May 20, 2015

Testimony by Privateer Holdings Managing Director and General Counsel Patrick Moen to Oregon's Joint Committee on Implementing Measure 91

Good afternoon/evening Madame Chair, Committee members:

My name is Patrick Moen and I am pleased to be here to provide information that may be helpful as you craft a regulatory structure guiding the legal cultivation and distribution of cannabis in Oregon.

I am a former police officer and a licensed attorney. I am also privileged to have spent 10 years serving as a criminal investigator and supervisor within the U.S. Drug Enforcement Administration, including two years running the DEA's inter-agency narcotics taskforce in Portland.

Today, I am managing director for Privateer Holdings, a private equity firm focused exclusively on the legal cannabis industry. We are building a portfolio of responsible, mainstream companies, including a subsidiary that is currently the only American-owned company to become a federally licensed producer of medical cannabis in Canada.

As a former law enforcement official, I've closely watched Washington and Colorado officials struggle to create new rules for cannabis retail sales and to integrate their existing medical marijuana programs. I've met with regulators in both states and understand some of the hurdles they've faced.

Let me begin by being absolutely clear: Privateer Holdings' mission is to help end cannabis prohibition and the social harms prohibition causes by building a professional industry globally. Currently we do not operate a cannabis cultivation or distribution business in the U.S., but we do share a common interest in Oregon being the first U.S. state to get this right. If you get this right, Oregon has the opportunity to become the model for ending cannabis prohibition nationally.

When Oregonians endorsed legalization, I believe they voted to take money and power away from the criminal market by creating a carefully regulated system that protects patients, serves consumers, grows tax revenues and keeps product away from schools and out of the hands of children.

The challenge in front of you is formidable. As we sit here today, a robust illicit market is flagrantly operating under the guise of your medical system. It is one of the biggest threats you face in creating a regulatory framework that successfully eliminates the illicit market and generates meaningful tax revenue.

The illicit market continues to persist in Colorado and, especially, in Washington for three reasons:

First, state officials underestimated illegal operators' ability to take advantage of weak rules related to state medical marijuana programs;

Second, restricted access to capital; and

Third, high taxes (particularly in Washington).

I'd like to focus on the first two issues. Let me start by briefly discussing the illicit market in Oregon. It might surprise some of you to know that, in 2013, officials identified 81 drug trafficking organizations and three money laundering organizations with foreign and domestic connections actively operating throughout Oregon. Those identifiable organizations are just the tip of the iceberg.

Illicit market marijuana is a lucrative business in Oregon. A typical pound of high-quality marijuana can be produced for as little as $150 to $300. That same pound can be sold on the illicit market in Oregon for $1,000 to $1,500, or it could be shipped to the Midwest or East Coast, where it might bring $3,000 to $5,000.

During my time at the DEA, I signed off on countless reports documenting the flow of marijuana out of Oregon and cash inbound. Illegal operators are so bold that they ship their product through the U.S. mail, UPS and Federal Express.

In 2013, law enforcement officials in just four Oregon counties –Douglas, Lane, Deschutes, and Multnomah – seized more than 140 outbound packages containing a total of more than 400 pounds of marijuana. While significant, these seizures are just a drop in the bucket relative to the amount of marijuana actually leaving the state, as I'll explain in a moment.

It's not just drug cartels and criminals who are involved in this illicit trade. Its bad actors who have been operating under the guise of the medical system for more than a decade.

A June 2014 report by the Oregon High Intensity Drug Trafficking Area program (known as HIDTA) **found Oregon's medical marijuana program** continues to be…and I quote… "exploited by local producers who use it to facilitate illegal cultivation."

Based on data supplied to the Oregon Health Authority and to law enforcement agencies, Privateer Holdings estimates that the Oregon Medical Marijuana Program produces significantly more marijuana than registered patients require – an excess of approximately 323,000 pounds per year.

It's likely that most if not all of this 323,000 pounds is being diverted to the illicit market.

For those of you who want to delve more deeply into the numbers, I've provided the committee with a white paper recently completed by Privateer Holdings.

History has shown that prohibition doesn't work for products with inelastic demand, leading to illicit markets. And history also shows that, while law enforcement plays an important role in seeking to eradicate illicit markets, the best way to defeat illegal operators is through a free, transparent and properly regulated and taxed marketplace. A quality marketplace which works hand in hand with law enforcement and regulators.

The bottom line is that until **all** marijuana production in Oregon is regulated, Oregon's legal and legitimate cannabis businesses will be competing with these well-established and well-financed illicit market operations.

And it will be that much more difficult to compete if cannabis businesses operating within Oregon's regulated system are prohibited from raising capital outside the state.

I know Oregon takes great pride in its craft brewing and wine industries. And it's reasonable for you to want to replicate that success with Oregon cannabis products.

Nobody…including Privateer Holdings…wants to see a cannabis industry in Oregon that discourages local entrepreneurs. However, I believe it's important to point out that neither Oregon's brewers nor vintners are prohibited from receiving support from investors just because those investors might be located outside the state.

In fact, many people were excited about the possibilities when Portland's Widmer Brothers Brewing Co. merged with Redhook Ale, based in Woodinville, Washington several years ago to create a new company known as the Craft Brewers Alliance. That company has gone on to create a variety of new, innovative products.

We know from experience, that cultivating and distributing lab tested, professionally packaged cannabis requires significant and ongoing investment to ensure quality and prevent diversion to the illicit market and to stop the product from ending up in the hands of children. For example, construction costs of our 60,000 square foot, state-of-the art grow facility on Vancouver Island topped $400 per square foot. Ongoing operating costs run about $7 per square foot. Oregon costs will likely not be as high. Yet, even small Oregon growers and processors will find it difficult to operate, hire and expand their businesses if they don't have access to capital.

These businesses must invest in security and surveillance systems to protect their operations as well as the community's safety.

And they need to meet a certain standard of quality assurance. Grown or handled improperly, we know that marijuana and cannabis products can be contaminated by mold, mildew, pesticides and even e coli and salmonella – which is particularly concerning for medical patients with compromised immune systems.

Let me also take a minute to talk about what we've learned about the integration of a legal, recreational program with long-established medical marijuana programs.

Colorado's fairly smooth transition to a recreational market was enabled by its existing system of medical marijuana regulations, which tracked product from seed to sale. The first year of recreational sales in Colorado generated more than $60 million in tax revenues for the state. However, in both the medical and recreational markets, we have seen a large number of failed businesses and a significant amount of consolidation, leading to a relatively small number of individuals who dominate the industry. Why? The prohibition on out-of-state investment has eliminated exit opportunities for many entrepreneurs or potential sources of capital to grow their businesses.

Washington is in even worse shape. Washington has a largely unregulated medical marijuana program. Some would say it is more similar to Oregon's current medical program. As a result, Washington was not able to leverage the existing medical market, which resulted in an extremely bumpy rollout of the recreational market, including constricted supply and wild price swings. The unregulated medical system has continued to dominate. As a result, despite a larger population than Colorado, Washington only realized a disappointing $16.4 million in tax revenue for the first 6 months of legal recreational marijuana (with sales and monthly tax collections in the past 5 months staying at about the same rate per month).

And in the end, both Washington and Colorado have plenty of out-of-state money invested – except that it is dark money, its true owners hidden by shell companies and all-cash transactions.

Why would Oregon want to create a monopoly for in-state investors that would be disadvantageous to Oregon growers and entrepreneurs? Restricting out-of-state capital would limit options for legitimate Oregon growers and entrepreneurs to legally and ethically obtain capital needed to grow and professionalize their businesses, which will in turn impede their ability to effectively compete with and eradicate the illicit market.

Oregon can do this the right way. To summarize, I encourage you to:

- Combat the illicit market by creating a well-regulated, competitive market, one in which all growers, processors and retailers (medical and recreational) are licensed, inspected, and accountable.
- Encourage professionalism and opportunities for Oregon growers and entrepreneurs by permitting out-of-state investment.
- Ensure safety by requiring seed-to-sale tracking, security systems and childproof packaging.

I, along with the other members of the Privateer Holdings team look forward to participating in the discussions leading to the successful implementation of Oregon's Measure 91. It's in everyone's interest to get this right.

Again, I submit to you that a well regulated, competitive free market is by far the most powerful way to eradicate the illicit market.

Thank you for your time and I'm happy to answer any questions you may have.