



**Colorado
Legislative
Council
Staff**

SB16-040

**FINAL
FISCAL NOTE**

FISCAL IMPACT: State Local Statutory Public Entity Conditional No Fiscal Impact

Drafting Number: LLS 16-0457
Prime Sponsor(s): Sen. Holbert
Rep. Pabon

Date: September 1, 2016
Bill Status: Signed into Law
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BILL TOPIC: MARIJUANA OWNER CHANGES

Fiscal Impact Summary	FY 2016-2017	FY 2017-2018
State Revenue	<u>at least \$850,687</u>	<u>at least \$1,445,000</u>
Cash Funds	at least 850,687	at least 1,445,000
State Expenditures	<u>\$1,175,824</u>	<u>\$1,543,032</u>
Cash Funds	995,738	1,320,463
Centrally Appropriated Costs	180,086	222,569
TABOR Impact		\$1,433,529
FTE Position Change	10.2 FTE	12.5 FTE
Appropriation Required: \$995,738 - Multiple agencies (FY 2016-17).		
Future Year Impacts: Ongoing state revenue and expenditure increases.		

Summary of Legislation

The bill replaces the current statutory definition for owner of a licensed medical or retail marijuana business (marijuana business) with two new ownership categories: direct beneficial interest owners (direct owners) and indirect beneficial interest owners (indirect owners).

Direct beneficial interest owner. A direct owner is a person or closely held business entity that owns a share or shares of stock in a licensed marijuana business, including the officers, directors, managing members, or partners of the licensed marijuana business or closely held business entity, or a qualified limited passive investor. A licensed marijuana business can be comprised of an unlimited number of direct owners if all owners are Colorado residents, but is limited to 15 direct owners if the business has any out-of-state owners. The Marijuana Enforcement Division (MED) in the Department of Revenue (DOR) may increase the number of direct owners based on developments in state and federal financial regulations, market conditions, and the licensee's ability to access legitimate sources of capital.

A direct owner who is a natural person must be a resident of Colorado for at least one year or a U.S. citizen prior to applying for a license. A person who intends to apply as a direct owner who has not been a Colorado resident for at least one year must submit a request for a finding of

suitability from the MED and receive a finding of suitability prior to applying for a license. A direct owner that is a closely held business entity must consist entirely of natural persons who are U.S. citizens including all parent and subsidiary entities, prior to applying for a license.

Qualified limited passive investor. A qualified limited passive investor is a natural person, a U.S. citizen and a passive investor who owns less than a 5 percent share or shares of stock in a marijuana business. A qualified limited passive investor is a direct owner but is subject to a limited background investigation. If the initial background check provides reasonable cause for additional investigation, the MED may require a full background check. The MED may promulgate rules on the parameters and qualifications of a qualified limited passive investor.

Indirect beneficial interest owner. The category of indirect owner includes permitted economic interest holders (PEIs), royalty recipients, licensed employees who receive profit sharing, and qualified institutional investors. The bill allows qualified institutional investors to own up to 30 percent of a marijuana business. Institutional investors includes banks, insurance companies, investment companies, investment advisers, collective trust funds, employee benefit plans, pension funds, and a group comprised of these. The MED may promulgate rules on the parameters and qualifications of indirect owners and expand the list of persons or entities through rule.

Finally, the bill prohibits a publicly traded company from licensure under the Medical and Retail Marijuana Codes. The bill applies to applications made on or after January 1, 2017.

Background

Under current law, owners of medical marijuana businesses and retail marijuana establishments are required to be Colorado residents for at least two years prior to application and to remain residents while licensed. As of April 1, 2016, there were 1,513 licensed medical marijuana businesses and 1,150 licensed retail marijuana establishments. Each medical and retail marijuana license applicant must undergo a fingerprint-based background check and supply personal history information in accordance with statutory requirements. Owners have heightened requirements, including divulging all ownership agreements. The agreements are often complex and require a substantial amount of time to investigate for compliance with the Medical and Retail Marijuana Codes, and to ensure that all interests have been revealed. The MED is required by the Colorado Constitution to take action on a retail license within 90 days of application.

In addition to initial licensing, each license must be renewed every year. Each renewal generates its own background investigation to ensure continued statutory and regulatory compliance. Change in ownership applications can be submitted at any time and require investigations. In calendar year 2015, the MED received nearly 450 change of ownership applications for medical marijuana businesses and retail marijuana establishments.

Current law, promulgated by House Bill 15-1379, allows individuals who are not Colorado residents to hold a PEI in a regulated medical marijuana business or retail marijuana establishment. Only a natural person who is a lawful United States resident may obtain a PEI, and the interest is limited to an unsecured debt instrument, option agreement, warrant, or any other right to obtain an ownership interest. Applicants must submit to and pass a criminal history record check, divestiture, and other agreements to qualify as PEIs. The MED began accepting PEI applications on February 10, 2016, so it is too soon to analyze the effect of that program.

Assumptions

This fiscal note is based on the following assumptions:

- 5 percent (133) of licensees will seek regulatory approval for out-of-state investors in FY 2016-17 and FY 2017-18;
- of the 133 licensees, 66 will seek approval of new owners in FY 2016-17 and 133 will seek approval in FY 2017-18; and
- each participating licensee will add two direct beneficial interest owners (266), one indirect beneficial interest owner (133), and two qualified limited passive investors (266); and
- investors will be added through 100 change of ownership applications in FY 2016-17 and 200 change of ownership applications in FY 2017-18.

State Revenue

This bill will increase state cash fund revenue from fees by at least \$850,687 in FY 2016-17 and \$1,445,000 in FY 2017-18 to the Marijuana Cash Fund in DOR.

Fee impact on individuals and business. State law requires legislative service agency review of measures which create or increase any fee collected by a state agency. Table 1 below identifies the fee impact of this bill which are explained below. Actual fees will be set by the MED in rule.

Type of Fee	Proposed Fee	Number Affected		Fee Revenue	
		FY 2016-17	FY 2017-18	FY 2016-17	FY 2017-18
Direct Beneficial Interest Owner	\$1,400	133	266	\$186,200	\$372,400
Indirect Beneficial Interest Owner	800	66	133	52,800	106,400
Qualified Limited Passive Investor	1,100	133	266	146,300	35,378
Transfer of Ownership	2,000	100	200	200,000	400,000
Due Diligence Investigations	Varies			250,000	500,000
Royalty Registration - fee to be set by the MED					
Background and Name Checks - CBI and FBI	46.35	332	665	15,387	30,822
TOTAL				\$850,687	\$1,445,000

Owner licensure. To become an owner in an existing marijuana business, newly eligible applicants will apply for a direct or indirect beneficial interest owner license which is required for any stockholder holding an interest in a marijuana licensee, and a transfer of ownership which is required whenever a percentage of a license is being sold. License fees will be paid annually.

Due diligence investigations. The MED will charge applicants for the direct costs of conducting due diligence investigations into the suitability of businesses and individuals. The revenue from applicants will offset the cost of the investigations. This includes an hourly rate for

investigator time; the number of hours required will depend on the complexity of an application. Based on experience from the Division of Gambling which also licenses nonresident owners, the MED will generate \$500,000 per year from these fees prorated in FY 2016-17.

Royalty registration. The MED will charge fees associated with the registration of commercially reasonable royalties. These fee types will include the applicable registration and the renewal of royalties should renewal be required. These registration fees will depend on the outcome of rulemaking and are not included in the fiscal note.

Fingerprint-based criminal background checks. This bill will increase state cash fund revenue by \$15,295 in FY 2016-17 and \$30,823 in FY 2017-18 collected by the MED and reappropriated to the Colorado Bureau of Investigation (CBI) in the Department of Public Safety (DPS) for fingerprint-based criminal background checks. Revenue increases assume a fee of \$46.35 per applicant for fingerprinting and name check. Of this amount, \$22.25 is retained by the CBI, \$17.25 is passed through to the Federal Bureau of Investigation (FBI), and \$6.85 is for the name check that also goes to the CBI.

TABOR Impact

This bill increases state cash fund revenue from fees, which will increase the amount of money required to be refunded under TABOR. TABOR refunds are paid out of the General Fund.

State Expenditures

This bill increases state cash fund expenditures by \$1,175,824 and 10.2 FTE in FY 2016-17 and \$1,543,032 and 12.5 FTE in FY 2017-18 and each year thereafter from the Marijuana Cash Fund in DOR. These costs are shown in Table 2 and explained below.

Table 2. Expenditures Under SB16-040		
Cost Components	FY 2016-17	FY 2017-18
Personal Services	\$561,856	\$686,084
<i>FTE - Department of Revenue</i>	<i>9.8 FTE</i>	<i>12.0 FTE</i>
Operating Expenses and Capital Outlay Costs	65,746	11,400
Law Enforcement Equipment and Supplies	23,108	3,948
Legal Services	71,258	71,258
Vehicle Lease and Mileage	8,475	16,950
<i>FTE - Department of Law</i>	<i>0.4 FTE</i>	<i>0.4 FTE</i>
Due Diligence Investigations	250,000	500,000
Pass Through Background Checks	15,295	30,822
<i>FTE - Department of Public Safety</i>		<i>0.1 FTE</i>
Centrally Appropriated Costs*	180,086	222,569
TOTAL	\$1,175,824	\$1,543,032

* Centrally appropriated costs are not included in the bill's appropriation.

Personal services. The MED will add to its Background Investigation Unit (BIU) to implement this bill:

- 4.0 FTE criminal investigators;
- 3.0 FTE compliance investigators;
- 1.0 FTE legal assistant;
- 1.0 FTE accountant;
- 1.0 FTE accounting technician; and
- 2.0 FTE administrative assistants.

Staff will be hired beginning in July 2016 and personal services costs are adjusted for variable start dates in FY 2016-17. With assistance from existing BIU staff, the new investigative staff will develop the new licensure program and train for the January 1, 2017 program start date. Staff duties will include:

- accepting and processing applications;
- updating the MED licensing software and database;
- conducting computer-based inquiries and requests;
- investigating applicants' financial backgrounds;
- interviewing applicants;
- traveling nationwide for verification of assets and investigative oversight; and
- preparing and reporting investigative findings for approved and denied changes of ownership.

Operating expenses and capital outlay costs. The fiscal note includes expenses for 12.0 new FTE for office furniture, telephones, computers, and supplies, which represents the number of FTE when all staff are hired.

Law enforcement equipment. The 4.0 FTE criminal investigators will hold peace officer status. The MED will supply these investigators with appropriate police equipment for one-time capital equipment costs of \$23,108 and ongoing annual supply costs of \$3,948.

Legal services. The MED is expected to require 750 hours of legal service costs at a rate of \$95.01 per hour annually. This volume of work requires an allocation of 0.4 FTE to the Department of Law (DOL). In FY 2016-17, the DOL will provide general counsel and rulemaking support. In FY 2017-18, the DOL will provide regulatory representation for disputed denials of royalties and licensure as well as compliance actions against licensees.

Vehicles. The MED requires three vehicles for the criminal investigators working in the field. These costs are prorated for FY 2016-17 and will be ongoing. The Department of Personnel and Administration, which will administer the vehicle leases, will be reappropriated \$4,950. The remainder of the costs are for mileage.

Due diligence investigations. As noted in the State Revenue section, the MED will charge applicants for the direct costs of conducting due diligence investigations into the suitability of businesses and individuals. The MED needs sufficient appropriations to conduct investigations of applicants. The applicants will be charged an hourly investigation rate, that will be set by the MED, and actual investigation expenses, which will include travel costs.

Pass through background checks. These costs are for the CBI in the DPS to conduct background checks and for the FBI portion of the background checks. For FY 2017-18, the number of background checks requires an increase of 0.1 FTE for the DPS.

Centrally appropriated costs. Pursuant to a Joint Budget Committee policy, certain costs associated with this bill are addressed through the annual budget process and centrally appropriated in the Long Bill or supplemental appropriations bills, rather than in this bill. Leased space is included to show the incremental impact of the additional FTE, and calculated at DOR's rate of 200 square feet per FTE at a rate of \$27 per square foot. The centrally appropriated costs subject to this policy are estimated in the fiscal note for informational purposes and summarized in Table 3.

Table 3. Centrally Appropriated Costs Under SB16-040		
Cost Components	FY 2016-17	FY 2017-18
Employee Insurance (Health, Life, Dental, and Short-term Disability)	\$78,906	\$96,292
Supplemental Employee Retirement Payments	48,080	61,477
Leased Space	53,100	64,800
TOTAL	\$180,086	\$222,569

Effective Date

The bill was signed into law by the Governor and took effect June 10, 2016. It applies to applications made on or after January 1, 2017.

State Appropriations

Consistent with the fiscal note, for FY 2016-17, the bill includes the following appropriations:

- the Department of Revenue - \$995,738 from the Marijuana Cash Fund and an allocation of 9.8 FTE;
- the Department of Law - \$71,258 reappropriated funds and an allocation of 0.4 FTE;
- the Department of Personnel and Administration - \$4,950 reappropriated funds; and
- the Department of Public Safety - \$15,296 reappropriated funds of which \$5,727 is passed through to the federal government for FBI background checks.

State and Local Government Contacts

Governor's Marijuana Office
Personnel

Information Technology
Public Safety

Law
Revenue