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August 16, 2022

Lara Gates, Deputy Director
City of San Diego
Cannabis Business Division
1222 First Avenue
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VIA EMAIL ONLY

**RE: Public Comment - August 18, 2022 City of San Diego Cannabis Stakeholder Meeting
Proposed SDMC Amendments to §126.0108(e) & “Operator” Term Use**

Dear Ms. Gates:

Austin Legal Group submits this comment letter on behalf of seven individual clients and as experts in the commercial cannabis industry and corporate law to address concerns related to the City's proposed amendments to San Diego Municipal Code (“SDMC”) sections 42.1507, 126.0108(e) and 126.0110. As explained below, the replacement of “Responsible Persons” with the definition of “Operator” does not prevent the City from improperly attaching corporate liability to individuals through its proposed amendment to SDMC §42.1507(e). The City's proposed changes to SDMC section 126.0108(e) and 126.0110 are vague, ambiguous, violates the permittees' due process rights, and does not appropriately support the City's objective.

Accordingly, we ask the Cannabis Business Division (“CBD”) to remove the proposed language of SDMC sections 42.1507(e), 126.0108(e), and 126.0110 from the amendments to be set for hearing until such time as it can be more narrowly tailored to achieve the City's goals and avoid unintended consequences.

DISCUSSION

A. The Proposed Replacement of “Responsible Persons” with “Operator” Does Not Prevent the Improper Attachment of Corporate Liability to Individuals.

The CBD's proposed amendment to SDMC §42.1507(e) improperly attaches corporate tax liability to individuals. Our office's July 18th, 2022 letter details this section's unlawfulness and incompatibility with common corporate transactions and employment changes. (See July 18th Letter attached as Exhibit “A”). The CBD is now proposing to replace “Responsible Persons” with “Operator.” This proposal does not alleviate our concerns.

1. The City's new "Operator" definition for cannabis businesses is detrimentally different than the City's "Operator" definition for businesses subject to the Transient Occupancy Tax ("TOT").

The City's "Operator" definition under Chapter 3 Article 4 Division 1 Cannabis Business Tax is:

[A]ny person engaged in Cannabis Business as the owner of such Cannabis Business, whether such ownership is partial or full. **Where an Operator is a corporation, partnership, limited liability company or other legal entity, the acts and omissions of the Operator shall be deemed to be the acts and omissions of its Officers.** Independent contractors engaged in Cannabis Business are Operators for the purposes of this Article [Emphasis added].¹

The City's "Operator" definition under Chapter 3 Article 5 Division 1 Transient Occupancy Tax is:

the Person who is the proprietor of the Hotel, Recreational Vehicle Park, or Campground, whether in the capacity of owner, lessee, sublessee, mortgagee in possession, licensee, or any other capacity. "Operator" includes a managing agent, a resident manager, or a resident agent, of any type or character, other than an employee without management responsibility.²

Nowhere within the TOT definition does the City include similar individual liability language. This liability language unfairly singles out individuals participating in the local cannabis marketplace as compared to other industries with City taxes imposed.

2. The City's proposed use of a new "Operator" definition for §42.1507(e) does not solve the improper personal liability concerns.

The City's proposed use of the new "Operator" definition does not solve the wrongful imposition of personal liability on individuals. The proposed definition allows the City to "pierce the corporate veil" and penalize individuals for *corporate* tax liability. This was and continues to be our main concern with §42.1507(e).

If §42.1507(e) were to remain as is, whether using "Responsible Persons" or "Operator", the City would unfairly prohibit certain individuals from seeking new cannabis business opportunities because their previous employer or company remains actively delinquent on taxes with the City. No similar prohibition is found within the SDMC or TOT regulations. The City's TOT and Cannabis Business Tax ("CBT") are imposed on the businesses themselves not the individuals associated with the businesses. Yet, the CBD is seeking to hold individuals liable and prohibit certain individuals who may not have any control over the business operations from participating in other cannabis business projects by attributing personal liability for corporate actions.

While prohibiting bad actors from participating in the cannabis industry is a goal supported by all, the current proposed language improperly attributes tax liability to an individual that adversely impacts innocent people from being able to participate in the legal regulated cannabis market within San Diego.

¹ SDMC §34.0103.

² SDMC §35.0102.

B. The Proposed CUP Rescission Amendments Are Vague and Violate the Due Process Rights of the CUP Holders.

The CBD has stated that its objective in proposing SDMC sections 126.0108(e) and 126.0110 is to develop a mechanism for the rescission of abandoned cannabis CUPs to create new permitting opportunities for others. According to the staff report the amendments are “to insure that if CPF abandonment occurs, City staff has the ability to rescind the CUP in an expedited manner.” Although we support this concept, the proposed text of Section 126.0108(e) and 126.0110 is not appropriate because it: (1) imposes vague and ambiguous utilization requirements that are contrary to the City’s stated objective; and (2) violates the procedural due process rights of CUP holders.

1. The proposed cannabis CUP utilization requirements are contrary to the City’s stated objective.

SDMC §126.0108(e) imposes requirements on cannabis CUP holders that are excessively broad and fail to accomplish the City’s own objectives. Laws must be sufficiently clear to prevent arbitrary and discriminatory enforcement.³ Section 126.0108(e) is drafted to allow the City unfettered discretion to cancel a CUP for a variety of reasons unrelated to CUP abandonment. Furthermore, even if there was a basis for the amended language, the proposed language leaves open the opportunity for unequal enforcement and arbitrary revocation given the poorly drafted language.

Proposed SDMC section 126.0108(e)(1) requires that after initial utilization (generally consisting of the pulling of building permits) “each cannabis business at the permitted premises shall have a valid license from the California Department of Cannabis Control (DCC) for the proposed business activity **at all times** [emphasis added].” There is no timeframe provided in the proposed language other than “at all times.” A DCC license cannot be issued until the certificate of occupancy is issued from the City. Therefore, under the proposed language, a licensed premise with a valid CUP would be immediately subject to the City’s revocation, without notice or a public hearing, upon the submission of building plans to the City. Similarly, since DCC permits are not transferable, if the property owner decides to lease the property to a new operator, that operator would need to obtain a new DCC license that can take up to six months. Clearly, prohibiting the continued utilization of the CUP is not what the CBD intended when it set out to create language to rescind a CUP in an expedited manner if CPF abandonment occurs. None-the-less, as drafted, this language has unintended consequences and must be revised.

SDMC section 126.0108(e)(2) is fraught with similar problems. This section requires that each “cannabis business at the permitted premises shall have a valid operating permit...and shall be current on any fees owed.” There is no timeframe upon which the business must have a valid operating permit and the City will not issue an operating permit until after the certificate of occupancy is issued. A change in ownership will require a new operating permit and that can take an excessive amount of time depending on the CBD and Treasurer’s workload.

The City has developed a two-step process for the operation of a cannabis facility. The first step is a land use entitlement that is tied to the land and the second step is an operating permit tied to the operator. The operating permit is a current requirement within the SDMC. The proposed changes are an improper backdoor attempt to revoke a vested land use entitlement for activities unrelated to the land use itself. The language in this section should be struck in its entirety.

SDMC section 126.0108(e)(3) again conflates the two separate permits that are required to operate a cannabis facility and has no correlation to CUP abandonment. This section proposes to immediately revoke a vested land use entitlement based upon an operator’s failure to pay the Cannabis Business Tax.

³ *Mason v. Office of Admin. Hearings* (2001) 89 Cal.App.4th 1119, 1126.

Because the CUP runs with the land, it is completely improper to allow the City to revoke a CUP based upon an operator who is a bad actor. If there is a bad actor operator, the City can and should revoke the operating permit (which is a requirement of the CUP and state licensure) but should not be allowed to revoke the CUP as it is an entitlement that runs with the land. This proposed language also fails to provide any notice or opportunity to cure delinquent taxes – an opportunity that is given to every other business within the City of San Diego.

The timely utilization of permits is a valid and necessary goal. The language proposed, however, goes well beyond ensuring the City's ability to revoke for failure to timely utilize a permit. On behalf of our clients, we request the City remove Section 126.0108(e) from the proposed changes and bring back revised language at a future date that properly supports the timely utilization of permits without the improper attempt to revoke a vested land use entitlement.

2. The proposed language in section 126.0110(d) is vague and ambiguous and would lead to arbitrary decision making by the City.

The proposed changes also add language to section 126.0110(d) that would allow for the cancellation of a cannabis development permit if the “City Manager can make a determination that a *cannabis outlet* or *cannabis production facility* is no longer in operation and has been abandoned by the Condition User Permit holder” through a Process 1 decision. Unfortunately, the proposed language completely fails to define how the City Manager determines that a cannabis outlet or production facility is no longer in operation and has been abandoned.

The staff report inaccurately suggests that SDMC section 126.0110 creates a “cancellation / recession process [that] is voluntary and a property is not eligible if all parties to a CUP cannot reach an agreement... [and that] because the current CUP cancellation/recession process depends upon voluntary approval by both the property owner and the CUP holder, the current Municipal Code abandonment procedures are extremely difficult to implement.”

Oddly, there is no definition for a “CUP holder.” Rather, section 126.0110 refers to a “*permit holder*” which is a defined term. A “*permit holder* means an applicant who has been granted a permit, or the applicant's successor, or the person using the property that is subject to the permit.” An “*Applicant* means any person who has filed an application for a permit, map, or other matter and that is the record owner of the real property that is the subject of the permit, map, or other matter; the record owner's authorized agent; or any other person who can demonstrate a legal right, interest, or entitlement to the use of the real property subject to the application; including any person who has an approved and executed Disposition and Development Agreement with the Redevelopment Agency of the City of San Diego [emphasis added].”

The CBD's frustrations are not codified but rather a creation of the CBD's own making. The requirement for both the property owner and the applicant (as listed on the DS-318) to agree to abandon the CUP is a City internal policy. Approval from the “Applicant” is only necessary to the extent the Applicant has a legal right or title to use the property. If the property owner provides documentation to the City that the Applicant has no legal right or title to use the property, there is no statutory or regulatory requirement for the City to require both parties to agree to abandon the CUP. On the other hand, if the two parties disagree on whether to abandon the CUP, allowing the City Manager to make this determination without specified criteria will only lead to arbitrary and capricious decisions.

The CBD's goals are lofty. The proposed language, however, is a solution without a problem. The CBD's statement that being able to rescind these CUPs will allow the CBD to “include them in the future

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pool for potential equity applicants” is unfounded and without support anywhere in the proposed regulations.

CONCLUSION

For the reasons identified above, we respectfully request the City to remove the proposed changes to SDMC sections 42.1507(e), 126.0108(e) and 126.0110 from the changes proposed to be taken to hearing until such time as the CBD can revise the language to properly achieve the City’s goals without the risk of negative impacts and unintended consequences.


Sincerely,
AUSTIN LEGAL GROUP, APC

Gina M. Austin, Esq.

Exhibit "A"

ALG July 18, 2022 Letter to CBD re: Proposed SDMC Cannabis Amendments

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July 18, 2022

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VIA EMAIL ONLY

RE: Preliminary Comments & Concerns on the Proposed SDMC Amendments to §42.1504 and §42.1507

Dear Ms. Gates:

Austin Legal Group submits this letter as experts in the commercial cannabis industry and corporate law to address several issues with the City's proposed amendments to San Diego Municipal Code ("SDMC") sections 42.1504 and 42.1507. As explained below, the proposed amendments (i) improperly attach corporate liability to individuals; (ii) are incompatible with common corporate transactions; and (iii) do not consider the negative implications to the active local cannabis market and the City's future Cannabis Social Equity and Economic Development (SEED) program. Accordingly, we ask the Cannabis Business Division ("CBD") to remove the proposed amendments to SDMC §42.1504 and §42.1507 from its Proposed Cannabis Municipal Code Amendments Report.

BACKGROUND

The SDMC's definition of a *responsible person* is extremely broad and includes "a corporate director or officer, manager or member-manager, partner, trustee, or sole proprietor of an entity or trust operating or owning a cannabis outlet or a cannabis production facility, and persons responsible for the operation, management, direction, or policy of a cannabis outlet or a cannabis production facility."¹

The DS-191 form (Cannabis Business Operating Permit Form) requires each entity to select one *responsible person* to be the "Designated Responsible Managing Operator." A "Designated Responsible Managing Operator" is not defined within the SDMC, but the City requires this *responsible person* to attest to several representations/conditions on behalf of the company. The City does not allow the COs and CPFs to designate the entity itself on the DS-191 form.

¹ SDMC §42.1502.

The CBD is proposing to amend the SDMC to make it unlawful for any individual to act as a *responsible person* for any Cannabis Outlet (“CO”) or Cannabis Production Facility (“CPF”) if that individual was a *responsible person* for a CO or CPF that is:

- (i) actively delinquent on taxes owed to the City at the time the delinquency occurred;
- (ii) actively delinquent on cost recovery fees at the time delinquency occurred; or
- (iii) actively has a deposit account in deficit at the time the deficit occurred.²

The CBD is also proposing to allow the denial of new DS-191 applications if the applicant had a permit revoked within the 5 years preceding the application date.³ “Applicant” is not defined.

The City is concurrently proposing and developing its SEED Program where it hopes to connect experienced cannabis operators with social equity applicants via mentorship programs, incubator programs, real estate relief, and more.

DISCUSSION

A. The Proposed Tax Amendments Improperly Attach Corporate Liability to Individuals.

The City’s COs and CPFs operate as corporations or limited liability companies. Corporations and LLCs are legal entities separate and distinct from the individuals who create and own them. Entities are established for the very purpose of limited personal liability. The fact that the City requires a “Designated Responsible Managing Operator” to sign the DS-191 form does not change that. Only a few instances exist where corporate protection can be breached and attached to an individual, such as alter ego liability or an individual’s tortious conduct (none of which apply here).⁴

The proposed regulations attempt to circumvent the law and attach the corporate tax liability to individuals because there have been “several instances where cannabis production facilities have not paid their taxes, but the *responsible person(s)* have continued to operate cannabis businesses at other locations.”⁵ The CBD’s proposal is improper. The City’s cannabis business taxes and fees are imposed on the cannabis business itself NOT the *responsible persons* of the business.⁶

The CBD attempts to muddle the true cause of its “tax responsibility concern” – the lack of an effective tax enforcement and appeal process for cannabis business operators. The City has the ability to challenge and review delinquent taxes and has complete discretion to pursue all legal avenues available to it with respect to these entities. Instead, the CBD is seeking to create a major roadblock in the local commercial cannabis industry by prohibiting several individuals, including investors, expert cannabis operators, and managers, from participating in other cannabis business projects.

² City of San Diego June 14, 2022 Development Services Department Staff Report to Community Planners Committee re: Proposed Cannabis Municipal Code Amendments (“Report”), PDF pp. 5-6; Proposed to be codified as SDMC §42.1507(e).

³ Report PDF p. 5; Proposed to be codified as SDMC §42.1504(h).

⁴ *CB Richard Ellis, Inc. v. Terra Nostra Consultants* (2014) 230 Cal.App.4th 405, 411 (stating that members are not personally liable for the debts, obligations, or other liabilities of the limited liability company except in limited circumstances).

⁵ Report PDF p. 5.

⁶ SDMC §34.0101.

B. The Proposed Tax Amendments Do Not Support the City's Future SEED Program.

The Proposed Tax Amendments are detrimental to the SEED Program. The amendments will prohibit qualifying individuals who have been impacted by the War on Drugs from obtaining a cannabis equity permit simply because the individual was a *responsible person* of a delinquent cannabis business. Further, the City's tax regulations provide that taxes are due regardless of whether the business is lawful. This means a qualifying equity individual would be prohibited from obtaining a cannabis permit if he or she was a *responsible person* of an unlawful cannabis business. This defeats the very purpose of an equity program. The City should not be creating additional barriers to entry for an equity program that seeks to assist those unfairly impacted by institutional racism and systemic disparities.

C. The Proposed Tax Amendments Are Incompatible with Common Corporate Transactions and Ordinary Employment Changes.

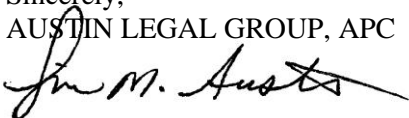
Assuming arguendo that the City is permitted to penalize individuals for corporate tax actions, the amendments are directly incompatible with common business transactions and operations and will inevitably inhibit the success of the local commercial cannabis market. To illustrate:

1. Purchase of Cannabis Company. What happens when a cannabis business is bought, the tax liability is assumed by the buyer, and the *responsible persons* change? How is it productive for the local commercial cannabis industry to prevent all original *responsible persons* from participating in another CO or CPF?
2. Officer, Director, or Management Changes. What happens when an officer, director, or manager leaves a cannabis business that is subject to the proposed SDMC §42.1507(e) and would like to take their expertise to another cannabis business in need?
3. Varying Roles and Responsibilities of Responsible Persons. What happens to the manager that did not have say in the cannabis business's tax payment decisions but would like to join another cannabis business?

The proposed SDMC §42.1507(e) allows the City to unfairly prohibit certain individuals from seeking new cannabis business opportunities because their previous employer or company remains actively delinquent with the City, but will allow other individuals to seek new cannabis opportunities even though their previous employer or company used to be actively delinquent but is no longer delinquent regardless of whether that individual had anything to do with the payment or nonpayment of the taxes.

CONCLUSION

In light of this, we respectfully request the City to reconsider the proposed amendment to SDMC §42.1504 and §42.1507. The unintended consequences will negatively impact the local commercial cannabis market, including the future SEED Program. The City has made extensive efforts in supporting a cannabis market that consists of local owners, operators, and managers who have developed a strong internal network. Placing restrictions and prohibitions on these experienced operators who are not necessarily directly responsible for a company's failure to pay appropriate taxes is not the solution to the CBD's tax concerns.

Sincerely,
AUSTIN LEGAL GROUP, APC

Gina M. Austin, Esq.