

United States Senate Committee on the Judiciary
Hearing on “Conflicts between State and Federal Marijuana Laws”

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Thank you Chairman Leahy, Ranking Member Grassley, and Members of the Committee for this opportunity to testify today.

My name is Jack Finlaw and I am Chief Legal Counsel to Colorado’s Governor, John Hickenlooper. For the past ten months, I have had the privilege of working with many thoughtful and hardworking colleagues in Colorado state government to implement Colorado’s new marijuana laws through the work of a task force, the enactment of enabling legislation and the promulgation of detailed rules for the regulation of this new industry. I have also participated in the ongoing conversation among Colorado and Washington State officials with representatives of the U.S. Department of Justice on the conflicts between state and federal marijuana laws.

Passage of Amendment 64 in November 2012

In 2012 advocates for the legalization of marijuana in Colorado gathered enough signatures to place an amendment to the Colorado constitution on the statewide ballot. Although Governor Hickenlooper, our state’s Attorney General John Suthers and other senior state officials opposed its passage, this amendment, which appeared on the ballot as Amendment 64, was approved by 55% of Colorado voters on November 6, 2012 and became law in Colorado on December 10, 2012. Amendment 64 is now codified in the Colorado Constitution as Article XVIII, Section 16.

Thanks to Amendment 64, personal use of marijuana is now permitted under Colorado law for adults 21 years of age or older. For example, adults can possess, use, purchase and transport one ounce or less of marijuana and possess and grow up to six marijuana plants. There are some limits to permitted personal use. Home grows must be in an enclosed, locked space and cannot be conducted openly or publicly, and marijuana from home grows cannot be sold (although up to an ounce can be gifted to

another adult). And furthermore, consumption of marijuana cannot be done openly or publicly or in a manner that endangers others.

Amendment 64 mandates the establishment of a regulatory scheme for the cultivation, harvesting, processing, packaging, display and sale of marijuana. Amendment 64 envisions a state and local licensing scheme requiring that retail stores, infused product manufacturers and grow operations be licensed by the state and local governments. Privacy of purchasers is guaranteed by a provision that prohibits the gathering of the personal information of consumers. Amendment 64 includes very short timelines for its implementation, such as the requirement that the state begin accepting and processing applications for licenses by October 1, 2013 and begin issuing licenses by January 1, 2014.

Amendment 64 permits local governments in Colorado to regulate the time, place, manner and number of marijuana establishments in their communities. And while local governments cannot prohibit home grows or possession and private use of marijuana within their bounds, they can outlaw the operation of retail marijuana cultivation and product manufacturing facilities and retail marijuana stores within their jurisdictions.

Amendment 64 specifically states that nothing in the amendment requires an employer to permit or accommodate the use or possession of marijuana by employees or affects the ability of employers to have policies restricting the use of marijuana by employees. And Amendment 64 is clear that persons and entities that own or control property can prohibit or regulate the possession, use, sale or growing of marijuana on or in that property.

Amendment 64 also authorizes the cultivation, processing and sale of industrial hemp.

Amendment 64 contemplates an excise tax on recreational marijuana but voter approval of Amendment 64 was not effective under Colorado law to authorize the tax. As described below, Colorado voters will have the opportunity to approve both an excise tax and a special sales tax on recreational marijuana in November 2013. Amendment 64 specifically bars an excise tax on medical marijuana.

Implementation of Amendment 64

Within days of the passage of Amendment 64, Governor Hickenlooper and Attorney General Suthers had a telephone meeting with U.S. Attorney General Eric Holder to seek federal guidance on the conflict between Amendment 64 and federal law, specifically the inclusion of marijuana in the Controlled Substances Act. Although Colorado did not receive a formal response to this request for guidance from the U.S. Department of Justice until August 29, 2013, we have appreciated General Holder's and the Justice Department's willingness to engage in frank and candid conversations with the Governor's Office over the past ten months to share federal law enforcement's concerns about the implementation of Amendment 64. Knowing how seriously the Justice Department and Colorado's U.S. Attorney's Office view the issues raised by the legalization of marijuana in Colorado encouraged us to focus our efforts to develop a robust regulatory and enforcement regime for recreational marijuana in Colorado.

Amendment 64 Implementation Task Force

In early December 2012, Governor Hickenlooper established an Amendment 64 implementation task force “to identify the legal, policy, and procedural issues that must be resolved, and to offer suggestions and proposals for legislative, regulatory, and executive actions that need to be taken, for the effective and efficient implementation of Amendment 64.” The task force convened later in December 2012 with representatives from the executive and legislative branches of state government, the Amendment 64 campaign, the medical marijuana industry, marijuana consumers, the criminal defense bar, the Colorado Attorney General’s office, Colorado’s district attorneys, law enforcement, academia, the medical community, employers, employees, and Colorado’s cities and counties. Barbara Brohl, the Executive Director of Colorado’s Department of Revenue, and Jack Finlaw, the Governor’s Chief Legal Counsel, co-chaired the task force.

The task force adopted these guiding principles for its work:

- Promote the health, safety and well-being of Colorado’s youth
- Be responsive to consumer needs and issues
- Propose efficient and effective regulation that is clear and reasonable and not unduly burdensome
- Create sufficient and predictable funding mechanisms to support the regulatory and enforcement scheme
- Create a balanced regulatory scheme that is complementary and clearly defined between state and local licensing authorities
- Establish tools that are clear and practical so that interactions between law enforcement, consumers and licensees are predictable and understandable
- Ensure that Colorado’s streets, schools and communities remain safe
- Take action that is faithful to the text of Amendment 64

Working in five work groups focused on 1) the regulatory framework, 2) local authority and control issues, 3) tax, funding and civil law matters, 4) consumer safety and social issues and 5) criminal law, the task force developed a comprehensive framework for the legislation and regulations needed to implement Amendment 64. The task force delivered its findings and recommendations to Governor Hickenlooper, Attorney General Suthers and the Colorado General Assembly in March 2013.

Amendment 64 Enabling Legislation

In response to the task force report, the Colorado General Assembly formed a special joint committee of members of Colorado’s House and Senate to hold hearings on the task force recommendations and craft them into legislation. This resulted in three bills being drafted by the joint committee – H.B. 13-1317 and S.B. 13-283 put into statute most of the task force recommendations including the framework for regulating retail sales of recreational marijuana; and H.B. 13-1318 referred a ballot question to Colorado voters in November 2013 asking them to approve a 15% excise tax on recreational marijuana and a 10% recreational marijuana sales tax. These three measures were then further revised in committees of

each house and through floor amendments. The final three bills constituting Amendment 64's enabling legislation were adopted by the Colorado General Assembly in early May 2013 and they were signed into law by Governor Hickenlooper on May 28, 2013.

Colorado also enacted legislation to authorize a state income tax deduction for a taxpayer who is prohibited from claiming a federal income tax deduction by Section 280E of the Internal Revenue Code. H.B. 13-1042. Section 280E of the Internal Revenue Code prohibits a business considered to be trafficking substances under the Controlled Substances Act from claiming any tax deductions on their federal tax returns. Section 280E effectively bars legal marijuana businesses operating in Colorado from claiming the types of business expense deductions that other legal businesses can claim. This change in Colorado tax law will allow owners of medical and recreational marijuana businesses to deduct their business expenses from their state income tax returns even though they cannot do so on their federal income tax returns.

Legislation enacted this year also authorized the creation of a program in the Colorado Department of Agriculture to regulate industrial hemp production in the state. S.B. 13-241.

Cognizant that legal access to recreational marijuana could lead to more people driving while impaired, Colorado also enacted legislation giving state and local law enforcement additional tools to prosecute persons driving under the influence of marijuana. H.B. 13-1325. Colorado law now provides that if a driver's blood contained five nanograms or more of delta9-tetrahydrocannabinol (commonly referred to as THC) per milliliter in whole blood, there is a permissible inference that the driver was under the influence of one or more drugs.

Colorado's New Rules Governing Retail Marijuana

Process of Rules Development

Amendment 64 and its enabling legislation directed the Colorado Department of Revenue to promulgate rules governing businesses that cultivate and sell recreational marijuana by July 1, 2013. To comply with this requirement within the short period of time between the adoption of the enabling legislation and constitutional deadline for the promulgation of rules, the Department of Revenue adopted emergency rules on July 1.

Immediately after adopting the emergency rules, the Department of Revenue convened five representative groups, to provide input and substantive suggestions regarding proposed rules governing retail marijuana establishments and medical marijuana businesses in Colorado. Each working group discussed the following diverse set of issues: Licensing, Licensed Premises, Transportation, and Storage; Licensed Entities and Inventory Tracking; Record Keeping, Enforcement and Discipline; Labeling, Packaging, Product Safety & Marketing; and Medical Differentiation. Representatives from law enforcement, the Governor's office, the Colorado Attorney General's office, the Colorado Department of Public Health and Environment, local authorities, medical marijuana industry members, trade industries, child protection advocates, and subject matter experts in the fields of substance abuse, toxicology, pharmacology and marketing participated in the working groups.

The Department of Revenue filed a notice of rulemaking on July 15, 2013. Many written comments from the public were then received. On August 20 and 21, 2013, a rulemaking hearing was held regarding the proposed rules, and members of the public provided oral testimony on the proposed marijuana rules. Written comments on the proposed rules were accepted through the close of business on August 27, 2013, and many additional written comments were submitted after the public hearing. The Department of Revenue issued its permanent rules for the regulation of recreational marijuana on September 9, 2013.

In addition to adopting rules necessary to implement Amendment 64, the Department of Revenue made changes to the state's lengthy medical marijuana rules to harmonize the two sets of rules to provide industry members, law enforcement and other stakeholders a more clear and consistent regulatory scheme in which to operate.

In its statement of basis and purpose for its rules, the Department of Revenue made clear that, during its final rulemaking deliberations, the Department took into consideration the direction provided by the U.S. Department of Justice through the August 29, 2013 letter from U.S. Attorney General Eric Holder to Governors John Hickenlooper of Colorado and Jay Inslee of Washington, and an accompanying memorandum to all United States Attorneys from Deputy Attorney General James Cole. Through this correspondence, the Justice Department has clarified that it will continue to enforce the Controlled Substances Act in Colorado, but that it will not challenge Colorado's ability to regulate the retail marijuana industry in accordance with state law, based upon the expectation that the state and local governments will implement strong and effective regulatory and enforcement systems that address public safety, public health and other law enforcement interests. Some of those federal law enforcement priorities of particular relevance to the rules include preventing the distribution of marijuana to minors, preventing the diversion of marijuana from Colorado to other states, and preventing the exacerbation of adverse public health consequences associated with marijuana use.

In adopting the final rules on September 9, 2013, the Department of Revenue affirmed that "above all these rules accomplish the state of Colorado's guiding principle through this process: to create a robust regulatory and enforcement environment that protects public safety and prevents diversion of retail marijuana to individuals under the age of 21 or to individuals outside the state of Colorado."

Highlights from the Rules

The 141 pages of rules issued yesterday cover the application and licensing process; what activity is permitted and/or required on the licensed premises; rules for retail marijuana stores, retail marijuana cultivation facilities, retail marijuana products manufacturing facilities, and retail marijuana testing facilities including the requirements for marijuana inventory tracking systems ; the transport and storage of marijuana; labeling, packaging and product safety requirements; signage and advertising restrictions; and penalties for rules violations.

Television, radio, print and internet advertising of recreational marijuana is prohibited unless the retail marijuana establishment seeking to place an advertisement has reliable evidence that no more than 30% of the audience for the program or web site or the readership of the publication is reasonably

expected to be under the age of 21. The rules also prohibit advertising that specifically targets individuals under the age of 21 or persons located outside of the state of Colorado.

It is important to note too what the rules do not cover. State regulators have no authority to promulgate rules to regulate the home growing of marijuana permitted by Amendment 64 or caregivers who are authorized to serve patients under the state constitutional provisions governing medical marijuana. The burden of ensuring that marijuana produced or managed by these unregulated growers does not supply the in-state or out-of-state black market will rest primarily with law enforcement. The Department of Revenue does intend to create a law enforcement liaison position to work pro-actively with state and local law enforcement with a focus on information-sharing to prevent the diversion of marijuana out of the regulated environment.

Next Steps in Colorado

Production Caps

The rules issued by the Department of Revenue do not include production caps on retail marijuana cultivation facilities. It is difficult to determine what the appropriate rules for production limits should be before regulators have a better understanding of what the in-state market for retail marijuana will be. The Department of Revenue intends in the near future to undertake a market study and develop production caps in response to the study. In the meantime, state regulators are considering imposing temporary production caps to limit the risk that overproduction will supply the black market or find its way into interstate commerce.

Need to Address Product Purity and Testing Issues

To protect public health, Governor Hickenlooper has directed the Colorado Department of Agriculture to promulgate rules to ban harmful and unsafe substances in the cultivation or processing of marijuana. The state's Agriculture Department also has been directed to form a private advisory group to develop good cultivation and handling practices for the marijuana industry. The Colorado Department of Public Health and Environment has been directed to assist in the formation of, and then to work with, a private advisory group that will develop good laboratory practices for the retail marijuana industry. Current Drug Enforcement Agency rules pose a particular challenge for marijuana testing labs because the rules create hurdles to the labs' purchasing the chemical solutions needed to calibrate marijuana testing equipment.

Education and Prevention Efforts

The Office of the Governor, in consultation with state agencies and other stakeholders including industry representatives and members of the public, has established a marijuana educational oversight committee to develop and implement recommendations for the education of all necessary stakeholders on issues related to marijuana use. This committee will develop and distribute educational materials regarding appropriate use of recreational marijuana. The number one goal of this committee is to consult with medical and marketing experts to distill best practices for marijuana prevention messaging

targeted at those age 20 and younger who may be potential marijuana users. We are committed to countering the perception among young people that marijuana is less dangerous to them because it has been made legal for adult use – we are convinced that the drug poses substantial danger for adolescent neurological development.

Funding for Regulation, Enforcement, Health, Public Safety, Education and Prevention

Colorado voters will be asked to approve Proposition AA on November 5, 2013. Proposition AA, if approved, would:

- Impose a 15% state excise tax on the average wholesale price of retail marijuana when the product is first sold or transferred by a retail marijuana cultivation facility, with public school construction receiving the first \$40 million of any tax revenues collected annually
- Impose a 10% state sales tax on retail marijuana and retail marijuana products, in addition to the existing 2.9% state sales tax, to increase funding for the regulation and enforcement of the retail marijuana industry and to fund related health, education, prevention and public safety costs
- Direct 15% of the revenue collected from the 10% state sales tax to cities and counties where retail marijuana sales occur
- Allow the state legislature to increase or decrease the excise and sales taxes on retail marijuana so long as the rate of either tax does not exceed 15%

Governor Hickenlooper strongly supports passage of this marijuana tax measure to ensure the state has the financial resources for a robust regulatory and enforcement regime, for an effective education and prevention program to protect our youth from the harmful effects of marijuana, and for the health and public safety costs associated with the retail marijuana industry.

Our Collaboration with the Federal Government

On August 29, 2013, Deputy Attorney General James Cole issued a memorandum to all United States Attorneys outlining enforcement of the Controlled Substances Act in light of Colorado and Washington State legalizing adult-use marijuana for recreational purposes. We commend the Department of Justice for issuing this important guidance and for providing timely clarification to us as we were finalizing our rules for the regulation of recreational marijuana in our state. This guidance also will be helpful to our local governments as they are in the process of drafting and implementing their recreational marijuana rules and regulations.

I am pleased to affirm that Colorado is completely aligned with the perspectives and guidance contained in the updated Cole memo. We share with the Justice Department a desire for robust enforcement actions against those who will not abide by Colorado's laws and regulations related to the cultivation, sale, transport and use of marijuana. As noted above, our Department of Revenue took the guidance in the new Cole memo into account as it drafted the final rules that it issued yesterday. We are committed to working with federal, state and local law enforcement authorities to see that the eight enforcement priorities outlined in the Cole memo are applied on the ground in Colorado.

Banking Issue

Now that we have the Cole memo from the Department of Justice, we believe that the next federal priority in this field is for the Department of the Treasury and other federal agencies that oversee our nation's financial institutions to address the banking challenges faced by marijuana businesses. This is both a public safety issue – businesses forced to operate as cash-only businesses because they are denied access to the banking system are a magnet for crime and criminal activity – and a regulatory and enforcement issue – it is more difficult to account for and track revenues and audit tax payments of businesses that do not use financial institutions.

Last week U.S. Representatives Ed Perlmutter (CO-07) and Denny Heck (WA-10) sent a letter to federal banking regulators urging them to issue formal guidance to banks, credit unions and other financial service providers that would allow these financial institutions to provide regular banking and financial services to legal, licensed marijuana-related businesses in states with laws allowing marijuana use. As Reps. Perlmutter and Heck note in their letter, “federal banking regulators have the discretion and authority under current law to issue guidance to regulated entities allowing licensed businesses operating in states and localities that have enacted laws relating to adult marijuana use to appropriately access the banking system if certain safeguards are in place and proper diligence is conducted.” We concur.

If federal banking regulators fail to act, we call on Congress to move forward to adopt the Marijuana Businesses Access to Banking Act (HR 2652). This bill, which has bipartisan support, would allow banks, credit unions and other depository institutions the legal clearance to provide banking services to a marijuana-related legitimate business.

Federal Tax Issue

Section 280E of the Internal Revenue Code prohibits a business considered to be trafficking substances under the Controlled Substances Act from claiming any tax deductions on their federal tax returns. Section 280E effectively bars legal marijuana businesses operating in Colorado from claiming the types of business expense deductions that other legal businesses can claim. Colorado's Amendment 64 Implementation Task Force recommended that this provision of the federal tax code be changed to allow legal marijuana businesses to claim the types of deductions that other legal businesses can claim. It is our understanding that this type of change cannot be made administratively by the Internal Revenue Service but requires amendment to the law. We therefore urge Congress to consider amending Section 280E of the Internal Revenue Code to allow legal, licensed marijuana businesses operating in states and localities that have enacted laws relating to adult marijuana use to claim the types of deductions that other legal businesses can claim on their federal tax returns.

Let me conclude by reiterating that we in Colorado understand that we are doing something new in legalizing recreational marijuana for adults. We are committed to fully implementing and funding a robust regulatory and enforcement regime. We understand the importance of limiting production so that the marijuana produced in Colorado is consumed in our state and is not diverted to other states. We are determined to educate our young people on the dangers posed to them by marijuana and to prevent the distribution of marijuana to those under age 21.

Thank you for the opportunity to speak with you today. I look forward to your questions.