

CALIFORNIA MINORITY ALLIANCE

February 11, 2019

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Los Angeles, CA 90012

REFERENCE: COUNCIL FILE NO. 14-0366-S5 [ADMENDMENTS]

In response to said draft AMENDMENTS, the California Minority Alliance ("CMA"), a non-profit corporation offers the following written comments and recommendations regarding the development and implementation of PHASE III, Social Equity Program Licensing Process ("SEPP").

1. RESPONSE: Possible Methods for Spring 2019.

CMA would like to offer a very general concept of integrating the two proposed models of Merit-system based evaluations and First come, first served for verified Tier 1 and Tier 2 applicants through a basic threshold model that can be applied to analyze the acceptance-rate consequences of either of DCR stand-alone methodologies. CMA proposes the implementation of what we call " *lottery-based rules with single hurdle thresholds.* " Such processing methodology sets a viable threshold (in addition to that listed in the verification process by DCR) for an applicant to qualify for the Spring 2019 processing and use a lottery to choose among applicants who are above that threshold to achieve the fixed number of **200** licensed Phase 3 Retail Storefronts.

With the appropriate threshold chosen, in terms of high predictive validity for operational success and business sustainability, **integrating Regulation No.5. Inspections (A)1., with Regulation No. 3. Application Procedure** such that the applicant must at least have two of the mandated departments inspect their premise of the application as the appropriate " *viable* " threshold in becoming one of the first **100**. That is, we offer a *single hurdle* (two department inspections prior to application submission), *variable threshold model* in which CMA considers a selection process whereby a proportion of all those who apply for a Retail Type 10 license are accepted based on their inspections (ensuring safety in the communities they operate), merit system score (approval of security plan & fire



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plan)¹. Additionally, a lottery shall be held among those who meet the threshold only when qualified applicants exceed the licensing availability. In fact, as applicants meeting the original threshold increase expanding the single hurdle to three of the four department's pre-license inspection for applicants 101-200. In this context, CMA believes that lottery-based rules will produce intermediate outcomes between "first come, first serve," "lottery" and "merit-based scores."

Contrary, lottery-based schemes with minimum thresholds (such as only Tier 1 or Tier 2 verification) must be scrutinized closely for their likely effects. On the one hand, lottery systems adds to the pool of applicants eligible for selection not only those in the less advantaged group who meet the lower threshold (those having met the current DCR proposed restrictions and verification requirements, but fail LAFD & DBS inspection of premise)--- just as in a merit-system—but also the larger number of persons in the more advantaged group (2 inspections passage) that meet the threshold. Hence, increasing the "viable" threshold as proposed mitigates this impact. Furthermore, the current combination of a simple merit-system scorecard based on submission of documents will not take any more time implementing than current compliance requires.

Suppose, for example, an applicant A submits a "contract" (evidence) for a "Track and Trace System" vendor for service, while applicant B does not. It seems that on a merit scorecard, applicant A may score higher, thus be processed first, in the pool of 100, while Applicant B will go to the 101-200 lottery pool. In other words, an integrated process method as proposed by CMA would work to ensure that the SEPP licensing process isn't limited in how close it may come to proportionality (i.e., 2 to 1 ratio) when all the dust settles three years from now.

Additionally, verification of Tier 1 or Tier 2 applicants ownership percentage (if less than 100%) transaction should be evidenced by a completed and submitted form DBO-260.102.14 of the California Department of Business Oversight².

Finally, CMA suggests that "letter[s] of intent" be removed from "deeming[ing] an application preliminarily complete..."(DCR, p.4). Letters of Intent are non-binding and it seems more than appropriate that SEPP applicant making the financial commitment to a leased commercial property should have priority of a "letter of intent" in which landlords take advantage and have gamed this qualifying criterion in Phase 2.

¹ Rules and Regulations for Cannabis Procedures: Regulation No.5. Inspections requires approval of security plan, fingerprinting, fire safety plan an on-site inspection of all building code and fire code requirements.

² State of California-Department of Business Oversight, " Notice of Transaction Pursuant to Corporations Code Section 25102(f).

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"A recent bidding war for a decent 1,600-square-foot storefront on the Westside of Los Angeles ended at \$35,000 per month, he said, or about \$22 per square foot. That's a high retail rent for the area"³.

NOTEWORTHY. CMA RECOMMENDS THAT REGULATION No. 5 Inspection. A (1) BE AMENDED TO REMOVE DCR STAFF FROM Pre-Licensing inspections. It seems self-defeating that the regulation would require a "pre-licensing" inspection of a department that has ***no CODE enforcement authority on non-licensed operations***. DCR staff and resources may be better utilized on the applicant's verification process and evidence examinations.

2. RESPONSE: Processing Restrictions.

CMA proposes the following restrictions considerations:

- A verified Tier 1 **ONLY** applicant may only be associated with one application and may only apply at one address. The reasoning assumes that majority ownership (51%) requires much more responsibility and accountability for both compliance and operational business functions. Whereas a Tier 2 ownership (33 1/3%) may not have as much management responsibilities, thus maintain the ability to cross function in more than one business⁴.
- In the event two applicants produce a letter of intent form a landowner at the same address, then the application is **voided for both applicants**.

³ Vincent, Roger. "Here's Why Pot Sellers Are Paying Prime Rents for Warehouse and Storefront Space." Los Angeles Times, Los Angeles Times, 31 Mar. 2018, www.latimes.com/business/la-fi-cannabis-real-estate-20180331-story.html.

⁴ Johnson, I. (2001). Corporate decision making in private equity transactions. *International Financial Law Review*, 26. In Crosby v. Beam, 47 Ohio St. 3d 105 (Ohio 1989), the court held that "Majority shareholders have a fiduciary duty to minority shareholders. A majority shareholder has a fiduciary duty not to misuse his power by promoting his personal interests at the expense of corporate interests." The court further observed that "Majority or controlling shareholders breach the fiduciary duty to minority shareholders when control of the close corporation is utilized to prevent the minority from having an equal opportunity in the corporation."

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C. RESPONSE: Additional Recommend Amendments

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1. RESPONSE: Delivery Non-Storefront Retail (Delivery) Pilot Program.

CMA recommends that the Pilot Program process number increase to 170 (*same number of Phase I applicants*). Also, Delivery Non-Storefront Retail is not limited to the City of Los Angeles and capturing said market generates an economic advantage for citizens of Los Angeles. In other words, the delayed process of Type 9 licensing has allowed other non-Los Angeles based firms to benefit from the Los Angeles Market. Obtaining market share opportunity for our citizenry should not be relaxed to a mere 60.

2. RESPONSE: Clarify and Relax Ownership Limits on Storefront Retail Licenses

CMA opposes this recommendation. There exist no economic, business, or other predictive indicators that an investor with equity in multiple operations of the same industry sector is more beneficial to the investee. One may contend that relative to the Equity Theory of Motivation, the investee of one dispensary from said investor may feel that negative tension state, in that, 49% is a lot of equity in one company, let alone 12. Furthermore, opportunist may argue that investor(s) is limited, it is well studied that ownership concentration limits economic growth, financial development, and the ability of an investee to take advantage of financial levers in their business⁵.

Moreover, sustainability in this nascent industry as a retailer will be determinant upon pricing flexibility among other performance drivers. ***If DCR's recommendation were to hold, Los Angeles would allow the possibility for as few as 17 investors to financially control (up to 49% ownership per retail) some 200 storefront retailers with the marketability of over \$5 million per retailer, some \$1 Billion in 2020.***

Exception: In the event, an investor(s) or organizations of which said investor serves as the board of director, officer, or in any compacity of directing investment(s) into more than 3 SEPP applicants, said investor must be in full compliance with Rule 501 of Regulation D of the Securities Act of 1933. That is, the firm of which the investor invest, must file a Form D with the Securities Exchange Commission (SEC) and file a copy with DCR. Furthermore, said investor must file with the California Department of Business Oversight a Limited Offering Exemption Notice of Transaction or Limited Offering

⁵ Tirole, J. 2006. The Theory of Corporate Finance. Princeton, NJ: Princeton University Press.

Villalonga, B., and R. Amit. 2006. How Do Family Ownership, Control, and Management Affect Firm Value? Journal of Financial Economics 80:385-417.



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Exemption Notice (LEON)⁶ and provide said documents and receipts of filing with all Tier 1 and Tier 2 applications invested in above three Retail Stores (includes non-storefront). The purpose provides full transparency on the investor or his/her investment vehicle. Moreover, compliance of Section 25102(f) of the California Corporation Code § (d) Relationship., requires “preexisting personal or business relationship” with investee (or firm). Thus, said investor would need to disclose said relationship as a condition of investing in such a large number of Retail businesses.⁷

CMA recommends that the DCR regulations adopts the Bureau of Cannabis Control (BCC) Regulations for defining “Owner”, in that a person shall be deemed to “hold” a retail license, includes an individual who will be participating in the direction, control, or management of the person [retailer] applying for a license. Such individuals include “manages a retailer.”⁸ Such definition is important in protecting public health and safety by ensuring ALL individuals, firms, and others assuming the responsibility that are beneficiaries of the retailer, whether in salary or dividends are transparent in who is responsible and are accounted for. That is, retailers are the face and entry point for the City’s cannabis commercial business activities. Thus transparency even in its most conservative interpretation ought to be implemented.

3. **RESPONSE: Allow DCR to Grant Temporary Approval to Phase 3 Storefront Retailer**

CMA recommends SUPPORT for this DCR recommendation.

4. **RESPONSE: Set Uniform Qualification for Tier 1 and Tier 2 Applicants.**

CMA recommends that a better draft of the DCR recommendation of conformity in the qualification of Tier 1 and Tier 2 applicants are drafted. In other words, it seems more confusing now than existing. Assuming that the semi-colon after qualification (i) Low income and has a California, Cannabis Arrest or Conviction implies the condition of being permutable between qualification (ii) or (iii).

⁶ Rule 260.102.14 of the California Corporation Code pursuant section 25102.

⁷ Rule 260.102.12 of the California Corporation Code pursuant section 25102.

⁸ BCC § 5003 (b)(6)a-(c)c., § 5004.



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5. RESPONSE: Modify Calculation of Tier 3 Property Support Fee

CMA OPPOSES the modification of calculating Tier 3 property support fee. It is CMA's common understanding that "*under normal circumstances*" of acquiring commercial leases for businesses the standardized method per square foot in establishing commercial real estate Rates, Base Rent and Operating Expenses are used in some areas the method of Gross Lease, Net Lease, and Triple Net Lease. However, in our City, most of the commercial real estate methodologies can be summarized in one word: extortion. Thus, to ensure equity DCR must ensure said calculations are used in the implementation of LAMC § 104.20 (e) (1). Simple use of IBM SPSS software or ATLAS.ti software on a volunteer's desktop can address said workload by DCR staff.

6. RESPONSE: Program Site-Specific Conditions from the SEPP

CMA SUPPORTS.

7. RESPONSE: Eliminate Tier 2 Obligation to Provide Business, Licensing, and Compliance Support

CMA OPPOSES DCR'S recommendation without a viable alternative to address the loss in the value-added benefit a Tier 1 applicant may receive from the BLC services as it is currently stated in LAMC 104.20 (d). In other words, Tier 1 applicants (with a conviction) may need all of the alternative services and resources available compared to any other licensee. The issues of resource limits may still exist and DCR should not at this stage limit ANY resource allocation that doesn't require equity in ownership transactions.

8. RESPONSE: Require Tier 3 Applicants with Temporary Approval to Enter into Social Equity Agreement at Time of Submitting an Annual License Application.

CMA SUPPORTS DCR's recommendation for City Council to specify when exactly Tier 3 applicant must enter into the Social Equity Agreement. *However, relative to the timing of such Agreement, CMA recommends that Tier 3 Applicants with Temporary Approval shall have 60 days from the date of said approval to enter into a Social Equity Agreement. Otherwise, such Temporary Approval shall be void.*

In accordance with LAMC § 104.20(e), Tier 3 applicants ONLY qualifying criteria is that of "*entering into a Social Equity Agreement with the City to provide capital, leased*



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space, *Business Licensing and Compliance assistance (BLC)* . . .”. To defer such requirement until “annual licensing application (at least 120 days, if not amended by BCC for extension in the near future), is against the “spirit” of the ordinance and the conceptual context of Social Equity. That is, the prolonging of such important things as space, and BLC to Tier 1 and Tier 2 applicants serves as an indirect supportive barrier of the application process⁹. In other words, Tier 1 and Tier 2 applicants immediate need for BLC versus postponement directly impacts their ability to reach the “completed” application stage. For example, a Tier 1 Applicant on March 1, 2019, needs space for a Storefront retail (min. 1,000 sq.ft or equivalent money to obtain such space [LAMC § 104.20 (e)(6)]), based on DCR’s proposal such capital or leased space may not be available until September 1, 2019, or later, while conditionally, the Tier 3 applicant has been obtaining both monies from sales and building market share. Furthermore, said Tier 3 would be a beneficiary of the Social Equity Process Program and may have NEVER been disadvantaged by the War on Drugs. **Unacceptable.**

9. RESPONSE: Non-storefront Retail Licenses in the Manner Provided in LAMC § 104.06 (b)

CMA SUPPORTS DCR’s recommendation.

10. RESPONSE: Miscellaneous Recommended Amendments

CMA SUPPORTS DCR’s recommendations, with clarification or addition that ALL Tier 3 Social Equity Agreements shall be made public and listed on DCR’s website for transparency purposes. That is, it is transparent by the criterion of qualifications why an applicant is a Tier 1 or Tier 2 Social Equity Program applicant, at least standardized (i.e., conviction and/or residency in the disadvantaged area). It is not so transparent as to the cost-benefit relationship for Tier 3 applicants who benefit from the SEPP based on the variety of qualifying criterion.

⁹ City of Los Angeles Office of the Chief Legislative Analyst. (November 2017). *Cannabis Social Equity Addendum*. Retrieved from http://clkrep.lacity.org/online/docs/2017/17-0653_rpt_CLA_11-16-2017.pdf



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D. Recommendation

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CMA appreciates the opportunity to offer its policy positions on the items above for consideration and at this moment formally request participation and acceptance of recommendations in the formulation of all Ordinance Amendments, Regulations, and Rules governing these policy adjustments.

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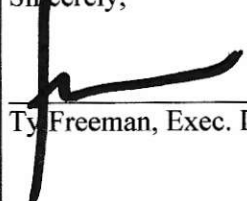
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Sincerely,


Tyrone Freeman, Exec. Dir.


Donald Anderson, President


Virgil Grant, Vice President