



# Memorandum

**TO:** HONORABLE MAYOR  
AND CITY COUNCIL

**FROM:** Edgardo Garcia

**SUBJECT:** SEE BELOW

**DATE:** January 2, 2019

Approved

*D. D. S. L.*

Date

*1/3/19*

**SUBJECT: CITY COUNCIL PRIORITY #27: CANNABIS MANUFACTURING,  
DISTRIBUTION, AND TESTING**

## **RECOMMENDATION**

Approve an ordinance amending Chapter 6.88 of Title 6 (Business Licenses and Regulations) of the San José Municipal Code (Code) to:

- 1) Add cannabis manufacture, distribution, and testing to the categories of regulated cannabis businesses;
- 2) Create a registration process, safety criteria, and other regulations for cannabis manufacturers, distributors, and testing labs;
- 3) Approve other changes to update the Code to align with new State regulations; and
- 4) Make other technical, non-substantive, or formatting changes.

## **OUTCOME**

Approval of this item would allow new cannabis manufacturers, distributors, and testing labs in San José, so long as they are located in the appropriate zone, obtain a City of San José Notice of Completed Registration, and obtain a State License. This would complete the actions referred to the City Manager in Council Policy Priority #27.

## **BACKGROUND**

On October 18, 2016, the City Council placed the following item on the Council Policy Priority List and ranked it #27: *Explore whether to allow medical marijuana distributors, manufacturers, and testing labs to operate in San José, and if so, how many and where.* Council also noted that voters would be considering Proposition 64 on the November 8, 2016 ballot to allow and license non-medical cannabis in California.

At that time, the City of San José had 16 Registered Collectives, which could transfer/sell, cultivate, or manufacture medical cannabis for patients who had a doctor's recommendation in conformance with State law.

On October 18, 2016, the City Council expanded the regulatory program to allow existing Registered Collectives to conduct delivery sales to medical patients if they met City requirements. On November 14, 2017, the City Council voted to allow the City's existing Registered Collectives to sell and deliver non-medical cannabis to individuals over age 21, in accordance with State law, if they met City and State regulatory requirements.

## **ANALYSIS**

Approval of the recommendations in this memorandum would add three new categories of cannabis businesses to the Municipal Code. Land use requirements for each would be codified in Title 20 (the Zoning Code) and regulatory requirements would be codified in Title 6, Chapter 6.88 (Medical and Non-Medical Cannabis Regulations).

The three categories are:

- 1) Cannabis Manufacturing – Under State law, cannabis manufacturing includes the production of cannabis-infused foods, beverages, topical products (i.e. lotions or salves), and other products available to the consumer. Cannabis manufacturing also includes blending, compounding, extracting, infusing, and otherwise preparing cannabis.
- 2) Cannabis Distribution – Under State law, distribution is the activity involved in the procurement, sale, and transport of cannabis and cannabis products between cannabis businesses. Distribution does not include delivery to a customer. The distributor's role under State law is modeled after that which is used for the alcohol industry in California, and this serves an important role for product tracking and taxation.
- 3) Cannabis Testing – Under State law, all cannabis must be batch tested before it enters the production stream or is provided to consumers. Cannabis businesses must use a State-licensed testing lab to do this testing. State law requires testing labs to be independent of the cannabis industry. Owners may not have any investments in other cannabis businesses.

After extensive research, including visiting State-licensed manufacturers, distributors, and testing labs, as well as participating in the State's rulemaking process for these businesses, the Administration recommends Council approve expanding the categories of cannabis businesses permitted in San José.

The City of San José has a well-established and robust cannabis regulatory program. Based on inquiries to date, staff anticipates businesses seeking an experienced and well-regulated landscape will be interested in locating in San José.

### ***Regulatory Framework***

Staff is recommending these new businesses be subject to the existing, proven regulatory framework as the existing Registered Cannabis Businesses.

Cannabis manufacturers, distributors, and testing labs would participate in a City Registration ("Registration") process and State licensing. The Registration process would include a review of the criminal backgrounds of the business' owners and managers, as well as financial information, and a review of licensing history in California and other states. It also would include a review of operations, security, odor management, and other elements of the business' processes.

Like the 16 existing registered cannabis dispensaries, each business would be required to have extensive security measures, including robust security camera systems, with 24/7 access by the San José Police Department and State licensing entities. Each employee would be required to go through backgrounding and badging with the Police Department. In addition, each business would be required to meet extensive good neighbor requirements. It is important to note that cannabis manufacturers, distributors, and testing labs may **not** be open to the public. They also may **not** sell or provide products to consumers; their operations are exclusively business-to-business.

### ***Three-Step Application Process***

To be more business-friendly and create a more manageable registration process, the Administration is proposing a three-step registration process for cannabis manufacturing, distribution, and testing businesses:

- 1) Preliminary Application – If the application, which includes business/owner information and a high-level operations plan, is complete and criteria are met, the applicant may proceed to submitting a site identification application.
- 2) Site Identification – The applicant must identify a site and obtain a zoning code verification certificate. The Office of Economic Development staff may provide assistance to the applicant, just as they do with other businesses.

- 3) Application to Register – The applicant must complete a full application and successfully pass the Police Department and Building/Code/Fire review processes. This final phase includes the disclosure of legal representation, financial information, and video surveillance information, as well as operational plans. It also includes site inspections and review. Successful completion would result in the receipt of a Notice of Completed Registration from the City and a State license.

Staff does not recommend including date limitations for taking applications from potential businesses, as the City did in 2014 with the 90-day application period for Medical Marijuana Collectives. The landscape was quite different in 2014, when San José had dozens of illegal dispensaries seeking a path to legalization. At the time, 65 collectives applied for registration, and there was a land rush for qualified sites; this included there being multiple applications for the same property and reports of long-standing businesses being displaced because landlords received promises of significantly higher lease revenue from a collective.

With the State issuing licenses, the cannabis industry is entering a new phase, and staff recommends taking applications for cannabis manufacturing, distribution, and testing labs as businesses are interested and able to submit.

### ***Job Creation***

The cannabis industry has already begun to generate jobs in San José. The 16 Registered Cannabis Businesses employ approximately 1,000 employees, primarily in the retail dispensary and delivery portion of their businesses.

In reviewing these three categories of businesses, staff focused on San José's Economic Development goals and the types and numbers of jobs that will be created. In doing so, staff reviewed information about like business categories that use similar processes, but do not involve cannabis. Manufacturing is projected to generate the highest number of jobs, while distribution and testing labs provide a critical service to the success of a well-regulated industry.

Although it was not included in Council's direction, staff conducted an analysis of cannabis cultivation as a potential business category; staff did not include cannabis cultivation in the full environmental analysis of the zoning and regulatory changes, as cannabis cultivation in the City's built environment would likely entail large-scale warehouse facilities and would yield relatively few jobs per square foot of plant canopy. Additionally, the Code already provides for the existing 16 Registered Cannabis Businesses to each have two cultivation sites, for a potential total of 32 cultivation sites in San José. The Administration does not recommend expanding cultivation, but instead recommends focusing on job creation in these other categories.

It is also important to note that, under State law, any cannabis business having 20 or more employees must provide evidence of a labor peace arrangement prior to State licensure.

### **EVALUATION AND FOLLOW-UP**

This item completes the direction provided staff in Council Policy Priority #27. Work was completed on this item prior to completing higher-ranked Council Policy Priority items due to the fact that this program has dedicated staffing, funded by regulatory fees, and the policy work aligned with licensing developments happening at the state level.

### **PUBLIC OUTREACH**

Staff followed Council Policy 6-30, Public Outreach Policy; notices for the public hearings were posted on the City's website, published in the San Jose Post-Record, and emailed to a list of interested groups and individuals. The staff report to the Planning Commission and attachments were posted on the City's website for the December 5, 2018 Planning Commission meeting.

Staff initiated outreach efforts to gather public input on the proposed Zoning Code changes and cannabis business category expansion, and held a community meeting at City Hall on May 21, 2018. Approximately 75 members of the public attended the meeting. The public was supportive of adding the new cannabis uses to the Municipal Code. Many members of the public commented on opening the retail registration process; staff informed them this would have to be Council directed. Other comments were made related to the rate at which cannabis is taxed; staff informed the public that any change to the rate of taxation require City Council approval.

This memorandum will be posted on the City's Council Agenda website for the January 15, 2019 Council Meeting.

### **COORDINATION**

This memorandum was coordinated with the City Attorney's Office, Office of Economic Development, Department of Planning, Building, and Code Enforcement, and Finance Department.

### **COMMISSION RECOMMENDATION/INPUT**

As discussed in Item 4.1 (a) and (b), the land use regulations associated with this item were heard at Planning Commission on December 5, 2018. The Commission recommended on a 5-0-1 (one commissioner was absent) vote that the City Council approve adding cannabis manufacturing, distribution, and testing to the City's existing cannabis program.

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**FISCAL/POLICY ALIGNMENT**

Approval of this item has the potential to create quality jobs, in accordance with the goals of the City's General Plan and Economic Development Strategy, as well as to generate additional Marijuana Business Tax revenues, to the benefit of the General Fund.

**CEQA**

Addendum to the Envision San José 2040 General Plan Final Program Environmental Impact Report (FEIR), for which findings were adopted by City Council through Resolution No. 76041 on November 1, 2011, and Supplemental EIR Resolution No. 77617, adopted by City Council on December 15, 2015, and Addenda thereto.

/s

EDGARDO GARCIA

Chief of Police

For questions, please contact Wendy Sollazzi, Division Manager, Division of Cannabis Regulation, San José Police Department, at (408) 537-9890.