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CANNABIS REGULATION AND LITIGATION LANDSCAPE

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HOT TOPIC

CANNABIS REGULATION AND LITIGATION LANDSCAPE



PANEL EXPERTS



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Eric W. Sleeper is a partner with the firm of Barton LLP based in New York City. Mr Sleeper and Barton are also members of Primerus, through which they partner with more than 200 law firms across the US and in countries around the world. Mr Sleeper has been practicing law for more than three decades. Historically, his practice has focused on risk management concerns, general corporate advice, commercial litigation, corporate restructurings and bankruptcies, as well as creditor rights. He also leads Barton's multi-disciplinary cannabis law practice as well as Primerus' cannabis practice group.



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Tina M. Maiolo is a partner at Carr Maloney P.C., a mid-size business and litigation law firm in Washington, DC. Ms Maiolo has over 25 years of experience as a business adviser and litigator across a variety of industry groups for nearly every issue in employment and labour matters, business law and commercial litigation, cannabis law, immigration law and civil rights.

CD: Could you describe the evolution of the legal cannabis market in the US, and provide an overview of its growth in recent years?

Sleeper: The sale and use of cannabis legally in the US became popular in about the mid-19th century, largely from a medicinal and therapeutic standpoint. However, by the 1930s, attitudes changed significantly, and most states had banned the use of cannabis except for some medicinal uses followed by the federal government via the 1937 Marihuana Tax Act and 1970 Controlled Substances Act (CSA). By the 1980s, attitudes once again changed in the US, with grassroots organisations pushing for greater decriminalisation of marijuana offences. In recent years, growth of the cannabis market can largely be summed up in one word: meteoric. Forty-four percent of American adults now have state access to legal adult use cannabis. That encompasses almost 250 million Americans living in states where cannabis is legal medically and roughly 150 million American adults live in states where cannabis is legal on a recreational basis. Usage rates, as self-reported, have correspondingly risen sharply since Washington and Colorado opened the doors beginning in 2012 to other states permitting the recreational use of cannabis. IBIS World has reported that between 2016 and 2021, medical and recreational cannabis cultivation and retail businesses in the US in terms of revenues, profits,

jobs and wages grew between 20 to 30 percent. Sales in the US increased this past year alone by 40 percent to \$24bn, eclipsing North American sales of Starbucks coffee, and projections show expected sales to grow to more than \$70bn within just the next four years, eclipsing the market for craft beers.

Maiolo: Marijuana made its way to North America via Jamestown settlers in 1611. For generations, hemp was used to make necessities and was so valuable it was considered legal tender. In 1906, through the Pure Food and Drug Act, cannabis was first labelled an “addictive and dangerous” drug. Then, through misinformation and propaganda, cannabis was effectively banned via the 1937 Marihuana Tax Act. In 1996, California became the first state to legalise medical marijuana. Between 1998 and 2012, 20 states had medical marijuana programmes. In 2012, Washington and Colorado became the first states to legalise recreational use. As of April 2022, 37 states have medical marijuana programmes and 18 states have legalised the recreational use. Marijuana remains illegal on the federal level but, on 1 April 2022, the US House of Representatives passed legislation that would legalise marijuana nationwide and remove criminal penalties for manufacturing, distributing or possessing. To be enacted this bill will still need to pass the US Senate. According to flowhub.com, weed sales reached \$25bn in 2021, mergers and acquisitions of multi-state operators (MSOs) nearly

doubled from 2020 to 2021 and the cannabis industry now supports nearly 450,000 jobs.

Bauchner: To understand the evolution of legalisation, it is important to first understand the racist history of criminalisation. Cannabis in the US was rendered criminal by an admitted racist named Harry Aslinger, the first commissioner of the US Treasury Department's Federal Bureau of Narcotics, who promoted passage in 1937 of the Marihuana Tax Act, specifically targeting African-Americans. Years later, the Nixon administration doubled-down on Aslinger's racism through passage of the federal CSA denoting cannabis as a schedule I narcotic having no medicinal benefit. Members of the Nixon administration, as well as Oval Office recordings, confirm that president Nixon wanted to continue the criminalisation of cannabis to target minorities and hippies – his perceived enemies. Against the backdrop of federal prohibition, states determined to both decriminalise and legalise cannabis, first recognising its apparent medicinal benefits and later appreciating the benefits of adult-use. Other factors converged, including grassroots campaigns for compassionate use, calls for criminal justice reform, and advocacy by groups such as the National Organization for the Reform of Marijuana Law (NORML) and others, heralding a more widespread state expansion of cannabis legalisation. As of this writing, 39 states permit access to cannabis through medical or adult-use programmes. Recognising this

trend, and the resulting tax revenue, the federal government has taken a hands-off approach to enforcement of the CSA except in extraordinary circumstances, such as when it is related to financing terrorism, child pornography or human trafficking.

CD: How would you characterise regulation of the US cannabis industry? How uniform has legalisation been from state-to-state thus far?

Maiolo: The regulation of the US cannabis industry is essentially non-existent on the federal level, because marijuana is still a schedule I drug, and is often strict but conflicting from state to state.

Bauchner: Regulation is far from uniform, although early legal jurisdictions such as Colorado and Massachusetts, and lessons learned throughout the country, have contributed significantly to the emergence of regulatory models. Our legal advice rests on industry best practices, based on how cannabis businesses have adapted in this fast-moving and diverse regulatory environment.

Sleeper: Regulation of the US cannabis industry is chaotic. The federal government continues to treat cannabis with more than 0.3 percent THC as illegal for any use. Only industrial hemp, with non-psychoactive levels of THC, such as in hemp

cannabidiol (CBD), is legal at the federal level, and that market has its own limitations commercially. This has led to the scattershot nature of laws and regulations in the US impacting the industry. Banking and financial markets remain a significant challenge for the industry due to the Money Laundering Control Act (1986) as well as the Bank Secrecy Act. Potential Congressional solutions, such as the Secure and Fair Enforcement Act (SAFE), the States Act and the Marijuana Opportunity Reinvestment and Expungement Act (MORE), have all remained stymied largely in the Senate. This has left things to the states to open pathways to decriminalisation, medical legalisation and recreational legalisation. Not surprisingly, this has led to a diverse landscape among states and marked inconsistencies.

CD: What implications do emerging regulations have for cannabis manufacturers and retailers? What key compliance challenges do they face?

Sleeper: Despite ongoing federal prohibition, the cannabis industry in the US has matured fairly significantly during the past decade while also experiencing dramatic growth. However, due materially to the notable regulatory hurdles and

their associated costs as well as limited access to the financial markets, legalisation continues to favour companies of scale. MSOs, many of which were early players in medicinal cannabis, have so far been better able to bear the costs of a diverse

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Carr Maloney P.C.*

US regulatory landscape, licensing process and multiple compliance obligations, while having much greater opportunities to raise the funding necessary to operate within this environment. Not surprisingly, 2021 saw almost 300 M&A deals within the industry as MSOs, in particular, strove to become even larger and expand into new markets, such as those in New Jersey and New York, by gobbling up smaller potential competitors. Some states, such as New Jersey and New York most recently, are attempting through various initiatives to give smaller players and ‘social equity’ participants greater access and legs up in the industry within their states.

Bauchner: Supply chain transparency from cultivation to point-of-sale, revenue tracking for tax purposes, and ensuring safety and quality are all paramount concerns. It is imperative to keep up with evolving regulatory guidance on all aspects of a cannabis business from seed to sale. The consequences of even inadvertently acting outside agency and local rules and regulations can threaten licensure, and be a headache at best to remedy, so one of the most important hallmarks of counselling clients is to understand their business from a more holistic standpoint. In this sense, the best legal advice will invariably rest on a complete understanding of both the legal and non-legal implications of each client's operations.

Maiolo: Until cannabis is legalised on a federal level, key challenges faced by cannabis manufacturers and retailers include banking, insurance and even tax reporting. As more regulations emerge, manufacturers or retailers with locations in more than one state must ensure they fully comply with the web of regulations in each of those states, which might, at times, be contradictory. Once marijuana is legalised on a federal level, regulations will control most aspects of manufacturing and sale. It will be a challenge to understand and comply with all controlling

regulations, particularly if a manufacturer or retailer has been operating under state regulations, only to have those operations changed by new federal regulations.

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CD: Is there a trend of market participants promising health benefits that are not supported by established science? To what extent is this a major risk factor for the future of the cannabis industry?

Bauchner: Safety is paramount now, especially in the largely unregulated CBD and non-THC markets. For any cannabis product, the company producing it should be clearly identified and the sourcing of its materials should be transparent. Its operation should

adhere to good manufacturing practices, such as to ensure that the product is free of heavy metals and harmful residues left over from solvents used in the extraction process. Some brands link certificates of analysis for their products on their websites, some even going so far as to ensure that they are frequently updated to keep up with new batches of product. Overall, however, there remains a clear and growing need for consumer education and medical research.

Maiolo: While there are many unsubstantiated claims of cannabis benefits, there are few market participants promising health benefits that are actually unsupported by established science. That might be because science has not yet had the opportunity to confirm or debunk the wide array of claimed physical and mental benefits. While any false claims risk the reputation of a product, there are so many proven benefits of cannabis that I do not think the false claims will be a major risk factor to the future of the industry as a whole.

Sleeper: Because of the illegal status of cannabis at the federal level for decades, research in the US as well as internationally into the health implications of cannabis has been constrained in comparison to, for example, pharmaceuticals. As such, there

have been and continue to be businesses within the industry that seek to take advantage of the limited oversight of products. Reputable businesses within the cannabis industry recognise this reality and generally support a greater level of oversight and enforcement to weed out the 'bad actors'. But regulatory and enforcement resources both federally and at the state and local levels are stretched thin in comparison to the huge growth of the industry and its products. This past year there was, however,



some more publicly disclosed 'enforcement' activities at the federal and local levels of companies professing the 'health benefits' of their products, especially for CBD products and infused edibles.

CD: What steps should cannabis companies take to ensure their products are represented both accurately and in line with the varying and developing regulatory guidance?

Maiolo: Companies need to know the existing regulations thoroughly and study the laws or regulations being proposed by the legislature. It is wise not only to comply with laws that are in existence but to prepare for what is coming. All labels and marketing efforts should be accurate, and companies should not make any claims that have not been proven to be true.

Sleeper: First, do not make undocumented and untested claims about products. Stay away from making unsubstantiated assertions about the alleged health and medical benefits of one or more products. Since research, especially as generally contemplated by the Food and Drug Administration (FDA) processes and peer reviews, is limited, at best, scientifically supportable claims of such

benefits can be, in certain respects, questionable. Also, be conscience of consumer products laws and regulations applicable to products and what could

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Ansell Grimm & Aaron, PC*

be deemed to cross the line into being actionable. There are also varying operating and compliance regulations to consider in each state that permit either or both the medical and recreational use of cannabis. Given the significant number and variances of regulations at the federal, state and local levels bearing upon operating a business in the cannabis sector, any such business would be well-advised to retain knowledgeable legal counsel in the US to properly route them through the multiple regulations while being certain they are following the same as needed.

Bauchner: Keeping up with the ever-changing regulatory environment is a complex issue with many moving parts, and legal consultation is strongly advisable. As one window into how regulators have dealt with concerns over false advertising or inadequate labelling, the FDA has announced enforcement actions from time to time against CBD companies which were found to have made false or misleading health claims. Best practices also show trends toward more comprehensive labelling of the compounds in any cannabis product, and this is especially useful for terpene profiles because the emerging scientific literature trends away from a simple, binary understanding of sativa and indica strains.

CD: Are you seeing a rise in cannabis-related litigation? Are there any key themes or underlying drivers?

Bauchner: Cannabis law touches many aspects of traditional lawyering, such as real estate, land use planning and zoning, product licensing, corporate formation and governance, as well as a variety of transactions from more conventional service agreements to mergers and acquisitions and complex investment vehicles. By and large, litigation that we have seen has little or nothing to do with the cannabis aspect of the business per se, but more involving those separate legal issues. This is why it is frequently important to seek out legal counsel

with experience in both the cannabis-side of the business, as well as a sophisticated business and corporate practice.

Sleeper: The litigation landscape in the US has matured over the past decade. Years back, much of the focus was on administrative law type matters of regulatory concerns and compliance. However, as the industry has matured, so too has the legal and litigation focus. Today, much of that focus is on commercial disputes typical to most industries. The growth in litigation has been seen in areas such as breaches of contract, partnership disputes and alleged breaches of fiduciary duties, insurance coverage disputes, intellectual property disputes, cyber security concerns, securities litigation, Federal Trade Commission (FTC) and consumer rights litigation, claims associated with the delta variants of cannabis, employment and employee testing-related litigation, as well as hemp-related claims.

Maiolo: Cannabis-related litigation is on the rise, as you would expect from a newly legalised product. Litigation is covering all types of claims. Some examples of the types of cases we are seeing are challenges to state residency requirements, discrimination claims against employers when the employee has tested positive for THC, and trademark claims between competing cannabis businesses.

CD: What essential advice would you offer to cannabis companies on navigating a complex regulatory landscape, reducing litigation risk, and protecting their assets and investments?

Sleeper: Companies should engage knowledgeable professionals up front, including legal counsel, outside compliance experts and the like. The regulatory field is huge and diverse. Compliance obligations are numerous. Trying to stay on top of the same in-house while also dealing with all of the complexities of getting a cannabis business off the ground and remaining operational and profitable could be a fool's errand. While the financial upside can be significant to a successful business in the cannabis sector, the demands to get there are equally significant and very time consuming. This is not an industry made for cutting corners or being pound wise and penny foolish. Beyond this are some common sense essentials, such as performing all necessary due diligence, staying on top of regulations and compliance obligations, getting things in writing as much as humanly possible, knowing your agreements before you sign them and paying attention to corresponding contractual obligations, and remaining flexible.

Maiolo: The best advice is to have a team of professional advisers from the start. At a minimum, companies should have cannabis-focused attorneys and accountants involved from the planning process through operations as the laws are complex and ever changing, and mistakes or violations can be costly.

Bauchner: While there will be some bumps in the road for all companies, those that are well-managed and committed to best practices will thrive the most. This includes staying collaboratively engaged with policymakers and stakeholders, taking no shortcuts in securing capital or running the business, carrying sufficient specialty insurance coverage, continuously monitoring business operations for regulatory compliance, and engaging the communities in which they are located from the ground up, in order to win local approvals and brand themselves most effectively. **CD**