

A close-up photograph of vibrant green cannabis leaves with serrated edges, set against a dark, blurred background. The leaves are the central focus of the top half of the page.

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Joint Defense: The Need for Prospective New York Cannabis Companies to Implement Strong Compliance Programs Now

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Cannabis companies vying for highly competitive New York licenses will want to prove their compliance readiness during the application process; and if they want to stay in the market, they will need to demonstrate their commitment to compliance once in operation.

Marijuana prohibition in New York ended in 2021, but it is a bit of a misnomer to say that the state has “legalized marijuana.” The Marijuana Regulation and Taxation Act of 2021 (MRTA) did not legalize *all* marijuana distribution under New York law; rather, it legalized only *licensed* distribution. The state plans to tightly regulate that licensed market, and cannabis companies will face stiff penalties for unlicensed distribution. To avoid those penalties, they have a strong incentive to create comprehensive compliance programs. But potential penalties aside, cannabis companies vying for highly competitive New York licenses will want to prove their compliance readiness during the application process; and if they want to stay in the market, they will need to demonstrate their commitment to compliance once in operation. Prospective licensees thus should be taking steps now to ensure they are ready to compete for licenses in 2022.

The MRTA

On March 31, 2021, then-Gov. Andrew Cuomo signed the MRTA, passing sweeping legislation that ended cannabis prohibition in New York and laid out the framework for its legal cannabis market. But Governor Cuomo did little to implement the legislation during the subsequent six months. Cuomo’s successor, Gov. Kathy Hochul, however, has made implementing the MRTA a priority, since assuming office in August 2021. She and the legislature have appointed the members of New York’s Office of Cannabis Management Control Board (Board)—a critical first step, as the Board has authority to craft regulations and grant licenses. The Board’s first meeting took place on October 5.

Even with this recent progress, though, implementation is still going to take time. The Board still must hire and train staff, issue and adopt regulations and develop the licensing process. See “What is in the Law—Adult-Use License Types,” [cannabis.ny.gov](https://www.cannabis.ny.gov). Estimates as to when the New York market will go live now range from late 2022 to 2023. This longer-than-anticipated delay, however, should not deter potential license applicants from preparing to enter the market. Although the Board has not yet issued its regulations, the MRTA offers much guidance to companies planning to enter the New York cannabis market.

The Licensing Scheme

The MRTA establishes a detailed licensing scheme for the legal cannabis market. The state will confer licenses at each level of the supply chain. See *id.* Suppliers may apply for a cultivator license that permits them to grow cannabis for distribution, as well as a nursery license that allows them to sell seeds and immature plants. Processors may apply for a license that permits them to manufacture concentrated cannabis or cannabis products for wholesale distribution. Wholesale distributors may apply for a license that permits them to obtain processed cannabis at wholesale for the purpose of distributing it to retailers. For retail distribution to consumers, the law establishes different licenses for (1) retail distribution from a commercial dispensary; (2) retail distribution for the purpose of use on-site at a dispensary; and (3) delivery directly to consumers. The MRTA also creates separate licenses for certain cannabis business types known as “cooperatives” and “microbusinesses.” Finally, it establishes separate licenses for cannabis businesses that already participate in New York’s medical marijuana market.

New York Licenses Will Be Highly Competitive

The competition for a New York license is likely to be fierce. The market is expected to be extremely lucrative: it is projected to be worth \$1.2 billion in 2023 and, by 2027, \$4.2 billion. These financial prospects are likely to set off a “green rush” for New York licenses. Coupled with these huge financial incentives, though, is the reality that the MRTA contains numerous limitations on the granting of licenses. That means that only a portion of the companies that want these lucrative licenses are likely to get them. Here’s why.

The Board may limit the number of each license type that it grants, although the law does not require it to do so. See MRTA §10.2. It is still too early to tell if the Board will impose caps. Other states with legal recreational markets have taken different approaches. For example, Virginia and Illinois have license caps throughout the supply chain. By contrast, California has eschewed statewide license caps, although it permits localities to implement their own. It is quite possible that, like some other states, the Board will impose limits.

The MRTA also establishes potential geographic limitations that may reduce the number of available licenses. Municipalities have the opportunity to opt out of retail establishments by year’s end, and some already have taken steps to do so. *Id.* §131. Additionally, in deciding whether to issue a license, the Board may consider the concentration of licensed locations already in the area. *Id.* §64(g)(ii). Applicants for certain retail licenses also must notify the local government or, in New York City, the community board where the premises will be located. *Id.* §76. The governing body then has the opportunity to weigh in on the license application. *Id.* §76.4. These geographic restrictions may lead to a reduction in the overall number of licenses issued.

Regardless of how many licenses it grants, the Board will seek to issue 50% of each type of license to “social and economic equity applicants,” which includes minority- and women-owned businesses, distressed farmers and service-disabled veteran owned businesses. *Id.* §10.2. Moreover, the MRTA largely prohibits vertical integration and bars a licensee from owning more than a certain number of the same licenses. See *id.* §§68.4-5, 69.4, 73.2, 74; “What is in the Law—Adult-Use License Types,” cannabis.ny.gov. The purpose of these limitations is to prevent large, vertically integrated companies from gobbling up the majority of the market. See “What is in the Law—Social and Economic Equity,” cannabis.ny.gov. Taken together, these provisions aim to reduce barriers to entry in the market and create a competitive and diverse group of applicants. *Id.*

Notably, though, cannabis companies already operating in the legal market for medical cannabis may have a leg up on new applicants. See Debra Borchardt, “New York State’s Original 10 Cannabis Companies are Big Winners,” *Real Money* (March 31, 2021). The Board may grant these companies unique licenses, which exempt them from some restrictions faced by new entrants into the market. In particular, because they already are vertically integrated, they will be

grandfathered into the new system in their current structure. With their experience in New York's existing market, the Board is likely to grant recreational licenses to these companies. Given their structural advantage and multiyear head start, they are positioned to be major players in the new market. This transition of medical cannabis companies into the recreational market may further reduce the number of licenses the Board grants to new entrants.

With a limited number of licenses, a crowded field of applicants and established players at an advantage, obtaining a New York license could be tough. And, for those companies to which the Board does not grant initial licenses, it is unclear when they will get a second bite at the apple. The Board will have discretion to decide whether and when to grant additional licenses or authorize the resale of licenses. See MRTA §§10.19, 13.2(g), 62.8, 67.3, 87.7, 126. At this point, then, it is unclear when a cannabis company will have the opportunity to reapply for or purchase a license. Applicants should not assume they will get more than one shot at a license in coming years.

The Need to Be Compliance Ready


Cannabis companies that do obtain New York licenses will be subject to a comprehensive regulatory regime. License applicants will need to demonstrate their readiness for such regulation during the application process. Successful applicants also will need to implement adequate compliance procedures right away. The Board will evaluate their compliance procedures not only during the initial licensed period—with the power to suspend or revoke licenses for inadequate compliance—but also when considering license renewal applications every two years. Developing and implementing adequate compliance procedures thus should be a top priority for potential entrants into the New York market. Indeed, to increase the odds of a successful entry into the New York market, cannabis companies should strive to make their compliance programs the industry gold standard.

The MRTA identifies important areas that the Board will regulate. For instance, the Board will establish regulations relating to books and records; methods of producing, processing and packaging cannabis; security requirements for licensed locations; ownership transparency; and employment requirements. *Id.* §§13.2-3; 137.1(a)-(b). It also will establish broad anti-diversion regulations, to prevent diversion of cannabis from the legal market to the illegal market, including regulations that prevent distribution of cannabis to persons under 21; revenue from the sale of cannabis from going to criminal enterprises; New York cannabis from going to other states and vice versa; and legal cannabis activity from being used as “a cover or pretext for the trafficking of other illegal drugs or other illegal activity.” *Id.* §13.3.

While the Board will articulate the full criteria for granting licenses, the statute provides certain baseline considerations, many of which require the Board to evaluate an applicant's ability to comply with the law's regulatory scheme. See *id.* §64.1(b)-(d), (g)(viii). It will be the responsibility of the licensee to ensure that it meets the law's requirements; in fact, licensees will be “held strictly accountable for any and all violations” on their premises or committed by their employees. *Id.* §125.8.

To detect violations of the law's provisions, the Board will have broad inspection authority. *Id.* §§10.7-8, 11.3, 11.5, 13.2(c). Licensees found to be in violation of those provisions face a range of penalties. On top of civil and criminal penalties, the Board also may suspend, cancel and/or revoke the license. *Id.* §§132, 133.3-5. It also may ban the licensee from selling cannabis in New York for a one-year period, seek an injunction against such a company from selling cannabis in the state and decline to renew its license. *Id.* §§125.9, 137.1(d)-(f), 138-a. In short, from a business perspective, the consequences of violating the law could be devastating, jeopardizing a company's ability to operate in New York at all.

The range of available penalties certainly will incentivize potential entrants into the New York market to develop and implement policies that ensure compliance with the MRTA. But beyond avoiding potential penalties for noncompliance, cannabis companies have additional incentives to ensure their compliance procedures go far beyond the bare minimum. Because of the expected strong competition for licenses in New York, the Board will get to be selective



about which companies get licenses, and it will want to pick cannabis companies that it feels confident will comply with the law. In addition, any company seeking to operate at the retail level will want to win the endorsement of its local government or community board as part of the licensing application process. Those governing bodies will want to endorse companies with strong compliance programs, ensuring that a company's operation within its borders does not foster an illicit market. Moreover, once in operation, cannabis companies will want to avoid costly investigations conducted by authorities, even if those investigations ultimately do not result in any penalties; the more robust the compliance program, the less likely regulators are to come knocking. Finally, for companies that envision going public, they will want a clean compliance record and a strong compliance program, so they are ready when the U.S. exchanges open up to them.

For these reasons, any company planning to enter the New York cannabis market should aim to be the gold standard in compliance. Investment in compliance now will be critical to long-term success in the New York market.

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