CANNABIS LAW

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CHALLENGES AWAIT DELAWARE MARIJUANA LOTTERY WINNERS

BY PETER S. MURPHY, ESQUIRE

Congratulations! After spending months preparing and submitting your marijuana license application, you have been selected by the Delaware Office of Marijuana Commissioner (OMC) to receive a coveted adult-use marijuana license — now the real work starts.

Over the last eight years, I have helped individuals and companies obtain, and more importantly, maintain, cannabis licenses across several states, including Delaware. I've learned during that time that those new to the industry quickly confront a sharp and formidable learning curve for which they are unprepared. After all, this is a highly regulated business, subject to the whims of markets, and the caprice of capitalism. Meticulous plans, colorful charts, and fashionable swag adorned with bespoke logos can all end up in the woodchipper of reality before your first harvest or sale. Your lone objective is to open your doors on time and on budget (more on that later).

Operational Clock

Eighteen months or 548 days. Remember those numbers. This is the length of time each successful Delaware applicant is given to find suitable (and eligible) property, complete construction and/or remodeling, pass inspections, and start operations under the proposed OMC regulations published July 1, 2024. This leaves no time to dawdle.

Within the first 30 days, all lottery winners must complete and submit a supplemental license application and pay applicable licensing fees. So, if you don't already have your licensing fees in an account ready to send to OMC on the day lottery winners are announced, you are already behind the ball. The supplemental application includes an investigation of each owner's criminal history, financial background and tax status. Only upon approval of the supplemental license application and payment of all fees will OMC issue a conditional license. We are down to 518 days, if you are keeping count.

The Search for Eligible, Available and Desirable Property

Unlike cannabis license applications in many states, Delaware does not require applicants to identify a specific property or demonstrate site control as part of their initial application. Securing qualifying property is typically one of the most time consuming and expensive parts of the licensing process. Omitting this requirement is a blessing to applicants and is sure to increase the overall number of applications received by OMC. This decision, however, only delays the inevitable by shifting the mad scramble for property from the application phase to the conditional licensing phase.

Under the Delaware Marijuana Control Act (the Act), a municipality may prohibit the operation of marijuana

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businesses. Several Delaware towns have already banned operations within their borders. As of this writing, the popular coastal towns of Rehoboth Beach, Dewey Beach, Fenwick Island, and Bethany Beach have passed ordinances that prohibit cannabis sales and manufacturing.

Does this mean cannabis will be unavailable to the millions of tourists who flock to Delaware's beaches from June to September? Of course not, it just means they will need to stock up on their way south from Pennsylvania, New Jersey or New York — or east from Baltimore and Washington, D.C. Competition for retail locations along these travel corridors will be fierce. The same factors that drive the placement of the next Wawa or Royal Farms will shape the cannabis retail landscape.

Even in Delaware cities or towns where cannabis operations are welcome, conditional licensees must navigate state and local restrictions to identify viable locations. Under the Act, the OMC may refuse to grant a retail cannabis license to an establishment located in the vicinity of a church, school, college, or substance abuse treatment facility. Couple this with the requirement that all retail cannabis stores must be at least 1,200 feet apart by accessible public road in incorporated cities and towns; and, at least one mile apart in any unincorporated or rural area, and the inventory of viable properties starts to dwindle.

Finally, the nature of the licensed activity (i.e., retail, manufacturing, cultivation) narrows the universe of potential sites. Indoor cultivation and manufacturing facilities require access to utilities (water and power) that can accommodate the anticipated demand and future growth, which are rarely found outside industrial zones. Retail stores will necessarily seek to be near population centers and easily accessible. When properties are filtered through these combined lenses of eligibility, availability, and desirability, it becomes a race to secure a limited number of sites in the shortest amount of time. Meanwhile, the operational clock continues to tick.

Feel The Burn Rate

For the conditional licensees fortunate enough to have identified an eligible property within six months of licensure, it's time to get out your checkbook.

Whether you are building from the ground up, or remodeling a standing structure for cannabis use, Hofstadter's Law still applies: "everything takes longer (and costs more) than you expected." This is especially true in the cannabis industry, known for its "Green Tax" — i.e., inflated prices vendors impose on cannabis businesses for both legitimate and spurious reasons.

All conditional licensees will face compliance costs that rival those found in the gaming, pharmaceutical, and financial services industries. Even simple retail locations are subject to enhanced design, security, surveillance and inventory requirements that add to buildout costs and operational expenses. Cultivation and manufacturing licensees will face substantial upfront capital expenditures, such as extraction equipment (mechanical or chemical), cultivation lighting, climate control systems, and sanitary food-grade kitchens for those manufacturing edible products.

In an industry where access to capital remains scarce and expensive, being realistic in planning and adaptable in execution can make all the difference. Today, individuals looking to invest in the cannabis space have a range of investment options that did not exist 10 years ago. Investors can purchase cannabis stocks and exchange-traded funds (ETFs) and spread their risk across the emerging industry without having to place their bets on a single license in an untested market. The forthcoming federal rescheduling of cannabis to Schedule III under the Controlled Substances Act is likely to draw new investors, but the conflict between state and federal cannabis policies and potential for greater federal oversight is likely to keep many would-be investors on the sidelines for the near term.

Those looking to debt to finance their operations will be equally frustrated. While cannabis loans do exist, there is still no regulatory framework for banks when it comes to lending to state-legal cannabis companies. There is no standard credit score for cannabis companies and no accepted underwriting model, making it difficult for financial institutions to evaluate risk.

All the above makes it critical for conditional licensees to budget conservatively and be miserly when it comes to any expense that does not directly advance the goal of becoming operational by the 18-month OMC deadline.

Conclusion

The combination of high startup costs, limited real estate, and lack of capital make launching and operating a cannabis business uniquely challenging. The euphoria of being selected in the lottery will fade and it is critical you enter the next phase of licensing with eyes wide open.

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