

“THE GREAT POT EXPERIMENT”:  
A BUDDING INDUSTRY

WOULDN'T IT BE BETTER IF IT WAS  
A LEGAL BILLION-DOLLAR INDUSTRY?<sup>1</sup>

*Comment*

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1. *The Great Pot Experiment*, ECONOMIST (July 10, 2014), <https://www.economist.com/united-states/2014/07/10/the-great-pot-experiment>; Curtis Silver, *Marijuana's \$40 Billion Dollar Green Rush*, FORBES (June 2, 2016, 7:35 AM), <https://www.forbes.com/sites/curtissilver/2016/06/02/marijuanas-40-billion-dollar-green-rush/#3cd012f8628c>.

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### ***Abstract***

Forty states cannot afford to pay their bills.<sup>2</sup> Cities are not faring any better. According to Forbes, “[sixty-four] of the [seventy-five] most populated cities do not have enough money to pay all of their bills.”<sup>3</sup> Nationwide marijuana legalization could solve this problem by producing an “entirely new tax revenue stream for the government”—about \$132 billion dollars over the next decade.<sup>4</sup> Despite these staggering figures, most states have been unwilling to embrace this huge potential source of untapped revenue.

States that have chosen to legalize marijuana continue to reap the rewards in the form of state taxes, local taxes and licensing fees. As of January 1, 2020, eleven states and the District of Columbia have legalized adult recreational use.<sup>5</sup> Among these states is Michigan, which

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2. See Mayra Rodriguez Valladares, *Forty U.S. States Cannot Afford to Pay All Their Bills*, FORBES (Sept. 24, 2018, 9:16 PM) (citing an analysis done by the non-partisan government watchdog group Truth in Accounting), <https://www.forbes.com/sites/mayrarodriguezvalladares/2018/09/24/fortyusstatescannotaffordtopayalloftheirbills/#6ce70341718a>.

3. *Id.*

4. Katie Zezima, *Study: Legal Marijuana Could Generate More Than \$132 Million in Federal Tax Revenue and 1 Million Jobs*, WASH. POST (Jan. 10, 2018, 4:47 PM), [https://www.washingtonpost.com/national/2018/01/10/study-legal-marijuana-could-generate-more-than-132-billion-in-federal-tax-revenue-and-1-million-jobs/?utm\\_term=.1ecdf41d21b2](https://www.washingtonpost.com/national/2018/01/10/study-legal-marijuana-could-generate-more-than-132-billion-in-federal-tax-revenue-and-1-million-jobs/?utm_term=.1ecdf41d21b2).

5. Jeremy Berke & Skye Gould, *Legal Marijuana Just Went on Sale in Illinois. Here Are All the States Where Cannabis is Legal*, BUS. INSIDER (Jan. 1, 2020), <https://www.businessinsider.com/legal->

was the first addition from the Midwest.<sup>6</sup> Additionally, thirty-three states have legalized cannabis for medical use.<sup>7</sup>

Although tax revenue is a driving factor in legalization, researchers caution that revenue from “sin taxes”—“a tax on a specific activity or good”—is far from guaranteed and should not be used as the sole remedy for solving structural issues with a state’s budget.<sup>8</sup> This warning is more applicable for “volatile [markets whose] forecasts rely on limited data,”<sup>9</sup> and for marijuana specifically, as “[u]ncertainties, including long-term consumption trends and shifts in the black market, make returns difficult to forecast.”<sup>10</sup> With this understanding, this Comment will focus on the licensing and regulatory policy decisions made by each state and its effects on the sustainability and structure of its recreational marijuana market.

This Comment examines the progress and choices of three states with long histories of blazing the trail in legalizing marijuana. In the absence of federal guidance or historical data, states have maintained the freedom to experiment, resulting in varying degrees of success. As support for legalization continues to rise, and marijuana decriminalization initiatives appear on the ballot in more states, it is imperative that the industry learns from the successes and failures of these early adopters.

This Comment will first address the history of marijuana, both nationally and then at a state level, focusing on California, Colorado, and Washington. It will then analyze the four critical issues affecting their respective retail marijuana markets: licensing restrictions, vertical integration, the degree of control available to local governments, and the persistence of the black market. Finally, this Comment will provide recommendations for other states experimenting with or considering legalization.

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marijuana-states-2018-1 (including Alaska, California, Colorado, Illinois, Maine, Massachusetts, Michigan, Nevada, Oregon, Vermont, and Washington).

6. *Marijuana Overview*, NAT’L CONF. OF ST. LEGS. (Dec. 14, 2018), <http://www.ncsl.org/research/civil-and-criminal-justice/marijuana-overview.aspx> (last updated Oct. 17, 2019).

7. *State Medical Marijuana Laws*, NAT’L CONF. OF ST. LEGS. (July 2018), <http://www.ncsl.org/research/health/state-medical-marijuana-laws.aspx> (last updated Sept. 27, 2019).

8. *Are Sin Taxes Healthy for State Budgets?*, PEW CHARITABLE TR. (July 19, 2018), [https://www.pewtrusts.org/-/media/assets/2018/07/sin\\_taxes\\_report.pdf](https://www.pewtrusts.org/-/media/assets/2018/07/sin_taxes_report.pdf). “These extra dollars and cents levied on products and activities detrimental to consumers – traditionally tobacco, alcohol, and gambling – are intended to accomplish two contradictory goals: Like all taxes, they generate revenue for the taxing entity, but they also aim to deter the behavior being taxed – which can ultimately negate the first goal.” *Id.*

9. *Id.*

10. *Id.*

## I. INTRODUCTION

Marijuana is a Schedule I narcotic under the Controlled Substances Act, a classification given by the federal government to drugs with “a high potential for abuse” or those with “no currently accepted medical use in treatment.”<sup>11</sup> The federal government has taken a largely deferential approach to the sale and availability of marijuana in states that have legalized. However, the direct conflict with marijuana’s federal classification introduces uncertainty that has had a chilling effect on the industry.<sup>12</sup>

Despite legislative efforts in both the U.S. House and Senate,<sup>13</sup> many congressional members still refuse to budge. This delay of federal action comes at an immediate cost to the fledgling industry; businesses that are perfectly legal under state law must operate under constant threat of federal crackdowns and are unable to access national financial institutions.<sup>14</sup> Because marijuana remains federally illegal, cash from the industry is, by definition, illegal under federal law.<sup>15</sup> Therefore, banks that work with marijuana businesses could be charged with money laundering.<sup>16</sup> As a result, marijuana-related businesses must pay all business expenses in cash, including state taxes.<sup>17</sup> The cash-only nature of the industry requires businesses to increase security to avoid becoming targets and hire additional employees to manage the process.<sup>18</sup> Cash-only sales also increase the risk that actual sale numbers will be underreported, which could have a significant effect on tax-collection efforts, and at worst, create a massive reservoir of untraceable cash.<sup>19</sup>

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11. 21 U.S.C. § 812(b)(1)(A)–(B), (c)(10) (2018).

12. See Trevor Hughes, *Uncertainty Roils American Marijuana Industry Over Feared Federal Crackdown*, USA TODAY (Jan. 4, 2019, 6:52 PM), <https://www.usatoday.com/story/news/2018/01/04/uncertainty-roils-american-marijuana-industry-over-feared-federal-crackdown/1004250001>.

13. See Marijuana Freedom and Opportunity Act, S. 1552, 116th Cong. (2019) (introduced by Sen. Chuck Schumer); see also Marijuana Justice Act of 2017, S. 1689, 115th Cong. (2017) (introduced by Rep. Cory Booker).

14. See *Why Marijuana Retailers Can’t Use Banks*, ECONOMIST: ECONOMIST EXPLAINS (Jan. 22, 2018), <https://www.economist.com/the-economist-explains/2018/01/22/why-marijuana-retailers-cant-use-banks> (explaining that most financial institutions are federally funded, thus prohibiting these funds from enabling federally illegal activities).

15. See *Cannabis Banking: Bridging the Gap Between State and Federal Law*, AM. BANKERS ASS’N (<https://www.aba.com/advocacy/our-issues/cannabis>) (last visited Jan. 1, 2020).

16. See *id.*; see also *Why Marijuana Retailers Can’t Use Banks*, *supra* note 14.

17. See *Why Marijuana Retailers Can’t Use Banks*, *supra* note 14; see also *Cannabis Banking*, *supra* note 15.

18. See *Why Marijuana Retailers Can’t Use Banks*, *supra* note 14; see also *Cannabis Banking*, *supra* note 15.

19. See *Why Marijuana Retailers Can’t Use Banks*, *supra* note 14; see also *Cannabis Banking*, *supra* note 15.

However, the conflict between state law and federal asset-forfeiture laws creates an additional risk for businesses in the marijuana industry because it allows federal law enforcement to seize profits that they suspect are derived from criminal activity. This becomes a considerable issue for marijuana businesses because they are forced to keep large amounts of cash-on-hand due to the difficulty of depositing the cash into bank accounts.<sup>20</sup> In one case, police raided a dispensary in San Diego, handcuffing employees and seizing \$325,000 from the safe.<sup>21</sup> The police then seized the family's personal funds, including the daughter's college fund.<sup>22</sup> Although no charges were filed, the dispensary has since gone out of business.<sup>23</sup>

By 2027, the North American market for marijuana is projected to exceed \$47.3 billion.<sup>24</sup> According to a report by the Tax Foundation, states that have not chosen to legalize marijuana are losing an estimated \$28 billion in annual tax revenue.<sup>25</sup> In 2018, Washington collected over \$367 million in marijuana taxes, licenses, and fees, and in 2019, Colorado collected over \$300 million.<sup>26</sup> On the other hand, California is off to a slower start than projected, collecting \$84 million in taxes from 2017 to 2018, which is approximately \$101 million short of its June 2018 projections.<sup>27</sup> However, California's market has seen an average quarterly growth of 33% since its first year of retail sales, and the revenue for the 2018–19 fiscal year is projected to be between \$280 million and \$410 million.<sup>28</sup> While states that have legalized are updating infrastructure and supporting public schools with this new tax revenue

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20. *Why Marijuana Retailers Can't Use Banks*, *supra* note 14.

21. Nick Sibilia, *Cops Raid Medical Marijuana Business, Seize Over \$100,000 Including Teenage Girl's College Savings*, FORBES (Nov. 2, 2016, 5:51 PM), <https://www.forbes.com/sites/instituteforjustice/2016/11/02/cops-raid-medical-marijuana-business-seize-over-100000-including-teenage-girls-college-savings/#6d0ef7442a5c>.

22. *Id.*

23. *Id.*

24. Thomas Pellechia, *Legal Cannabis Industry Poised for Big Growth, in North America and Around the World*, FORBES (Mar. 1, 2018, 8:35 AM), <https://www.forbes.com/sites/thomaspellechia/2018/03/01/double-digit-billions-puts-north-america-in-the-worldwide-cannabis-market-lead/#2807965c6510>.

25. Gavin Ekins & Joseph Bishop-Henchmen, *Fiscal Fact No. 509: Marijuana Legalization and Taxes: Federal Revenue Impact*, TAX FOUND. (May 12, 2016), <https://taxfoundation.org/marijuana-tax-legalization-federal-revenue/>.

26. *Marijuana Tax Data*, COLO. DEP'T OF REVENUE, <https://www.colorado.gov/pacific/revenue/colorado-marijuana-tax-data> (last updated Feb. 2020); *Washington Marijuana Revenues, and Health*, WASH. ST. TREASURER, <https://www.tre.wa.gov/portfolio-item/washington-state-marijuana-revenues-and-health/> (last visited Jan. 24, 2019).

27. Seth Kerstein, *Cannabis Tax Revenue Update*, LEGIS. ANALYST'S OFF. (Nov. 15, 2018), <https://lao.ca.gov/LAOEconTax/Article/Detail/326>.

28. *Id.*

stream,<sup>29</sup> the federal government has not only failed to lead, but actively stands in the way of the will of voters, states, and economic data.

A. *Marijuana Has Sparked Billion Dollar Investments*

Once considered a niche product, marijuana is becoming more mainstream each year, and companies are finding creative ways to market and sell it.<sup>30</sup> Private corporations, like pharmaceutical companies and beverage distributors,<sup>31</sup> are now investing billions of dollars in the cannabis industry to stake their place in this emerging market.<sup>32</sup> One such example is Constellation Brands, Inc., the parent company of Corona.<sup>33</sup> In 2017, Constellation Brands purchased a 10% stake in Canopy Growth, a Canadian cannabis startup, for \$190 million dollars.<sup>34</sup> Less than a year later, Constellation Brands increased that holding to 38% by investing another \$4 billion.<sup>35</sup> Another beverage company, Heineken-owned Lagunitas, has launched a non-alcoholic, THC-infused sparkling water.<sup>36</sup> Other large investors in the cannabis industry include a subsidiary of Scotts Miracle-Gro; big-tobacco company, Altria Group; Molson Coors Brewing, which owns Coors, Blue Moon, and Miller; and Anheuser-Busch InBev.<sup>37</sup> These iconic brands do not seem deterred by the fact that their investments could disappear with one directive from the Department of Justice; their interest

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29. *Marijuana Tax Revenue and Education*, COLO. DEPT. OF EDUC. (<https://www.cde.state.co.us/communications/2019marijuanarevenue>) (last visited Jan. 1, 2020).

30. Andre Bourque, *As Cannabis Goes Mainstream, are Celebrity Brands the Future of the Industry?*, FORBES (Apr. 24, 2019, 8:44 AM), <https://www.forbes.com/sites/andrebourque/2019/04/24/as-cannabis-goes-mainstream-are-celebrity-brands-the-future-of-the-industry/#4e7febbf7b2c>.

31. The U.S. Food and Drug Administration recently approved a drug for the treatment of seizures associated with two rare forms of epilepsy, the first FDA approval for a drug that contains a derivative of marijuana. Press Release, U.S. Food & Drug Admin., *FDA Approves First Drug Comprised of an Active Ingredient Derived from Marijuana to Treat Rare, Severe Forms of Epilepsy* (June 25, 2018) (<https://www.fda.gov/news-events/press-announcements/fda-approves-first-drug-comprised-active-ingredient-derived-marijuana-treat-rare-severe-forms>).

32. Jen Skerritt & Craig Giammona, *Coca-Cola Is Eyeing a Possible Entry Into the Cannabis Market*, TIME (Sept. 23, 2018), <http://time.com/5404095/coca-cola-cannabis-market-cbd-drinks/>.

33. *Corona and Heineken Spending Billions of Dollars Developing Weed-Infused Beer*, MAXIM (Aug. 16, 2018), <https://www.maxim.com/food-drink/big-beer-invests-in-cannabis-drinks-2018-8>.

34. *Id.*

35. *Id.*

36. *Id.*

37. Sean Williams, *5 Brand-Name Companies Involved in the Marijuana Industry*, MOTLEY FOOL (July 31, 2019, 7:21 AM), <https://www.fool.com/investing/2019/07/31/5-brand-name-companies-involved-in-the-marijuana-i.aspx>.

remains strong despite various market uncertainties and the inherent risk in violating federal law.<sup>38</sup>

### B. Critical Factors

The ad-hoc nature of legalization has given rise to different forms of experimentation that have allowed states to take advantage of an opportunity to build a market from the ground-up. Three critical concepts in conceiving a regulatory structure across legalizing states have been: licensing restrictions (both in quantity and designation), the appropriate degree of vertical integration in the manufacturing and retail process, and the extent of regulatory authority delegated to localities.

#### 1. Licensing Restrictions

Licensing restrictions are one tool that states use to maintain control over legalization efforts.<sup>39</sup> Typical examples of restrictions include limiting the number of licenses available in each area, opening a short application period, and restricting the number of licenses a single entity or individual may hold.<sup>40</sup> One reason for these restrictions could be that, when dealing with an unpredictable market, it is easier for regulators to keep an eye on a smaller number of licensees.<sup>41</sup> Theoretically, a smaller number of licenses bound to the strictest regulations would provide regulators more control over the market. Moreover, regulation should have the goal of assisting in the creation of a stable, thriving market. However, the combination of current cannabis regulations could limit competition by artificially reducing the supply of licenses well below the actual demand for them, thus creating an anticompetitive application process.<sup>42</sup> “This trend will only continue when the federal government’s [eighty-year] experiment with cannabis prohibition finally comes to an end.”<sup>43</sup> Though the approaches vary, a state’s decisions to limit or promote licensing tends to reflect the wider policy priorities of that state.

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38. 21 U.S.C. § 812(d)(1) (2018) (classifying marijuana as a schedule I narcotic and stating that schedule I narcotics have a “high potential for abuse” and “no currently accepted medical use in treatment”).

39. Kris Krane, *Cannabis Cultivation Will Be a Race to the Bottom*, FORBES (Apr. 25, 2018, 11:30 AM), <https://www.forbes.com/sites/kriskrane/2018/04/25/cannabis-cultivation-will-be-a-race-to-the-bottom/#540ffa6e4184>. There is already “a trend towards large-scale greenhouse and outdoor production, which is driving prices down in states that do not have strict limits on the number of licenses they grant.” *Id.*

40. *Id.*

41. *Id.*

42. *Id.*

43. *Id.*

## 2. Vertical Integration

The marijuana industry involves several industrial processes, including the cultivation and harvesting of cannabis plants, as well as manufacturing, processing, distribution, and retail operations. Vertical integration—a key factor in establishing an efficient industry—is defined as “the combining of manufacturing operations with [the] source of materials and/or channels of distribution under a single ownership or management especially to maximize profits.”<sup>44</sup>

With certain restrictions, California allows a single company to hold licenses for different stages of the process, while Washington generally restricts marijuana producers from acquiring multiple licenses.<sup>45</sup> Proponents believe that vertical integration provides the ability for tighter control over a smaller number of parties, thus allowing for more efficient regulation.<sup>46</sup> Others contest that “vertical integration is a heavy lift” because it creates significant barriers to entry, which results in less economical, social, and racial diversity in the market.<sup>47</sup> Vertical integration can also discourage specialization and narrow choices available to consumers because it requires “farmers to also be retailers, or retailers to also be farmers.”<sup>48</sup> Specialization allows for the farmer and retailer to each focus on their particular skill set, which leads to a more competitive industry because it means each party, respectively, can produce the best product possible.<sup>49</sup>

## 3. Degree of Flexibility

While control is a common element in most regulation, the overall regulatory structure for marijuana, in particular, must be sensitive to the evolving market and the level of acceptance within each community. This is analogous to the compromise seen after prohibition, where the legalization of alcohol was determined by each state individually.<sup>50</sup>

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44. *Vertical Integration*, MERRIAM-WEBSTER, <https://www.merriam-webster.com/dictionary/vertical%20integration> (last visited Feb. 14, 2020).

45. *Resource Map State-by-State Marijuana Policies*, NAT'L CANNABIS INDUS. ASS'N, <https://thecannabisindustry.org/ncia-news-resources/state-by-state-policies/> (last visited Feb. 26, 2019).

46. Jolene Hansen, *The Pros and Cons of Vertical Integration*, CANNABIS BUS. TIMES (Sept. 21, 2017), <http://www.cannabisbusinesstimes.com/article/the-pros-and-cons-of-vertical-integration/>.

47. *Id.* (quoting Brian Vicente).

48. *Id.*

49. *Id.*

50. Following the end of prohibition in 1933, the question of alcohol control was left to the states. Like marijuana, states delegated a substantial grant of power to localities to determine alcohol policies for their respective communities. *See, e.g.*, NAT'L ALCOHOL BEVERAGE CONTROL ASS'N, DRY AM. 21<sup>ST</sup> CENTURY 1 (2016).



Similarly, states that are legalizing marijuana should empower counties and municipalities to decide whether to reject the industry or alter the regulatory scheme within their local bounds. At the same time, states must consider that legalization has occurred largely by ballot initiative—through majority approval by each state’s populace. In implementing legalization measures, states must also strike a balance between delegating regulatory authority to localities and maintaining the “strong and effective regulatory system” that the federal government requires from states.<sup>51</sup>

## II. BACKGROUND

*“Marihuana is that drug—a violent narcotic — an unspeakable scourge—The Real Public Enemy Number One!”<sup>52</sup>*

The American debate over marijuana has recently been framed as a moral question, though history suggests otherwise.<sup>53</sup> As criminalization occurred, marijuana policy became a pretext to stigmatize minority and alternative communities who were seen as threats to the fabric of society.<sup>54</sup> The government’s first step to banning marijuana was a revenue measure, which is ironic given the tax implications dominating the legalization debate today.

### A. Federal Action

The Marihuana Tax Act of 1937 used taxes and regulations to effectively prohibit the drug by requiring a special tax and imposing outsized fines for violations.<sup>55</sup> Under this law, a transfer of one ounce of marijuana to a person who had not paid the special tax and registered

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51. James Cole, Dep’t of Justice, Memorandum for all U.S. Attorneys: Guidance Regarding Marijuana Enforcement, (Aug. 29, 2013), *as reprinted in* 26 Fed. Sent’g 4 (2014).

52. REEFER MADNESS (George A. Hirliman Productions 1936).

53. *Historical Timeline: History of Marijuana as Medicine—2900 B.C. to Present*, PROCON: MED. MARIJUANA (<https://medicalmarijuana.procon.org/historical-timeline>) (last visited Jan. 1, 2020).

54. Allison McNearney, *The Complicated History of Cannabis in the US*, HISTORY.COM: HIST. STORIES (Apr. 20, 2018), <https://www.history.com/news/marijuana-criminalization-reefer-madness-history-flashback> (suggesting that marijuana was introduced to portions of the United States by Mexican immigrants fleeing the violence of the Mexican Revolution and was quickly adopted by other subcultures, including the black jazz community and the Beat Generation); *see* David Downs, *The Science Behind the DEA’s Long War on Marijuana*, SCI. AM. (Apr. 19, 2016) (quoting author and historian Martin Lee), <https://www.scientificamerican.com/article/the-science-behind-the-dea-s-long-war-on-marijuana/> (“Who’s going to be stepping up to the plate [in 1937] to defend a drug that blacks, Latinos, and jazz musicians use?”).

55. Marihuana Tax Act of 1937, 75 P.L. 238, ch. 553, 50 Stat. 551 (repealed 1970).

under the Act would be fined \$100 per ounce,<sup>56</sup> which is the equivalent of \$1,778.27 today.<sup>57</sup>

The Boggs Act of 1951 went one step further, imposing strict mandatory minimum sentences for drug offenses.<sup>58</sup> A first offense conviction would result in a fine up to \$2,000 and a prison sentence between two and five years.<sup>59</sup> An individual's second offense carried the same fine with imprisonment of at least ten years.<sup>60</sup>

In 1970, the Controlled Substances Act classified marijuana as a Schedule 1 narcotic,<sup>61</sup> "placed in the same 'most dangerous' category as heroin."<sup>62</sup> Just two years later, the commission that was designed to provide scientific evidence to confirm whether a drug's placement on the Schedule 1 list was appropriate recommended "substantial changes to federal law," including decriminalization of cannabis for private use and possession of up to one ounce.<sup>63</sup> However, the commission's recommendation was personally and vehemently rejected by President Nixon.<sup>64</sup>

### B. Initial Attempts at Decriminalization

In the 1970s, over the federal government's objections, states began to decriminalize cannabis possession.<sup>65</sup> Between 1973 and 1979, eleven state legislatures greatly reduced or eliminated penalties for marijuana use.<sup>66</sup> These measures did not create a legal market for the

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56. *Id.*

57. *CPI Inflation Calculator*, BUREAU OF LAB. STAT., U.S. DEP'T OF LABOR, <https://data.bls.gov/cgi-bin/cpicalc.pl?cost1=100&year1=193701&year2=201808> (last visited Sept. 17, 2019).

58. Boggs Act of 1951, Pub. L. No. 255, ch. 666, 65 Stat. 767 (1951).

59. *Id.*

60. *Id.*

61. Controlled Substances Act of 1970, Pub. L. No. 91-513, § 202(c)(C)(10), 84 Stat. 1236, 1247-49 (1970).

62. *Id.*; Harrison Jacobs, *The DEA Treats Heroin and Marijuana as Equally Dangerous Drugs*, BUS. INSIDER (May 22, 2016, 4:54 PM), <https://www.businessinsider.com/us-drug-scheduling-system-heroin-marijuana-2016-5>.

63. Gabriel G. Nahas & Albert Greenwood, *The First Report of the National Commission on Marihuana (1972): Signal of Misunderstanding or Exercise in Ambiguity*, 50 NAT'L COMM'N ON MARIHUANA, 55, 55 (1972).

64. Downs, *supra* note 54 (quoting a 1971 recording of President Nixon where Nixon states that he "want[s] a goddam strong statement on marijuana").

65. Marc Fisher, *Marijuana's Rising Acceptance Comes After Many Failures. Is It Now Legalization's Time?* WASH. POST (Feb. 22, 2014), [https://www.washingtonpost.com/politics/marijuanas-rising-acceptance-comes-after-many-failures-is-it-now-legalizations-time/2014/02/22/9adc8502-98dd-11e3-80ac-63a8ba7f7942\\_story.html?utm\\_term=.d9e070b62cdb](https://www.washingtonpost.com/politics/marijuanas-rising-acceptance-comes-after-many-failures-is-it-now-legalizations-time/2014/02/22/9adc8502-98dd-11e3-80ac-63a8ba7f7942_story.html?utm_term=.d9e070b62cdb).

66. *Id.*; see Emily Dufton, *U.S. States Tried Decriminalizing Pot Before. Here's Why It Didn't Work*, TIME (Dec. 7, 2017), <http://time.com/5054194/legal-pot-experiment-history/> ("Between 1973 and 1978, a dozen states decriminalized the possession of up to an ounce of marijuana.").

drug itself, but incidentally created a secondary market for paraphernalia.<sup>67</sup> A market for “pipes, bongs, rolling papers, and drug-oriented magazines” quickly emerged, with sales of more than \$250 million per year, today’s equivalent of about \$1 billion.<sup>68</sup> Without regulation or oversight, paraphernalia was readily available, and products were frequently targeting teenagers.<sup>69</sup> By 1981, most decriminalization laws were overturned when First Lady, Nancy Reagan, “adopt[ed] adolescent drug-abuse prevention as her program.”<sup>70</sup> In 1986, President Ronald Reagan declared marijuana use a “national emergency.”<sup>71</sup>

### C. The Shift

*“I have always loved marijuana . . . And I still think of it as a basic staple of life, along with beer and ice and grapefruits—and millions of Americans agree with me.”<sup>72</sup>*

The door to modern cannabis legalization was opened by the same people who firmly closed it decades before: voters. In 1996, voters in California passed Proposition 215, legalizing the use of medical marijuana,<sup>73</sup> despite prominent national figures who called the decision “a cynical hoax,”<sup>74</sup> “dangerous,”<sup>75</sup> and a “threat to the health of all Americans.”<sup>76</sup> In the 1990s, four additional states and the District of Columbia legalized medical marijuana.<sup>77</sup> Eight more states followed in the 2000s, and since 2010, sixteen states have passed medical marijuana laws.<sup>78</sup> In 2013, in reaction to the legalization movement, the Department of Justice issued the Cole Memo, which confirmed the federal government’s stance on marijuana and issued guidance that it

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67. Dufton, *supra* note 66.

68. *Id.*

69. *Id.* (detailing one instance of a mother who bought a bong made out of a frisbee so she could take it to her PTA meeting as proof that children and teens were being targeted by the marijuana industry).

70. *Id.*

71. *Id.*

72. Hunter S. Thompson: *In His Own Words*, GUARDIAN (Feb. 21, 2005, 7:30 AM) (quoting Hunter S. Thompson), <https://www.theguardian.com/books/2005/feb/21/hunterstompson>.

73. Medical Use, CAL. HEALTH & SAFETY CODE § 11362.5 (Deering 1996) (codifying Prop. 215).

74. Carey Goldberg, *Medical Marijuana Use Winning Backing*, N.Y. TIMES (Oct. 30, 1996) (quoting the Clinton Administration), <https://www.nytimes.com/1996/10/30/us/medical-marijuana-use-winning-backing.html>.

75. *Id.* (quoting then-Republican Presidential candidate Bob Dole).

76. *Id.* (quoting former Presidents George Bush, Gerald R. Ford, and Jimmy Carter).

77. Leslie Shapiro & Katie Mettler, *U.S. Marijuana Laws: A History*, WASH. POST, fig. 4, <https://www.washingtonpost.com/graphics/health/marijuana-laws-timeline/>.

78. *Id.* at figs. 6 & 8.

would not be “an efficient use of federal resources” to target states with legal, medical marijuana markets.<sup>79</sup>

In 2012, “in a groundbreaking move, Colorado and Washington voters . . . passed referendums legalizing marijuana for recreational use,” becoming the first two states to do so.<sup>80</sup> By January 2020, perhaps emboldened by the federal government’s acquiescence to state legalization for medical use,<sup>81</sup> eleven states and the District of Columbia have approved recreational use of marijuana;<sup>82</sup> nine those states have done so via voter referendum.<sup>83</sup> Although Vermont was the first state to legalize recreational use through its state legislature,<sup>84</sup> Illinois became the first state to do so for recreational retail sales, which is monumental because of its large population.<sup>85</sup>

#### D. Human & Economic Implications of the Federal War on Drugs

While this Comment focuses on state action, it is worth noting that federal drug policy continues to have notable consequences beyond the enforcement implications for those directly engaged in the marijuana business. For one, it has devastating effects on the workforce. About half of inmates in federal prisons are serving time for drug-related crimes, and, as of 2015, 12% were incarcerated for crimes involving marijuana.<sup>86</sup> This is relevant because an individual with any sort of drug conviction faces difficulties finding employment.<sup>87</sup> Additionally, “[a]pproximately 50,000 [to] 60,000 students are denied financial aid

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79. Cole, *supra* note 51.

80. Christina Ng et al., *Colorado, Washington Become First States to Legalize Recreational Marijuana*, ABC NEWS (Nov. 7, 2012), <https://abcnews.go.com/Politics/OTUS/colorado-washington-states-legalize-recreational-marijuana/story?id=17652774>.

81. See Shapiro & Mettler, *supra* note 77, at fig. 8.

82. Berke & Gould, *supra* note 5.

83. *Legal Recreational Marijuana States and DC: Cannabis Laws with Possession and Cultivation Limits*, PROCON: MARIJUANA (<https://marijuana.procon.org/legal-recreational-marijuana-states-and-dc/>) (last visited Feb. 19, 2020).

84. Katie Zezima, *Vermont Is the First State to Legalize Marijuana Through Legislature*, WASH. POST (Jan. 24, 2018), <https://www.washingtonpost.com/news/post-nation/wp/2018/01/23/vermont-is-the-first-state-to-legalize-marijuana-through-legislature>.

85. *Id.*; Trevor Hughes, *Illinois Approves Legal Weed, Expunging Criminal Records for Pot Crimes*, USA TODAY (June 25, 2019, 12:33 PM), <https://www.usatoday.com/story/news/nation/2019/06/25/legal-weed-illinois-approves-recreational-marijuana-criminal-reform/1552697001>.

86. SAM TAXY ET AL., DEP’T OF JUST., NCJ-248648, SPECIAL REPORT: DRUG OFFENDERS IN FEDERAL PRISON: ESTIMATES OF CHARACTERISTICS BASED ON LINKED DATA 2 (2015).

87. Christopher J. Coyne & Abigail R. Hall, *Four Decades and Counting, the Continued Failure of the War on Drugs*, CATO INST., Apr. 12, 2017, at 2.

every year due to past drug convictions,”<sup>88</sup> which means that many of these individuals are also unable to access higher education and are therefore limited in their opportunities to improve their situation. While some may see these statistics as isolated occurrences affecting only these individuals, what these statistics actually show is that these misguided policies have many important, indirect costs to society as a whole. Likewise, The war on drugs costs U.S. taxpayers more than \$40 billion each year.<sup>89</sup> Federal cannabis legalization “could generate up to \$106.7 billion in annual budgetary gains for federal, state, and local governments[,]” by decreasing enforcement costs and simultaneously increasing tax revenue.<sup>90</sup>

### E. *Today's Climate*

The momentum for legalization continues to grow, with 62% of American voters supporting legalization, which is nearly double the level of public support measured in 2000.<sup>91</sup> The development of a market for recreational marijuana and the economic benefits derived from tax revenues and licensing fees are clear; however, the federal government continues to stick to its official, albeit increasingly confusing, stance on marijuana prohibition.<sup>92</sup> The pendulum swing from decriminalization efforts to the war on drugs and back toward state-led legalization should serve as a lesson to the observing public and encourage support for this new economic experiment.

To avoid federal government scrutiny and the backlash that frequently accompanies large-scale social change, states that are considering legalization should design comprehensive licensing and regulatory structures for the emerging cannabis market. In issuing the Cole Memo, the Justice Department made abundantly clear that the priorities set forth for federal enforcement regarding state legalization are contingent upon “state and local government[s’ ability to] implement strong and effective regulatory and enforcement systems.”<sup>93</sup>

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88. *Id.* at 2 (citing Doug Lederman, *Drug Law Denies Aid to Thousands*, INSIDE HIGHER ED. (Sept. 28, 2005), <https://www.insidehighered.com/news/2005/09/28/drug-law-denies-aid-thousands>).

89. *Id.* at 3.

90. Jeffrey Miron, *The Budgetary Effects of Ending Drug Prohibition*, CATO INST. (July 23, 2018), <https://www.cato.org/publications/tax-budget-bulletin/budgetary-effects-ending-drug-prohibition>; see Curtis Silver, *Marijuana's \$40 Billion Dollar Green Rush*, FORBES (June 2, 2016), <https://www.forbes.com/sites/curtissilver/2016/06/02/marijuanas-40-billion-dollar-green-rush/#3cd012f8628c>.

91. Hannah Hartig, *About Six-in-Ten Americans Support Marijuana Legalization*, PEW RES. CTR. (Oct. 18, 2018), <http://www.pewresearch.org/fact-tank/2018/10/08/americans-support-marijuana-legalization/>.

92. *Id.*

93. Cole, *supra* note 51.

Some states have carried the torch by experimenting with legalization to help pave the way for other states to follow. This section will discuss the approaches taken by three states—Colorado, California, and Washington—that have a long history of state action regarding marijuana legalization efforts.

*F. How Some States Went From “Reefer Madness” to “Reefer Gladness”<sup>94</sup>*

1. Colorado

Colorado has a rich and storied history of legalization efforts.<sup>95</sup> In 1973, a Republican State Senator, Michael Strang, introduced the first legalization bill, but it subsequently died in committee.<sup>96</sup> However, Strang’s efforts were not in vain because, in 1975, Colorado became “one of the first states to decriminalize marijuana.”<sup>97</sup> The state made two subsequent attempts to legalize medical marijuana for patients with glaucoma or cancer; both bills were signed by then-Governor Dick Lamm but were eventually thwarted by federal prohibition.<sup>98</sup>

In 1998, Colorado residents made another attempt at legalization via ballot measure but were unsuccessful when Colorado’s Secretary of State disputed the number of signatures and declined to count the vote.<sup>99</sup> In 2000, Colorado finally succeeded by approving Amendment 20 to the Colorado Constitution, which legalized marijuana for limited

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94. Michelle Butterfield, *All the Ridiculous Pot Puns You’ll Need This Week, Canada*, HUFF. POST (Oct. 16, 2018), [https://www.huffingtonpost.ca/2018/10/16/pot-puns-canada-marijuana-legalization\\_a\\_23562758/](https://www.huffingtonpost.ca/2018/10/16/pot-puns-canada-marijuana-legalization_a_23562758/).

95. Sophie Gilbert, *When Hunter S. Thompson Ran for Sheriff of Aspen*, ATLANTIC (June 26, 2014), <https://www.theatlantic.com/national/archive/2014/06/when-hunter-s-thompson-ran-for-sheriff-of-aspen/372949/>. Thompson ran for Sheriff of Aspen in 1970 on a platform calling for relaxed drug policies and, less predictably, to change Aspen’s name to deter others from capitalizing on its principles and values. *Id.* Although “[h]is campaign symbol was a double-thumbed fist, clutching a peyote button superimposed on the sheriff’s star[,]” he narrowly lost by 31 votes. *Id.*

96. William Breathes, *The History of Cannabis in Colorado...or How the State Went to Pot*, WESTWORD (Nov. 1, 2012), <https://www.westword.com/news/the-history-of-cannabis-in-colorado-or-how-the-state-went-to-pot-5118475>. Michael Strang, a Republican legislator from Carbondale, introduced legislation that would have legalized possession and use by people over the age of eighteen and created a regulatory structure that included licensing and excise tax. *Id.*

97. Angela Dills, Sietse Goffard & Jeffrey Miron, *Dose of Reality: The Effect of State Marijuana Legalizations*, CATO INST. (Sept. 16, 2016), <https://www.cato.org/publications/policy-analysis/dose-reality-effect-state-marijuana-legalizations>; Breathes, *supra* note 96.

98. *See* Breathes, *supra* note 96 (explaining that both the “Dangerous Drugs Therapeutic Research Act” and the “Therapeutic Use of Cannabis Act” were signed into law but never received government approval).

99. James Brooke, *The 1998 Elections: The States—Drug Policy; Five States Vote Medical Use of Marijuana*, N.Y. TIMES (Nov. 5, 1998), <https://www.nytimes.com/1998/11/05/us/the-1998-elections-the-states-drug-policy-5-states-vote-medical-use-of-marijuana.html>.

medical use.<sup>100</sup> For years, the market was loosely regulated by the Department of Public Health and Environment, which oversaw a medical program that was run mostly by caregivers.<sup>101</sup>

In 2007, the number of patients each caregiver could treat with medical marijuana increased due to a change in the law's interpretation, which subsequently allowed the opening of dispensaries.<sup>102</sup> After this expanded reading, the state introduced HB 1284 and created the Medical Marijuana Enforcement Division to rein in the medical marijuana market, which was almost entirely unregulated up until that point.<sup>103</sup> In 2012, the Colorado constitution was amended again to legalize adult use of marijuana for non-medical purposes—starting the legalization trend for recreational use.<sup>104</sup>

## 2. California

Before passing Proposition 64 in 2016, California voters twice rejected legalizing marijuana—first, in 1972, while many states were considering some level of decriminalization, and again in 2010.<sup>105</sup> During the interim, however, the state successfully passed the Medical Marijuana Initiative, which contained an exemption for patients and caregivers with a valid prescription.<sup>106</sup> As a result, California had an existing marijuana market for nearly two decades before legalizing recreational retail sales.

Initially, the state left the task of regulating the medical market largely to local governments.<sup>107</sup> However, in 2015, state agencies were given authority to set standards for the manufacture and production of medical marijuana and to regulate the issuance of licenses by local governments.<sup>108</sup> In 2016, when recreational retail sales were legalized, California essentially repealed the prior medical marijuana law but included certain provisions in the new legislation that encompasses

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100. COLO. CONST. art. XVIII, § 14. Caregivers were initially limited to five patients, and no provisions were made for the opening of dispensaries. *Id.*

101. *See* Breathes, *supra* note 96.

102. *Id.*

103. *Id.*

104. *See* COLO. CONST. art. XVIII, § 16.

105. *California Marijuana Legalization: Proposition 19 (1972)*, BALLOTPEDIA, [https://ballotpedia.org/California\\_Marijuana\\_Legalization,\\_Proposition\\_19\\_\(1972\)](https://ballotpedia.org/California_Marijuana_Legalization,_Proposition_19_(1972)); *California Proposition 19: The Marijuana Legalization Initiative (2010)*, BALLOTPEDIA, [https://ballotpedia.org/California\\_Proposition\\_19,\\_the\\_Marijuana\\_Legalization\\_Initiative\\_\(2010\)](https://ballotpedia.org/California_Proposition_19,_the_Marijuana_Legalization_Initiative_(2010)).

106. *California Proposition 215: the Medical Marijuana Initiative (1996)* BALLOTPEDIA, [https://ballotpedia.org/California\\_Proposition\\_215,\\_the\\_Medical\\_Marijuana\\_Initiative\\_\(1996\)](https://ballotpedia.org/California_Proposition_215,_the_Medical_Marijuana_Initiative_(1996)).

107. LEGISLATIVE ANALYST'S OFFICE, THE CALIFORNIA LEGISLATURE'S NONPARTISAN FISCAL & POLICY ADVISOR, KEY DIFFERENCES BETWEEN RECENT MEDICAL CANNABIS LAWS AND PROPOSITION 64: A PRELIMINARY REVIEW (2016), <https://lao.ca.gov/Publications/Report/3517>.

108. *Id.*

both the medical and recreational market.<sup>109</sup> Today, three cannabis licensing authorities exist in the state—the Bureau of Cannabis Control, CalCannabis Cultivation Licensing, and the Manufactured Cannabis Safety Branch—and these state authorities issue licenses for the cultivation, manufacturing, distribution, retail, and laboratory testing of marijuana.<sup>110</sup>

### 3. Washington

In 1971, during the height of the decriminalization wave, Washington began to relax its marijuana laws,<sup>111</sup> and in 2011, the state enacted additional measures to pave the way for the legalization of medical marijuana.<sup>112</sup> First, the state made medical use an affirmative defense to the violation of state marijuana laws. Second, it defined the amount that would be eligible for the affirmative defense, expanded eligible health conditions, and set clear parameters for physician documentation.<sup>113</sup> In 2012, following adult-use legalization, Washington merged the regulatory schemes of its medical and recreational markets.<sup>114</sup> Two years later, the state gave all licensed health professionals the authority to prescribe medical marijuana.<sup>115</sup>

## III. ANALYSIS

For nearly forty years, these three states have been the leaders with regards to marijuana decriminalization and legalization, and while the current state of the marijuana industry is often referred to as an experiment, it is not immune from the “natural consequences of legalizing along a for-profit commercial model.”<sup>116</sup> Using the insights gained from the data and collected from the developments of their markets since legalization, legislators from other states can more easily identify the successes and failures of established programs as they

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109. 2017 Cal. Stat. 94.

110. Stephanie Romine, *Before You Buy Cannabis, Brush Up on California Laws and Safety Precautions*, USA TODAY (July 8, 2019, 11:19 AM), <https://www.usatoday.com/story/sponsor-story/higher-elevation/2019/07/08/before-you-buy-cannabis-brush-up-california-laws-and-safety-precautions/1672816001>.

111. Dills, Goffard & Miron, *supra* note 97.

112. *Id.* Following a high-profile case in which a terminally ill patient was treated with marijuana, Washington legalized medical marijuana in a “citizen-driven ballot initiative.” *Id.* Patients with certain conditions were permitted to possess, sell, and cultivate with a doctor’s note. *Id.*

113. Initiative 692 (1998) 59%; S.B. 6032, 65th Leg., Reg. Sess. (Wa. 2018).

114. *Id.*

115. S.B. 5798, 61st Leg., Reg. Sess. (Wa. 2010).

116. Lester Black, *Legal Weed Isn’t the Boon Small Businesses Thought It Would Be*, FIVETHIRTYEIGHT (Dec. 29, 2017, 6:00 A.M.), <https://fivethirtyeight.com/features/legal-weed-isnt-the-boon-small-businesses-thought-it-would-be/>.



attempt to respond to the concerns of individual communities and create a stable market that brings economic benefits to their own state.

### A. Licensing Restrictions

Legalization poses challenges for regulators and policymakers who are “facing a big change with very little experience” and the added challenge of addressing an extensive and entrenched illegal market.<sup>117</sup> One method states use to regulate the cannabis market is establishing a variety of licensing restrictions to determine the scope of obligations and permissions for regulated parties.

#### 1. Priority Licensing

The path to recreational marijuana usually proceeds through the legalization of medical use; thus, many states extend priority licensing to parties who have successfully entered the medical cannabis industry. These parties are familiar to state regulators and have demonstrated the ability and resources to operate within a heavily regulated industry. For example, in Washington, priority was assigned based on qualifications *and* experience,<sup>118</sup> and applicants who met all the qualifications but had not applied for a license by the deadline were considered next.<sup>119</sup> Colorado gives priority to applicants who have “prior experience producing or distributing marijuana” and have demonstrated compliance with the state’s laws and regulations.<sup>120</sup> California gives priority to those operating in compliance with its medical marijuana regulations.<sup>121</sup>

Allowing experienced parties to be the first to enter the market eliminates several variables from the regulatory experiment. The justification for priority licensing is simple: “to ensure the most secure, reliable, and accountable system” for the retail marijuana market.<sup>122</sup> A state that is considering cannabis legalization, but is wary of attracting the ire of the federal government, should consider adopting a

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117. Jonathan Rauch, *Colorado’s Marijuana Legalization Rollout is a Success*, BROOKINGS INST. (July 31, 2014), <https://www.brookings.edu/blog/fixgov/2014/07/31/colorados-marijuana-legalization-rollout-is-a-success/>.

118. See WASH. ADMIN. CODE § 314-55-020(c) (2016). The first priority was given to those who applied for a license prior to a set date, operated or was employed by a collective garden, maintained relevant state and municipal business licenses, and met all tax and fee obligations. See *id.*

119. *Id.* at § 55-020(b).

120. COLO. CONST. art. XVIII, § 16 (5)(b)(I)-(II).

121. *Summary of Public Comment Regarding Medical Cannabis Regulation and Safety Act Proposed Regulations*, CAL. BUREAU OF CANNABIS CONTROL 4 (2017), [https://bcc.ca.gov/law\\_regs/mcrsa\\_comments.pdf](https://bcc.ca.gov/law_regs/mcrsa_comments.pdf).

122. COLO. CONST. art. XVIII, § 16 (5)(b)(I)-(II).

Washington-like regulatory system with a strict priority licensing scheme. For these states, maintaining a small number of sophisticated regulated parties may override initial concerns of market diversity.

## 2. Types of Licenses

The states diverge sharply in their numbers of license classifications. Some licenses issued by states include producer-specific licenses and retail-specific licenses.<sup>123</sup> Producers and manufacturers focus on creating an array of products using the plant, while retailers operate storefronts where products can be sold.<sup>124</sup> Splitting the process of producing or growing the plant from retailing allows regulators to maintain tighter control over the actions of regulated parties. A blanket license that allows broad involvement in the legal marijuana business would make it more difficult for states to maintain track and trace programs and for regulators to ensure licensee compliance without additional, individualized factfinding. Each of the three states discussed in this Comment offer a different number of licenses, but they all maintain one important commonality: using a tiered-system for cultivation licenses.<sup>125</sup> The policy behind a tiered-system is two-fold: first, it protects smaller- and medium-sized producers, which helps maintain market diversity; second, it limits the scope of the regulated parties' activities.

Colorado and Washington follow similar regulatory schemes; both states split licenses into categories for the stages of production and divide cultivation licenses into tiers based on the size of each applicant's proposed grow operation.<sup>126</sup> However, Washington's law differs from Colorado's by allowing licensed cultivators to incur additional fees to expand their allotted plant count.<sup>127</sup> California takes a different approach; its tiered-system creates a complex licensing structure with twenty distinct categories. Licensing for cultivation is based not only on the size of the operation but also the conditions under which the plant

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123. See, e.g., COLO. REV. STAT. § 44-12-401 (2018); WASH. REV. CODE § 69.50.325 (2017).

124. See generally Sean Williams, *5 U.S. Pot Stocks With the Most Dispensary Licenses*, MOTLEY FOOL (June 26, 2019, 7:21 AM), <https://www.fool.com/investing/2019/07/31/5-brand-name-companies-involved-in-the-marijuana-i.aspx> (describing different large-scale marijuana businesses).

125. See Miles Sinclair, *Tier 1, 2 and 3 Licenses: What Do These Labels Mean, and Why Does It Matter?*, DOPE MAG. (June 26, 2017), <https://dopemagazine.com/tier-1-2-and-3-licenses/>.

126. Washington and Colorado provide classifications for retail, cultivation, and product manufacturing. The main difference is that Colorado offers an additional license for testing. COLO. REV. STAT. § 44-12-401 (2018); WASH. REV. CODE § 69.50.325 (2017).

127. MARIJUANA ENF'T DIV., RETAIL FEES, <https://www.colorado.gov/pacific/sites/default/files/MED%20Fee%20Table%20Color%20May%202017%20%281%29.pdf> (last updated May 10, 2017).

is grown.<sup>128</sup> Despite these restrictions, it is dubious whether these licensing techniques are even minimally effective; they require complementary regulatory decisions in other licensing areas to ensure success. For example, despite California's complex licensing scheme, five farms hold more than 20% of issued licenses.<sup>129</sup> In Washington, oversupply caused prices to plummet, which led to smaller farmers "going out of business competing against [other] people [also] going out of business."<sup>130</sup>

It appears that these states enacted tiered-systems hoping to exercise a degree of control over the market and licensed parties, especially over applicants who are new to the highly regulated industry. Given these results, however, it is unclear whether specific classification systems can encourage market diversity without considerable regulation on the number of licenses allowed and the qualifications required to obtain them. Moreover, for states looking to either limit or cap initial licenses, injecting flexibility into the regulatory scheme can better accommodate particular market conditions and allow existing businesses to grow. However, states must also be aware that these economic benefits may come with a price to market competition because the flexibility also creates an opportunity for those with outsized resources to expand and quickly gain market share.

### 3. Overall Issuance of Licenses

States can place caps on the number of licenses issued within the state or a particular area of the state, or even limit the number of licenses allowed for each individual or business. Limiting the number of licenses issued can help a state prevent oversaturation of the market. This is essential because oversupply results in depressed market prices. California chose not to initially limit the overall number of licenses issued to avoid "creating arbitrary barriers to entry,"<sup>131</sup> but it provided for denial of a license in areas with an "excessive concentration" of marijuana businesses.<sup>132</sup> Less than one year after legalization, California

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128. *See id.*

129. Scott Rodd, *As Smaller Marijuana Businesses Get Squeezed, State Revenue Takes a Hit*, PEW RES. CTR. (June 21, 2018), <https://www.pewtrusts.org/en/research-and-analysis/blogs/stateline/2018/06/21/as-smaller-marijuana-businesses-get-squeezed-state-revenue-takes-a-hit>.

130. Bart Schanemen, *Washington State Cannabis Oversupply Spurs Calls for Change*, MARIJUANA BUS. DAILY (Jan. 10, 2018), <https://mjbizdaily.com/washington-state-cannabis-supply-hits-new-low-spurs-calls-change/>.

131. CAL. BUS. & PROF. CODE § 26000(h) (2017).

132. *Id.* at § 26051.

has already issued more than 6,000 licenses.<sup>133</sup> By contrast, Washington has only 1,947 licensed businesses,<sup>134</sup> and it has “no plan[s] to open the window” to issue additional commercial licenses.<sup>135</sup> Colorado has even fewer current retail businesses, with only 1,712 total licenses issued as of February 1, 2020.<sup>136</sup>

Without altering the existing provision that allows an individual in the medical program to grow up to ninety-nine plants at home, strictly limiting licenses has been insufficient in preventing overproduction in Washington. This oversight has also led to the continued existence of an entrenched black market. Intuitively, Washington’s strict licensing limits should have protected the market from plummeting prices, but in reality, the price of legal marijuana has fallen every quarter since legal sales began in 2014.<sup>137</sup> It is unclear how much of the price decrease is attributable to the regulatory structure rather than to the general effects of legalization. “[P]rohibition of production and sale is [incredibly effective] at raising drug prices.”<sup>138</sup> This is because “[p]rohibition imposes huge costs on drug producing industries that are passed on to consumers in the form of higher prices.”<sup>139</sup>

#### 4. Limits on Individual Licenses

While an overall cap on licensing may be insufficient to maintain the diversity of market participants, it can be made more effective if used in conjunction with limits on the number of licenses one individual may hold. Neither Colorado nor California limit the number of licenses available to an individual.<sup>140</sup> California’s regulatory structure is purposely structured to support small and medium-sized businesses, by

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133. Brooke Staggs, *So Far California Has 6,000 Licensed Cannabis Businesses. Here's What That Looks Like*, ORANGE CTY. REG. (Apr. 27, 2018, 5:22 PM), <https://www.ocregister.com/2018/04/27/so-far-california-has-6000-licensed-cannabis-businesses-heres-what-that-looks-like/>.

134. *Licensed Businesses*, WASH. ST. LIQUOR & CANNABIS BD., <https://data.lcb.wa.gov/Licensing/Licensed-Businesses/u3zh-ri66> (last updated June 27, 2018).

135. *Marijuana Licensing FAQ*, WASH. ST. LIQUOR & CANNABIS BD., [https://lcb.wa.gov/mjlicense/mj\\_licensing\\_faq](https://lcb.wa.gov/mjlicense/mj_licensing_faq) (last visited Feb. 15, 2020).

136. *MED Resources and Statistics*, COLO. DEP’T OF REVENUE ENF’T DIVISION, <https://www.colorado.gov/pacific/enforcement/med-resources-and-statistics> (last visited Feb. 15, 2020).

137. Keith Humphreys, *How Legalization Caused the Price of Marijuana to Collapse*, WASH. POST (Sept. 5, 2017), [https://www.washingtonpost.com/news/wonk/wp/2017/09/05/how-legalization-caused-the-price-of-marijuana-to-collapse/?utm\\_term=.1d738e3f1396](https://www.washingtonpost.com/news/wonk/wp/2017/09/05/how-legalization-caused-the-price-of-marijuana-to-collapse/?utm_term=.1d738e3f1396).

138. *Id.*

139. *Id.*

140. *Marijuana Legalization Laws and Regulations: Colorado and Washington*, NAMSDL: NAT’L ALL. FOR MODEL ST. DRUG LAWS (Feb. 15, 2014), <http://www.namsdl.org/library/B2BFFCFC-65BE-F4BB-A8550E680B06E35B/>.

prioritizing equitable and easy market entry.<sup>141</sup> However, unlimited licensing creates a loophole for established cannabis businesses to dominate the market prior to the issuance of large cultivation licenses.<sup>142</sup>

Proposition 64 stated that the “marijuana industry will be built around small and medium sized businesses.”<sup>143</sup> However, in Santa Barbara, half a dozen companies have been issued hundreds of small licenses, which effectively skirts the purpose of the regulation.<sup>144</sup> The failure to effectively limit the number of licenses issued to an individual could frustrate the state’s intent to protect small and medium-sized ventures. Closing this loophole would help California to reach the policy priority of equitable access to market entry and to guard against large companies amassing an outsized market share.

In contrast, Washington imposes strict limits on the number of retail licenses issued to an individual—each person is allowed five.<sup>145</sup> For producers and processors, the limit was raised from one to three in 2017.<sup>146</sup> These limits reflect the intent of Washington’s legalization initiative—to clearly prioritize a “tightly regulated, state-licensed system.”<sup>147</sup> Licensing restrictions have the immediate effect of limiting regulated parties, but they can also influence economic factors in the market. With the comparatively small number of licenses issued, Washington should be in a better position to control consolidation. However, the state’s approach to vertical integration has provided larger businesses with more resources a head start.

In Colorado, a decision made early on in its medical use program has had lasting consequences on the market. Initially, Colorado state law allowed a medically licensed patient or caregiver to grow up to ninety-

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141. CAL. BUS. & PROF. CODE § 26000 (West 2017).

142. *California Farmers Sue State Over Loophole Allowing Multiple Licenses*, MARIJUANA BUS. DAILY (Jan. 24, 2018), <https://mjbizdaily.com/california-cannabis-farmers-sue-state-loophole-allowing-multiple-licenses/>.

143. *See id*; *see also* 2016 CAL. LEGIS. SERV. PROP. 64 (Proposition 64) (West) (approved by voters Nov. 8, 2016).

144. Stagg, *supra* note 133; *see* Scott Rodd, *Cannabis Growers Association Drops Lawsuit Against State Over Permitting Large-Scale Cannabis Cultivators*, SACRAMENTO BUS. J. (Jan. 22, 2019, 10:25 AM), <https://www.bizjournals.com/sacramento/news/2019/01/22/growers-association-drops-lawsuit-against-state.html> (discussing the later withdrawn California Growers Association suit against the California Department of Agriculture, where the plaintiffs argued that the state’s refusal to cap farm size and failure to limit the number of small licenses issued to one entity violated one of the stated purposes of the act).

145. WASH. REV. CODE ANN. § 69.50.325 (West 2018).

146. *Id.*

147. Initiative Measure No. 502 § 1(3) (Wash. 2011), [https://sos.wa.gov/\\_assets/elections/initiatives/i502.pdf](https://sos.wa.gov/_assets/elections/initiatives/i502.pdf).

nine plants at home.<sup>148</sup> This allowance was carried into the recreational scheme, and Colorado has become a major exporter of illegal marijuana.<sup>149</sup> Police, prosecutors, government officials, and marijuana industry insiders all point to the home-grow provision as the main culprit.<sup>150</sup> Regulations implemented at the start of 2018 have limited individuals to twelve plants, but authorities believe it will take time to undo the damage caused by this initially lax regulation.

The licensing strategies of these states could be characterized as divergent, but the results are anything but. Licensing restrictions appear to be more effective at regulating the number of parties and their respective market share than protecting the industry from oversaturation and falling prices. For example, despite strict limitations, the largest ten farms in Washington produced a higher percentage of the state's marijuana than the smallest 500 farms combined.<sup>151</sup> Licensure is a critical part of any regulatory scheme, but it has been inadequate at preventing the consolidation of market share in the industry.

### B. Vertical Integration

The number of regulated cannabis businesses is also affected by the degree to which the regulatory system allows vertical integration. If significant vertical integration is allowed, it has the potential to ease the burdens of oversight. The inherent risk of requiring integration is that the market might be well regulated, while also dominated by large companies with extensive resources that allow them to bear the financial burden to entry. As in any other industry, a small concentration of cannabis companies could reduce competition and encourage monopolistic behavior, which would artificially raise prices and gives consumers fewer choices.

Data collected over the years since legalization show that the market “increasingly favors big businesses with deep pockets.”<sup>152</sup> While this is a foregone conclusion for other modern markets, when it comes to the budding cannabis industry, a state is still able to structure its market to prioritize its particular policy goals. Pioneering states, like

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148. Colleen Sikora, *How the Original 99-Plant Law Grew Colorado's Marijuana Black Market*, KRDO (May 7, 2018 6:40 PM), <https://www.krdo.com/news/how-the-original-99-plant-count-law-grew-the-marijuana-black-market-in-colorado/739255174>.

149. See Brittany Freeman et al., ROCKY MOUNTAIN PBS, *Cultivating Crime: How Colorado Became a Major Exporter of Black Market Marijuana*, COLORADOAN (Dec. 20, 2018, 6:00 AM), <https://www.coloradoan.com/story/news/2018/12/20/colorado-recreational-marijuana-black-market-cannabis/2369154002/> (explaining that Colorado marijuana has been found in thirty-four states and law enforcement is building complex cases that involve labor trafficking).

150. *Id.*

151. Black, *supra* note 116 (“The ten largest farms harvested 16.79% of all the dry weight weed grown in the state, which is more than the share produced by the 500 smallest farms combined.”).

152. *Id.*

Washington and Colorado, necessarily focused on tight regulatory controls to avoid conflicts with federal law and ensure their laws' continued existence. However, the probability of federal interference diminishes as more states move to legalize recreational marijuana, which will provide states with more freedom and flexibility to fully consider the long-term effects that their laws and regulation have on the market. For now, states continue to see benefits for vertical integration, namely the sophistication and ability of regulated parties to comply with the regulatory fluidity and resulting market complexities.

### 1. Required

In a vertically integrated model, the cost of entering the market is prohibitively high, which inadvertently limits the number of parties that the state must regulate. While this effect might be desirable from a regulatory standpoint, limiting competition generally narrows consumer choices and would enable the growth of a "Big Marijuana," comparable to Big Tobacco.<sup>153</sup> Once a few companies gain a substantial competitive advantage, it can be "difficult to reverse and may increase the integrated [firms'] market power and the opportunism that comes with it."<sup>154</sup> The high cost of market entry leads to further market consolidation, which is a natural consequence of requiring a business to engage in all aspects of production and retail activities.

Colorado relied heavily on vertical integration in the early implementation of legalized marijuana. For the first two years, a party was required to grow at least 70% of the marijuana that it sold.<sup>155</sup> This holdover requirement from the medical use program gave regulators an interim period to evaluate the effects of the policy while also mitigating the harmful effects of failure.<sup>156</sup> The existing medical market provided the state with the perfect pool of priority applicants, who had the resources and experience to operate efficiently in a highly regulated industry.

The market opened up after a relatively short time, allowing Colorado to reap the benefits of a controlled rollout with a relatively low risk of long-term impact on the market. However, data shows that even this short period allowed the larger businesses to gain a foothold in the industry—a situation that will prove difficult to reverse. While not inherently negative, consolidation to this extreme restricts market entry

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153. *Id.*

154. Georgina Moreno, *Balancing Vertical Integration in Calif.'s Cannabis Industry*, LAW360 (Jan. 12, 2018, 3:49 PM), <https://www.econone.com/wp-content/uploads/2018/01/Balancing-Vertical-Integration-In-Calif.-by-Georgina-Moreno.pdf>.

155. Lael Henterly, *The Vertical Integration Debate*, MARIJUANA VENTURE (Apr. 18, 2016), <https://www.marijuanaventure.com/vertical-integration-debate/>.

156. Rauch, *supra* note 117.

to those parties with substantial resources while simultaneously limiting consumer choices and innovation within the industry.

## 2. Restricted

A strict vertical integration requirement is designed to limit the number of regulated parties but there are negative effects as well. Common complaints of vertical integration include the resulting inefficiencies and the inability to specialize, and these effects occur when businesses are involved in every step of the production and development process. On the other hand, flexibility in the regulations can help regulators by limiting the scope of necessary regulatory oversight. For example, Washington chose to keep retail in its own silo but allowed vertical integration of cultivator and processor licenses.<sup>157</sup> Washington's regulatory compromise attempted to address the lack of specialization inherent in a vertically integrated model by facilitating specialization in the most related parts of the process—growing and processing the plant—while keeping the retail function separate.

Restricting participants to a single part of the process can be effective in substantially lowering the barrier to entry and encouraging competition. Washington's common-sense division between the retail sale of marijuana and the growth and production stages allows both regulated parties and enforcement officials to become experts in their respective areas. Moreover, businesses with adequate resources may choose to expend the capital to hire experts at each stage. At the same time, however, these experts are likely the same parties who could enter the market individually if not for requirements of vertical integration. Thus, the result could either be a streamlined, cost-effective, efficient business model, or the suppression of a more competitive market.

## 3. Free for All

California took the opposite approach and delayed issuing large cultivation licenses until 2023,<sup>158</sup> thus leaving vertical integration largely unrestricted.<sup>159</sup> Theoretically, this delayed approach gives smaller businesses more time to grow a sustainable presence before established chains are able to expand quickly and entrench themselves.<sup>160</sup>

Conversely, while minimum or limited regulation may make sense for some localities, states do not have that luxury. Given the federal

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157. Moreno, *supra* note 154.

158. *Id.*

159. *Id.* (noting that only testing is not allowed in conjunction with other licenses).

160. Moe Afaneh, *California Cannabis—What's the Deal with Vertical Integration?*, CANNABIS MAVEN (July 4, 2017), <https://cannabismaven.io/theweedblog/growing/california-cannabiz-what-s-the-deal-with-vertical-integration-JVZxhyKPaUKipd9u7JJGwQ/>.



government's strong preference for tighter regulation on fewer parties, waiting to establish limits on the issuance of licenses could exponentially increase the number of regulated parties. Although this could indeed lead to a more diverse market, as seems to be the objective of California's policy, it could also overburden regulators and prevent adequate oversight.

Each state's stance on vertical integration is indicative of its priorities that it determined when creating the industry. Colorado and Washington were the first two states to legalize recreational marijuana, which likely affected their decisions to take a more conservative approach in crafting their regulations and market structures. Arguably, these states had less freedom to regulate with regards to certain policy expectations because they were subject to higher levels of scrutiny by the federal government. Colorado and Washington were more cautious because they knew it would be easier for the federal government to challenge state legalization in its infancy when there were lower expectations for success and when fewer people were affected by the result. These pioneers sought to create a long-term, stable market by establishing their regulations and market on the foundation of controlling fewer parties in hopes of preventing significant federal government intervention.

Moreover, many have made the argument that due to a large number of people serving prison sentences for marijuana and because prior enforcement was felt largely by minority communities, protecting market access is both an economic and moral consideration. The benefit of California's approach is that it stresses equality and the opportunity for inclusion in the market. However, it is the conservative methods taken by Washington and Colorado that has made space for other states, like California, to advance the creation of the recreational marijuana markets with more policy-driven initiatives. Further, with thirty-three states that recognize medical marijuana sales and eleven and the District of Columbia that allow recreational use, large-scale federal action would have higher consequences today than when only two states began blazing the trail.

The emergence of new industries is rare, and the federal government generally places a significant focus on antitrust concerns in other markets and industries. In this regard, it must also recognize that the implications of vertical integration make it easier for large companies to quickly amass market share, while average Americans are unable to participate, which can have significant unintended consequences on consumers, the market, and its participants, as well as on other markets and the economy at large.

### C. Local Control

As seen in the initial decriminalization movement, change of this magnitude within a short amount of time is often accompanied by “backlash.”<sup>161</sup> It has been twenty-three years since the first state legalized marijuana for medical purposes and just seven years since the first legalization of marijuana for recreational use.<sup>162</sup> A key measure used by states to avoid controversy and ease the transition has been to leave some control measures in the hands of localities. Allowing, or even encouraging, some element of local control affords communities the opportunity to decide how and when to introduce the industry to their citizenry.

Under most state cannabis laws, a locality may adopt state regulations, prohibit the recreational industry entirely, or enact and tailor regulations to meet the specific needs and desires of its community.<sup>163</sup> While the delegation of power to localities is enshrined by statute, the wisdom of local control remains controversial. Issues of local control typically touch on three main points: the effect on the strength and stability of the state regulatory scheme, the extent to which a locality benefits economically, and the fundamental importance of the democratic process.

1. “Strong and effective regulatory and enforcement systems”<sup>164</sup>

A strong state regulatory structure is key to ensuring that state laws do not put its residents at risk of violating federal narcotics laws.<sup>165</sup> States have a strong motive to act conservatively with respect to licensing requirements and establishing enforcement divisions, and control has been an essential element in most regulatory and licensing decisions. However, the power of localities to tinker with the state

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161. Kirk Johnson, *Cannabis Legal, Localities Begin to Just Say No*, N.Y. TIMES (Jan. 26, 2014) (quoting Kevin A. Sabet, executive director and co-founder of Smart Approaches to Marijuana (SAM)), <https://www.nytimes.com/2014/01/27/us/cannabis-legal-localities-begin-to-just-say-no.html> (“If legalization advocates just took a little bit more time and were not obsessed with doing this at a thousand miles per hour,” he added, “it might be better. Instead, they are helping precipitate a backlash.”). Mr. Sabet of Smart Approaches to Marijuana states “[i]t’s about widespread access, it’s about changing the landscape of a neighborhood, it’s about widespread promotion and advertising, and it’s about youth access.” *Id.*

162. Lori Moore, *Milestones in Marijuana Law*, N.Y. TIMES (Oct. 27, 2013), [https://archive.nytimes.com/www.nytimes.com/interactive/2013/10/27/us/marijuana-legalization-timeline.html/#time283\\_8136](https://archive.nytimes.com/www.nytimes.com/interactive/2013/10/27/us/marijuana-legalization-timeline.html/#time283_8136).

163. See Johnson, *supra* 161.

164. Cole, *supra* note 51.

165. *Id.*

regulatory structure could come at the risk of instability and inconsistencies in the regulatory scheme.

Despite increasing widespread acceptance, marijuana remains controversial, and proponents of local involvement in marijuana policy believe that local governing bodies and residents are in the best position to speak for the values and priorities of their respective communities. This creates a situation most analogous to the existence of dry counties following prohibition.<sup>166</sup> California, Colorado, and Washington each provide that localities retain police power to use zoning and licensing requirements to alter the regulatory landscape of the local marijuana market.<sup>167</sup>

In particular, Washington has faced challenges reconciling its regulatory structure with local concerns. Initially, it was unclear that any element of local control existed. A state pot shop's challenge to local prohibitions failed in the Washington State Court of Appeals.<sup>168</sup> The state Attorney General issued a legal opinion providing that local prohibition and regulation was not preempted by the passage of I-502, while also making the informal argument that denying local control would lead to constitutional challenges that would jeopardize the entire state system.<sup>169</sup>

The fallout from this case illustrates both sides of the debate and the consequences of confrontation. Whether it is a marijuana business protesting local prohibitions or localities challenging the legality of a state's marijuana law, a legal challenge from either side can potentially lead to federal involvement and a subsequent defeat of state legalization. Thus, the inclusion of an explicit statutory provision delegating power to localities is imperative to keeping the peace and the market.

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166. Eighty-five years after the end of Prohibition, about 10% of the country maintains restrictions on alcohol. *Why America Still Has "Dry" Counties*, ECONOMIST: ECONOMIST EXPLAINS (June 5, 2018), <https://www.economist.com/the-economist-explains/2018/06/05/why-america-still-has-dry-counties>. While the situations are similar in many respects, the threat of federal action is a distinguishing factor in the legalization of marijuana. See Serene Desiree, *4 Lessons Alcohol Prohibition Should Teach Us About Cannabis*, LEAFLY (Jan. 4, 2017), <https://www.leafly.com/news/cannabis-101/cannabis-legalization-lessons-from-alcohol-prohibition>.

167. CAL. BUS. & PROF. CODE § 26200(a)(1) (West 2017); COLO CONST. art. XVIII, § 16 (5)(f) (2012); WASH. ADMIN. CODE § 413-55-515 (West 2018), WASH. REV. CODE § 69.50.331 (West 2018).

168. See generally *Emerald Enterprises, LLC v. Clark Cty.*, 413 P.3d 92 (Wash. Ct. App.), review denied, 190 Wash. 2d 1030 (2018).

169. WASH. ATT'Y GEN. OFF., NO. 2, WHETHER STATEWIDE INITIATIVE ESTABLISHING SYSTEM FOR LICENSING MARIJUANA PRODUCERS, PROCESSORS, AND RETAILERS PREEMPTS LOCAL ORDINANCES (2014).

## 2. Primary Tools

Localities have exercised their existing police powers to control the rollout of marijuana. The primary tools are zoning and licensing requirements. California and Colorado both require compliance with local ordinances for the issuance of a state license,<sup>170</sup> and in Washington, localities are authorized to prohibit marijuana or designate appropriate zones through land-use regulations.<sup>171</sup> In Washington, however, the Liquor and Cannabis Board makes the final decision in issuing a state license, and it must give “substantial weight” to local objections.<sup>172</sup> Examples of ordinances include limiting the number of retail marijuana businesses,<sup>173</sup> setting appropriate buffer zones in compliance with state law,<sup>174</sup> adopting temporary moratoriums to allow time for further consideration,<sup>175</sup> and outright prohibition.<sup>176</sup>

## 3. Instability & Inconsistency

If local control is not exercised with caution, it can weaken the regulatory framework of the state and frustrate the purpose of legalization. Because locality is often defined broadly to include cities, counties, cities and counties together, and municipalities,<sup>177</sup> there is increased potential for conflicting regulations covering the same geographic area. In California, Imperial County permits marijuana, while two of the largest cities within its borders have prohibited the industry.<sup>178</sup> This illustrates the danger local control can pose to a stable regulatory structure within the state, which risks the attention of federal enforcement.

## 4. Black Market

Due to local regulations, access to legal recreational marijuana is not guaranteed. The existing illegal market for marijuana will not cease to exist simply because a legal option becomes available. Inconsistent

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170. CAL. BUS. & PROF. CODE § 26200(a)(1) (West 2018); COLO. CONST., art. XVIII, § 16 (5)(f).

171. WASH. REV. CODE ANN. § 69.50.325(3)(v) (West 2018).

172. WASH. REV. CODE ANN. §§ 69.50.325(1), 69.50.331(10) (West 2018).

173. *E.g.*, EVERETT, WASH., ORDINANCE 3486-16 (Apr. 5, 2016) (amending ORDINANCE 3443-15).

174. SEATTLE, WASH. MUN. CODE §§ 23.42, 47-50, 66, 84.

175. County of Del Norte, Cal., Ordinance 2017-005 (Dec. 12, 2017).

176. Teller County, Colo., Ordinance 18 (Mar. 14, 2013).

177. CAL. BUS. & PROF. CODE § 26250 (Deering 2016); COLO. CONST., art. XVIII, § 16; WASH. ADMIN. CODE § 314-55-010.

178. Brooke Edwards Staggs & Brooke Staggs, *Database of Marijuana Rules From Every City and County in California Shows Slow Acceptance of Prop. 64*, REPORTER (Apr. 19, 2018), <https://www.thereporter.com/2018/04/19/database-of-marijuana-rules-from-every-city-and-county-in-california-shows-slow-acceptance-of-prop-64/> (last updated Aug. 29, 2018).

and inconvenient availability of legal marijuana creates “pot deserts” that encourage consumers to continue purchasing marijuana illegally.<sup>179</sup> California localities in particular have been slow to embrace the industry. Fewer than one-third of cities allow any type of marijuana business, and fewer than one in seven allow recreational cannabis stores.<sup>180</sup> If one leaves Los Angeles and travels north, it takes roughly 200 miles to reach the next dispensary.<sup>181</sup> In Colorado, fewer than half of its sixty-four counties allow recreational cannabis businesses.<sup>182</sup> In Washington, eighty-one cities have prohibited the industry entirely, while ninety-five more have taken restrictive action through zoning.<sup>183</sup>

The black market is discussed briefly as a consequence of inadequate individual limits, but the leakage of legally grown marijuana into an illegal market is made substantially easier when a locality introduces strict regulation or prohibition. Consumers are likely to continue purchasing marijuana in the nearly 100-year-old “robust illicit [black] market,”<sup>184</sup> which is now made easier due to legal supply pockets within a legalized state. Many consumers who would follow the law and make legal purchases if dispensaries were conveniently located, may not be equally willing to drive twenty, fifty, or 100 miles to the nearest dispensary. This element of local control undermines the purpose of state legalization, interrupts expected revenue streams, and encourages the continued existence of an illegal market.

To date, no state has been able to regulate or license the black market away, and its persistence can be traced back to an array of factors, including overproduction, effects of inadequate licensing restrictions, and inconsistent supply. While the first two considerations are tied into wider economic forces, the lack of adequate regional supply can be attributed to the amalgamation of local regulations and prohibitions that are inconsistent with state law. Going forward, states should consider adopting a set of best practices for exercising local

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179. Brad Branan & Nathaniel Levine, *Weed is Legal. But This Map Shows Just How Much of California Is a 'Pot Desert'*, SACRAMENTO BEE (Mar. 22, 2018), <https://www.sacbee.com/news/state/california/california-weed/article205524479.html> (last updated Mar. 25, 2018).

180. Staggs & Staggs, *supra* note 178.

181. Chloe Aiello & Jeff Daniels, *California Governor Jerry Brown's New Budget Says Pot Revenue Is 'Slower Than Anticipated'*, CNBC (May 11, 2018), <https://www.cnbc.com/2018/05/10/california-gov-brown-could-slash-cannabis-tax-revenue-forecasts.html>.

182. Thomas Mitchell, *Which Colorado Counties Allow Cannabis Sales?*, WESTWORD (Mar. 7, 2018, 11:51 AM), <https://www.westword.com/marijuana/colorado-counties-allowing-marijuana-sales-10046595>.

183. MARIJUANA REGULATION IN WASHINGTON STATE, MUN. RES. & SERV. CTR., <http://mrsc.org/Home/Explore-Topics/Legal/Regulation/Marijuana-Regulation-in-Washington-State.aspx> (last updated Dec. 14, 2018).

184. Thomas Fuller, *Now for the Hard Part: Getting Californians to Buy Legal Weed*, N.Y. TIMES (Jan. 2, 2019), <https://www.nytimes.com/2019/01/02/us/buying-legal-weed-in-california.html>.

control to mitigate these internal conflicts. A menu with a limited number of state-approved local controls or a narrower definition of “locality” that minimizes the number of governing bodies involved in regulatory decisions would help diffuse tension in this area and remove a large obstacle to effective legalization.

## 5. Economic Benefit

The potential revenue from licensing and taxes is a substantial part of what makes legalization so enticing for states. Revenue sharing arrangements with localities are common in regulatory structures as an incentive for participation in the market. While any increase in state funding benefits people of the state, localities that do not participate in the legal marijuana market do not receive the full and direct financial benefit. Localities may have strong opinions about welcoming marijuana, but revenue sharing models can be a strong motivator to eschew local control.

### *a. Revenue Sharing*

In 2015, Washington began revenue sharing with localities based on participation in the market and population, and the localities where marijuana is prohibited remain ineligible for these economic benefits.<sup>185</sup> California enacted a similar arrangement.<sup>186</sup> Localities with market participation in Colorado receive 10% of the special excise tax, which totaled \$14.8 million in 2017.<sup>187</sup> Local prohibitions can undermine the state regulatory system, and revenue sharing has been a persuasive tool for state governments to ensure compliance and prevent federal interference.

### *b. Local Sales & Excise Taxes*

Localities do not have to rely on the benevolence of the state to profit from the industry. Just as localities may enact regulations and licensing restrictions, they are also empowered to impose local sales and excise taxes. Jurisdictions in California have chosen a variety of

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185. Wash. Rev. Code § 69.50.540 (2018).

186. Cal. Rev. & Tax. Code § 34019(f)(3)(C) (Deering 2018).

187. Michael Roberts, *Here's Where Your Colorado Marijuana Tax Dollars Go*, WESTWORD (Apr. 18, 2018), <https://www.westword.com/news/heres-where-your-colorado-marijuana-tax-dollars-go-10214271>.

strategies, such as a 1% tax on gross sales or a flat rate of \$30,000 per year.<sup>188</sup> In Colorado, the average rate of local sales tax is 4.6%.<sup>189</sup>

These revenue streams from local taxes provide a different facet of funding for local priorities. For example, in Colorado, Denver recently raised its 3.5% local excise tax to 5.5% in order to fund affordable housing,<sup>190</sup> and Aurora has used its \$16 million to address homelessness.<sup>191</sup> In California, the city of Adelanto previously had \$2.4 million in debt. In 2017, the deficit was reduced to \$500,000, thanks in large part to a marijuana cultivation facility.

Cities and towns that have enacted prohibitions are beginning to second-guess the decision to opt out of legalization as they witness neighboring areas revitalized through these revenues. In 2017, an economics professor at the University of Denver estimated that Colorado Springs would see an additional \$20 million in taxes if the local prohibition is lifted. In 2018, the town partially responded by lifting the prohibition on medical marijuana, however, it declined to extend to recreational.<sup>192</sup>

### c. Democratic Process

Finally, for some, “opt-out” provisions spark concern for the democratic process because state-level legalization of marijuana is largely accomplished by vote rather than legislation. While legalization is typically in the hands of the voters, prohibitions are often enacted by local councils and ordinances and are passed without any voter input. Washington attempted to remedy the issue with HB 2336—legislation requiring any prohibition or additional regulation to be passed by ordinance or public vote—but the legislation failed to pass.<sup>193</sup> Local control is undeniably an important factor in the success of legalization, but what about the pro-legalization voters who inhabit these communities? Does prohibition by local councils mean that the ruling minority is imposing its views on the voting majority? This is a valid

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188. Brooke Staggs, *Cannabis Rules in California: How Does Your City Make Money on Weed?*, OC REGISTER (Apr. 12, 2018), <https://www.oregister.com/2018/04/12/cannabis-rules-how-does-your-city-make-money-on-weed>.

189. Morgan Scarboro, *How High are Marijuana Taxes in Your State?*, TAX FOUND. (June 1, 2017), <https://taxfoundation.org/marijuana-taxes-state/>.

190. Joe St. George, *Denver Hikes Marijuana Tax to Fund Affordable Housing*, KDVR (Aug. 28, 2018), <https://kdvr.com/2018/08/28/new-marijuana-taxes-will-fund-affordable-housing-in-denver/>.

191. Ann Marie Awad, *Where Does All The Marijuana Money Go? Colorado's Pot Taxes, Explained*, COLO. PUB. RADIO (Oct. 22, 2018), <http://www.cpr.org/news/story/where-does-all-the-marijuana-money-go-colorado-s-pot-taxes-explained>.

192. *Marijuana in Colorado Springs*, COLO. SPRINGS, <https://coloradosprings.gov/marijuana-working-group/page/marijuana-colorado-springs> (last visited Jan. 11, 2018).

193. H.B. 2336, 65th Leg., Reg. Sess. (Wash. 2018).

concern for any democratic institution. Yet, this fundamental conflict with the will of the voters has not impaired the delegation of authority to localities.

At the same time, it can be argued that the will of the majority is not necessarily the will of each individual community because state legalization usually passes by relatively narrow margins.<sup>194</sup> Moreover, local prohibitions are not permanent; many local governments and councils seem to employ a wait and see approach to legalization, to allow time for them to assess the results of the varying policies and regulations of others. As more data becomes available and a set of best practices subsequently evolve, the local prohibitions on the market are likely to diminish. Voters in localities that have not embraced marijuana retain the most powerful tool for change—the method that brought about legalization in the first place—engagement in the political process.

*d. The Black Market Issue*

“The easy part of legalization was persuading people to vote for it . . . [t]he hard part, now that it’s legal, is persuading people to stop buying from the black market.”<sup>195</sup> The economic argument for legalization rests on the proposition that legalizing marijuana will create a new stream of tax revenue out of a currently thriving illegal market. While earned tax revenue demonstrates a partial success, the continued existence of a black market for marijuana persists. In a complex market, there is no singular cause, but several contributing factors have been identified. These factors vary state by state.

The first is an issue of simple economics. Without effective regulation, legalization leads to a “market glut,” which leads to depressed prices within the legal market.<sup>196</sup> Market glut also prompts illegal exportation to more profitable markets. The issue of surplus has been most acute in California, where total marijuana sales dropped by \$500 million *after* recreational use was legalized.<sup>197</sup> California has a massive surplus of marijuana, producing “as much as 15.5 million pounds of cannabis and consuming just 2.5 million pounds.”<sup>198</sup> It is not a stretch to assume that a substantial portion of that 11 million pounds surplus is being exported across state lines. Colorado and Washington

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194. Colorado: 55.32% to 44.68%; California: 57.13% to 42.87%; Washington: 55.7% to 44.3%. MARIJUANA ON THE BALLOT, [https://ballotpedia.org/Marijuana\\_on\\_the\\_ballot](https://ballotpedia.org/Marijuana_on_the_ballot).

195. Fuller, *supra* note 184.

196. Martin Kaste, *Despite Legalization, Marijuana Black Market Hides in Plain Sight*, NPR (May 16, 2018), <https://www.npr.org/2018/05/16/610579599/despite-legalization-marijuana-black-market-hides-in-plain-sight>.

197. Fuller, *supra* note 184.

198. *Id.*



have faced similar problems with a burgeoning illegal market, which has been caused more by supply and demand issues than by having a massive surplus. “Law enforcement officials have intercepted Colorado-grown pot in at least [thirty-four] states.”<sup>199</sup>

Another potential issue is that the black market has taken an international turn, with Washington discovering a “large network of illegal marijuana grows run by Chinese nationals,”<sup>200</sup> which causes a growing concern over large-scale trafficking operations and organized crime. If more serious violations become more common, federal attention (and subsequent action) is likely to follow. In the words of one licensed producer, “if they are able to do this, and the attention is brought on us...I don’t think that is great for all of us.”<sup>201</sup>

For small-scale, domestically-licensed farmers trying to stay afloat, plummeting wholesale prices provide a “powerful temptation” to export when the same product would “easily fetch three or four times that price” across state lines.<sup>202</sup> A licensed producer in California could take his or her product to a non-producing state, a relatively short distance away, and escape the low wholesale prices caused by overproduction. In turn, consumers in the prohibitive state are able to procure better quality product without taking any additional risk. In this way, legalization without proper controls may actually do more to improve the black markets of other states than the legal market at home.

#### IV. CONCLUSION

Legalization and regulation on a federal level have stalled, which means states, at least in the near future, will have the latitude to experiment in its implementation. Coupled with this responsibility is the power to shape the market structure in accordance with explicit guidance from the Department of Justice to create a “strong and effective regulatory enforcement system . . . contain[ing] robust controls and procedures on paper.”<sup>203</sup> Furthermore, states seeking to legalize must ensure that these controls are “effective in practice.” While the recreational marijuana industry remains young, “there might be more public data on how this market works than any other market in the world.”<sup>204</sup>

Regulations do not operate in a vacuum, and lawmakers must consider many contingencies when enacting certain controls and

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199. Freeman et. al, *supra* note 149.

200. Kaste, *supra* note 196 (“Police in three counties served 50 search warrants, confiscated 32,000 pot plants, 26 vehicles, and \$400,000 in cash and gold. They also arrested 44 people.”).

201. *Id.*

202. *Id.*

203. Cole, *supra* note 51.

204. Black, *supra* note 116.

limitations. In doing so, state legislatures must make a joint effort with local governments to create effective control measures that decrease the uncertainty and instability of the emerging market. It is important to remember that restrictions must be baked into a comprehensive scheme to avoid loopholes that undermine the system. For example, vertical integration in the market limits the number of regulated parties, but the state must ensure they are sophisticated parties and have the resources to operate efficiently and comply with a highly regulated industry. If a state seeks market diversification as a high priority, it should consider restrictions on vertical integration because lower barriers to entry allow for an infusion of diverse parties with fewer resources to compete within this budding industry. On the other hand, a higher degree of vertical integration removes some of the instability and inconsistencies in the regulatory scheme by reducing the number of applications to review, licenses to grant, and parties to regulate, making compliance and enforcement easier for governing bodies. Efficiency is key, and if a major goal for a state is to grow its tax revenue stream, then another should be trimming the resources expended to do so.

Regarding state legalization of recreational cannabis, fewer issues are more contentious than the delegation of power to localities for further regulation or prohibition on sales. The moral arguments and potential implications on this topic in relation to citizen voting power are subjective, and those with strong views on either side of this polarizing subject are unlikely to be swayed. However, the consequences of local control extend beyond the county or city line, which creates layers of inconsistent regulation that further entrench the illegal market.

It is challenging enough for states to enact a comprehensive regulatory system to appease the federal government's objectives, but it seems impossible to maintain a comprehensive system when every county, city, and municipality is able to enact legislation in direct conflict with state law. Moreover, the scope and extent of police powers, and who should exercise them, is a critical issue in this debate because a lack of enforcement can shatter the rigorous and effective regulatory structure established by state lawmakers and required by the federal government. Using data from early adopters, like California, Colorado, and Washington, will help states that are pursuing legalization to identify loopholes that have rendered regulation less effective, which will help them to strike a balance in regulation that is conducive to attaining their respective policy initiatives.

While the wisdom of legalizing marijuana for adult use will remain controversial, with passionate arguments on both sides of the debate, dissent alone has been insufficient to slow momentum for legalization. The 2018 midterm elections point to several states moving toward

legalization in 2019.<sup>205</sup> In 1996, California became the first state to legalize medicinal marijuana, doing so without federal authorization or any examples to follow. Colorado and Washington expanded that effort to recreational use in 2012, armed with no precedent and only their knowledge of the medicinal market. Now is the time for other states to examine the regulatory structures of these trailblazers, assess the consequences of each regulation, and inject their own policy initiatives and ideas to build upon “the great pot experiment.”<sup>206</sup>

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205. See Tom Angell, *These States Are Most Likely to Legalize Marijuana in 2019*, FORBES (Dec. 26, 2018, 2:11 PM), <https://www.forbes.com/sites/tomangell/2018/12/26/these-states-are-most-likely-to-legalize-marijuana-in-2019/#5fdf11b15add>. Pro-legalization gubernatorial candidates were victorious in Connecticut, Illinois, Minnesota, New Jersey, New Mexico, New York. Measures in New Hampshire and Vermont are expected to have wide support despite gubernatorial opposition. *Id.* The Democratic Governor of Rhode Island, Gina Raimondo, believes legalization will come to the state through peer pressure, as neighboring states reap the benefits of tax revenue and social costs are more widely shared. *Id.*

206. *The Great Pot Experiment*, ECONOMIST (July 10, 2014), <https://www.economist.com/united-states/2014/07/10/the-great-pot-experiment>.