

HOUSE BILL REPORT

HB 2255

As Reported by House Committee On:
Regulated Substances & Gaming

Title: An act relating to detecting and preventing the illegal inversion and diversion of cannabis and cannabis products into and out of Washington's regulated cannabis system.

Brief Description: Concerning inversion and diversion of cannabis.

Sponsors: Representatives Waters, Wylie, Kloba, Davis and Cheney.

Brief History:

Committee Activity:

Regulated Substances & Gaming: 1/22/24, 1/23/24 [DP].

Brief Summary of Bill

- Requires the Liquor and Cannabis Board (LCB) to regularly audit the data in the Cannabis Central Reporting System (CCRS), with a goal of identifying and preventing illegal inversion and diversion of cannabis into and out of Washington's regulated cannabis system.
- Directs the LCB to compare data in the CCRS with data or information like the status of a cannabis license, the status of a business license, and filings and reports related to taxes or business activity submitted to the Department of Revenue.

HOUSE COMMITTEE ON REGULATED SUBSTANCES & GAMING

Majority Report: Do pass. Signed by 11 members: Representatives Kloba, Co-Chair; Wylie, Co-Chair; Stearns, Vice Chair; Chambers, Ranking Minority Member; Robertson, Assistant Ranking Minority Member; Caldier, Cheney, Morgan, Orwall, Reeves and Waters.

Staff: Peter Clodfelter (786-7127).

This analysis was prepared by non-partisan legislative staff for the use of legislative members in their deliberations. This analysis is not part of the legislation nor does it constitute a statement of legislative intent.

Background:

The Liquor and Cannabis Board (LCB) administers cannabis laws including licensing and regulating cannabis producers, processors, and retailers. The LCB may adopt rules regarding, among other things, the books and records required to be created and maintained by cannabis licensees, the reports to be made to the LCB, and inspection of the books and records.

The LCB uses a system called the Cannabis Central Reporting System (CCRS) for mandatory data reporting by cannabis licensees. This data reporting system created by the LCB has been used since Washington transitioned away from a previous version of a traceability system that relied on a third-party vendor.

Under Washington law and the terms of their licenses:

- Licensed cannabis producers may sell cannabis only to licensed cannabis processors and to other licensed cannabis producers, and may sell immature plants, clones, and seeds to cooperatives, qualifying patients, and designated providers.
- Licensed cannabis processors may sell cannabis products only at wholesale to licensed cannabis retailers and to other licensed cannabis processors, and may purchase cannabis only from licensed cannabis producers or cannabis products from other licensed cannabis processors.
- Licensed cannabis retailers may sell cannabis products only at retail to adult consumers age 21 and over and to certain qualifying patients who are age 18 and over, and may purchase cannabis products only from licensed cannabis processors.

Licensed cannabis producers and licensed cannabis processors may use a cannabidiol (CBD) product as an additive for the purpose of enhancing the CBD concentration of any product authorized for production, processing, and sale. These CBD product additives may be obtained from a source not licensed under the Uniform Controlled Substances Act (UCSA), subject to requirements including that the CBD product not meet the definition of "cannabis product" in Washington law, not be a synthetic cannabinoid, and be tested for contaminants and toxins by an accredited testing laboratory.

Except for activities authorized under the following authorities, it remains illegal under the UCSA for a person to manufacture, sell, distribute, deliver, or possess with intent to manufacture or deliver cannabis or cannabis products: (1) licenses issued by the LCB or the Pharmacy Quality Assurance Commission; (2) provisions of the Washington State Medical Use of Cannabis Act; and (3) terms of tribal-state cannabis agreements.

Summary of Bill:

The LCB is required to regularly audit the data in the CCRS to identify outliers or anomalies in data for inconsistencies in reporting, for the purposes of identifying locations

where either or both the activities of inversion of cannabis or cannabis products, or diversion of cannabis or cannabis products, are occurring, and undertaking enforcement to prevent their occurrence.

Inversion of cannabis or cannabis products into the regulated cannabis system is described as a person licensed by the LCB as a cannabis producer, processor, or retailer, purchasing or obtaining cannabis or cannabis products from an unauthorized person or source.

Diversion of cannabis or cannabis products out of the regulated cannabis system is described as a person licensed by the LCB as a cannabis producer, processor, or retailer, selling or transferring cannabis or cannabis products to an unauthorized person or recipient.

In addition to data in the CCRS, including reports of sales of cannabis and cannabis products, for the purpose of preventing inversion and diversion of cannabis and cannabis products, the LCB may also consider and compare any books and records of cannabis licensees that the LCB has authority to inspect. The LCB must also consider and compare the following data or information:

- the status of a cannabis license issued by the LCB and whether it is active and valid or whether it has been suspended, revoked, canceled, or has otherwise not been active and valid during any applicable time;
- the status of a business license issued by the Department of Revenue (DOR) and whether it is active and valid or whether it has been suspended, revoked, canceled, or has otherwise not been active and valid during any applicable time; and
- filings and reports related to taxes or business activity submitted to the DOR.

For purposes of the bill, the CCRS is defined as the system used by the LCB for the reporting of events or information submitted by or on behalf of cannabis licensees and certified laboratories to the LCB, as required by the LCB.

Appropriation: None.

Fiscal Note: Available.

Effective Date: The bill takes effect 90 days after adjournment of the session in which the bill is passed.

Staff Summary of Public Testimony:

(In support) Inversion and diversion of cannabis is a problem everyone agrees is a serious offense and should be prevented. To the industry, enforcement has felt driven by licensees submitting complaints against each other, with enforcement officers spending time on minor infractions. The LCB could use the data the agency collects to help direct and prioritize enforcement. There could be things entered into the CCRS that look off compared to what

is normal, and that could lead the LCB to investigate further into possible serious violations. The intent of Initiative Measure 502 (2012) was to establish a tightly regulated state-licensed system. The United States Department of Justice Cole Memorandum stated the federal government's expectation that state systems legalizing cannabis prevent diversion from states where cannabis is legal under state law to other states, and called for strong regulatory and enforcement systems. This bill is a common sense way for that to occur and has no direct fiscal impact. Several years ago a law changed the makeup of the LCB's enforcement, and was successful in emphasizing compliance over issuing infractions. However, there is still a problem of focusing on small violations. For example, in one licensee's facility two water tanks were located next to each other, and it was determined that a person could sneak between the tanks and be out of view of a camera. Therefore, the licensee was required to install an additional video camera above the water tanks, at a cost of several thousand dollars. Technically the rule required the camera. But it felt like unproductive enforcement, especially when compared to big industry events that are occurring. It is known within the industry that, for a period of time, there were licensees illegally bringing in distillate from other states. The enforcement system did not catch these big violations. Similarly, it took too long to prevent bringing in altered or synthetic cannabinoids. Licensees playing by the rules are being hurt. The bill seeks to direct the focus of the LCB to these bigger violations. As a suggested addition to this bill, add more to ensure all licensees are using the CCRS system, which is another problem. Nothing hurts businesses playing by the rules more than inversion by competitors, which drives prices down. The depth of data in the CCRS is remarkable. In one individual's analysis of inventory table data from August 2023 through November 2023, data indicated that four licensed cannabis processors may have illegally imported cannabis into the system as opposed to purchasing from a licensed producer, and that about 32 percent (plus or minus 5 percent) of all cannabis licensees were not actively reporting data to the CCRS. The LCB has done a good job improving enforcement and this bill helps to continue those improvements.

(Opposed) None.

Persons Testifying: Representative Kevin Waters, prime sponsor; Lukas Hunter, Harmony Farms; Ezra Eickmeyer; Scott Waller, Washington Association for Substance Misuse and Violence Prevention; and Brooke Davies, Washington CannaBusiness Association.

Persons Signed In To Testify But Not Testifying: None.