

Maryland Cannabis Wholesale Licensing Assessment

Legislative Report

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Executive Summary

This report, mandated by the Cannabis Reform Act (CRA) of 2023, explores the feasibility and potential impact of introducing wholesale cannabis licenses in Maryland. The CRA specifically requires an evaluation of four criteria: regulatory costs, market necessity, implications for supply and demand, and the appropriate number of licenses. The report assesses these criteria and provides insights into the role of wholesale licenses within Maryland's cannabis market, considering current and future scenarios, common ownership regulations, and social equity goals.

The primary purpose of this report is to fulfill the requirements of the CRA by analyzing the costs associated with regulating wholesale cannabis licenses, the market necessity for wholesale cannabis licensing, the potential for wholesale licenses to balance supply and demand and facilitate an equitable marketplace, and the estimated number of wholesale licenses suitable for Maryland's market.

The report finds that Maryland would need around 13-19 wholesale licenses to support the maximum number of dispensaries. Regulatory costs could be managed through licensing fees and tax revenues, although a wholesale tax should be considered carefully to avoid consumer price increases. There is no pressing need for wholesale cannabis licenses to balance supply and demand, however, they could enhance market efficiency and support equity goals by streamlining inventory management and reducing costs.

The report recommends starting with a limited number of licenses to match the expected number of dispensaries and market needs. It explores two scenarios: the current market scenario and the future interstate market scenario. In the current market scenario, wholesale licenses could offer significant benefits by providing centralized storage and inventory management, particularly for smaller, equity-focused businesses. This model could support social equity goals by making it easier for less capitalized businesses to manage inventory and regulatory compliance. In the context of potential federal legalization and interstate commerce, established wholesale distributors would be crucial for managing out-of-state product flows and ensuring compliance. Early adoption of wholesale licenses could position Maryland as a strategic hub for cannabis distribution in a national market.

The report concludes that while the immediate necessity for wholesale licenses is limited, they offer significant potential benefits for market efficiency and equity. Preparing for future interstate commerce is crucial, and early establishment of wholesale licenses could provide long-term advantages. Based on this analysis, the report recommends introducing cannabis wholesale licenses in Maryland, allowing micro dispensaries and retailers to utilize wholesale services for inventory management and storage, and carefully considering the implementation of a wholesale tax to balance regulatory costs without deterring market participation. This report provides a comprehensive analysis of the potential introduction of wholesale cannabis licenses in Maryland, highlighting the strategic benefits and considerations for policymakers.

The following surmises the factors posed in the Cannabis Reform Act:

1. *The costs to regulate wholesale cannabis licenses.*
 - a. We assume the cost may be that of one additional MCA licensing and compliance employee, but also may be no costs or additional staff needed depending on the capacity of the current MCA team.
2. *Whether there is a market necessity for wholesale cannabis licensing.*
 - a. In the current state, there is no market “necessity” for wholesale cannabis licensing. However, there will be a market necessity for future markets where interstate commerce is authorized. While not necessary for market functions, the availability of these cannabis wholesale licenses could result in gains if utilized.
3. *Whether there is a need for wholesale cannabis licensing to alleviate supply, demand and facilitate an equitable marketplace for suppliers and retailers; and*
 - a. There is no “need” for wholesale cannabis licenses to alleviate supply and demand. However, there are opportunities to facilitate a more equitable marketplaces for suppliers and retailers through cannabis wholesale licenses.
4. *The approximate number of wholesale cannabis licenses appropriate for the size of the marketplace in the state.*
 - a. Based on recently published data and modeling, it is assumed 8-13 wholesaler licenses would be appropriate for the size of the marketplace in the state. It is assumed that not all authorized wholesale licenses would be pursued provided the cost-intensive nature, the lack of their statutory necessity (i.e. not a required element of the supply chain), and challenges entering an already established marketplace.

The MCA worked with Cannabis Public Policy Consulting (CPPC) in developing this report. Cannabis Public Policy Consulting (CPPC) is a collective of researchers, data scientists, public health professionals, and policy experts working together toward a unified goal: to bring much-needed data, innovation, and nuance to cannabis policymaking. The MCA appreciates CPPC’s assistance and expertise in the preparation of this report. The MCA would specifically like to acknowledge the work of Mr. Gideon Cunningham, CPPC’s Senior Economic Researcher and Pre-Doctoral Fellow. CPPC has previously provided support to the State through the Medical Cannabis Patient Survey, and the General Assembly’s “Future Adult Use Cannabis Demand & Predictive Modeling” study.

Purpose of Report

Under the Cannabis Reform Act (“CRA”) passed in 2023, Chapter 255 Section 12 states that “the Maryland Cannabis Administration shall contract with an independent consultant to complete a study on wholesale cannabis licenses”. The independent consulting firm used for the preparation of this report is Cannabis Public Policy Consulting (CPPC). In that request, four criteria are laid out as to what is to be included in said study. The requested information is as follows:

1. *The costs to regulate wholesale cannabis licenses;*
2. *Whether there is a market necessity for wholesale cannabis licensing;*
3. *Whether there is a need for wholesale cannabis licensing to alleviate supply, demand and facilitate an equitable marketplace for suppliers and retailers; and*
4. *The approximate number of wholesale cannabis licenses appropriate for the size of the marketplace in the state.*

The following report takes these criteria into consideration and examines two possible scenarios of which a wholesaler license may be of value. Additionally, this report examines common ownership and the integrity of social equity licensing as elements of importance under these scenarios. Under current law dictating cannabis market structure, wholesale licenses have not been considered as a category of licenses in either statute or regulation¹. However, the following list dictating the limits of common ownership across cannabis businesses are important considerations as they intend to minimize concentrations of market power to any one license type or license owner. This is vital context to explore as wholesale models have historically led to concentrated market powers. The list dictating the limits of common ownership across cannabis businesses are as follows²:

- (2) *Subject to paragraph (3) of this subsection, a person may have an ownership interest in or control of, including the power to manage and operate:*
 - (i) *for standard licenses and micro licenses:*
 1. **one** grower licensee;
 2. **one** processor licensee; and
 3. **not more than four** dispensary licensees;
 - (ii) *for incubator space licenses, not more than **two** licensees; and*
 - (iii) *for on–site consumption licenses, not more than **two** licensees.*
- (3) (i) *A person who owns or controls an incubator space licensee or an on–site consumption licensee may not own or control **any other** cannabis licensee.*
 - (ii) *The Administration shall adopt regulations **limiting** a person or fund from acquiring a nonmajority ownership interest in multiple cannabis businesses beyond the limitations established under this subsection.*

¹ Cannabis Reform Act, Chapter 255, §36–401 (2023)

² Ibid.

Furthermore, statute has laid out social equity criteria set to be implemented July 1st, 2023. The following provision is listed below³:

*(3) ensure **that at least 25%** of cannabis and cannabis products in the dispensary are from social equity licensees and growers and processors that do not share common ownership with the dispensary.*

Considering the State of Maryland’s present interest in providing limits to common ownership and ensuring there is an adequate amount of social equity licensee involvement in the cannabis market, this report will take into consideration these factors when presenting its findings and recommendations.

Background Information

Wholesale businesses play a critical role throughout a variety of industries within the United States. Wholesale distribution companies typically have two component parts: large storage facilities and considerable product transportation capabilities. The wholesale business model, generally, is straightforward. Wholesale suppliers purchase large amounts of raw, or processed goods, from producers at a low per-unit cost, and sell their purchased goods to retailers at a higher per-unit cost to be profitable. Wholesale distributors provide value from being comparatively efficient at logistics and inventory management through large capacity for storage. The wholesale model is also an incentive for compliance and lowering the costs of retailers and suppliers alike by operating as the negotiating party between the two. Wholesale businesses take advantage of economies of scale, on both the demand side (acting as the facilitator of demand from retail locations) and supply side (purchasing large quantities from producers). Often, the entry costs to owning a wholesale or distribution business are comparatively capital intensive with large up-front costs. This will play a large role in understanding the likelihood that new businesses, with ownership that is not already utilized for other cannabis license types across the state, may enter.

Pertinent to this report is the role wholesale and distribution companies have played in the regulation of alcohol across the United States. Post alcohol prohibition, many states adopted and have maintained the “three-tiered” distribution system for beer and liquor, including Maryland.⁴ Under this system, manufacturers are required to sell to wholesalers and distributors, which in turn are required to sell to retailers. The underlying principle to this system is that each tier has no financial interest in any of the other tiers and therefore has an incentive to comply with regulatory requirements ensuring safe access to alcohol, and not promote overconsumption of alcohol or specific brands through profit-maximization.

The three-tier distribution system has largely been effective as a market structure and provides three primary societal benefits:

1. **Regulatory.** Large companies have many vested stakeholders that are incentivized to maintain compliance, as well as the resources to ensure compliance is an element of continuous improvement.
2. **Public health.** Each tier is accountable to downstream tiers in providing quality, safe goods.

³ Ibid.

⁴ <https://atcc.maryland.gov/Pages/alcohol.aspx>

3. **Tax.** Wholesale and distribution businesses have produced large amounts of state tax revenue).⁵

On the other hand, three-tiered distribution systems tend to favor large manufacturers as well as wholesale and distribution companies due to their considerable market power.⁶ Any future adjustments to statute by policymakers concerning wholesale or distribution licenses should consider the past-experiences of states with regulating alcohol.

Wholesalers in the Context of Cannabis Markets

Cannabis market structures, unlike alcohol markets, within the United States are more varied in their licensing structure, both between states, and within states (adult-use cannabis market structures vs. medical cannabis market structures). Wholesalers and distributors play a critical role in many state's markets, and less so in others. In some cases, such as in Canada, some provincial governments operate wholesale distribution for the entire retail market⁷. In other cases, such as Oklahoma, there exists no separate category of 'wholesale distribution' under licensing regulations, but there are licenses for strictly transporting cannabis between licensed businesses⁸. By in large part, most states have a separate category of license for wholesale in the form of a distribution license. In Washington, each business along the supply chain, like the three-tiered system, can not have a financial interest in retailers. But business owners can own a processing license and cultivation license and sell directly to retailers, mirroring what might be called a two-tiered system while permitting separate transportation businesses to operate⁹. Conversely, different states allow for different combinations of licenses that are permitted or required to be combined under one ownership structure, such as mandatory (such as Virginia's medical cannabis market) or permitting voluntary vertical integration (such as in Oregon)¹⁰. Under different regulatory systems, there are different sets of costs and benefits to each system, and stemming from that, different roles for how wholesale and distribution companies fit into the supply chain. Policymakers should take into consideration what role they envisage wholesalers and distributors operate under any future system that allows for a *separate* license category.

Cost Considerations to Regulate Wholesale Cannabis Licenses

Currently, the Alcohol, Tobacco, and Cannabis Commission (ATCC), which regulates alcohol sales in the State, has 390 registered beer, wine, and liquor wholesalers in the state and 8,419 retailers. This equates to a ratio of 1 wholesaler per 22 retailers. According to CRB Monitor, there are

⁵ Changdae Baek, Ending the Federal Cannabis Prohibition: Lessons Learned from the History of Alcohol Regulations, Twenty-first Amendment, and Dormant Commerce Clause Jurisprudence, 71 Case W. Rsr. L. Rev. 1323 (2021)

⁶ Jonathan R. Elsner, An Argument Against Regulating Cannabis Like Alcohol, 3 Ohio St. Pub. L., Working Paper No. 482, (2019)

⁷ Pace, H. Justin. Convergence and Divergence of Alcohol and Marijuana Regulation in a Federalist System. *Seton Hall Legis. J.* 46 (2022): 623.

⁸ <https://oklahoma.gov/omma/businesses/commercial-licenses/transporter-license.html>

⁹ Adams, Edward S. "Just Don't Do It: Why Cannabis Regulations are the Reason Cannabis Businesses are Failing." *Minnesota Legal Studies Research Paper 24-16* (2024).

¹⁰ Adams, Edward S. "Just Don't Do It: Why Cannabis Regulations are the Reason Cannabis Businesses are Failing." *Minnesota Legal Studies Research Paper 24-16* (2024).

approximately 11,724 cannabis retailers nationally and approximately 1,431 wholesale or distribution licenses, which equates to roughly a ratio of 1 wholesaler per 8 retailers¹¹ For a state-confined cannabis market and large population density, a wholesaler to retailer ratio would be considerably lower. We assume that wholesale licenses are inversely related with population density. Maryland is one of the densest states within the United States. Under our estimation and statute permitting, Maryland's cannabis market would allow for a maximum of 13 wholesale licenses in the near term, with a maximum of 19 wholesale licenses if retailers were to reach the maximum licensee allowance in the long term. These estimates are largely dependent on the role wholesalers and distributors are expected to operate as and what regulations govern them. For example, it is possible that wholesaler licenses were expected to operate as a secure-storage facility only, rather than operating as a distributor, this number would be expected to be much lower.

For example, if regulations or statute stipulate testing is to be conducted separately at point of entering or exiting wholesale facilities, a maximum of 1 regulatory employee may be needed to ensure compliance with regulatory requirements across the State. Should regulations not add new layers of compliance oversight, additional regulatory employees may not be of necessity. However, the capacity of the licensing and compliance team of MCA should be consulted directly in this examination. Costs of an additional regulatory employee would be expected to be significantly lower than the licensing fees and tax revenue that the wholesaler license would be expected to bring in. While some states have seen large increases in state tax revenue from taxation on wholesale sales, it is important to note that these costs are often passed down to retailers which then pass them to consumers, estimating the cross elasticity of demand is crucial to not push consumers out of the legal, regulated market and into other substitution markets, such as out of state legal markets or the illicit market. Adjusting the total wholesale tax burden, if contemplating a wholesale tax, to accommodate any new oversight costs should be a consideration policymakers make when contemplating what role in tax revenue generation wholesalers will participate in.

Potential Pathways for Maryland's Cannabis Market and Market Necessity of Wholesale Cannabis Businesses

Pathway I: Wholesaler License in Current State to Strengthen Equity Goals

As mentioned earlier in the report, the costs and benefits of wholesale licenses are dependent on the market structure, regulatory requirements, and what role they are expected to function as. Likewise, to attract capital investment to wholesale licensing as a business category, there would need to be the necessary profit incentive to enter the market. This in turn means utilization by downstream businesses, either in the form of streamlining distribution, acting as secure storage facilities, or both. There are potential pathways to wholesale businesses being utilized under existing statute. Such pathways found in existing law are listed below.

A. An incubator space may provide one or more of the following:

- (1) Secure storage of cannabis or cannabis products for licensed micro dispensaries;*
- (2) Commercial kitchen space for the processing and production of cannabis products by licensed micro processors; or*
- (3) Space for the cultivation of cannabis by licensed micro growers.¹²*

¹¹<https://news.crbmonitor.com/2024/05/first-quarter-2024-crb-licensing-activity-review/>

¹² COMAR 14.17.09.05

Additionally, in the MCA's permanent regulations, which printed in the Maryland Register as a Notice of Proposed Action on May 3, 2024, further contemplate storage facilities for Micro Dispensaries, under COMAR 14.17.12.03:

A. A micro dispensary may store its inventory in:

- (1) A storage facility that it controls and operates, in accordance with §C of this regulation;*
- (2) A storage facility controlled and operated by a licensed grower, processor, or incubator space, in accordance with §C of this regulation; or*
- (3) A storage facility controlled and operated by a licensed standard dispensary, in accordance with Regulation .02 of this chapter.*

Under the proposed rule, micro dispensaries or incubator spaces can store cannabis products in secure storage facilities. If creating a wholesale license, these storage facilities can operate as a wholesale storage facility, rather than directly engaging in distribution. Wholesalers will obtain products from suppliers such as cultivators and processors to then be transferred by micro dispensaries, or directly to consumers. If these storage facilities were strategically placed throughout the state in high-demand areas where consumers are concentrated, such as Baltimore, there would be considerable efficiency gains in the form of on-demand storage spaces ready for utilization. These gains would be amplified for all stakeholders if multiple micro dispensaries could rent storage space from the same storage facility.

Permitting other licensing types to participate in a similar system would have considerable benefits in the form of comparative advantage. For example, should retail businesses also be able to utilize this storage, retailers and micro dispensaries would assess the benefits of utilizing the storage facilities based on their own assessment of if it would increase profits or decrease costs. If the marginal benefit (i.e. additional benefits to businesses from procuring one additional unit of that good) outweighs the marginal cost for these license types, the uptake of the wholesaler service would increase efficiency through gains from trade (i.e. wholesale licenses provide a service that retailers could also produce, but do so more efficiently and the "trade" of services leaves both parties better off, profit for wholesalers and decreased costs for retailers) . In turn, operators of this new separate wholesaler license would have the incentive to become more efficient themselves and attract more customers. In other industries, this is primarily the role that wholesalers have played through maximizing their comparative advantage by decreasing costs for downstream retailers in the form of outsourced inventory management and coordination of funneling the in-demand products from up-stream suppliers to retailers.

Importantly, this model could also serve important for equity goals as less capitalized retailers and micro dispensaries may find this option appealing to stream-lining their business and focusing more intently on the products that are demanded from consumers. Additionally, down-stream businesses could ensure that 25% of their products are produced by social equity licensees as a prerequisite of doing business with wholesale companies. This model would allow for greater regulatory efficiency in ensuring this element of regulatory compliance, as it provides an ease of traceability to origin for retailers at large. In other words, products could be aggregated from cultivators into a central clearinghouse that ensures social equity products are making it into the supply chain for downstream businesses. In turn, this would outsource procurement functions to experienced

inventory managers who take on the risk of compliance with regulatory requirements or risk losing customers.

Notably, the costs of business failure at the wholesale level under a system such as is described above is largely absorbed by the investors and the employees that work for the business. Permitting rather than requiring businesses to obtain products from wholesale storage facilities will give businesses the option to utilize the service, *only if it is in their financial interest to do so*. In other words, their function would be not necessary to the continuation of products making it to the point of sale, but rather serve a complimentary function that provides benefits to other businesses. Market disruptions due to failure at this level of the supply chain should be minimized as businesses still can negotiate separately with processors and suppliers. This increase in competition would incentivize both suppliers, and downstream wholesale companies, to compete on negotiating deals with retailers.

Despite possible success to the wholesale license model in the current state model, barriers to entry and calculations of potential costs and profits will be critical to future uptake of a standalone wholesale license. Importantly, the passive permission of using wholesalers as opposed to requiring their utilization may dilute incentive for pursuing a license. Additionally, the question of if the state would levy a wholesale tax should be considered. Tax burden may also dilute incentive for downstream retailers and micro dispensaries to utilize these licenses, as costs will essentially compound down-stream. As a capital-intensive business category, these elements should be considered when policymakers are considering the statutory limits of what a wholesale business will entail.

Pathway II: Wholesaler License in Future Market with Interstate Commerce Permissions

A second pathway for pursuit may be waiting until a national market emerges, where the wholesale license may be of greater utilization and market power. Under any future system of cannabis interstate commerce, Maryland would benefit by having experienced wholesale distributors that could manage the influx of out-of-state products into Maryland's market. Wholesale distribution companies would be critical to logging these products into the State's seed-to-sale system to ensure compliance with regulatory standards and pre-test batches before products are released to the wider market. Moreover, under some scenarios of federal legalization that leaves the status of cannabis like that of alcohol, Maryland could attract business as a regional stop-point for distribution of cannabis products destined for other states while generating tax revenue from the proceeds. The wholesaler license in any national marketplace would be of great utilization and important for establishing Maryland's position in a national setting. While the current state model does not provide great incentive for new businesses to pursue a wholesaler license, the inevitability of a future national marketplace may serve as a large enough incentive to attract new businesses in short order.

Conclusion and Recommendations

Section 12 of the Cannabis Reform Act requires a study to consider the necessity and costs of creating a wholesale cannabis business license. Wholesale distributor models are common in cannabis markets, as well as parallel industries like alcohol. In Maryland, a three-tiered distributor

system is utilized for alcohol, wherein manufacturers are required to sell to wholesalers as opposed to directly to retailers. However, based on common ownership principles outlined in Chapter 254/255, the legislative intent for cannabis markets strongly opposes concentrations of market power to any one license type or license holder. Wholesaler licenses in a three-tiered distribution model have historically resulted in concentration of power at the distribution level as other businesses are mandated to interact with them to secure a supply chain. This is further amplified when limiting the availability of this license. At this same time, wholesaler licenses are cost-intensive businesses with many barriers to entry. Should use of their services not be mandated, there may be little incentive for new entrants to pursue this license type. However, should a wholesale cannabis license be made available and pursued, there are benefits that could be realized.

At this point in time, there is no “necessity” for wholesale cannabis licensing generally, nor to alleviate supply and demand. There are, however, opportunities to facilitate an equitable marketplace for suppliers and retailers. This is particularly true for smaller businesses or social equity licenses like micro dispensaries who may use their services for storage of product. The utilization of a wholesaler for both procuring products as well as efficiency in inventory logistics could provide cost savings for micro dispensaries. Should retailers also be able to use wholesalers in a similar storage capacity as opposed to stocking surplus inventory onsite, these gains could be further realized, and cost savings could flow downstream to consumers.

In the future, it is inevitable that a cannabis wholesale license in Maryland would be of great value for local and interstate cannabis markets. As this future-state may emerge in an undefined amount of time, making this license type available in advance of interstate commerce may attract new business entrants to establish themselves in the market well before the future state.

Based on this information and the goals of the legislature in passing Chapter 254/255, the following proposals may be considered:

- Make available a cannabis wholesale license in the near term, however, do not mandate that the supply chain interact with them. Rather, make this a voluntary activity (i.e. not a three-tier system).
- Allow for micro dispensaries to utilize wholesalers as an inventory management and safe storage facilities.
- Authorize retailers to utilize wholesalers in a similar fashion to micro dispensaries.
- Consider the cost-benefit on levying a wholesale tax or excise tax at point of wholesale, understanding that this tax would compound and make cannabis less affordable for consumers, as well as potentially disincentivize new businesses from pursuing this cost-intensive license in an already established market.
- Consider a reasonable cannabis wholesale license fee to cover the costs of regulatory oversight, while not serving as a barrier to entry for new entrants pursuing this cost-intensive license type in an already established market.