

## ***Discussion of Policy Option 1, Regulation & Taxation, and Related Policy Alternatives***

Below is discussion on the following regulatory topics, as well as proposed draft ordinances:

- (1) Zoning/Land Use Policy;
- (2) Regulatory Program;
- (3) Cost for Regulatory Program;
- (4) Taxation Analysis; and,
- (5) Schedule of Fines.

### **1. Zoning/Land Use Policy**

At the March 30<sup>th</sup> City Council Meeting, the City Council discussed Councilmember Oliverio's recommendation for the City ordinance to consider: "...industrial zoning as the primary area to be considered for medical marijuana cultivation and sale and specify that no on-site consumption of medical cannabis shall be allowed." After extensive City Council discussion and public testimony, the City Council decided to allow staff to bring forward other possible recommendations related to appropriate areas of the City that the Council could consider for various types of land uses related to medical marijuana in the event Council decided to move forward with some amount of allowed activity. Upon the Administration's review and analysis, the draft ordinance contains proposed amendments to Title 20 to include specific land use provisions for Medical Marijuana Collectives (Collectives). These provisions include:

1. **Commercial General (CG) Zoning District and Sensitive Uses:** Collectives are the locations where qualified patients and/or their primary caregivers come together to collectively cultivate and distribute marijuana for medical purposes. The Commercial General Zoning District is best suited to Collectives because this district is typically located on major streets with public transit and is not always located adjacent to neighborhoods. For this reason, if the Council decides to allow Collectives, the Administration recommends that Collectives be allowed only in the Commercial General (CG) Zoning District, as long as the location is not within a certain number of feet of enumerated sensitive uses such as a residential use, a school, a child day care center, a church that includes a school or a child day care use, a community or recreation center, a park, a trail, a library, substance abuse rehabilitation center or another Collective. Since the draft ordinance was proposed in June, State law has changed to require that medical marijuana establishments be located at least 600 feet from k-12 public and private schools, as discussed in more detail below (this is more restrictive than the City's June 2010 action).

**Policy Alternative(s):** The City Council could consider these other options:

- a. **Industrial Zoning Districts:** Allow these uses in another Zoning District, such as the Industrial Park or Combined Industrial/Commercial Zoning Districts. Staff is opposed to Collectives locating in any Industrial Zoning District given the City's longstanding challenge to attract and retain jobs to secure fiscal sustainability. The employment lands zoned Industrial need to be preserved and used for industrial, economic development purposes. The introduction of Collectives tends to undermine this critical goal and could compromise the availability of this land for future businesses entering the City's Industrial Areas. For these

reasons, the Administration recommends that the Commercial General Zoning District is the only logical zoning district for Collectives given their exchange of goods nature.

b. **Distance Requirement from Sensitive Uses.** Establish any of the alternative distance requirements from sensitive uses or none at all:

- (1) Adopt a 1,000 feet distance requirement from sensitive uses and/or remove some of the proposed sensitive uses. As sensitive use categories or distance requirements from the proposed sensitive uses are added to the proposed land use policy requirement, the number of potentially eligible sites is reduced significantly.
- (2) Remove entirely a distance requirement from sensitive uses and the concept of a sensitive use.
- (3) Conform distance requirements to Assembly Bill No. 2650, which was signed into law on September 30, 2010 and is effective January 1, 2011. This new law requires medical marijuana businesses to not be located within a 600-foot radius of any public or private school providing instruction in kindergarten or grades 1 to 12, inclusive, except as specified. The statute provides that the Legislature intended to preempt local governments, including charter cities from regulating the distance between medical marijuana establishments and schools, but also provided that nothing in the bill shall prohibit a city, county or city and county from adopting ordinances that further restrict the location or establishment of these medical marijuana establishments. Therefore, the distance requirement from schools, must be at least 600 feet, and cannot be the 500 feet distance originally proposed.

2. **Cultivation:** The Administration's recommendation to allow only a Collective's cultivation is based on the desire to ensure a "closed-loop system" where the distribution of medical marijuana is traceable back to the cultivation of it. The primary concern is to ensure that the medical marijuana is not diverted from, or to, non-legal uses and to enable adequate regulation of Collectives during a time of implementation of this ordinance and transition for the organization. If the system is not "closed-loop," schemes could easily be set up to facilitate the sales of marijuana for profit, instead of the cultivation of marijuana for medical patients belonging to collectives, as intended by state law. Permitting multiple cultivation locations for a Collective presents additional regulatory issues for the City to resolve and integrate into the proposed ordinances and staffing plan upon the receipt of more detailed input from the City Council.

There is concern in that the Police Department would not be able to definitively determine where the medical marijuana is being produced and obtained from. This could mean that, among other things, (1) marijuana is emanating from sources that support criminal activity, (2) marijuana is being grown with chemicals and substances that could be harmful, and/or (3) marijuana is being grown in residential homes that have been converted to illegal "grow-houses." San Jose's experience suggests that these are very real outcomes and the ability to prevent these three concerns exceeds staff's capacity under the proposed staffing plan. It is therefore recommended, that the "closed-loop" system be instituted and all marijuana be required to be grown at the designated Collective's site.

**Policy Alternative(s):** Allow multiple cultivation locations for Collectives in limited Zoning Districts and direct staff to complete its evaluation and assessment upon the receipt of more detailed input from the City Council of criteria and related buffering distances and return with

recommendations, including a revised land use policy, staffing plan, and revised Registration Fee.<sup>1</sup>

3. **No Land Use Permit/Zoning Verification Issued:** The proposed draft ordinance does not require a land use permit for a Collective. This is because land use permits run with the land rather than the operator/owner of the Collective. Given the requirements that the Collective owners/operators, it would not be possible to transfer those obligations and clearances to another Collective. Instead, the Administration recommends that the Department of Planning, Building, and Code Enforcement (PBCE) complete a ministerial "Zoning Verification" for any proposed Collective to document that it meets the zoning, location, and distance criteria mentioned above. Since there would not be a requirement for a land use permit for a Collective, Council Policy 6-30: Public Outreach Policy for Pending and Development Proposals would not strictly apply (see "noticing" discussion below for more on this point).

**Policy Alternative(s):** The City Council could direct the Administration to require a Conditional Use Permit (CUP) for Collectives. This would provide for public involvement and a public hearing before Planning Commission. The Planning Commission, and Council on appeal, would determine the conditions affecting a Collective's operation consistent with the proposed Title 6 registration requirements. Such a permit would "run" with the property regardless of the operator or business.

This is a significant concern and the main reason why the Administration is not recommending this alternative.

4. **Noticing:** As noted in item #3 above, a Zoning Verification does not have a public outreach or noticing requirement. Given the concerns expressed about where a Collective may locate, the City Council may be interested in having staff develop a noticing process that would be used only to inform a Collective's proposed location. If neighbors express concern(s), these concerns could be considered by the Police Department in their review of the Collective's operation. The input could not affect the Zoning Verification which is based on the site's Zoning District and physical distances to sensitive uses. Careful consideration needs to be integrated into this process such that it does not convert into a land use permit process. Staff's proposal to prevent some adverse impacts based on applying a distance requirement and inventory of sensitive uses partially addresses the lack of a noticing requirement.

**Policy Alternative(s):** The City Council could establish a noticing process and put into place the additional resources needed to support this function.

5. **Non-Transferability:** A Zoning Verification is non-transferable to different locations or a change in Collective operator at the same location. Each location needs its own verification to determine if the site meets the proposed Zoning and sensitive use distance requirements. A change in Collective operator(s) at the same location would require a new Zoning Verification. This is due to the dynamic nature of land use. For example, a new sensitive use could have located to the area, and/or the property owner applied for and obtained approval for a rezoning of the property.

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<sup>1</sup> It should be noted that during the week of December 7, 2010, the Department of Justice issued a warning to the City of Oakland, raising objections to their City's new ordinance that will allow licensed operators of large scale off-site cultivation farms to be taxed and regulated.

**Policy Alternative(s):** No policy alternative available. If the City Council would like to allow for the proposed use to transfer to another Collective at the same location, then other land use measures, such as a CUP requirement, might be more appropriate.

In addition to the amendments to Title 20 described above, the proposed draft ordinance also amends Section 1.13.050 of Title 1 to provide that Collectives that are in full compliance with the Municipal Code and applicable state law are not deemed a public nuisance solely because these facilities are in violation of a federal law or regulation.

## 2. Regulatory Program

Upon the March 30, 2010 City Council referral, the City Attorney's Office and staff developed an ordinance entitled, "Medical Marijuana" (also referred to as the "Regulatory Program") that was designed to regulate the cultivation and use of medical marijuana by both individuals and specific groups of individuals. If the City Council decides to regulate medical marijuana, staff has proposed several regulatory elements to address concerns that have surfaced over the past year. In addition, there are policy options for the City Council to consider if it decides to deviate from staff's recommendations. This section is formatted to provide information regarding the following:

- Comparison to Pharmaceutical Medicines;
- Proposed Regulatory Framework; and,
- Additional Medical Marijuana Activity Referrals.

### Comparison to Pharmaceutical Medicines

Advocates of medical marijuana establishments have drawn comparisons between Collectives and pharmacies, particularly concerning how Collectives are/should be considered akin to pharmacies in terms of how pharmacies operate their business and/or how pharmaceutical medicines are taxed. Specifically, there have been requests from stakeholders regarding greater flexibility with respect to medical marijuana product distribution, customer choice, and overall operations. However, these two entities are very different, both by the laws that set each in place (e.g., pharmaceutical product manufacturing, distribution, and research and development vs. medical marijuana cultivation and distribution) and by the significant differences in the manner in which they are regulated. For instance:

- Pharmaceutical companies are closely regulated by the Federal Drug Administration (FDA) and the Drug Enforcement Agency (DEA) in terms of how they function and the quality control of products supplied to the public. There are no such regulatory systems set up for medical marijuana except for the Medical Marijuana Program Act, which only provides parameters for a defense against criminal prosecution.
- Pharmacies distribute medicine by certified pharmacists based on prescriptions from certified medical doctors. The prescription products administered are scientifically tested by professionally recognized and regulated laboratories, approved for distribution upon research and validation by the FDA, and subjected to rigorous continued federal regulation and law by the

DEA and the FDA. In contrast, medical marijuana establishments are not required to adhere to these continuous regulatory practices and product quality is not regulated by state or federal agencies, standards, and/or the law.

- For prescription drugs, safety protocols are in place to alert and protect consumers of possible product contamination or defect, which results in the ability to recall products should they present health or safety concerns for consumers. Such is not the case for medical marijuana products or patients.
- Pharmaceutical medicine is not subject to sales tax, but over the counter medicines are subject to sales tax.

**Proposed Regulatory Framework**

The following discussion is formatted after the nine sections of the Medical Marijuana draft ordinance:

**Part 1: Purpose and Intention**

There are no proposed policy alternatives. This section outlines the purpose and intent of the draft ordinance.

**Part 2: Definitions**

This section outlines the definitions of the draft ordinance, which are largely driven by the California Health and Safety Code. The following definition may be adjusted:

**Medical Marijuana Collective:** An incorporated or unincorporated association, composed solely of four (4) or more qualified patients, persons with identification cards, and designated primary caregivers of qualified patients and persons with identification cards (collectively referred to as “members”) who associate at a particular location to collectively or cooperatively cultivate marijuana for medical purposes, in strict accordance with California Health and Safety Code Sections 11362.5, *et seq.*

**Policy Alternative(s):** The City Council may restrict the threshold number of qualified patients and primary caregivers (e.g., four or more) that are considered a Collective. Staff’s recommendation is based on a review of various ordinances from other cities which indicated that the least numbers of specified individuals that make up a collective vary by city and can range from two to ten. For example, earlier this year, the City of Mountain View was considering an ordinance that defines cooperatives or collectives as an association of two or more patients, while the City of Los Angeles has its minimum at four.

The various other elements provided in the definition are standard or directly defined and required by law.

**Part 3: General Provisions**

This section establishes the registration processes, outlines the various requirements to establish a Collective and, among other administrative requirements, sets the grounds for disqualification from the registration process.

1. **Registration Required:** No Collective shall operate in the City until after it has filed a registration form, paid all registration fees, and its registration has been accepted as complete by the Chief of Police. The term of each registration is for one year, unless the proposed ordinance sunsets before that time.

**Policy Alternative(s):** The City Council could adjust the term of each registration beyond one year, but fees for a cost recovery program would need to be adjusted accordingly for budget planning purposes. Staff has modeled the registration process after other administrative processes utilized by the Police Department and the Department of Planning, Building and Code Enforcement such that this process is not a departure from other administrative processes within the City.

2. **Maximum Medical Marijuana Collective Number:** Allows for a maximum of ten (10) Collectives in the City.

**Policy Alternative(s):** The City Council could expand or decrease the maximum number of Collectives. Staff is recommending ten (10) as the maximum number to ensure that the City balances the availability of medical marijuana at approved Collectives, while sustaining a Regulatory Program within the proposed staffing plan. Any changes that require greater oversight or regulation would require an adjustment to the proposed staffing plan, the cost of the Regulatory Program and consequently, the fee for registration charged to the Collectives. Upon City staff implementing the Regulatory Program, the City Council could reconsider the maximum Collective number and adjust it based on its evaluation of how the Collectives and/or Regulatory Program are performing. Staff is suggesting 10 Collectives as a starting point, subject to more evaluation and discussion, and to facilitate proper implementation of the proposed regulation. It should be noted that if the maximum number of collectives were to increase beyond 10, it may be necessary to add additional staff to the proposed regulatory program to help offset the potential increase of workload due to the additional collectives.

3. **Priority Order:** The Chief of Police may hold one or more lotteries for the purpose of determining the priority order in which the Chief of Police will consider the registration forms submitted by Collectives. Any Collective that fills out the registration form for the drawing can participate in the drawing; provided it meets the requirements set forth in the draft ordinance and is not disqualified for specific reasons provided therein, such as having an operating model that does not meet the definition of a Collective or having managers who are on parole for possession of a controlled substance or have a criminal record for certain violations of the Penal Code. The Chief of Police will set the deadlines for submittal and publish the date, time and place for the drawing, as well as the results of the drawing.

**Policy Alternative(s):** The purpose of this Priority Order system is to impose a process to narrow the pool in the event that more than 10 of the existing medical marijuana establishments

currently operating would qualify as a Collective under the draft ordinance. Given our awareness of existing operations, it is doubtful that any establishment is operating as a true collective. City Council could consider developing a decision-making framework that is based on a competitive process, rather than on a first-come first-served basis. This could be accomplished by requesting applicants to submit responses to a uniquely developed process that is similar to a Request for Proposals (RFP) process, applying a scoring mechanism, and selecting the highest scoring proposals to operate Medical Marijuana Collectives in the City. Staff did not propose the competitive process because it believes that the Priority Order approach is transparent and establishes clear order of how the applications will be processed/considered.

There was much community input provided at the June 7 and July 20 community meetings regarding the Priority Order, also referred to as "lottery," during the public discussion. It should be clarified that the Priority Order is proposed to establish an order and sequence for administratively processing and reviewing applications for consideration and does not constitute a random or arbitrary approval of the application. It does, however, provide a place "in line" to have an application reviewed and considered by the City. However, a place in line doesn't itself guarantee approval of registration. This proposed selection process will impact the determination and order of who may ultimately receive approval for registration. For example, if the City Council decides to allow 10 collectives in the City, an applicant can qualify for the drawing and subsequently be drawn as applicant or pre-registrant #14. Under the priority order lottery system, this applicant (e.g., #14) would only receive consideration once three applicants who were drawn ahead of him/her are disqualified or withdraw from the process.

A patient or qualified patient caregiver whose activity does not fall under the proposed definition of Collective but engages in personal/individual cultivation and use of marijuana for medical purposes, does not need to enter the Priority Order process, which was also the source of confusion during the June 7<sup>th</sup> community meeting.

Lastly, as dictated in Part 8 of the draft ordinance, any existing Collective, dispensary, operator, establishment, or provider that does not comply with the requirements of the draft ordinance must immediately cease operation until such time, if any, when it complies fully with the requirements of the Regulatory Program. In other words, once the ordinance is in effect, everyone must stop operating until the Registration process is complete. Furthermore, no Collective, dispensary, operator, establishment, or provider that existed prior to the enactment of Part 8 of the draft ordinance shall be deemed to be a legally established use and such Collective, dispensary, operator, establishment, or provider shall not be entitled to claim legal nonconforming status. Existing fines for non-compliance can be used to cover some of the costs for implementing the Council's action.

#### **Part 4: Operating Regulations and Conditions**

This section outlines the terms and conditions for operating a Collective in San Jose. Generally, this section outlines requirements for: security, cultivation, collective operations, owner, manager and membership requirements and packaging of medical marijuana.

- 1. Security:** In the draft ordinance, certain conditions are outlined to address security concerns, including required monitoring by a web-based closed-circuit television; centrally-monitored fire and burglar alarm system that at minimum cover the perimeter of the location and are monitored

by a professional alarm company; fire-proof safe for the storing of all records required; medical marijuana storage requirements; storage of cash overnight at the location; onsite state-licensed and uniformed security guard; and, standards to prevent unauthorized entry.

**Policy Alternative(s):** The City Council could expand or decrease the safety requirements as detailed in the ordinance; however, staff believes that it has put forward a minimum set of security requirements to ensure the safety of other commercial activity, residents, and surrounding neighborhood activities/uses.

2. **Cultivation:** Collective cultivation of marijuana at or upon the location of that Collective.
  - (a) No cultivation of medical marijuana at the location shall be visible with the naked eye from any public or other private property, nor shall cultivated marijuana or dried marijuana be visible from the building exterior.
  - (b) No cultivation shall occur at the location unless the area devoted to the cultivation is secured from public access by means of a locked gate and any other security measures necessary to prevent unauthorized entry are installed.
  - (c) No manufacture of concentrated cannabis in violation of California Health and Safety Code section 11379.6 is allowed.
  - (d) No collective shall possess more dried marijuana or plants per member other than the amounts permitted pursuant to State law.
  - (e) No collective shall possess or provide marijuana other than marijuana that was cultivated by the collective at the location and in strict accordance with State law and the Municipal Code.
  - (f) If marijuana is grown out of doors it must be grown in an area immediately adjacent to the physical structure where the Collective meets and proper security measures must be in place to prevent non-members from accessing the marijuana growing outdoors.

**Policy Alternative(s):** The following alpha order corresponds to the above provisions:

- (a) The City Council could lift this cultivation requirement. Staff's purpose for placing this requirement is to ensure safety for the Collective's operations and medical marijuana and staff believes that open view of medical marijuana may create an easy target for crime and/or theft.
- (b) See (a) above.
- (c) No policy alternative available.
- (d) No policy alternative available.
- (e) A policy alternative for the City Council to consider is allowing the off-site cultivation of medical marijuana (See Section 1, Zoning/Land Use Policy for a discussion on this alternative).
- (f) Policy alternative detailed in Section 1, Zoning/Land Use Policy.

3. **Collective Operations:** This section of the ordinance sets out several operational requirements for Collectives. The key areas are:
  - (a) Hours of operation (9:00 a.m. to 8:00 p.m.);
  - (b) Prohibition of operating for profit;
  - (c) Prohibition on the sale and/or manufacturing of medical marijuana products (e.g., edibles, oils, ancillary products, etc.);
  - (d) Prohibition on the diversion of medical marijuana to non-qualified patient caregivers or patients; and,



- (e) Prohibition on the consumption of medical marijuana and alcoholic beverages onsite.

**Policy Alternative(s):**

- (a) The City Council could adjust the proposed hours of operation. In developing these hours, careful consideration was given to a patient's need to have access to the collectives at reasonable hours while also considering the needs of other commercial activity, residents, and surrounding neighborhood activities/uses. The proposed hours, 9:00 a.m. to 8:00 p.m., are somewhat modeled after hours of operation for traditional pharmacies or general stores, which cursory researched showed the following: Monday - Friday: 9:00 a.m. to 7:00 p.m.; Saturday: 9:00 a.m. to 5:00 p.m.; and, Sunday: 11:00 a.m. to 5:00 p.m. The City Council could adjust the days of operation, as well, or model the hours of operation based on the above cursory research.
- (b) Based on the City's legal review, operating for profit exceeds the law; thus, there are no policy alternatives.
- (c) Based on the City's legal review, the "sale" and/or manufacturing of medical marijuana products exceeds the law; thus, there are no policy alternatives.
- (d) There are no policy alternatives, diverting marijuana to non-medical marijuana patients or caregivers exceeds the law.
- (e) The City Council could adopt measures that allow for the consumption of alcoholic beverages onsite provided that all of the proper licenses are in place; however, staff is very concerned about the additional regulatory issues that would need to be addressed and the potential for public nuisance activity beyond what has already been brought to the City's attention. If marijuana were to be approved for onsite consumption, it would need to be regulated closely to ensure that consumption occurs within the facility. Other concerns include the potential risk of patients driving under the influence if consuming onsite.

**(4) Owner, Manager and Membership Requirements**

- (a) No member convicted of a crime of moral turpitude or convicted of those crimes listed below shall have an ownership interest in the Collective or be a manager for, or engage directly or indirectly in the management of the Collective. Conviction within the last 10 years of any misdemeanor or felony involving:
  - The use of violence, force, fear, fraud or deception
  - The unlawful possession, sale, distribution or transportation of a controlled substance
  - The use of money to engage in criminal activity
- (b) No member under the age of 21 shall be a manager for, or engage directly or indirectly in the management of the Collective.

**Policy Alternative(s):** While staff has put forward the regulatory requirements for owning and/or managing a Collective, the City Council could adjust the following requirements noted below. However, the requirements are established to achieve, at minimum, the legal, responsible and adequate management of a Collective. Alternatives include:

- Reduce 21 years of age or older age limit to "18 years of age or older" to align with the legal definition of an adult;
- Modify or limit conditions placed on a person with a misdemeanor or felony conviction; and/or,

- Request staff to further evaluate the proposed management structure based on any additional input that the City Council receives, which may then require an adjustment to the staffing plan and/or Registration Fee.

**(5) Packaging of Medical Marijuana:** This section sets requirements for the frequency that a patient or primary caregiver can obtain medical marijuana and how a Collective needs to package it before distributing it to a patient or primary caregiver.

- (a) The draft ordinance establishes that no medical marijuana shall be dispensed by the Collective or any of its members to a member more than once per day.
- (b) At past City Council meetings, there has been specific discussion on the safety and product quality of medical marijuana. Staff has evaluated and put forward, to the extent possible, the regulatory requirements that place some standards for product safety, quality control, and health and safety notifications, such as the following: use childproof containers; complete legal name of the qualified patient who will be using the medical marijuana; primary caregiver's name if s/he obtained the medical marijuana on behalf of the patient and the patient's complete name; Collective's contact information; amount of medical marijuana packaged in the container; name of the recommending physician; date the medical marijuana was provided; chemicals and/or substances used to process the medical marijuana; all necessary health and safety warnings; and, a statement that the City of San Jose neither warrants nor guarantees the safety of the medical marijuana. The City's regulations cannot guarantee the safety or quality control of the medical marijuana provided by Collectives, but the requirement of some information is intended to identify qualified patients and primary caregiver should they need to be contacted in the event that some of the medical marijuana poses a public health risk (e.g., mold, contamination, etc.). These controls are based on what is found on typical pharmaceutical drug containers that are used to package controlled substances.

**Policy Alternative(s):** The City Council could:

- (a) Increase or eliminate the number of times that a Collective can dispense medical marijuana to a member. Staff believes that the ability to obtain medical marijuana once per day allows a qualified patient or primary caregiver adequate opportunity to obtain medical marijuana and enables the opportunity to plan accordingly under these requirements. The once a day limitation would help to minimize traffic impacts for neighborhoods and/or other commercial activity.
- (b) Increase, lessen or eliminate the above packaging requirements proposed for medical marijuana. Staff believes that it has recommended a minimum set of disclosures consistent with any medical recommendation issued with the intent to protect the public health and safety for a patient, as suggested by the City Council on March 30th.

### **Part 5: Maintenance of Records**

The draft ordinance outlines the minimum requirements for the maintenance of records to properly and professionally review the Collectives' activities. Adjusting the proposed requirements for the Maintenance of Records is not recommended and would adversely impact the City's ability to

adequately support this Regulatory Program. Though the Maintenance of Records requirement is not legally required, these requirements facilitate regulation and keep regulatory costs down. If the City Council should lessen or eliminate these requirements, staff would need to evaluate its staffing plan, and related Regulation Fee to ensure that the appropriate resources are in place to obtain this information and adequately regulate the Collectives. Key requirements noted in this section include:

- (a) Requirement to store vital Collective documents in a fireproof safe;
- (b) All records required shall be maintained by the Collective for a period of five (5) years.
- (c) The following shall specifically be maintained:
  - (1) **Collective:** Name and contact information for the owner, landlord, and/or lessee of the location;
  - (2) **Member:** Name, contact information, and copy of valid government issued photo identification for each Collective member; copy of a member's identification card or the physician's recommendation; date the member joined the Collective; and, the Nature of the member's participation in the collective cultivation of medical marijuana.
  - (3) **Primary Caregivers:** Name and contact information for each primary caregiver member to whom the Collective provides medical marijuana; and, a copy of every written designation for every qualified patient that designated the person as his/her primary caregiver.
  - (4) **Financial:** Information for all savings accounts, checking accounts, investment accounts and trusts associated with the Collective; and, all receipts of the Collective, including but not limited to all contributions and all expenditures incurred by the Collective for the cultivation of medical marijuana.
  - (5) **Inventory/Transactions:** Information log documenting each transfer of medical marijuana reflecting the amount of marijuana provided, the date provided, the time provided and full legal name of the member to whom it was provided.
  - (6) **Complaints:** Information log documenting the date, time, nature, and response by the Collective to all complaints received by the Collective.
  - (7) **Audits:** Copy of the annual audit reports required under Title 6 (Section 6.88.600).
  - (8) **Registration:** Proof of registration with the San Jose Police Department.

**Policy Alternative(s):** The City Council could increase, lessen, or eliminate any of the above Maintenance of Records requirements.

**Part 6: Audits**

The draft ordinance recommends an audit of operations which is required to be completed and certified by an independent certified public accountant in accordance with generally accepted auditing and accounting principles, no later than February 15 of each year. This requirement ensures that the City receives an independent report on the Collectives' activities and enables the City's ability to properly support this Regulatory Program.

Adjusting the proposed requirements for the auditing of records is not recommended and would adversely impact the City's ability to adequately support this Regulatory Program. Though the Audit requirement is not legally required, these requirements facilitate regulation and keep regulatory costs down. If the City Council should lessen or eliminate this requirement, staff would need to evaluate

its staffing plan, and related Regulation Fee, to ensure that the appropriate resources are in place to obtain this information to adequately regulate the Collectives and obtain this information.

**Policy Alternative(s):** The City Council could increase, lessen, or eliminate this Audit requirement.

### **Part 7: Inspection and Enforcement**

This section allows for the Chief of Police and any other City Official that is charged with enforcing the provisions of the draft ordinance to enter and inspect the Collective and its records. This section further outlines enforcement guidelines with respect to inspections, such as:

- (a) Allows for any official charged with enforcing the Regulatory Program to enter and inspect the location of any Collective and the recordings and records maintained.
- (b) Makes it unlawful for the Collective to refuse to allow or to impede, obstruct, or interfere with an inspection, review of records or closed-circuit monitoring authorized, or to conceal, destruct, or falsify any recordings, records, or monitoring.
- (c) Establishes that any official charged with enforcing the Regulatory Program may enter the Collective at any time during the hours of operations and without notice, and may obtain samples of medical marijuana for law enforcement and/or public safety purposes.

Adjusting the proposed requirements for the inspection and enforcement is not recommended and would adversely impact the City's ability to properly support this Regulatory Program. Though the Inspection and Enforcement requirement is not legally required, these requirements facilitate regulation and keep regulatory costs down. If the City Council should lessen or eliminate this requirement, staff would need to evaluate its staffing plan, and related Regulation Fee, to ensure that the appropriate resources are in place to obtain this information to adequately regulate the Collectives and obtain this information.

**Policy Alternative(s):** The City Council could increase, lessen, or eliminate this Inspection and Enforcement requirement.

### **Part 8: Application of Chapter; Other Legal Duties**

This section establishes the requirement for all existing Collectives, dispensaries, operators, establishments, etc., not properly registered with the City to immediately cease operation. This section also outlines other legal requirements and outlines how violations will be addressed by the City. It also contains a release of liability and a hold harmless clause. Last, it sets a sunset clause for when the draft ordinance would expire.

1. **Sunset Clause:** The proposed term of the draft ordinance shall be for two (2) years, unless the City Council adopts an ordinance to extend these provisions.

**Policy Alternative(s):** The City Council could adjust the length of the sunset clause or remove it entirely. Staff proposed a sunset clause of two years to pilot this Regulatory Program, bring

forward any recommended changes upon a reasonable period of time to observe the application of the regulations, and to enable further adjustments if needed.

### **Part 9: Personal Use Requirements and Regulations**

This section outlines generally the guidelines for personal cultivation of medical marijuana outside of the Collective model.

The draft ordinance allows for the cultivation and possession of medical marijuana for medical use by groups of less than four qualified patients or primary caregivers. Key features in the draft ordinance for personal cultivation are that cultivation is limited to an area not to exceed 50 square feet per residence (a legal dwelling unit) and cultivation of medical marijuana for personal cultivation shall be in conformance with the following standards:

- (a) Residence shall remain at all times a residence with legal and functioning cooking, sleeping and sanitation facilities;
- (b) Medical marijuana cultivation shall remain at all times secondary to the residential use of the property;
- (c) Qualified patient or primary caregiver shall reside in the residence where the medical marijuana cultivation occurs;
- (d) Medical marijuana cultivation area shall be in compliance with the California Building Code;
- (e) Cultivation shall not adversely affect the health or safety of the residence in which it is cultivated or nearby properties through creation of mold, mildew, dust, glare, heat, noise, noxious gasses, odor, smoke, traffic, vibration, or other impacts or, be hazardous because of the use or storage of materials, processes, products or wastes;
- (f) All electrical equipment used in the cultivation of medical marijuana shall be plugged directly into a wall outlet or otherwise hardwired, the use of extension chords to supply power to electrical equipment used in the cultivation of medical marijuana is prohibited;
- (g) From a public right of way, there shall be no exterior evidence of medical marijuana cultivation occurring at the property;
- (h) Medical marijuana cultivated or processed for personal use as provided herein shall not be distributed to any other person or to any Collective;
- (i) Medical marijuana cultivation lighting shall not exceed 1200 watts; and,
- (j) Medical marijuana sale is prohibited.

**Policy Alternative(s):** The City Council could choose to impose any specific requirements for the personal cultivation of medical marijuana or adjust the above requirements, so long as they do not exceed the law by being too restrictive with regard to the rights of qualified patients or their primary caregivers. City staff's recommendation on the requirements for personal cultivation are based on the desire to not interfere with a patient's right to use medical marijuana and to ensure that the cultivation of medical marijuana at a residence does not become the primary purpose for the dwelling. Staff has also added requirements to ensure that cultivated medical marijuana is not diverted for non-legal purposes and to ensure the safety of residents and neighbors. Staff believes that these regulations will assist in attempting to control some of the recent fires that were created as a result of residential marijuana "grow-houses" as described earlier in this memorandum.

Additional Medical Marijuana Activity Referrals

Last, the June 22<sup>nd</sup> City Council report contained topics that required more additional review and below is staff's recommendation:

**Medical Marijuana Inventory Limits:** Staff proposes that each Collective should determine the amount of marijuana needed onsite based on the number of members that belong to the specific Collective, the immediate needs of those members, and the usual distribution quantities per day at the Collective. Collective management should take into account security measures and concerns when determining the inventory limits that should be set. A maximum amount of marijuana to be located onsite should be set, however, until such time as the Collectives are legally established this number is difficult to establish. As a starting point, staff proposes that a maximum amount of marijuana should not exceed 20 pounds on any given day, understanding that until such time that the Collectives' activity is more clearly understood, this amount may be subject to adjustment.

**Policy Alternative(s):** The Council could establish that a maximum amount of marijuana should not be mandated by the City and is left to the Collective to determine. If this alternative is preferred, it should clearly include that a Collective will take into account security measures and concerns when determining the inventory that it will have on hand.

**Transporting/Deliveries:** Patients can individually transport and/or process marijuana for personal use and primary caregivers can individually transport, process, administer, deliver or give away that marijuana, but "only to the qualified patient of the primary caregiver." The law does not allow for commercial transportation and delivery activity of medical marijuana.

**Policy Alternative(s):** None.

**Business Plan/Operational Issues**—If the City Council decides to regulate medical marijuana, staff would also like the opportunity to work with the selected 10 Collectives to put in place minimum internal controls, staff training, and product recall notification processes.

**Policy Alternative(s):** Do not direct staff to support this effort.

<p><b>3. Cost for Regulatory Program</b></p>
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Estimating the staffing needs to implement and sustain a Medical Marijuana Regulatory Program has been difficult given staff's lack of experience in the regulation of medical marijuana, lack of information about the population size subject to the draft ordinances, and the final Regulatory Program that the City Council ultimately puts in place. As already noted, based on the final decisions that the City Council makes, should the regulatory structure based on the draft ordinances move forward, staff may need to adjust its staffing plan accordingly to meet the regulatory needs. In addition, staff requires sufficient time to complete materials, fill proposed staffing positions, and provide training to administratively support this ordinance.

In order to develop a “cost recovery” Regulatory Program, staff evaluated options that ranged from a full complement of sworn staff in the Police Department to multi-department staffing plan. Staff’s goal was to develop a cost recovery staffing plan that could effectively address the significant resources and diverse sets of professional expertise/disciplines needed to support the Regulatory Program, such as: professional, policy, legal, and financial reviews; law enforcement operations and, any other issues that may surface during support of this ordinance. Given the complexity of implementing and supporting implementation over the next fiscal year, it appears that a staffing plan that focuses on a multi-department approach is the most prudent. This approach leverages staffing disciplines/expertise from core departments required to ensure the support of this ordinance’s success and includes the resources required from the City Attorney’s Office which are funded by the City’s Indirect Cost Rates or by PBCE which is a fee-based department. The success of implementing this Regulatory Program, at a time of significant change for the organization, will rely heavily on the ability to pace ourselves and work by intra-department teams and respective areas of expertise.

Table 1 represents an estimate of staffing resources based on the draft ordinance, without consideration to the policy alternatives noted in this report. The various line items in the Table represent the costs to the City for the Regulatory Program and include the indirect costs rates in accordance with the City-wide Cost Allocation Plan. The indirect costs account for the costs of administrative support activities associated with this Regulatory Program and are considered revenue to the General Fund. Costs of the positions have slightly increased from the staffing plan that was proposed in June due to an increase of retirement costs. Once the Regulatory Program is approved, staff intends to recognize the additional revenue generated through overhead as a recommendation to the City Council as part of the 2010-2011 Annual Report process. Additionally, indirect costs associated with the Departments of Fire and PBCE will need to be resolved and the costs are not reflected in Table 1.

**Table 1: Medical Marijuana Ordinance “Cost Recovery” Staffing Plan**

<b>Staff Classification</b>	<b>Level (FTEs)</b>	<b>Cost</b>
<b><u>Citywide Policy Coordination and Policy/Evaluation Review</u></b> Executive Analyst (City Manager’s Office)	1.0	\$118,978
<b><u>Law Enforcement and Investigation</u></b> Police Officers	2.0	\$380,526
Sergeant	1.0	\$217,620
Indirect Cost Rate*		\$153,310
Non-Personal /Equipment		\$2,930
<b><u>Financial Audit</u></b> Analyst II (Finance Department)	1.0	\$132,403
Indirect Cost Rate*		\$40,685
<b>Total</b>	<b>5.0</b>	<b>\$1,046,450</b>
<b>Registration Fee Per Collectives (10 total)</b>		<b>\$104,645</b>

\*Indirect Cost Rates (overhead costs) are based on FY 2010-2011 rates

Below is discussion of key areas of responsibility for each of the proposed functions:

**Law Enforcement & Investigation:** The registration of Collectives would follow a process similar to the process used for permitting and licensing public entertainment venues (nightclubs). The Police Department will utilize the components of the system that are already in place to register Collectives (e.g., photo log, computer systems, etc.). Additionally, Police Department staff, along with an internal City staff review team representing various departments, would review the registration forms and collectively make determinations. This internal staff review team would be comprised of members from the Police Department, PBCE, Human Resources Department - Risk Management Division, City Manager's Office, Finance Department, and Fire Department to review applications and confer with other City departments or offices to effectively support the program. The Police Department would conduct criminal background investigations of management and owners of the Collectives and perform the day-to-day regulation of the Collectives. Two Police Officers would be responsible for conducting investigations, issuing citations, regulating and taking action against Collectives if they are not in compliance with the adopted ordinance. Because of the nature of the work and the potential problems that may arise, it is staff's professional opinion that the regulation and inspections of Collectives should be performed by two Police Officers.

A Sergeant would be responsible for the overall management and coordination of the law enforcement and investigation work performed by the Police Department, along with the immediate supervision of the two Police Officers. Additionally, given staff resources, the Sergeant would provide back up support when officers are not available due to training, court obligations, vacation, or other authorized absences. The Sergeant would also be charged with developing, implementing and administering internal policies and procedures and training staff on such procedures and would be responsible for coordinating department-wide notifications/communications of this Regulatory Program through the appropriate internal structure. The Sergeant would serve as a liaison between the community (responsible for responding to citizen complaints), Collectives, other City Department, the District Attorney's Office, and other municipalities, etc.

The proposal allows for the City to use existing organizational infrastructure to most easily implement the administrative processing for this ordinance and keeps costs down for a Collective; however, given the extent of the work required to regulate the collectives, the Department is unable to absorb these additional law enforcement tasks and requires the addition of 3.0 FTEs sworn positions as detailed above.

**Policy/Evaluation Review:** Given that the success of implementation requires coordination of multiple departments and close tracking of policy issues over the first years of implementation, this Regulatory Program requires that a 1.0 FTE, Executive Analyst position, be allocated in the City Manager's Office. In June 2010, the Administration had originally recommended a .5 FTE for this position, however, since then, there have been reductions of analytical staff in the City Manager's Office leading to the fact that the ability of this office to absorb this work does not exist; and, additional reductions are anticipated in FY 2011-2012 given the projected deficit.



This staffing plan models other high-profile initiatives that have required the City Manager's Office direct support and oversight, much like the City Council has appropriated staffing to launch new initiatives in the past, such as: Green Vision, downtown entertainment zone coordination, domestic violence coordination, open government initiatives, etc. After two years (consistent with the Sunset Clause), staff will reevaluate the program's stability and make a determination on whether to continue City Manager's Office staffing or to accordingly distribute the duties at the department level. Additionally, this position would play a key role in convening the internal working group, tracking the policy issues over the first year associated with implementation or support of the ordinance, and develop a one- and two- year evaluation prior to the sunset of the ordinance for the City Council. Since the Registration Fee requires that the funding be disbursed to multiple departments, the City Manager's Office would be responsible for fiscal management of this citywide appropriation and ensuring that revenue and costs are assigned appropriately. Lastly, this position would coordinate the public outreach processes and address non-law enforcement components of the Regulatory Program to ensure that sworn staff is appropriately supporting law enforcement duties.

**Financial and Compliance Review:** This 1.0 FTE, Analyst II position, would review the financial records of all collectives to ensure compliance with the ordinance and work in coordination with the Police Department on financial investigations of collectives. This position would be assigned to the Finance Department.

It should also be noted that the final number of Collectives approved by the City Council may result in a different staffing plan, and to the degree that Collectives comply with the requirements of the ordinance, may also result in less staff regulation than if the Collectives are non-compliant. Another factor that may have an impact on staffing needs is the unknown patient population. For instance, one San Jose cannabis club expressed that in Oakland, clubs have experienced a 40% patient increase when Hayward adopted a ban on medical marijuana dispensaries. Any changes to population served, activity taken by surrounding cities that result in impacts to San Jose operations, etc. may directly impact the staff resources needed to maintain an effective Regulatory Program: an issue to be closely monitored.

**Registration Fee Applied to Patient Population and Collective Model**

The above staffing plan provides the minimum level of resources required to implement and support a Medical Marijuana Regulatory Program. As noted, there is a lack of certainty about the patient population served and how this may impact the Registration Fee and Collective model outlined in the ordinance. There has been much concern expressed at City Council and community meetings about the impact of the City's Registration Fee on Collective members.

Information obtained from operating cannabis clubs and/or stakeholders in San Jose regarding the medical marijuana patient population demonstrates that there is no scientific knowledge of the actual medical marijuana population count, as figures provided ranged from 15,000 to 35,000 to up to 100,000. Given the lack of accurate information, it is difficult to determine the impact to a patient that decides to obtain medical marijuana through the Collective structure; however, some figures are provided below to develop some level of fiscal impact.

**Table 2: City's Registration Fee vs. Fiscal Impact on Medical Marijuana Patients/Collectives**

Collective Patient Population	Approximate Average Annual Fee (Registration Fee/Patient Population =Annual Fee)	Approximate Average Monthly Fee (Annual Fee/12 =Monthly Fee)
50	\$2,093	\$174
100	\$1,046	\$87
500 – 1,000	\$209—\$104	\$17 - \$9

**4. Taxation Analysis**

On August 3, 2010, the City Council approved the placement of the following ballot measure on the November 2 General Election ballot:

**MEASURE U**

<b>Marijuana Business Tax</b> In order to provide funding for essential City services such as police, fire, emergency response, street maintenance, pothole repair, parks, libraries, and youth and senior programs, shall an ordinance be adopted to impose a tax at the rate of up to 10% of gross receipts on marijuana businesses in San José, subject to existing independent financial audits, with all revenue controlled by the City?	YES
	NO

Voters approved Measure U on November 2 at a 78.42% approval rating (Source: Santa Clara County Registrar of Voters, Unofficial Results as of November 15, 2010). With the City Council's certification of the election outcome on December 7, the City Council now has the ability to set the tax rate. The tax itself does not go into effect until the operative date, which is March 1, 2011. Measure U allows the City Council to impose a business tax on marijuana businesses in San Jose at a rate of up to 10% of gross receipts. The tax would only be imposed if the City Council approved an ordinance setting the specific tax rate, which could not exceed 10% of gross receipts. This tax would be in addition to the current city business tax that is already imposed on businesses in San Jose.

The ballot measure language was strategically designed to preserve flexibility for the City Council to set a tax rate upon the outcome of the November 2 General Election. The City Council cannot set the tax rate higher than 10% of gross receipts; however, as long as the rate does not exceed 10%, the City Council has the flexibility to set the tax rate lower than 10% or to change the tax rates in the future, as long as it does not exceed 10%. Measure U does not permit medical marijuana businesses: it only allows the City Council to impose a tax on marijuana businesses. Under Measure U, the revenues from the marijuana business tax would be subject to the annual audit performed by the City's independent auditor, which is reported in the City's Comprehensive Annual Financial Report.

**City's Current Business Tax:** In general, the City currently taxes every person engaged in business in San José based on the number of employees. A minimum business tax of \$150 per year is charged, plus an additional tax in the amount of \$18 per employee over 8, not to exceed a maximum of \$25,000. The City's business tax was enacted solely to raise revenue and is imposed on

businesses operating legally and illegally within the City. The payment of a business tax and its acceptance by the City, does not entitle the taxpayer to engage in business activities in the City unless the operator complies with all of the requirements of the City’s Municipal Code and all other applicable laws.

**New Marijuana Business Tax:** The new Marijuana Business Tax can be implemented by Council as early as March 1, 2011. Marijuana businesses will pay the business license tax in Chapter 4.76 based on employee count concurrently with the new marijuana business tax in Chapter 4.66 at a rate of up to 10% of gross receipts as determined by Council. The draft regulations pertaining to medical marijuana collectives allow for in kind contributions, monetary contributions and property contributions provided by members to support all of the collective's overhead expenses that are associated with medical marijuana cultivation (Section 6.88.440D). Accordingly, in the case of medical marijuana collectives, all of this would be part of the gross receipts that the City would tax under the new marijuana business tax.

**Taxation Analysis:** The draft ordinance for the Regulatory Program prohibits the collectives from generating a profit, which is not the same as being a non-profit under Federal and State law. Not making a profit does not relieve the collectives of their business tax liability. Absent the non-profit tax designation by the Federal or State government, the collectives will be subject to the City’s Marijuana Business Tax Ordinance.

Under the draft ordinance, consistent with State law, only in-kind contributions, monetary contributions and property contributions provided by members towards the collective’s overhead expenses will be allowed. Given the limitations imposed by State law on the ability of collectives to engage in sales, the revenue generating potential of raising significant new revenues from the recently voter approved Marijuana Business Tax is small. While the City is able to tax in-kind contributions and bartered-for-exchanges under the new Marijuana Business Tax, it is unclear at this time what additional revenues the City could expect to receive; however, the tax revenue generated appears to be low. For this reason, staff recommends setting the tax rate at 5% of gross receipts for all marijuana businesses, operating legally or illegally in the City to enable maximum revenue collection. Other cities either are currently charging or proposing the taxing of marijuana businesses as follows:

**Table 3: Summary of Medical Marijuana Tax Rates for Other Cities**

City	Tax Rate
Oakland	5%
Berkeley	2.5%
Sacramento	4% maximum, starting at 2%
Long Beach	5%
Richmond	5%
Stockton	2.5%

**Policy Alternative(s):** Staff recommends setting the tax rate at 5% of gross receipts for all marijuana businesses, operating legally or illegally in the City. However, as a policy alternative, the City Council can decide to only apply the 5% medical marijuana tax to the 10 Collectives, as noted in the proposed regulatory program.

## 5. Schedule of Fines

Staff has proposed a Schedule of Fines for the City Council's consideration pertaining to violations of the proposed regulatory framework.

Chapter 6.88 outlines the proposed fine schedule for violating various sections of the Medical Marijuana Regulatory Program under the following categories:

- Medical Marijuana Registration Process;
- Medical Marijuana Updated Registration Form Required;
- Medical Marijuana Operating Regulations and Conditions;
- Medical Marijuana – Compliance with the Code;
- Medical Marijuana – Security;
- Cultivation of Medical Marijuana;
- Medical Marijuana Collective Operations;
- Medical Marijuana Owner, Manager and Membership Requirements;
- Packaging of Medical Marijuana;
- Medical Marijuana – Public Safety and Safety of Location;
- Medical Marijuana – Maintenance of Records;
- Medical Marijuana – Audits;
- Medical Marijuana – Inspection and Enforcement;
- Medical Marijuana – Compliance and Chapter and State Law;
- Medical Marijuana Registration Nontransferable;
- Medical Marijuana – Cease Operations after Sunset of Chapter; and,
- Medical Marijuana Personal Use Requirements and Regulations.