



Senate Bill 3335 (SD 2): Analysis and Recommended Changes

Prepared for: Hawaii House of Representatives Committees on Judiciary & Hawaiian Affairs and Agriculture & Food Systems

Prepared by: Geoffrey Lawrence, Director of Drug Policy

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Senate Bill 3335 Contains Important Protections and Stringent Overregulation

Dear Chair Tarnas, Chair Gates, and Members of the Committees:

On behalf of Reason Foundation, I thank you for accepting these comments and making them part of the public record. Among other things, Reason Foundation is committed to ensuring that state-regulated cannabis markets are designed in such a way that they remain dynamic and offer genuine economic opportunity to individuals from a range of backgrounds. Senate Bill 3335 contains many constructive components, but also would impose unnecessary restrictions on licensing that will raise barriers to entry, limit entrepreneurial opportunities, and inhibit the transition of legacy cannabis suppliers into the regulated marketplace.

Below, we outline both the bill's constructive components as well as potential areas for improvement:

Constructive Provisions:

- **Basis of licensing decisions:** Sec. A-17(3) stipulates that the qualifications for licensure should be “directly and demonstrably related to the operation of a licensed business.”
- **Change of ownership:** Sec. A-17(17) makes clear that regulations must be designed to facilitate a change in ownership of a licensed business. Many entrepreneurs develop a business with the hope of later selling it to realize their financial goals. This is an important market function.
- **Local control:** Sec. A-25(a) strikes an appropriate balance for local control of commercial cannabis activity by allowing counties to use zoning ordinances to “place reasonable restrictions on the location of licensed businesses.” This stops short of allowing counties to ban commercial cannabis activity. In other states, local bans on legal sales have created opportunities for illicit sellers to thrive.
- **Outdoor cultivation permitted:** Sec. A-17(12) makes clear that security requirements cannot preclude cultivation in a greenhouse or outdoor area. These methods of cultivation are less costly and consume less energy. This results in savings to both producers and consumers and makes the legal market more price-competitive with the illicit market.
- **Automatic expungement of prior cannabis convictions:** SB 3335 has been amended to include Sec. A-63, which provides for the automatic expungement of past convictions for the distribution or possession of marijuana by January 1, 2026. In the interim, individuals can petition to have these convictions expunged. Society should not continue to penalize individuals

DRUG POLICY PROJECT CONTACTS:

Geoffrey Lawrence, Director (geoff.lawrence@reason.org)

Michelle Minton, Sr. Policy Analyst
(michelle.minton@reason.org)

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for actions that are legal today.

- **New license types:** Sec. A-118 grants the board flexibility to create new types of cannabis licenses not currently specified within the bill. This flexibility is important because it allows regulators to address emergent market needs. For instance, regulators in Michigan used a similar provision to create a temporary cannabis event license once it became clear that such a license type would be necessary.
- **Training for drug recognition experts:** Sec. A-161(b)(1) directs a portion of cannabis tax revenues to be used for training of drug recognition experts within law enforcement. Research indicates this is the best available method for law enforcement to determine inebriation from marijuana.¹
- **Banking protections:** Sec. A-171 protects financial institutions from liability under state law for servicing marijuana licensees as account holders. Subsection (c) also authorizes the cannabis authority to enter into data-sharing agreements with financial institutions once consent has been obtained from a licensee. These agreements will allow financial institutions to access the licensee's application documents and transaction histories so they can complete know-your-customer requirements and verify that all transactions are legitimate. This form of data sharing is the best measure states can enact to facilitate financial services for cannabis licensees because it eliminates the administrative burdens facing financial institutions to comply with guidance from the U.S. Treasury Department.²
- **Competitive retail excise tax:** Sec. 26 outlines a retail excise tax against cannabis goods at the rate of 10%. Cannabis goods would also be subject to the statewide sales and use tax of 4%. Medical cannabis products would be exempt from excise tax. As can be seen in the table on the following page, this tax structure would be among the most competitive in the nation. Limiting the tax burden is crucial if policymakers hope to displace the illicit market because taxes create a price disparity between legal and illicit goods.³

¹ Teri Moore and Adrian Moore, "A Common Sense Approach to Marijuana-Impaired Driving," Reason Foundation Policy Study, January 2019, <https://reason.org/policy-study/a-common-sense-approach-to-marijuana-impaired-driving/>.

² Geoffrey Lawrence, "Marijuana Industry Financial Services: The Obstacles and the Policy Solutions," Reason Foundation Policy Brief, September 2019, <https://reason.org/policy-brief/marijuana-industry-financial-services-the-obstacles-and-the-policy-solutions/>.

³ Geoffrey Lawrence and Spence Purnell, "Marijuana Taxation and Black Market Crowd-Out," Reason Foundation Policy Study, January 2020, <https://reason.org/policy-study/marijuana-taxation-and-black-market-crowd-out/>.

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Marijuana Tax Structure by State

| State | Retail Excise Tax | Avg. Gen. Sales Tax | Addt'l Local Excise Tax | Total Retail Tax | Wholesale Tax |
|-------|-------------------|---------------------|-------------------------|------------------|----------------------------------|
| AK | | N/A | Varies | 0.00% | \$800/pound |
| AZ | 16% | 8.37% | 2% | 26.37% | |
| CA | 15% | 8.85% | Varies | 23.85% | |
| CO | 15% | Exempt | Varies | 15.00% | 15% |
| IL* | 10%, 20%, 25% | 8.84% | 3.5% | 22.34% - 37.34% | 7% |
| MD | 9% | Exempt | | 9.00% | |
| ME | 10% | 5.50% | | 15.50% | \$335/pound |
| MA | 10.75% | 6.25% | 3% | 20.00% | |
| MI | 10% | 6% | | 16.00% | |
| MO | 6% | 8.36% | 3% | 17.36% | |
| MT | 20% | N/A | 3% | 23.00% | |
| NV | 10% | 8.24% | 3% | 21.24% | 15% |
| NJ | | 6.60% | 2% | 8.60% | \$17.60/pound |
| NM | 12% | 7.60% | | 19.60% | |
| NY** | 9% | Exempt | 4% | 13.00% | \$0.005, \$0.008, \$0.03 /mg THC |
| OH | 10% | 7.24% | | 17.24% | |
| OR | 17% | N/A | 3% | 20.00% | |
| RI | 10% | 7% | 3% | 20.00% | |
| VA | 21% | 5.77% | 3% | 29.77% | |
| VT | 14% | 6.36% | | 20.36% | |
| WA | 37% | 9.40% | | 46.40% | |

*Illinois assesses different retail excise tax rates on marijuana flower (10%), edibles (20%) and concentrates (25%).

**New York assesses different wholesale tax rates per milligram of THC in flower (\$0.005), concentrates (\$0.008) and edibles (\$0.03).

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Provisions Needing Improvement:

- **Residency requirements:** Sec. 72(b)(2) and Sec. 72(c)(1)(B) stipulate that any applicants for a commercial cannabis license must have been legal residents of Hawaii for five years. Sec. 72(c)(2)(A) also stipulates that the majority of ownership interest must continuously be held by Hawaii residents. These provisions are clear violations of federal case law regarding the Dormant Commerce Clause and would be subject to injunction. In New York, a federal injunction against similar requirements delayed the issuance of any retail licenses for two years. During this time, unlicensed sellers proliferated and captured significant market share.

Art. 1 Sec. 8 of the United States Constitution grants Congress the authority to regulate interstate commerce. The U.S. Supreme Court has interpreted this as an exclusive jurisdiction that prevents states from imposing any barriers to interstate commerce. In 2019, the Supreme Court struck down a Tennessee requirement that applicants for a liquor retail license must be legal residents of the state for at least two years as an unlawful barrier to interstate commerce. This rationale has resulted in injunctions against state cannabis rules by federal courts in Maine, Missouri, and New York. Hawaii should not include similar language.⁴

- **License caps:** Sec. A-13(6) directs the cannabis control board to study market conditions so it can “determine the maximum number of licenses that may be issued in order to meet estimated production demand.” Sec. A-75(b) also makes clear that the board will only make a limited number of licenses available at specified times. Limiting the availability of licenses creates an artificial barrier to entry into the legal marketplace and reduces competition among legal providers in a manner that may damage consumer welfare. States that have been most successful in displacing the illicit market, such as Michigan and Oregon, impose no license caps.

Moreover, the notion that supply must be targeted narrowly to meet estimated demand incorrectly assumes that cannabis products are fungible. There is a wide variety of product types and quality within the cannabis industry and no two products are identical. Consumers should be free to choose which products succeed in the marketplace. Meanwhile, makers of products consumers choose not to buy will disappear from the marketplace to balance supply and demand. This natural market process should not be overridden by regulators.

- **Licensee selection criteria:** Sec. A-75(b) directs the board to open a distinct application period each time it plans to make a license available. The board is permitted to change the selection criteria for these licenses in every application period. These criteria could be chosen capriciously and, in the worst case, could enable corruption if criteria are written to benefit a particular applicant. Instances of this form of corruption have proliferated in California, where local governments can establish their own licensing criteria, and these instances of corruption have prompted federal investigations. All licensing decisions should be based on a standard set of qualifications that meet the standard in Section A-17(3) as “directly and demonstrably related to the operation of a licensed business.”
- **Licensing fees not specified:** Sec. 17(2) delegates the entire fee structure for commercial cannabis licenses to agency rulemaking. Lawmakers should clearly establish the initial fee

⁴ Geoffrey Lawrence and Michelle Minton, “The Case for Interstate Marijuana Commerce Right Now,” Reason Foundation Policy Brief, January 2024, <https://reason.org/policy-brief/the-case-for-interstate-marijuana-commerce-right-now/>.

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structure at rates low enough to minimize the barrier to entry and allow illicit producers to easily transition into the legal and regulated market.

- **Canopy restriction:** Sec. A-112(d) establishes a maximum canopy size for licensed cultivators at 2,000 square feet for an indoor facility and 5,000 square feet for an outdoor facility. These limitations are too small to allow licensees to achieve an economy of scale and will thus result in high production costs relative to illicit cultivators. No state has canopy limitations this small. In Massachusetts and Illinois, the limitation is 100,000 square feet. California has no canopy restriction but regulators assess larger licensing fees for larger facilities. Michigan also assesses higher licensing fees based on the number of plants. Other states, like Nevada and Colorado, impose no limitation on canopy size or plant count, instead allowing producers to expand per their ability to satisfy consumer demand.
- **Packaging restrictions:** Sec. A-84(a) restricts all packaging of cannabis products to include only black lettering on a single-color background. No graphics or images would be permitted on the packaging. The stated intent of this provision is to ensure products are not marketed to minors. However, nearly all state cannabis programs are able to more narrowly restrict marketing to minors by precluding the use of cartoon characters or other images that would be appealing to children. Cannabis products are not interchangeable, and producers need a way to clearly communicate their marks and branding to consumers to facilitate an efficient market.
- **Potency limits:** Sections A-17(20) and A-84(a) direct the board to establish potency limits for cannabis products. However, research indicates that cannabis consumers tend to self-titrate their use of higher-potency products to achieve a similar psychological effect. As a result, high-potency products like concentrates may be beneficial for public health relative to smoking marijuana flower because individuals consume less plant material that contains potential carcinogens.
- **Pre-market product approval:** Sec. A-84(a) also appears to require registration of every product with the cannabis control board before it can enter commerce. This pre-market approval can significantly delay product development and increase costs to both producers and consumers. Most state cannabis markets allow licensees to innovate with new products so long as they fit within an existing, defined set of rules. Violation of the rules can result in regulators ordering the products to be destroyed. Hawaii should follow this trend.
- **Social equity definitions:** Sec. A-141 defines a qualified social equity applicant as an entity of which 51% of ownership is held by individuals who have lived 5 of the past 10 years in a disproportionately impacted area, or for whom most employees live in a disproportionately impacted area. If the purpose of Hawaii's social equity program is to provide opportunities for victims of the drug war, then social equity treatment should only be available to individuals who have been arrested or convicted of a nonviolent marijuana offense. Basing eligibility on residency within a given neighborhood allows nonvictims to access these benefits on equal standing with victims.⁵
- **Social equity grants:** Sections A-142 and A-143 direct the board to make grants of public funds to social equity applicants. This direct financial support of a marijuana enterprise would

⁵ Geoffrey Lawrence and Michelle Minton, "Marijuana's Social Equity Misfire," Reason Foundation Policy Brief, April 2023, <https://reason.org/wp-content/uploads/marijuana-social-equity-misfire.pdf>.

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implicate the state as a participant in a federal criminal enterprise. The state could face liabilities for aiding and abetting a federal crime or under federal racketeering laws. States can impose a well-designed regulatory structure for marijuana but cannot invest directly in these markets.

- **Per se driving limit:** Sec. 5 establishes a per se limit for the presence of THC in a driver's blood as indicative of driving under the influence. This limit is specified as 10 nanograms of THC per millimeter of blood. THC accumulates in human fat cells and may be present in the blood even when a person is not under the influence of marijuana. This means that a per se measurement will incorrectly implicate some drivers as driving under the influence. Instead, law enforcement should rely on certified drug recognition experts to determine inebriation.
- **Employee registration:** Sec. 79(g) requires licensees to register every employee with the Hawaii cannabis authority and to notify the authority of any discontinuation of employment within one business day. This reporting requirement is unnecessarily restrictive and may cause licensees to run afoul of regulations even when acting in good faith. At a minimum, licensees should have five business days to report staffing changes. Many states, like California, do not require every employee in the industry to be registered with the state and instead charge licensees with keeping logs of employees and providing identification credentials to those employees.
- **Annual audit requirements:** Sec. A-23(3) requires all licensees to undergo an independent financial audit each year using generally accepted auditing standards in the United States. No other state imposes this requirement for licensure. Paying for a financial audit would be financially burdensome for small licensees. Moreover, the general lack of financial services within the cannabis industry makes it difficult for auditors to issue an opinion on the financial statements of licensees because they lack a sufficient audit trail.
- **No protection of parental rights:** Sec. A-26 clarifies that contracts are enforceable under Hawaii law and Sec. A-27 protects holders of professional licenses from censure for working with cannabis licensees. There should be a similar provision to clarify that the legal use of marijuana by adults cannot be a primary cause for removing a person's parental rights.
- **Regulatory authority doesn't need its own police unit:** Sec. A-20 would create the cannabis enforcement unit within the Hawaii cannabis authority. The unit would be composed of armed law enforcement officers with the authority to execute searches, seize property, arrest individuals with or without a warrant, and perform other duties as assigned. No other state cannabis regulator hosts its own police force. These functions can be carried out by traditional law enforcement and, indeed, Sections A-21 and A-22 make clear that traditional law enforcement agencies also have jurisdiction to enforce state cannabis laws.

Reason Foundation commented on several cannabis legalization proposals during the 2023 legislative session and was thrilled to see several of its recommendations adopted as amendments. We are committed to ensuring that Hawaii's future market for adult-use cannabis is a success. We hope the legislature will consider the recommendations made herein and view Reason Foundation as a key resource as this bill progresses through the legislative process.

Sincerely,
Geoffrey Lawrence
Research Director and Director of Drug Policy, Reason Foundation

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