

DEPARTMENT OF CANNABIS REGULATION (DCR)

SOCIAL EQUITY PROGRAM APPLICANT ELIGIBILITY VERIFICATION

EQUITY SHARE GUIDANCE

DCR has prepared this guidance to provide Social Equity Applicants further information regarding the requirements in Los Angeles Municipal Code Section 104.20 that they own minimum percentages of the Equity Shares in the business being licensed. **DCR will update this document as it further develops its procedures for reviewing Social Equity Applicants' business structures.**

TIER 1 SOCIAL EQUITY APPLICANT EQUITY SHARE REQUIREMENTS - FOR BUSINESSES SEEKING PRIORITY PROCESSING

A Tier 1 Social Equity Applicant must demonstrate that it holds the minimum required Equity Shares in the business applying for a license for the application to receive priority processing. A Tier 1 Applicant must hold at least 51% of the business's Equity Shares to receive Priority Processing.

As defined in LAMC Sec. 104.20(b), "Equity Share" means a share of all of the following:

- (i) a business's profits, including dividends, distributions or other payments;
- (ii) the proceeds of a sale of a business's assets, liquidation of a business, merger of a business into another business, or another transaction that would constitute the end of an original business; and
- (iii) the voting rights on fundamental decisions relating to the business.

TIER 2 SOCIAL EQUITY APPLICANT EQUITY SHARE REQUIREMENTS - FOR BUSINESSES SEEKING PRIORITY PROCESSING

A Tier 2 Social Equity Applicant must demonstrate that it holds the minimum required Equity Shares in the business applying for a license for the application to receive priority processing. A Tier 2 Applicant must hold at least 33 and ⅓% of the business's Equity Shares.

As defined in LAMC Sec. 104.20(b), "Equity Share" means a share of all of the following:

- (i) a business's profits, including dividends, distributions or other payments;
- (ii) the proceeds of a sale of a business's assets, liquidation of a business, merger of a business into another business, or another transaction that would constitute the end of an original business; and
- (iii) the voting rights on fundamental decisions relating to the business.

DOCUMENTS THAT MUST BE PROVIDED TO DCR

A Tier 1 or Tier 2 Social Equity Applicant must provide DCR all business records and agreements necessary to demonstrate that the Equity Share requirements are met. These records will vary based upon the structure of the business seeking a license. Below are the documents that must be provided to DCR by business type:

- Corporation: Articles of Incorporation, bylaws and stock ledger
- Limited Liability Company: Articles of Organization and operating agreement
- Limited Partnership: Certificate of Limited Partnership and partnership agreement
- General Partnership: Statement of Partnership Authority (if filed) and partnership agreement

Additionally, a Tier 1 or Tier 2 Social Equity Applicant must provide DCR all agreements or contracts the Applicant, the business or its owners have entered into concerning the distribution of the business's profits or revenues or the right to control the business, including but not limited to, subscription agreements, management agreements, loan agreements, and profit-sharing agreements.

PROHIBITED TERMS AND PROVISIONS

Below are specific provisions and terms DCR will not approve as they would violate the Equity Share requirements. **This is not an exhaustive list.** DCR will closely review an Applicant's business structure and related agreements to verify that the Equity Share requirements have been followed and it may deny an application if it finds the business structure violates the requirements.

Vesting of Minimum Required Equity Shares

A Tier 1 or Tier 2 Applicant must hold the minimum required Equity Shares in the business at the time of applying for a license. An agreement by which a Tier 1 or Tier 2 Applicant's minimum required Equity Shares vest over time is strictly prohibited.

Disproportionate Profit-Sharing Provisions

A Tier 1 or Tier 2 Applicant must receive a portion of the business's profits proportionate to its minimum required Equity Shares. An agreement by which a Tier 1 or Tier 2 Applicant owns a minimum of 51% or 33 and $\frac{1}{3}$ %, respectively, of the licensed business's Equity Shares but receives a lesser percentage of the business's profits is strictly prohibited.

Disproportionate Voting or Control Provisions

A Tier 1 or Tier 2 Applicant must hold voting or control rights in the business proportionate to its minimum required Equity Shares. An agreement by which a Tier 1 or Tier 2 Applicant owns a minimum of 51% or 33 and $\frac{1}{3}$ %, respectively, of the licensed business' Equity Shares but receives a lesser percentage of the business's voting or control rights is strictly prohibited.

Provisions That Disguise Distribution of Profits

DCR may prohibit provisions that it determines have the intent or effect of disproportionately distributing a business's profits under the guise of seemingly legitimate business expenses. This includes but is not limited to the payment of excessive salaries, bonuses or management fees to non-Social Equity Applicant owners as a means to dilute a Social Equity Applicant's Equity Shares.

MANAGEMENT AGREEMENTS

As provided under LAMC Sec. 104.21, a Management Company may manage commercial cannabis activity on behalf of a Tier 1 or Tier 2 Social Equity Applicant provided that DCR approves the management agreement. A Management Company may also share in the profits generated by a Tier 1 or Tier 2 Social Equity Applicant provided that its profit-sharing interest remains below 20% (profit-sharing of 20% or greater would make the Management Company an Owner of the licensed business and subject to the ownership restrictions in LAMC Sec. 104.02(a)(2)). **Further, whatever a Management Company's profit-sharing interest, the Tier 1 or Tier 2 Social Equity Applicant must still receive a share of the licensed business's profits proportionate to the required minimum Equity Shares.**

Additionally, DCR will review management agreements to assess whether there are any provisions that would effectively dilute the Tier 1 or Tier 2 Social Equity Applicant's Equity Shares, such as excessive management fees.

CONSEQUENCES OF FAILURE TO DISCLOSE ALL RELEVANT AGREEMENTS

Applicants that fail to disclose all agreements and other documents relevant to the Equity Share requirements will face serious consequences. If DCR discovers that an Applicant, either during the application process or post-licensure, has entered into an undisclosed agreement relating to Equity Shares, DCR will deny its application for a license or revoke its license, respectively. Further, such an Applicant may be subject to civil and criminal penalties for its fraudulent conduct.