could be sellable in a lower supply environment), the 20% of the harvest that is added to usable marijuana stock in inventory continues to indicate that supply exceeds demand in the recreational market.

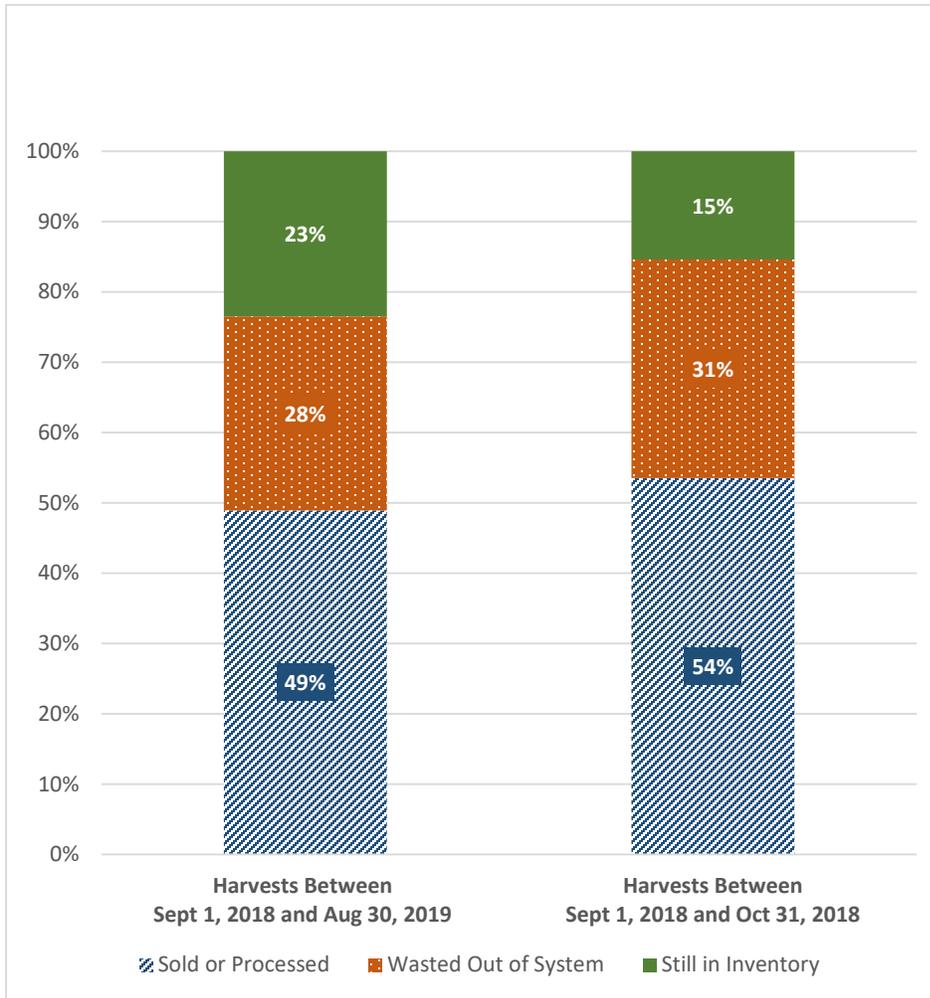


Figure 9: Status of usable marijuana inventory by date of harvest

SENATE BILL 218

Overview

In the 2019 legislative session Governor Kate Brown introduced Senate Bill 218 in an effort to curb marijuana production, due to growing concerns regarding oversupply and out-of-state diversion of marijuana. SB 218 proposed to place a moratorium on new producer licenses until January 2022, and was signed by the Governor on June 17, 2019.

SB 218 requires OLCC to:

1. Inactivate all new producer applications received after June 15, 2018.
2. Inactivate all new producer applications received prior to June 15, 2018 but that did not submit an approved Land Use Compatibility Statement (LUCS) prior to July 8, 2019.
3. Discontinue allowing producer applicants to change ownership of the application.
4. Discontinue allowing producer applicants to change location applied for.

5. Adopt rules that establish timelines in which a producer applicant must complete the licensing process after being assigned.
6. Study the effect of the bill's requirements on the marijuana industry and prepare a report on the effects for the legislature by December 31st of each year.

As noted at the beginning of this report, because SB 218 was adopted just six months ago and the steps to implement its provisions are in progress, there is little information available to evaluate the effects on the industry as a whole. The remainder of this report will describe the steps OLCC has taken to implement SB 218's requirements to date, as well as other strategies being implemented to address the backlog of applications for all license types.

OLCC Implementation of SB 218

The following section outlines the specific activities to implement SB 218 that OLCC has taken to date.

Inactivation of Producer Applications

Since the passage of SB 218 the OLCC has inactivated 125 producer applications. A majority of these applicants were unable to receive a Land Use Compatibility Statement by July 2019.

Discontinued Application Changes

In August 2019 OLCC adopted temporary rules that disallowed changes in ownership or location of producer applications. These rule changes were made permanent at the December 19, 2019 Commission meeting and are effective on January 1, 2020. As applications are assigned to investigators and if OLCC determines these ownership or location changes were made without notifying OLCC prior to SB 218's effective date, those applications will be inactivated.

Timelines to Licensure

Also in August 2019, OLCC adopted temporary rules that required producer applicants to complete the licensing process within 60 days of being assigned for investigation. These rule changes were made permanent at the December 19, 2019 Commission meeting and are effective on January 1, 2020. Applications that cannot be completed within 60 days of assignment will be placed on hold, and won't be reassigned until all other pending applications have had an opportunity be processed. Once reassigned, applicants will have an additional 60 days to complete the process or be inactivated.

Beyond SB 218 Requirements

In addition to SB 218's specific mandates, OLCC has undertaken some additional work (through policy, process, and rule changes) in an effort to address the backlog of licensing actions waiting for approval for all license types, not just for producer applicants. OLCC has set several goals in performing this work:

- Provide faster avenues for all license type applicants to be assigned and receive approval for a license when ready;
- Set better time-to-licensure estimates for all license types; and
- Provide more predictability for licensees to receive regulatory approvals for change requests.

Because much of this work has just been started and is in progress, the impacts and effects (positive, negative or neutral) cannot be fully evaluated in this report.

Licensing Staff Restructure

Since the start of licensure the OLCC's marijuana licensing staff has been limited in number, in part due to the uncertainty of the long term needs of the agency's licensing division to keep up with the industry's needs. During the latter half of 2019, OLCC restructured its licensing staff and workflows to better maximize the resources it currently has. Investigators and technical staff were organized into teams based on specific license types, to allow for better specialization and quicker processing times. The new team structures were initiated in early November 2019 with new expectations for staff put in place, including key performance indicators.

It is too soon to tell what impact this strategy will have on the backlog of applications in general. OLCC will continue to monitor this effort to determine if it is supporting the desired change, and will respond as needed.

Policy Changes

The negative effects caused by specific changes being made to applications and applicant delays in completing the licensing process are not unique to producer applicants. In November 2019 OLCC announced that it would begin applying the same restrictions on application changes and timelines for completion to all license types, and is in the process of adopting those requirements in permanent rule.

In order to reduce the volume of change requests that require agency approval, OLCC has also recently revised its standards on the types of financial interests that must be pre-approved. The goal of these changes is to allow licensed businesses to take on additional financing and capital with less regulatory red tape, and limit the volume of changes that licensing staff must review outside of renewing a license. These new policies were just adopted and published in November 2019, but OLCC anticipates that reducing the number of change requests that must be pre-approved will allow the agency to focus on processing more critically required changes, renewals, and new applications.

Change in Assignability Standards (2020)

While the Legislature expressed its clear intent, through SB 218, to curb overall production of marijuana in Oregon, its intent to preserve a path forward for existing producer applicants was equally clear. Therefore one of the more significant changes OLCC will be making in the near future is to the standards by which a producer application is assigned. The goal of this change is to provide a faster path to licensure for applicants who actually have invested time and money to establish their business.

SB 218 expressly directs OLCC to process all pending producer applications submitted before the effective date. At the time SB 218 became law there were nearly 500 producer applications in that category, and all had been pending with OLCC for more than a year. Historically, OLCC has used the date an approved Land Use Compatibility Statement (LUCS) is received for an application to establish an applicant's "place in line" for assignment; a LUCS indicates the proposed use is not prohibited by local zoning requirements. When recreational marijuana licensing started this standard made sense because there was little to no backlog of applications. OLCC has determined that the volume and length of time all pending producer applications have been waiting to this point warrants a different approach. Therefore, in the near future OLCC will begin assigning producer applicants based on an applicant's readiness to complete the licensing process.

Under the new standards, in order to be assigned, applicants will need to submit a detailed checklist, certifying that they have completed all major licensing requirements. OLCC will begin using the submission date and checklists to establish specific dates for assigning an investigator to begin processing an application. Applicants must adhere to the strict requirements for completing the checklist to have their application accepted by OLCC; falsely certifying that the application checklist is complete could result in OLCC denying the application.

The impact of this approach remains unknown at this point because this work has not yet been implemented. However OLCC estimates that approximately one-third to one-half of the applications currently in the backlog were submitted merely as placeholders in advance of the announced "administrative pause," or are applications that cannot be completed due to the current licensing timelines and change restrictions discussed above. OLCC anticipates that focusing on an applicant's readiness instead of relying solely on the LUCS submission date will provide a much more realistic picture of the volume of legitimate applicants in the backlog and total number of anticipated licensees in the Oregon market.

The agency anticipates rolling out this new process for producer applicants in February 2020. OLCC sees this process also being beneficial for other applicants as well, because should the implementation be successful for producer applications, the OLCC is tentatively planning to adopt a similar requirement for all other license types.

Change Fees

Finally, OLCC anticipates engaging in rulemaking next year to establish and apply fees for certain types of license changes made during a license year. The volume of changes that require regulatory approval is higher than existing staff can perform, in addition to processing new applications and renewing existing licenses. Because OLCC's marijuana program is fee-funded, OLCC must capture fee revenue sufficient to meet the program's needs. Adding fees for additional work required of the agency by licensees that are not captured in annual licensing fees will allow the agency to grow the necessary resources in this regard.

Conclusion

Oregon's nascent recreational cannabis industry has come a long way in a few short years. It has already experienced boom and bust dynamics similar to other commodities, as well as the effects of consumer demand and oversupply, while at the same time far surpassing expectations for providing a significant source of revenue for the state. OLCC views its role in regulating the recreational market as one of educating, building, and partnering with stakeholders as the industry develops, and OLCC takes seriously its mission to support both public safety and economic development in this state. Due to its recent passage, SB 218 has not yet had an effect on the supply, demand, or other economic factors within the recreational marijuana market. There are licensure process changes established as part of SB 218 that are being implemented by OLCC to facilitate faster processing times for new applications and license renewals. However, these processes are in early stages of implementation and their full effect on time to licensure is currently unknown. This initial report on the effects of SB 218 provides a limited snapshot due its recent effective date and limited implementation, but as the OLCC continues to implement its provisions the OLCC anticipates having a more comprehensive analysis to present the legislature when the OLCC submits the next SB 218 outcomes report.