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FEATURE ARTICLE

NEW JERSEY GRAPPLES WITH THE LEGALIZATION OF CANNABIS

By Joshua Horn and Joseph McNelis III

The story of cannabis legalization in New Jersey is still being written a after a recent push to legalize recreational or "adult use" cannabis narrowly failed in the State Senate. In response to this close call, the legislature has enacted an expansion of the state's medical marijuana program. And in the last year, one state trial court and one U.S. District Court have weighed in on whether New Jersey employers have a duty to accommodate medical marijuana use in the workplace. Given these recent developments, it is a perfect time to take stock of the cannabis industry in the state, and discuss the how the legal landscape may change in the coming years.

Adult Use Cannabis Legislation Narrowly Fails

In 2018, then candidate, now Governor, Phil Murphy ran on a platform of passing recreational marijuana legislation in New Jersey in the first 100 days of his administration. While he did not deliver his 100-day "promise," an adult use cannabis bill was drafted and introduced in both the New Jersey Senate and Assembly. The New Jersey Cannabis Regulatory and Expungement Aid Modernization Act (Senate Bill No. 2703, Assembly Bill No. 4497, is a wide-ranging bill that was the result of negotiation from both sides of the aisle.

Primarily, the bill would legalize marijuana in the state for recreational use, allowing individuals 21 and older to possess up to 1 ounce for personal use, provided for the delivery of marijuana, and would permit social consumption at state-licensed dispensaries. There were also provisions paving the way for the expungement of prior marijuana-related convictions.

While a recent Monmouth University public opinion poll showed that nearly two-thirds (62 percent) of New Jersey residents favored legalizing the possession and use of small amounts of marijuana, many legislators pushed back on the proposed bill. The sticking points for these legislators included questions regarding the level of taxation, driver safety, law enforcement training, and the potential for recreational cannabis to get into the hands of minors. To allay some of these concerns, the law allowed municipalities to "opt out" of allowing the sale of recreational cannabis. Although none of these issues could be seen as the ultimate death knell, the opposition (or trepidation) to the bill ultimately won out. In March 2019, State Senate President Steve Sweeney announced he was pulling the legislation, with a promise to continue working on the issue and to potentially re-introduce it at a later date.

In the wake of the bill's failure, several state legislators have expressed interest in placing a recreational cannabis legalization initiative on the ballot in 2020. This is a common tactic for cannabis legalization advocates, as states across the country have enacted both medical and recreational cannabis legislation via ballot initiative. And with the 2020 election expected to drive overall turnout, especially among the "young voter" population, a cannabis legalization initiative has promise in the Garden State. However, regardless of when adult use cannabis legislation does pass, residents and stakeholders alike should expect a period of 12-18 months between legalization and full implementation of the program, during which time the state will issue regulations and licenses for the adult use program.

Major Expansions to the Medical Marijuana Program

Perhaps in response to the aforementioned setback on recreational marijuana, both the legislature and

Governor Murphy recently announced significant moves to alter the state's medical marijuana program. In 2018, the New Jersey Department of Health issued licenses to 12 entities, six of which are fully operational (Compassionate Care Foundation, Inc.; Greenleaf Compassion Center; Garden State Dispensary; Breakwater Alternative Treatment Center; Harmony Dispensary; and Curaleaf NJ, Inc.). However, the new expansion from the Governor calls for over 100 additional licensees, among other important changes. According to the Department of Health, the additional cultivators and dispensaries will help to meet growing demand for the product in the state, which has seen long lines at dispensaries and depleting inventory at dispensaries. A June 3, 2019 statement from Department of Health Commissioner, Shereef Elnahal, M.D., announced the opening of applications for 24 cultivators, 30 manufacturers, and 54 dispensaries.

Legislative Developments in Medical Marijuana

On the legislative sides comes the Jake Honig Compassionate use of Medical Marijuana Act (Jake's Law), named in memory of a seven-year old who suffered from cancer and treated with medical cannabis before he passed away. Jake's Law passed the State Senate on May 30, 2019 by a 33-4 vote. The bill represents a significant expansion of New Jersey's medical marijuana program. Changes include increasing the amount of cannabis a patient can purchase per month from 2 to 3 ounces; simplifying the process for patients to get a doctor's recommendation by eliminating the previous requirement that patients see their doctor four times per year; phasing out the sales tax on medical marijuana by 2025; permitting home delivery; and setting a goal of issuing 15 percent of the state's cannabis business licenses to minority owners and 15 percent to women, disabled people and veterans. Finally, in addition to Jake's Law, the New Jersey Senate has introduced a bill that would make the expungement process easier for individuals with prior non-violent marijuana-related prosecutions, legislation that will be re-introduced and voted on in June.

Jake's Law would also have significant employment law implications. The law includes an provisions that protect an employee's right to use medical cannabis, although it does not require an employer to accommodate on-site possession or use. However, the law prohibits employers from:

> . . .taking adverse employment action against an employee who is a registered qualified patient based solely on the employee's status as a registrant with the commission.

It also requires employers to give employees the opportunity to present a "legitimate medical explanation" if they test positive for cannabis on an employer-required drug screening. Such proof could include submitting information explaining the test result, retesting at the employee's expense, and submission of a doctor's authorization to use medical cannabis. Jake's Law also contains a provision stating that an employer need not commit any act that would cause it to be in violation of federal law, or that would result in the loss of a license or federal funding (such as a government contract). This type of "carve-out" provision appears in nearly every state medical cannabis law, and is necessitated by the fact that marijuana is still a prohibited controlled substance under federal law, due to the Controlled Substances Act.

While Governor Murphy supports expansion of the state's medical marijuana program in principal, some commentators have suggested it is not a given that he will sign Jake's Law in its current form. For one, the Governor has pushed back on the creation of a state commission to administer the program, which would take administration of the program out of the hands of the New Jersey Department of Health. Despite this potential opposition, there is strong momentum for this expansion, particularly as advocates look for a win after failing to pass the aforementioned adult use cannabis legislation. Some version of Jake's Law is likely to pass and be signed into law in New Jersey in 2019.

Convergent Rulings on Workplace Accommodations for Medical Marijuana

Courts across the country have recently been faced with the question of whether employers must provide accommodations for employees who use medical marijuana. Similarly, employers have had to decide whether and how to continue enforcing employee drug testing policies, and employees have struggled with whether they should inform their employers they use medical marijuana. These questions are complicated by the dichotomy between federal and state law concerning the legal status of marijuana, and are unlikely to be fully resolved until new legislation is

passed. Indeed, as will be explained below, one federal and one state court issued rulings in the past year—one of which could be seen as a win for employers, and the other, for employees.

Federal Court—New Jersey's Medical Marijuana Law Does Not Require Exceptions to Drug Testing Policies for Medical Marijuana Use

In *Cotto v. Ardagh Glass Packing, Inc.*, ___F. Supp.3d___, Case No. 18-1037 (D. N.J. Aug. 10, 2018), the U.S. District Court for the District of New Jersey dismissed the complaint of a medical marijuana user who refused a drug test mandated by his employer. The District Court held that the New Jersey Compassionate Use Medical Marijuana Act (CUMMA) and the New Jersey Law Against Discrimination (LAD) do not require employers to waive drug testing requirements for employees who use medical marijuana.

Background

Plaintiff Daniel Cotto worked as a forklift operator. During his employment, Cotto used medical marijuana to treat neck and back injuries. At the time of his hiring in 2011, the plaintiff informed his employer that he used medical marijuana recommended by a doctor to treat these injuries, and provided his employer with medical documentation showing it as safe for him to work and use medical marijuana. He suffered another work injury in November 2016, and was placed on "light duty" as a result. The plaintiff was told that no "light duty" work was available at that time.

Subsequently, the plaintiff had a phone conversation and a meeting with his employer in which the company noted its concern about the plaintiff's ability to safely work while using medical marijuana. The company informed plaintiff of its policy requiring him to pass a drug test before returning to duty after suffering a work injury. The plaintiff objected to the drug testing requirement, and again provided his employer with his medical marijuana card and documentation stating that his medical marijuana was safe for use related to his work. Nevertheless, the employer did not allow the plaintiff to return to work until he could pass a drug test.

Mr. Cotto did not return to work, and later filed suit against Ardagh. He alleged that Ardagh's actions amounted to a termination, and that the employer's actions constituted disability discrimination in violation of the CUMMA and the LAD. He claimed that he was still capable of performing the essential duties of his job and that Ardagh failed to provide a reasonable accommodation. The employer filed a Motion to Dismiss the Complaint.

The LAD prohibits:

> . . .any unlawful discrimination against any person because such person is or has been at any time disabled or any unlawful employment practice against such person, unless the nature and extent of the disability reasonably precludes the performance of the particular employment. N.J. Stat. Ann. § 10:5-4.1.

The District Court's Decision

The District Court held that plaintiff was "disabled" under the LAD, but that he could not complete the essential functions of his job. Specifically, the court stated that while the plaintiff could physically complete his job, his passing a drug test pursuant to the employer's policy was an "essential function" of his position. And the court predicted that a New Jersey state court would hold that:

> . . .the LAD does not require an employer to accommodate an employee's use of medical marijuana with a drug test waiver.

Because plaintiff could not perform this function, the court found that Ardagh was within their rights to terminate him.

The court also dismissed the plaintiff's claim under the CUMMA. The court first noted that although the employer took a "more permissive stance" towards the plaintiff's use of Percocet than his use of medical marijuana, this was justified by the Controlled Substances Act and the federal prohibition on marijuana use. The court stated that although the use of medical marijuana was legal in the State of New Jersey, it was required to examine whether the CUMMA contained employment-related provisions to support plaintiff's discrimination claims.

The court noted that it was constrained by the language of the CUMMA, which contains no provision requiring employers to make any accommoda-

tion for the use of medical marijuana. Indeed, the law provides just the opposite:

> . . .[n]othing in this act shall be construed to require . . . an employer to accommodate the medical use of marijuana in any workplace. N.J. Stat. Ann. § 24:6I-14.

The court also distinguished the provisions of the CUMMA (or lack thereof) from other state statutes with more expansive employee protections. The court made clear that it was making a "narrow" decision based on the statute's language, which did not require any accommodation for employee medical marijuana use or a waiver of the employer's legitimate drug testing policy. Ultimately, the court held that the employer was, "within its rights to refuse to waive a drug test for federally-prohibited narcotics."

One main takeaway for employers from this case is that the language of the state statute at issue is paramount in making employment decisions. In *Cotto*, the applicable statute—the CUMMA—lacks any provision requiring employers to make an accommodation for medical marijuana use. But as the *Cotto* court noted, several states do contain provisions protecting employees from certain adverse employment actions based on their medical marijuana use. And assuming Jake's Law does pass, the landscape of employment protections for medical marijuana users will look very different, and will allow employees to affirmatively prove that their positive drug test was the result of state-sanctions medical marijuana use. Therefore, before making any employment decisions concerning medical marijuana users, employers and practitioners would be wise to examine the status of any employee or applicant under the state's medical marijuana law, and engage the employee in an interactive process to determine: 1) if they are a medical marijuana user, 2) how the use of medical marijuana might affect their ability to complete the essential functions of their job, and 3) whether a reasonable accommodation is feasible, allowing the employee to use medical marijuana off-site. It is also important for employers dealing with employees in safe-sensitive positions to determine if passing a drug test could be seen as an "essential function" of the employees' job title, as the employer in *Cotto* did.

State Court—New Jersey Law against Discrimination May Require Reasonable Accommodations for Medical Marijuana Users

In March 2019, a New Jersey appellate court reversed a dismissal of employment discrimination claims under the LAD in the case of *Wild v. Carriage Funeral Holdings, Inc*. The plaintiff was a funeral director who had been using medical marijuana to treat pain related to his cancer. The plaintiff was forced to take time off after suffering injuries in a car accident. After returning to work, the plaintiff informed his employer that he had been using medical marijuana to treat his cancer. The company then administered its own drug test, for which the plaintiff tested positive for marijuana. As a result of the drug test, the plaintiff and was terminated.

The plaintiff filed a complaint, alleging among other things that his termination as a violation of the LAD. In ruling upon the defendant's motion to dismiss the complaint, the trial court held that the plaintiff could state a claim under the CUMMA based on the provision stating that:

> . . .nothing in [the Compassionate Use Act] shall be construed to require ... an employer to accommodate the medical use of marijuana in any workplace.

The Appellate Court's Decision

However, the appellate court disagreed, stating that this provision "neither creates nor destroys rights and obligations," ultimately holding that the employee may be able to state a claim under the LAD.

This ruling did not represent a full win for the plaintiff, since the case was on appeal of a motion to dismiss the complaint. However, the at such an early stage, the appellate court did determine that the plaintiff made a prima facie showing of discrimination, which requires a plaintiff to allege four elements:

- The employee has a disability or that the employer perceived the employee to have a disability;

- The employee was qualified to perform the essential functions of the job;

- The adverse employment action was because of the disability or perceived disability; and

- The employer thereafter sought a similarly qualified, but non-disabled, individual.

The court found that the plaintiff established each of these elements by alleging that he had a history of cancer, he had been performing the essential functions of his job, and that his employer terminated him after learning that he was a medical marijuana user.

While this case and the *Cotto* case discussed above may seem divergent, there are some conclusions to draw from these cases for employers who want to make employment decisions that comply with both federal and state law. In previewing potential defenses to such a claim, the court did not a caveat that state law does not immunize medical marijuana users from adverse action, noting that employers can still terminate an employee for arriving to work under the influence of marijuana or for possessing or using marijuana on the employer's premises. What is clear from these cases, however, is that companies should not rely solely on a positive drug test as a basis for their employment decisions where the applicant or employee is a medical marijuana user. Rather, such evidence should be coupled with evidence that the employee was actually impaired in the workplace, or that the presence of marijuana in their system would inhibit their ability to perform the essential functions of their job. Managers and supervisory employees should also be trained to recognize and document the signs of impairment, which may include: the presence of marijuana, the presence of paraphernalia used to consume marijuana, the odor of marijuana, bloodshot eyes, poor coordination, slurred speech, disorientation, lack of focus, confusion, delayed reaction times and/or an inability to perform routine tasks. These tips are even more important for employers if and when Jake's Law is signed into law, which significantly increases protections for employees who are medical marijuana users.

Conclusion and Implications

As with the landscape on the federal level and in several states, marijuana laws in New Jersey are in flux. Adult use cannabis legalization faced challenges, with a much-lauded bill narrowly failing to pass in the New Jersey Senate. However, all signs point to expansion in the state's medical marijuana program, whether by the Governor, the legislature, or both. Whether this expansion allays the concerns of adult-use advocates or spurns further debate is yet to be seen. However, what is certain is that medical marijuana use will increase in the Garden State and employees in the state are likely to receive increased protections in the workplace. Therefore, individuals, businesses, and industry watchers in the state should be prepared for a legislative and regulatory environment that increases the availability and use of cannabis in the state, first for medical use, and inevitably, for recreational of adult use.

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CANNABIS NEWS

SUCCESSFUL CALIFORIA RETAIL CANNABIS SALES: A COOPERATIVE MODEL BETWEEN BUSINESSES AND LOCAL JURISDICTIONS

In the two years since California voters approved Proposition 64, most local governments throughout the state have debated the merits of allowing or prohibiting the various types of commercial cannabis businesses. A recent cannabis industry study found nearly all of California's 482 cities have adopted regulations that affect some or all types of adult-use cannabis activity enabled under the Adult Use of Marijuana Act (AUMA). (*See:* Schroyer & McVey, *Most California Municipalities Ban Commercial Cannabis Activity* [February 18, 2019] *Marijuana Business Daily*; https://mjbizdaily.com/chart-most-of-california-municipalities-ban-commercial-cannabis-activity/ as of February 21, 2019.)

Following this initial wave of regulations, entrepreneurs and business owners must now decide where and how to best establish their cannabis businesses. A part of that calculus will invariably be based on whether the chosen business model will be, at the very least, legally authorized and, ideally, even encouraged in the local jurisdiction where they chose to place their business. But while this acceptance may be a moving target over time, it is not one that is completely outside of the control of the cannabis industry. Through cooperation between businesses and local governments, a positive model for success seems to be developing which could lead to broader acceptance of the industry while increasing the amount of input local jurisdictions have to shape how the industry develops in their community.

Working With Jurisdictions Implementing Local Regulations Is an Opportunity for Business to Show What Works

The policy decisions behind whether or not to allow certain types of use have largely already been made, but work remains to be done to implement those policy decisions. Because of the nascent nature of this regulatory framework, local elected officials and their staffs will continue to evaluate and re-evaluate their decisions and decision-making processes. While such re-evaluation may be based on changes to the membership of these legislative bodies, it will just as likely be driven by the practical considerations and experiences of seeing what works and what does not in the implementation of the approval and vetting processes.

This reality leaves applicants and business owners in a unique position as compared to businesses operating under a mature regulatory scheme. At the local level, cannabis business owners and applicants can directly influence how their industry will be regulated in the future. This influence can come in a variety of forms. First, and perhaps foremost, businesses that successfully navigate the regulatory scheme and operate within the law will serve as a positive example and template for others no matter if they are operating in Los Angeles or Rio Dell in Humboldt County. The success of such businesses, and the regulatory processes that allowed them to operate, will provide guidance to other local jurisdictions pondering modifications to their policies or procedures. Similarly, news of failures in process and non-compliance on the part of businesses will also impact future decisions.

No California jurisdiction yet has a fully mature regulatory framework for cannabis. Some jurisdictions, such as Santa Barbara County and the City of Los Angeles, have expended great efforts to develop programs that are robust and well-considered. But even their regulatory programs are subject to re-evaluation based on the banner successes and cautionary tales of business and regulatory failures that are just now unfolding.

Cooperation Comes in Many Shades

Regardless of whether a business owner is looking at Santa Barbara County, the City of Los Angeles, or one of the myriad other jurisdictions that has decided to welcome some or all aspects of AUMA-legalized cannabis, bringing a cooperative spirit will go far in facilitating whatever process the local jurisdiction

has in place. That cooperation can come in various forms—below are the most valuable steps a cooperative applicant can take to assist the local jurisdiction in its process to evaluate its application:

- Become familiar with the policies that have been adopted by the local jurisdiction with respect to the desired business type and any application processes that have been implemented.

- Submit an complete application package that includes all required information and includes a comprehensive, well thought out business plan.

- Be accessible to questions by staff, and ensure any consultants or business partners are also available.

- Communicate with city staff before any public hearings to reduce the likelihood of last minute surprises. Ask staff to help you anticipate the types of questions or concerns that the Planning Commission or City Council members may have, so you can prepare responses to those concerns in advance.

- Communicate clearly with staff throughout the process, and in writing, to ensure you understand next steps. For example, you might ask if staff is waiting on any additional materials from you to prepare its recommendation, or what the next steps are in the approval process. Many of the approval procedures for cannabis activities are new, and clear communication can help prevent sticking points.

Conclusion and Implications

Recreational cannabis law begins with the state regulations and overseen by the state Bureau of Cannabis Control. But implementation of the state regulations is realistically a land use decision in California, and in many other states, is a creature of local government. Municipalities have significant control over sales and many in the state have said "no" completely to recreational cannabis sales. In the end, a cooperative model can be very positive in achieving real results while reinforcing the notion that recreational cannabis sales can be achieved in a safe and reasonable manner. And this cooperative model can achieve success in other states where local jurisdictions determine much about recreational sales. (Andreas Booher)

NEVADA STATE TAX REVENUE NUMBERS RELEASED BY THE STATE DEPARTMENT OF TAXATION

In late April 2019, the State of Nevada, Department of Taxation (Department) released the first comprehensive numbers referencing taxes collected from the retail sales of cannabis. Projected revenue numbers were also released.

Background

In February 2019, Nevada was in its eighth full month of legalized retail cannabis sales. Many numbers were projected and anticipated from cannabis sales, and in many states, Nevada included, this represented a key and important aspect of the debate over legalization.

In April the numbers were compiled and Bill Anderson, Executive Director of the Nevada Department of Taxation released those actual receipts.

Taxation in Nevada on cannabis includes revenue from two different taxes and a mix of both medical and adult-use sales. Taxes include the Wholesale Marijuana Tax, which is paid by cultivators on both medical and adult-use marijuana, and the Retail Marijuana Tax, which is paid by consumers on adult-use marijuana purchases (not medical).

Tax Revenue

For the month of February, the Department reported revenue of just under $6 million. This represented the largest revenue monthly number since inception of legalized sales.

The Department divides the summary of revenue from cannabis sales are as follows:

- Total taxable sales of adult-use marijuana to date is $263.72 million;

- Total combined taxable sales for medical marijuana, adult-use marijuana, and marijuana-related tangible goods for the first eight months of the fiscal year is $336.43 million;

- The total amount of marijuana tax revenue projected for fiscal year 2018 is $50.32 million;

- Fiscal year 2018 projections for Wholesale Marijuana Tax are $23.84 million;

- Fiscal year 2018 projections for Retail Marijuana Tax are $26.48 million.

October 2017 was the second largest month of marijuana tax revenue at $5.84 million; July 2017 was the smallest at $3.68 million. In addition, marijuana-related fees, penalties, and assessments have generated $9.53 million to date.

Taxes and Tax Revenue Distribution

The tax rates and certain disbursements in Nevada on cannabis sales are summarized below.

The Wholesale Marijuana Tax rate is 15 percent. This is charged on the Fair Market Value at Wholesale rate set by the Department. The revenues from this tax, along with fees/penalties/assessments, first go to fund the Department's costs of administering the marijuana program, $5 million per fiscal year goes to local governments to cover their costs, and the remainder goes to education via the state Distributive School Account.

In March, the Department issued its first $5 million disbursement to local governments. The Department will make the fiscal year 2018 distribution to the state Distributive School Account at the end of the fiscal year, estimated to be approximately $25 million.

The Retail Marijuana Tax rate is 10 percent. This is calculated on the sales price paid by the consumer. The revenues from this tax go the state Rainy Day Fund. Through February, the Department had distributed all $26.37 million to the Rainy Day Fund.

The Number of Retailer Licensed by the State

The Department of Taxation also released the number of licensees registered for lawful sales. The number are divided by categories of: Cultivation; Product Manufacturing; Retail Stores; Distribution; and Laboratory. As of April 2018, the Department has issued a total of 316 "final" licenses/registration certificates for adult-use and medical marijuana establishments:

> [The] number of adult-use licenses issued by type: 115 Cultivation, 80 Product Manufacturing, 61 Retail Stores, 34 Distribution, and 9 Laboratory.

'Projected' Tax Revenues

The report goes on to differentiate the amount of "projected" revenue for the period ending in February 2019 from actual "excise" taxes collected. In summary, $41.88 million was collected against a projected number of [forecasted number] of $50.32 million. This represents 83 percent collected against forecasted numbers. February 2019 was the single largest month since legalization of reported sales. The Department concluded that:

> The overall revenue picture is strong and, if it continues the path it is currently on, we can expect to see end-of-year revenue totals that substantially exceed expectations.

Conclusion and Implications

The pros and cons for states considering whether to legalize cannabis in some form or another are many. But the lure of tax revenue most certainly plays some important consideration—perhaps a predominant one—in the decision-making process. Certainly, states that are considering legalization are undoubtedly watching tax revenue numbers from legalized sales states and the Nevada Department of Taxation's report on these numbers will be viewed by many within the state and without.

The Report is available online at: http://marijuana.nv.gov/uploadedFiles/taxnvgov/Content/TaxLibrary/News-Release-February-Marijuana.pdf
(Robert Schuster)

LAS VEGAS ADOPTS ORDINANCE APPROVING RECREATIONAL CANNABIS CONSUMPTION LOUNGES

Nevada voted to permit adult use of cannabis just two years ago in 2016, and now its most famous and populous city is taking the state's new laws on the use of recreational cannabis one step further. On May 1, 2019, Las Vegas City Council voted to allow cannabis consumption lounges within the city. The bill, sponsored by Councilman Bob Coffin, received a 4-1 vote in favor of its passing. The lone dissenter, Councilman Stavros Anthony (also a retired Metropolitan Police Department Captain), stated that he preferred the City to wait and see where the state of Nevada is headed on the issue. However, Coffin stated that the City of Las Vegas cannot wait for the state to take action and expects that Nevada will catch up. Las Vegas is not the first U.S. city to allow cannabis lounges. California, Alaska, and Colorado are among some of the states that already have cities permitting cannabis lounges.

Background

In February of this year, Clark County, where Las Vegas is located, postponed discussions regarding cannabis lounges pending possible decisions from the state Legislature. Governor Steve Sisolak in January of this year signed an executive order to establish a seven-person marijuana advisory panel to formulate guidelines for a Cannabis Compliance Board. Such a board would serve a similar function to the state's long-established Nevada Gaming Commission, which currently regulates the operation of casinos within the state. However, Chris Giunchigliani, a former Clark County Commissioner, state lawmaker and member of the panel has stated that there has not been any movement for a state-wide decision on cannabis lounges. As far as Giunchigliani is concerned, Las Vegas does not have the authority under state law to create cannabis lounges. Giunchigliani, like Councilman Anthony, would have preferred that Las Vegas wait for the panel to make some recommendations before passing the cannabis lounge bill.

Consumption Lounges in Las Vegas

As for the City of Las Vegas, cannabis lounges are not without limitations. For the first 12 months, only city-licensed dispensaries will be able to operate lounges; however the lounges cannot sell cannabis—patrons must bring their own. Despite this prohibition on cannabis sales, lounges will be permitted to sell cannabis paraphernalia. Further, lounges will be prohibited from serving alcohol or permitting their patrons to smoke outdoors. Only patrons that are 21 years of age or over can partake in the social lounges' offerings.

In order to obtain a special use permit for a lounge, licensed owners will be looking at paying $5,000 annually and lounges must be approved by city council. This includes meeting odor, security, training, fire safety, air quality and sanitation standards. As far as zoning, for now, the lounges must be 1,000 feet from schools or casinos, and 300 feet from churches.

The concept of cannabis lounges has been in the works since the state of Nevada first adopted its recreational consumption laws. Currently, the only licensed consumption lounge in Las Vegas is an establishment named Paint & Puff, which was started two years ago. Yet, in order to comply with the then-city laws at the time, Paint & Puff only serves CBD (or non-THC) products. According to their website, Paint & Puff provides snacks, painting with an instructor, a retail store, a lounge room, and a gaming area. While it is unclear what the new cannabis consumption lounges will provide in terms of amenities, it is likely that licensed owners will seek to market their own unique brand of lounges, much like Paint & Puff.

For tourists or residents hoping to combine their love of gambling with recreational cannabis use, casinos will not be taking advantage of the new ordinance, at least for now. The Nevada Gaming Commission has instructed casinos to follow federal law and to continue prohibiting the use of cannabis in casino facilities. Further, cannabis lounges will not be permitted on the Las Vegas Strip, as Las Vegas Boulevard is controlled by Clark County, not the City of Las Vegas.

Conclusion and Implications

Despite the passing of the ordinance, the future of cannabis lounges in Las Vegas remains murky. Nevada lawmakers are actively advancing Assem-

bly Bill 533, a bill which would not only establish the Cannabis Compliance Board, but—as presently amended—would also prohibit cities from licensing cannabis lounges. The amended bill also proposes that cannabis dispensaries be located even further away from casinos by another 500 feet. For now, it is unclear how Assembly Bill 533, if passed, will affect Las Vegas's new ordinance.
(Brittany Ortiz, Nedda Mahrou)

LEGISLATIVE DEVELOPMENTS

ILLINOIS LEGISLATURE VOTES TO LEGALIZE RECREATIONAL CANNABIS

Background

On May 31, the Democratic-controlled Illinois Legislature voted to legalize recreational cannabis use. As this article went to print, the bill has not yet been signed by Governor JB Pritzker but since the Governor made legalization a key component of his election campaign, he is expected to sign bill into law shortly. With his signature Illinois will join ten states who have legalized recreational cannabis use. However, in the ten preceding states, the vast majority have sanctioned legalization via ballot measures—*i.e.*, via a direct vote of that state's populace. Only in Vermont in 2018 did a previous legislature legalize some variation of legalize cannabis. The Vermont bill legalized the possession, by those over the age of 21, of up to an ounce of cannabis and to grow no more than two plants to maturity at any one time. The Vermont bill was also passed by a Democratic lead legislature. The Vermont passage did not create any protocol in which cannabis is sold via dispensaries. In the New England region of the nation, Vermont's legalization joined the States of Maine and Massachusetts which both sanctioned recreational cannabis use in 2016.

The Illinois Legislation Legalizes Recreational Cannabis

Governor JB Pritzker took office on January 14, 2019. His campaign to election included taking the state to the legalization of recreational cannabis. Obviously, with the Illinois Legislature's passage, Governor Pritzker was more than pleased:

> The state of Illinois just made history, legalizing adult-use cannabis with the most equity-centric approach in the nation. This will have a transformational impact on our state, creating opportunity in the communities that need it most and giving so many a second chance. I applaud bipartisan members of the General Assembly for their vote on this legislation. . . .In the interest of equity and criminal justice reform, I look forward to signing this monumental legislation.

Legalization Details

Once signed into law, the new bill would take effect January 1, 2020. The bill allows those 21 and over to purchase cannabis from a licensed dispensary. As to possession, Illinois residents may do so up to 30 grams. Perhaps more interestingly, *non-residents* can purchase only up to 15 grams. (*See*, CBS News; https://www.cbsnews.com/news/illinois-to-legalize-recreational-marijuana-house-votes-to-approve-recreational-cannabis-today-2019-05-31/)

This would appear to address the perceived issue of residents in neighboring "dry" states coming to Illinois predominantly for cannabis purchase.

The "Cannabis Regulation and Tax Act" has as its preamble the following:

> (b) In the interest of the health and public safety of the residents of Illinois, the General Assembly fur finds and declares that cannabis should be regulated in a manner similar to alcohol. . . .

The Cannabis Regulation and Tax Act addresses a wide category of topics including:

- proof of age;
- prohibition on sales or transferring to minors;
- driving under the influence;
- sales, testing and labelling, et, all subject to "additional regulation";
- disclosures about health risks;
- workplace safety;
- licensing;

• taxation; and

• possible expungement of cannabis related convictions.

The bill defines cannabis as:

> . . .marijuana, hashish, and other substances that are identified as including any parts of the plan Cannabis sativa, or Cannabis indica, whether growing or not; the seeds thereof, the resin extracted from any part of the plant; and any compound manufacture, salt, derivative, mixture, or preparaton of the plant. . . .

Past Cannabis Related Convictions

The bill, under Article 7, is entitled: "Social Equity In The Cannabis Industry." In summary it declares:

> (b) The General Assembly also finds and declares that individuals who have been arrested or incarcerated due to drug law suffer long-lasting negative consequences, including impacts to employment, business ownership, housing, health, and long-term financial well-being.

The bill declares the need for a "social equity program. . ." Presumably, this program will establish regulations and guidelines paving the way for cannabis related convictions to be expunged.

Taxation

No discussion of state legalized cannabis would be complete with addressing the issue of taxation. While only part of the equation for consideration of legalization, it nevertheless plays an important part. States considering legalization have no doubt observed and consulted with "legal states" about tax revenues. Legalization represents an opportunity to collect tens of millions of tax dollars each year to most states. The bill also addresses taxation related to sales and cultivation sales.

Conclusion and Implications

Illinois now joins a rapidly-growing list of states that sanction recreation cannabis sales, possession and use. The bill is expansive on the many topics and issues related to legalized sales, including the purity of the cannabis. The bill comes as the culmination of one of Governor Pritzker's campaign promises. With his anticipated signing of the bill, Illinois will become the 11th state to legalize recreational cannabis with other states actively considering legalization. All of this is occurring in a nation that criminalizes recreation use. For more information on the bill, *see:* http://www.ilga.gov/legislation/101/SB/10100SB0007sam001.htm
(Robert Schuster)

WASHINGTON SENATE BILL LOOKS TO EDUCATION AND COMPLIANCE OVER PUNISHMENT FOR CANNABIS RETAILERS WHO RUN AFOUL OF STATE'S REGULATORY STRUCTURE

Compliance with Washington State's regulatory structure has been challenging for cannabis licensees. Since legalization, the Washington State Liquor and Cannabis Board's (LCB) policies have been more stick than carrot. Violations of the Washington Administrative Code (WAC) have leaned towards heavy fines and revocation of licenses over guidance and education. Even temporary suspension of a license or assessment of monetary penalties can be a death knell for a cannabis business. This "enforcement first" approach has led to friction between the LCB and lawmakers, not to mention the licensees themselves.

Washington State's Senate Bill 5318 (SB 5318) hopes to remedy these issues by changing the way that the LCB treats cannabis licensees who may not be in compliance with regulatory requirements. SB 5318 delineates how the LCB must:

> . . .adopt rules to perfect and expand existing programs for compliance education for licensed marijuana businesses and their employees. 5318-S.E. SBR FBR 19, 2.

In an "enforcement first" climate, licensee mistakes are uniformly approached. Little gradation exists between the severity of errors and concepts of "good faith" and "bad faith" are mostly irrelevant. This bill puts focus on mitigating and aggravating factors. Senate Bill 5318 underscores the notion that lawmakers prefer education and guidance towards compliance over harsh punishment for cannabis licensees.

Senate Bill 5318

Senate Bill 5318 was enrolled by the 66th Legislature on April 23, 2018.

Notices of Correction

SB 5318 creates a process to issue a "notice of correction" over a civil penalty. These notices serve as both an educational opportunity as well as put the licensee on notice that they are out of regulatory compliance. A notice of correction has several components: a description of:

> . . .the noncompliant condition, the relevant text of the law or rule, a statement of what is required to achieve compliance, the date by which compliance must be achieved, notice of how to contact any technical assistance services, and notice of when, where, and to whom a request to extend the time to achieve compliance for good cause may be filed with the LCB. 5318-S.E. SBR FBR 19, 2.

Notices of correction are not formal or appealable, but do appear on public records. Notices of correction are set to be a standard "first step" for license violations outside of a few notable exceptions. Most importantly, the LCB will not issue a notice of correction when it can prove through a preponderance of the evidence that the licensee is: 1) illegally selling marijuana (either across state lines or via the local illicit market); 2) selling marijuana products to minors; 3) diverting revenues to problematic parties (criminal organizations or individuals not qualified to hold a marijuana license due to criminal history requirements); 4) committing non-marijuana related crimes; 5) or knowingly lying about any of these violations. Licensees can also be penalized without a notice of correction when they have "previously been given notice of, or been subject to, an enforcement action for the same or similar violation of the same statute or rule" or by failing to address an issue by the date set out in a previous notice of correction. 5318-S.E. SBR FBR 19, 2.

Enforcement and Punishment Procedures

A single violation can no longer result in license cancelation unless the LCB can prove by clear, cogent, and convincing evidence that the violation was caused by intentional or grossly negligent action/inaction involving one of the above-enumerated public-safety violations. For other violations, the licensee must have committed at least four violations within the past two years. As applied, violations occurring before April 30, 2017 are no longer grounds for denial, suspension, non-renewal, or cancellation of a license unless they are proven to fall within one of the enumerated major public-safety violations.

SB 5318 encourages licensees to develop educational programs for their employees. Specifically, it requires the LCB to give "substantial consideration" to mitigating any penalty originating from employee conduct if that employee has had adequate training. Establishment of a compliance program designed to prevent the violation (as well as not enabling or ignoring the violation) is a common sense step that licensees can now take to provide one more layer of protection against being penalized by the LCB.

Finally, SB 5318 enables administrative judges to consider mitigating and aggravating circumstances in cases involving licensees. It further allows for these judges to deviate from prescribed penalties. A heavier focus on settlement conferences and agreements also means that the LCB will give substantial weight to any agreements made between licensees and LCB agents.

Conclusion and Implications

Senate Bill 5318 makes clear the Washington State Legislature's intention that the Washington State's Liquor and Cannabis Board be predominantly a guiding, educating entity, not a punitive one. The clearer system for correcting procedural violations without directly penalizing licensees highlights the difference between run-of-the-mill mistakes and intentional commission of crimes that threaten the public interest. SB 5318 lets cannabis licensees focus on conforming to both the spirit and letter of

the law while LCB agents and administrative judges can make individualized decisions that better guide licensees and protect the interests of Washington State citizens. Senate Bill 5318's final language is available online at: http://lawfilesext.leg.wa.gov/biennium/2019-20/Pdf/Bills/Senate%20Passed%20Legislature/5318-S.PL.pdf
(Cassidy Patnoe, Mia Getlin)

REGULATORY DEVELOPMENTS

UPDATES TO CALIFORNIA STATE WATER RESOURCES CONTROL BOARD'S CANNABIS POLICY, EFFECTIVE APRIL 16, 2019

On February 5, 2019, the California State Water Resources Control Board adopted proposed updates to the Cannabis Policy - Principles and Guidelines for Cannabis Cultivation under Resolution No. 2019-0007 (Cannabis Policy). Subsequently, the state's Office of Administrative Law approved the updates to the Cannabis Policy, which is now in effect as of April 16, 2019.

Background

California's relatively new cannabis industry is regulated by multiple state agencies. The State Water Resources Control Board (SWRCB) is responsible for ensuring that individual and cumulative effects of water diversion and discharge related to cannabis cultivation do not affect instream flows needed for fish spawning, migration and rearing. (Cal. Bus. Prof. Code, § 26060.1(b).) The SWRCB's Cannabis Policy establishes principles and guidelines (requirements) for cannabis cultivation activities to protect water quality and instream flows. The purpose of the Cannabis Policy is to ensure that the diversion of water and discharge of waste associated with cannabis cultivation does not have a negative impact on water quality, aquatic habitat, riparian habitat, wetlands, and springs. These requirements are primarily implemented through the SWRCB's Cannabis Cultivation General Order and Cannabis Small Irrigation Use Permits (SIUR), in addition to the California Department of Food and Agriculture's CalCannabis Cultivation Licensing Program.

Original proposed edits to the SWRCB's Cannabis Policy were released for public comment in September 2018. The recent updates to the Cannabis Policy were generally focused on requirements related to tribal buffers, onstream reservoirs, and winterization requirements.

Tribal Land Buffer

The Cannabis Policy requires cannabis cultivators to obtain written permission from affected California Native American Tribes if cultivation area is on or within 600 feet of tribal lands (which means lands recognized as "Indian country" within the meaning of title 18, United States Code, § 1151). The SWRCB must provide the tribe's governing body a 45-day review period, during which the tribe may accept, reject, or not act regarding the cannabis cultivation proposal. If the tribe provides notice that it rejects the proposal or that it waives the 45-day review period for current and future proposed cannabis activities on their land, the SWRCB must then act based on the nature of the tribe's request. The SWRCB may either not approve the cannabis cultivation proposals on or within 600 feet of the tribal lands, or may abide by the waiver and, at its own discretion, act on cannabis cultivation requests within 600 feet of tribal land as though the affected tribe accepted the proposal.

When it comes to identified tribal cultural resources, there can be no cannabis cultivation activities within 600 feet of the resource site. However, the updates to the Cannabis Policy allow the SWRCB to modify this restriction for specified cultural resource sites at the affected tribe's request and after consultation with such tribe.

Onstream Reservoirs

The Cannabis Policy was also edited to update cannabis cultivation activities relying on water from onstream reservoirs. Specifically, cultivators using water for cannabis cultivation activities from an onstream reservoir under an approved SIUR Program certification will only be allowed to withdraw such water during the surface water forbearance period. The purpose of this restriction is to minimize the impacts of the reservoir on high flow variability during the wet season.

Winterization Requirements

In California, rainstorm events that create sediment transporting flows on upland slopes and in

channels typically occur during the winter period or non-growing season for outdoor cannabis cultivation. One of the main water quality concerns during the winter period is the increased potential for sediment transport due to storm water or water flow from cannabis cultivation activities, especially in areas considered to be "hilly" or "mountainous." The Cannabis Policy was updated to require a site management plan approved by the applicable Regional Water Quality Control Board where heavy equipment (*e.g.* agricultural equipment) is used in the winter period for cannabis cultivation soil preparation or planting. The activities will only be authorized if soil preparation activities are outside riparian setbacks and are located on an average slope that is equal to or less than 5 percent. This requirement is consistent with California Regional Water Quality Control Board, San Francisco Bay Region's General Waste Discharge Requirements for Vineyard Properties in the Napa River and Sonoma Creek watersheds, which require additional performance standards to control storm runoff and sediment discharge from hillslope vineyard parcels.

Conclusion and Implications

The State Water Resources Control Boards' final Cannabis Cultivation Policy is now I play and can be accessed online at the following link: https://www.waterboards.ca.gov/water_issues/programs/cannabis/docs/policy/final_cannabis_policy_with_attach_a.pdf (Nedda Mahrou)

OVERVIEW OF OREGON'S CURRENT RULES FOR RECREATIONAL CANNABIS IN ANTICIPATION OF THE LIQUOR CONTROL COMMISSIONS IMPENDING NEW GUIDANCE

Over the course of the summer of 2019, the commission in Oregon tasked with rulemaking and oversight of recreational cannabis sales and use are expected to release a new guidance clarifying its implementation rules. In the interim it is helpful to recall what rules and definitions are now in place

Background

One of the primary responsibilities of the Oregon Liquor Control Commission's (OLCC) Recreational Cannabis Division is ensuring that the program and its licensees avoid running afoul of federal enforcement priorities, as laid out in the now rescinded Cole Memorandum. Limiting ownership of and financial interest in recreational cannabis companies is crucial in complying with several of those priorities. Thus, oversight of financial interest in and ownership of licensed businesses is necessary for a healthy industry.

As the industry has matured and evolved, ownership structures and financial interests have become more complicated, thus complicating the pre-approval and disclosure rules, and leading to rule and policy changes. Licensees, their attorneys, and even OLCC representatives, often find themselves confused about which category an entity or individual falls into and whether or not personal information and fingerprints need to be included in the application.

The OLCC is releasing new guidance this summer to clarify the rules and policies. Meanwhile, the agency continues to adjust and hone the rules based on industry changes and stakeholder input. This article is a non-exhaustive explanation of the current rules implemented by OLCC according to the new guidance.

Basic Reporting Requirements

Depending on its connection to a licensed business, an individual or entity may need to submit one of several forms, and an individual may need to submit fingerprints for a background check. Further, while some changes to the licensed business's structure and its financial interest holders require only disclosure to the OLCC, most require preapproval. The maximum penalty for failing to properly disclose or gain preapproval for financial interests and changes in ownership is license cancellation. The OLCC has become increasingly focused on enforcement of these types of violations:

- Individual History Form

The Individual History Form discloses to the OLCC an individual's identifying information,

including their birthdate, social security number, address, spouse or domestic partner's identity, and some information about their criminal history.

•Entity Questionnaires
Each business entity type has a corresponding entity questionnaire. These questionnaires are used to disclose an entity's owners and the people who control the entity.

•Fingerprints
Individuals who are required to submit to a full background check provide fingerprints through Fieldprint office. Their fingerprints are then used by the state police to run a background check, with the results being provided to the OLCC within about a week of fingerprinting.

Financial Interest Holders

The OLCC takes a broad definition of "financial interest" in determining who has a financial interest and is subject to disclosure and approval requirements. According to OAR 845-025-1015(26):

> . . .'financial interest' means having an interest in the business such that the performance of the business causes, or is capable of causing, an individual, or a legal entity with which the individual is affiliated, to benefit or suffer financially.

Financial Interest Holders Outside the Licensed Structure

Individuals and entities outside the licensed structure are generally those that they do not have a direct or indirect right to any ownership of the business, either on their own or through an entity or spouse or domestic partner. The following individuals and entities are financial interest holders:

•Those that are entitled to receive any portion of revenue, profits, or losses from the business. This includes landlords who receive a portion of a business's profits as rental payment and employees who are paid compensation based on the performance of the business. Contracts must be carefully drafted to avoid creating unintended financial interests; even some intellectual property licensors can be financial interest holders based on the structure of their compensation.

•Individuals and entities that loan or give $100,000 or more to a business, or 50 percent or more of the business's start-up costs if less than $100,000, if such loan or gift is unsecured and not convertible into ownership interest in the company.

•Individuals and entities that loan money to a licensed business at a commercially unreasonable rate. The OLCC does not have a firm definition of "commercially unreasonable rate" at this time. The OLCC should be consulted if a licensed business, investor, or an attorney representing one of the parties is unsure about whether a particular interest rate is commercially reasonable.

Financial Interest Holders Within the Licensed Structure

Financial interest holders within the licensed structure broadly includes anyone with a direct or indirect right to any ownership in the licensed business, whose interest is not sufficient to make them an applicant, as described below.

Financial interest holders within the licensed structure include:

•Spouses, domestic partners, and financial interest holders of applicants.

•Individuals and entities with an ownership interest of less than 10 [percent] in the licensed structure.

•Individuals and entities with loans that are secured by an interest in the business or its assets.

•Individuals and entities with convertible loans of any amount to the business.

Documentation Required for Financial Interest Holders

Entity financial interest holders must submit entity questionnaires and an analysis will be done on their owners and operators to determine the status and documentation requirements for each.

Individual financial interest holders must submit individual history forms. Some individual financial interest holders, such as convertible note holders, must submit fingerprints as well.

Applicants and Documentation

The following individuals and entities are applicants:

- Individuals and entities that do or can exercise control over the business, over an applicant entity within the licensed structure, or over an applicant entity outside the licensed structure, other than under the direction of an owner.

- Individuals and entities that do or can incur debt on behalf of the business, other than under the direction of an owner.

- Individuals and entities that do or can enter into contracts on behalf of the business, other than under the direction of an owner.

- Individuals and entities identified as lessees on a lease for the license premises.

- Individuals and entities that hold or control 10 [percent] or more of a licensed business, or of an applicant entity within the licensed structure. "Holds or controls" includes any right to receive revenues or profits of the business, such as in the case of a lease that provides for a landlord receiving 15 [percent] of the company's profit as rent payments.

- Individuals and entities that hold or control 10 [percent] or more of an applicant entity outside the licensed structure.

- Entity applicants must submit entity questionnaires. The owners and operators may be financial interest holders or applicants and need to submit the corresponding documentation.

- Individual applicants must submit individual history forms and fingerprints.

More About Entities

When an entity has a financial interest or is an applicant, the owners and those who have direct control over the entity are generally subject to the same pre-approval and disclosure requirements as they would be if they owned or controlled the licensed business directly. Thus, if a corporation is an applicant entity, such as because it owns 20 percent of the licensed entity, the corporation's principal officers, directors, and shareholders holding 10 percent or more of the corporation are also applicants, subject to the same disclosure requirements (entity questionnaire or individual history form) and, for individuals, the same fingerprinting and background check requirements as if their ownership or control were in the licensed entity. The disclosure and 10 percent or more ownership or control test is repeated until there are no more entities that hold financial interests or are applicants. Note that this may result in an individual with only a small ownership interest in the licensee being subject to fingerprinting. For example, if a corporation with ten shareholders, each owning 10 percent of the corporation's stock, purchases 15 percent of a licensed business, the shareholders of the corporation will be subject to fingerprinting requirements, even though they each have only a 1.5 percent interest in the licensed entity.

Preapproval of Changes

Changes to a licensed business's structure and financial interests generally must be approved by the OLCC prior to being implemented. This includes reallocation of ownership interest among current owners.

Publicly Traded Companies

Publicly traded companies that own or invest in licensed businesses have a hard time complying with some of the disclosure and preapproval rules. A company cannot gain OLCC preapproval for ownership changes when their shares are trading on the open market, and they may not be able to determine the identity of all of their shareholders. While the rules themselves do not exempt publicly traded companies from disclosure and approval rules, the OLCC has been flexible in finding solutions that allow publicly traded companies to participate in the industry without weakening the OLCC's ability to properly oversee ownership interest and control of licensed entities.

OLCC Representative Discretion

OLCC representatives have discretion in determining which parties related to a licensed business or applicant business need to submit to various levels

of vetting. While business owners and attorneys can generally rely on these guidelines, they should be prepared to provide additional information as requested and for any individuals related to the business to have to provide fingerprints. The risk of surprise background checks or additional information requests increase as the business structure becomes more complex and OLCC representatives are likely to ask for more information if a business structure appears designed to shield particular individuals or entities from being disclosed to or vetted by the OLCC.

Conclusion and Implications

Proper disclosure and approval of financials interests in a licensed business is among the most important compliance tasks for a licensed business. The OLCC takes its responsibility to monitor financial interests seriously and the penalties for financial interest related rules violations are severe. These rules and the policies surrounding them will continue to evolve for the foreseeable future. Industry players and their legal representatives need to monitor the rules and policies diligently to ensure compliance.
(Mia Getlin)

JUDICIAL DEVELOPMENTS

FEDERAL COURT IN COLORADO ADDRESSES ANCILLIARY CANNABIS BUSINESS PROTECTION IN BANKRUPTY

In re Way to Grow, 597 B.R. 111 (Bankr. D. Colo. Dec. 14, 2018).

Cannabis sales in the United States is a peculiar phenomenon if viewed through the lens of the federal government and federal law. But what happens when a cannabis business, licensed and "legal" within a given state, faces bankruptcy? And to what extent are the bankruptcy court doors shut in the face of the cannabis-related businesses? A recent decision out of the U.S. Bankruptcy Court for the District of Colorado is highly informative in addressing the closed-door policy and to what extent.

Background: U.S. Bankruptcy Law and Cannabis

The U.S. Constitution, at Article 1, § 8, Clause 4 authorizes Congress to enact uniform laws on the subject of bankruptcies throughout the United States. Congress has exercised this authority several times since 1801, including through adoption of the Bankruptcy Reform Act of 1978 (BRA), 11 U.S.C. § 101, *et seq*., and the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 (Pub.L. 109–8, 119 Stat. 23, enacted April 20, 2005), which amended various portions of the BRA. Courts have described the BRA, at least with respect to Chapter 11 thereof, as "to assist financially distressed business enterprises by providing them with breathing space in which to return to a viable state." *In re Encore Prop. Mgmt*., 585 B.R. 22, 29 (Bankr. W.D. N.Y. 2018).

Not surprisingly, the illegality of cannabis under the federal Controlled Substances Act of 1970 (CSA), 21 U.S.C. § 101, *et seq*., complicates this issue as the above-quoted bankruptcy concepts derive from federal law. And despite the fact that cannabis is legal to grow and use recreationally and medically in many states like Colorado, the U.S. Supreme Court definitively held in *Gonzales v. Raich*, 545 U.S. 1 (2005) that the CSA supersedes any state law contrary to it, such as is the case with state legalization of cannabis.

The *Way to Grow* Case

The recent case of *In re Way to Grow*, 597 B.R. 111 (Bankr. D. Colo. 2018), indicates that—not only is federal bankruptcy protection not available to actual cannabis companies—but such access may also be denied to businesses "ancillary" to the cannabis industry, including companies whose businesses, but for the sale of their products to cannabis companies, would not be illegal under state ***or*** federal law. Such was the case in *Way to Grow*, 597 B.R. at 111.

In *Way to Grow*, the Bankruptcy Court held that a company in the business of selling indoor hydroponic and gardening-related supplies primarily to companies in the business of growing cannabis, under the particular facts of that case, was in violation of federal law and accordingly denied access to the federal bankruptcy courts pursuant to 11 U.S.C. § 1112(b) (providing bases for the dismissal of bankruptcy cases). *Id*. at 131-32.

Previous Decisions Addressing Cannabis and Ancillary Businesses in Bankruptcy

In analyzing this issue, the *Way to Grow* Bankruptcy Court first analyzed two earlier cases from the Colorado Bankruptcy Court addressing Chapter 11 bankruptcy in the context of an ancillary business doing business with cannabis companies, as well as a bankruptcy cases in which the bankruptcy trustee would have been required to administer marijuana-related assets. *Id*. at 117-18.

The first case, *In re Rent-Rite Super Kegs West Ltd*., 484 B.R. 799 (Bankr. D. Colo. 2012), involved a debtor that derived 25 percent of its revenue from leasing warehouse space to cannabis businesses. *Id*. at 810. In that case, the Colorado Bankruptcy Court found that the activity violated the CSA and dismissed the debtor's Chapter 11 case pursuant to 28 U.S.C. § 1112(b). *Id*. at 805.

Not long thereafter, the Colorado Bankruptcy Court confronted a Chapter 7 case where the debtor's bankruptcy estate contained cannabis-related assets. *In re Arenas*, 514 B.R. 887 (Bankr. D. Colo. 2014). In that case, the court dismissed the case because the bankruptcy trustee would be required to administer assets in violation of federal law. The *Arenas* court reasoned that:

> . . .the Debtors' chapter 7 trustee cannot take control of the Debtor's property without himself violating § 856(a)(2) of the CSA. . . .The Court finds that administration of this case under Chapter 7 is impossible without inextricably involving the court and the Trustee in the Debtors' ongoing criminal violation of the CSA. *Id.* at 891.

The Court's Decision

The *Way to Grow* court here turned to the issue before it—whether debtor Way to Grow, Inc. (WTG) could proceed with a Chapter 11 bankruptcy given that: 1) it was not in the business of growing or selling cannabis but 2) 95 percent of its growing supplies were sold to companies in such businesses. The *Way to Grow* court answered this question with a definitive "no" and dismissed the case pursuant to 11 U.S.C. § 1112(b). *Id.* at 128-132. The court reached this conclusion by analyzing whether WTG's activities violated the CSA and concluded that they did. From there it was an easy step for the court to dismiss WTG's Chapter 11 case. *Id.* at 131-32.

The court first analyzed WTG's liability for aiding and abetting violations of the CSA, pursuant to 21 U.S.C. § 841(a)(1) and 16 U.S.C. § 2. After analyzing the issue, the *Way to Grow* court held that WTG was not aiding and abetting violations of the CSA. *Id.* at 124-27. The court did find, however, that the WTG violated another provision of the CSA, 21 U.S.C. § 843(a)(7), and this was sufficient for dismissal of its Chapter 11 bankruptcy case. Section 843(a)(7) of the CSA makes it a federal crime to "manufacture" or "distribute" any:

> . . .equipment, chemical, product or material which may be used to manufacture a controlled substance . . . knowing, intending, or having reasonable cause to believe, that it will be used to manufacture a controlled substance. *Id.* at 827.

To determine whether WTG ran afoul of § 843(7), the *Way to Grow* court analyzed a factually-developed record and determined that WTG was in violation of the statute because, among other things, it credited testimony that:

- As much as 95 [percent] of the customers in a WTG store used WTG's products to grow cannabis;
- An investor deck prepared on behalf of WTG specifically referred to "marijuana as 'the catalyst for hydroponic R&D'";
- WTG had participated in cannabis industry promotional events and had given away promotional materials at industry events that were strongly associated with cannabis use.

On this factual record, the court concluded that WTG's conduct was in violation of § 843(7) of the CSA and dismissed its Chapter 11 case under 11 U.S.C. § 1112(b). *Id.* at 128-32.

Conclusion and Implications

This should raise a clarion call of caution for those ancillary businesses (and investors therein) that currently rely on the fact that their businesses do not touch the actual cannabis plant and/or that they are not directly involved in the manufacture or sale of cannabis to insulate them from lack of access to federal processes such as the federal bankruptcy system or, even criminal liability (not the subject of this article), if the federal enforcement of such potential crimes is increased from its current level and the criminal courts were to follow the analysis of the *Way to Grow* court.

(Eric Liebman)

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