Volume 1, Number 6
November 2019

CANNABIS LAW™

& REGULATION REPORTER

CONTENTS

ARGENT COMMUNICATIONS GROUP

WWW.ARGENTCO.COM

Publisher's Note:

Accuracy is a fundamental of journalism which we take seriously. It is the policy of Argent Communications Group to promptly acknowledge errors. Inaccuracies should be called to our attention. As always, we welcome your comments and suggestions. Contact: Robert M. Schuster, Editor and Publisher, P.O. Box 1135, Batavia, IL 60510-1135; 530-852-7222; schuster@argentco.com

WWW.ARGENTCO.COM

Subscription Rate: 1 year (11 issues) $595.00. Price subject to change without notice. Circulation and Subscription Offices: Argent Communications Group; P.O. Box 1135, Batavia, IL 60150-1135; 530-852-7222 or 1-800-419-2741. Argent Communications Group is a division of Argent & Schuster, Inc.: President, Gala Argent; Vice-President and Secretary, Robert M. Schuster, Esq.

CLR

FEATURE ARTICLE

MAKING YOUR CANNABIS COMPANY AN ATTRACTIVE ACQUISITION TARGET

By Gabriel S. García and Tom Lawrence

Consolidation is coming to the cannabis industry. Mergers-and-acquisitions activity in the cannabis space has skyrocketed in recent years, rising from $146 million across 53 deals in 2016 to more than $8.4 billion over 287 deals in 2018 according to data from Pitchbook. (*See*, https://files.pitchbook.com/website/files/pdf/MGO_ELLO_Cannabis_Private_Investment_Review.pdf)

This trend is expected to continue as the federal government continues to broaden cannabis' legal status, which in turn is spurring increased participation from traditional financial institutions and established outside investors.

Background

As cannabis operators know, obtaining a new license to grow, process, distribute, retail, or test cannabis products can be an arduous, expensive, and time-consuming process. Cannabis licensure requires approval from a variety of regulatory bodies, specialized expertise, and patience. Rather than going through the entire process from the beginning, many investors choose to acquire established cannabis businesses with licenses already in place, so they can focus their time and attention on activities most likely to add immediate value, like superior marketing and achieving scale. Whether a particular business will be one of the few that will profit from this wave of interest may depend on its level of preparedness for a transaction that proceeds with as little friction as possible. Here are some basic steps an early stage cannabis business should take to ensure it is an attractive target for potential acquirers.

Choice of Entity

A basic but critical first step is to ensure that the cannabis enterprise has been formed as a legal entity that is capable of accepting outside investment. Because they lack the protection of limited liability, enterprises organized as sole proprietorships or general partnerships are not amenable to investment from outside partners. Furthermore, under California's Bureau of Cannabis Control regulations adopted in January 2019, cannabis businesses experiencing a complete change in control must not operate under new ownership until a new license application has been submitted and received regulatory approval. In order to avoid a lengthy disruption in business due to this regulation, most acquisitions of cannabis licensees moving forward will be conducted in at least two steps: an initial transaction preserving at least one original owner and then a second consisting of that remaining owner transferring their interest to the new investors. As a result, cannabis businesses should select a corporate form which can accomplish such a two-step transaction: individual owners' interests must be capable of being transferred independently of one another, and the company must be capable of issuing new equity in the future to outside investors.

Additional factors cannabis companies should take under consideration when choosing a corporate form include:

- Whether the business should be taxed as a separate entity, or whether its profits should be treated directly as income to its owners.

- The number, identities, and geographic distribution of investors in the enterprise.

•The extent to which the management of the enterprise will be separate from ownership, and whether the business intends to offer equity compensation as an employee incentive.

•Limitations imposed by federal and state securities laws on offerings and transfers of the company's equity securities.

Corporate Records

Whatever form of corporate organization entrepreneurs chose for their cannabis business, the company must develop a set of governance documents for the directors and managers of the business as well as a set of equity agreements for the shareholders and members of the company.

For corporations, one of the primary corporate documents needed are bylaws, which are a comprehensive set of governing policies and rules of how the corporation will conduct its business vis-à-vis its board and its officers. For equity owners, agreements such as Shareholders Agreements, Buy-Sell Agreements, or Restricted Stock Purchase Agreements often define the rights and obligations of the corporation's shareholders. These contracts often restrict the fungibility of the corporation's shares and place specific parameters on how the stock may be sold, if at all, to third parties. For limited liability companies (LLCs), the Operating Agreement is the principal document that contains both governance terms and economic terms for the division of profit/loss among its members.

Regardless of the corporate form chosen, the equity documents must establish:

•The division of equity interests and voting rights in the business among its owners;

•Restrictions on sales, transfers, encumbrances, and other dispositions of equity interests by ownership;

•Rights to dividends or other distributions of capital from the entity;

•Which officers, employees or other representatives of the business have authority to represent the company in negotiations over major corporate actions;

•Mechanisms and procedures for approval of major corporate actions by the business's board of directors and/or shareholders;

•Priority of payments of proceeds of an acquisition transaction; and

•Procedures for winding down the business.

Once equity documents are in place, companies should create and maintain a "cap table" setting forth the entity's ownership interests. This necessary documentation is critical for giving equity owners and any potential acquirer a snapshot of your business's stakeholders. Cap tables should include:

•Names and contact information of each stakeholder, including holders of common equity, preferred equity, convertible debt, SAFEs, options, warrants, unvested equity, and any treasury stock held by the corporation, organized by the type of interest each stakeholder holds.

•The number of shares controlled by each stakeholder.

•The percentage of the entity's economic rights and voting rights represented by each stakeholder's interests, given as a share of the outstanding equity and on a fully-diluted basis.

•Information specific to your non-common equity interests, *e.g.*: mandatory dividends on preferred equity; strike prices for options, warrants, SAFEs, and convertible debt; vesting schedules for unvested equity interests; and acceleration provisions on any change of control or sale.

In addition to this cap table, companies should centralize copies of all their equity agreements within their data room, to ensure review of these agreements during the diligence process can be conducted as swiftly and efficiently as possible.

Preparing for Cannabis-Specific Due Diligence

One of the most important aspects of any corporate acquisition is the due diligence process, during which the acquiring company investigates the economic and legal *bona fides* of the target company.

Potential acquirers in the cannabis space must also be satisfied that their target's cannabis local and state licensure is in good standing and that the company is operating in full compliance with its regulatory obligations. There are three primary concerns for potential acquirers.

First, though California cannabis licenses themselves are not transferrable, they are usually the most valuable assets in a transaction of this kind. In order to go through with the deal, any potential acquirer must ensure that your license is in order and not in jeopardy from your operations.

Second, even if regulatory violations do not pose the threat that a target's license may be *revoked*, many carry the possibility of incurring fines and other penalties that can add up quickly and destroy the economic value of the transaction. Under § 26031.5(a) of the Business and Professions Code, each day a cannabis licensee operates in violation of the code counts as a separate violation of the code subject to its own independent administrative fine. With fines authorized up to $5,000 per violation, even a brief period of noncompliance can result in enormous potential liabilities.

Third, even under a best-case scenario in which the target's business is being run in perfect compliance with every applicable regulation, the time and labor involved in *establishing* that fact to the satisfaction of a potential acquirer during the diligence process may prove fatal to the deal if the target does not have appropriate structures and systems in place to facilitate diligence. It is not enough to merely run a cannabis business by the book; its owners must be able to *prove* their compliance to a skeptical third party. The more easily and concretely management is able to establish these matters in the diligence process, the stronger representations it can make in the final acquisition agreement, driving up the value of the deal.

To be prepared for a potential acquisition in the future, companies should take the following steps now to ensure a smooth diligence process:

- Proactively conduct a thorough, independent review of business operations to ascertain whether they are operating in compliance with applicable regulations;

- Establish and maintain procedures to verify and document ongoing compliance; and

- Establish and maintain a data room centralizing all financial, regulatory, and legal records.

General Diligence Considerations

In addition to the unique regulatory risks posed by operation of a cannabis business, potential acquirers will need to be satisfied that with more ordinary commercial matters as well. In particular, acquirers will want to be aware of contractual restrictions on the ability to change control or assign rights and responsibilities or other legal liabilities.

In order to ease the diligence process and assuage those fears, you should do what follows.

Create and maintain a debt table analogous to the cap table described above. The debt table should set forth the identities and contact information for the company's creditors and the amounts and terms of their corresponding debt obligations. It should also include information as to the interest rates, mandatory payments and their due dates, maturities, security (if any), and convertibility to equity (if any) for these debt instruments, as well as the order of priority among debtholders. Copies of all agreements relating to these debt instruments should be centralized in the data room, and the company's legal counsel should be familiar with and able to answer questions about the events of default, acceleration provisions, and governance and operational requirements imposed on the company by the covenants, representations, and warranties included in these instruments.

Scrutinize your leases, debt instruments, and other commercial contracts to determine whether and under what conditions they are assignable or allow for a change in control of your business and centralize this information within your data room.

Conduct ongoing review of liabilities related to ongoing or potential litigation, workers compensation, and other issues that may be outstanding at the time of negotiation.

Conclusion and Implications

Time kills most deals. Following the steps herein will allow a target company to be "acquisition ready." Target companies that are organized and transparent from the outset will inspire confidence in their acquirers, thereby speeding up the deal and increasing the likelihood of a successful close to the transaction.

Gabriel S. García is General Counsel for Natura Management, LLC, a cannabis company located in Sacramento, California that will be launching a 12-acre, vertically-integrated cannabis campus in spring of 2020. For the last 15 years, Gabriel has been a trusted legal advisor to leading brands in the rapidly growing cannabis and wellness industries. Prior to Natura, Gabriel launched his own cannabis law boutique firm, served as in-house commercial counsel for Abbott Laboratories, and worked as an attorney advisor to the United States Tax Court.

Tom Lawrence is a California- and New York-licensed emerging companies attorney. Tom counsels innovators and entrepreneurs in their transactional and compliance-related matters. Recently relocated to California, Tom is open to joining an innovative practice or company in a full-time role. You can reach Tom via email at twl2108@columbia.edu.

CANNABIS LAW NEWS

DEMOCRATIC PRESIDENTIAL CANDIDATES RELEASE MEDICAL MARIJUANA PLANS REGARDING VETERANS

Multiple presidential candidates commemorated this Veteran's Day with plans to better care for and support those who've served in the military. Of these, three frontrunners have specifically included portions regarding medical marijuana—Bernie Sanders, Elizabeth Warren, and Pete Buttigieg. Current policy of the U.S. Department of Veteran's Affairs (VA) regarding medical marijuana stems from the most recent Veteran's Health administration (VHA) directive, Directive 2017-1315, released in December 2017. This statement was the first since 2011 to formally change the VA's cannabis policy, and made significant changes from VHA Directive 2011-004.

Policy Background

VHA Directive 2011-004 emphasized marijuana's status as a Schedule I drug under federal law, and that any state laws authorizing its use run contrary to federal law. As such, it further declares that VHA policy shall prohibit VA facilities/providers from completing any forms seeking opinions or recommendations concerning a Veteran's participation in a State medicinal marijuana program.
The 2011 directive, which expired in 2016 but remained in effect into late 2017, also laid out that:

- If a Veteran presents an authorization for marijuana to a VA provider or pharmacist, VA will not provide marijuana nor will it pay for it to be provided by a non-VA entity;

- Possession of marijuana, even for authorized medical reasons, by Veterans while on VA property is in violation of VA regulation 1.218(a)(7) and places them at risk for prosecution under the Controlled Substances Act; and

- That if a patient reports participation in a State marijuana program to a member of the clinical staff, that information is entered into the "non-VA medication section" of the patient's electronic medical record following established medical facility procedures for recording non- VA medication use.

Current Policy

A little over a year after Directive 2011-004 expired, Directive 2017-1315 rescinded the former and came into effect. This directive, more than double the length of the previous one, and much more detailed, still stresses that marijuana is a Schedule I drug. As such, and as with other Schedule I drugs, there is no currently accepted medical use for marijuana. The VHA adds here that Schedule I "includes drugs . . . with a high potential for abuse, without a currently acceptable medical use . . . in the United States, and lacking accepted safety for use under medical supervision." Notably, the directive takes the time to define marijuana and differentiate it from hemp/other parts of the plant:

> All parts of the plant Cannabis sativa L., whether growing or not; the seeds thereof; the resin extracted from any part of such plant; and every compound, manufacture, salt, derivative, mixture, or preparation of such plant, its seeds or resin.

The directive makes a number of points regarding policy and the responsibilities of those in charge of or working within VA facilities, which have been summed here:

- Veterans must not be denied VHA services solely because they are participating in State-approved marijuana programs.

- If a Veteran presents an authorization for marijuana to a VHA provider or pharmacist, VA will not provide marijuana nor will VA pay for marijuana to be provided by a non-VA entity.

- Employees of VA, including those who are Veterans receiving care through VHA, are prohibited

from using a Schedule 1 drug, including marijuana.

•Clinical staff may discuss with Veterans relevant clinical information regarding marijuana.

•If a provider discusses marijuana with a Veteran, relevant information must be documented in progress notes, and considered in the development or modification of the treatment plan.

This policy is scheduled for recertification in December of 2022, but will remain in effect beyond that date unless otherwise rescinded or recertified. While Directive 1315 makes changes to the veteran-provider relationship, paving the way for more open discussion regarding medical marijuana, the use of and access to it will remain at the state level. That is, unless the plans of three major presidential candidates comes to fruition. For access to the full directive (and other VHA directives), *see*: https://www.va.gov/vhapublications/publications.cfm?pub=1.

The Candidates' Plans

Sanders

Previously, Bernie Sanders has outlined that he intends to legalize marijuana federally within the first 100 days of his administration via executive action. He would also direct revenue from legal marijuana to be reinvested into communities hardest hit by the War on Drugs (as states such as Illinois are doing). He also stresses plans to keep legalized marijuana from becoming like or heavily connected with Big Tobacco.

Regarding medical cannabis and veterans, Sanders just recently laid out plans to safeguard the ability of VA providers to appropriately prescribe medical marijuana to their patients when applicable. This follows on the heels of his co-sponsoring a pending Senate bill that would federally legalize the possession and use of marijuana for military veterans (in states where marijuana is allowed). His recent plan also states that any member of our armed forces who has been discharged for marijuana use or possession, would be able to apply for a discharge upgrade. Previously if discharged for marijuana, they would not have been eligible for the services and benefits of the VA.

These details come predominately from Sanders' veteran's plan, but for much more on his plans regarding legalizing marijuana, *see*: https://berniesanders.com/issues/legalizing-marijuana/.

Warren

Elizabeth Warren's plan is not dissimilar, supporting the expansion of currently successful programs and cannabis as an opioid alternative. By their press releases and website plan outlines, Warren and Buttigieg both summarize their thoughts regarding cannabis in short statements within broader plans. In her words:

> Many states have established veterans' courts or other diversion programs to provide treatment rather than incarceration for veterans with behavioral issues as a result of trauma, and I support the expansion of these programs. I also support legalizing marijuana. I've co-sponsored legislation to study the use of medical cannabis to treat veterans as an alternative to opioids, because we need to pursue all evidence-based opportunities for treatment and response.

Warren's site does not have an explicit section regarding marijuana, but for her plans concerning service members and veterans, *see*: https://elizabethwarren.com/plans/promises-to-veterans/.

Buttigieg

Pete Buttigieg also supports empowering VA physicians to prescribe or recommend cannabis where appropriate, and the legalization of cannabis nationwide. He continues:

> In the meantime, recognizing the benefits of marijuana for certain service-connected issues like post-traumatic stress, Pete will support legislation that will empower VA physicians to issue medical cannabis recommendations to augment a veterans' broader treatment plan, in accordance with the laws of states where it is legal, and to conduct studies on the use of marijuana to treat pain.

For more on Buttigieg's veteran's policy (with some detail concerning cannabis) *see*: https://peteforamerica.com/policies/veterans/.

Conclusion and Implications

Sanders, Warren, and Buttigieg all have made a point to recognize marijuana within their wider Veteran's Day plans. Sanders plan contains the most detail, and across his website, he addresses medical marijuana and cannabis legislation in other areas as well. All three, however, outline similar ideas—chiefly, that VA physicians be able to prescribe cannabis, and that it be legal at the federal/nationwide level. Notably, Joe Biden sets himself apart as one of few Democrat candidates who has not embraced full federal legalization. Democratic presidential candidates Sens. Cory Booker, Bernie Sanders, Kamala Harris, Elizabeth Warren and Michael Bennet have all co-sponsored a Senate proposal that would legalize marijuana, expunge criminal records, and develop a fund to reinvest in communities hurt by the war on drugs.
(Miles S. Schuster)

THE VAPING CRISIS AND OREGON'S RESPONSE

Vaping of both THC and nicotine products has soared in popularity over the last several years. In many states with legalized marijuana markets, vaping products have seen the fastest growth as new and seasoned consumers alike have been attracted by their convenience and, at least until recently, a perception that vaping is less harmful that smoking flower. But the mysterious vaping illness, which started in the spring as a few isolated cases of illness, has spread through 49 states, sickened over one thousand people, and killed more than a dozen.

Pressure to take action has been mounting for some time and a second death in Oregon last month spurred the Governor's office to take action. However, the lack of information as to what is actually making people sick has made crafting new rules that have a chance at being effective and yet are still narrow enough to limit damage to Oregon businesses a difficult task.

What We Know about the Illness

Since March 2019, users of vaping products across the country have been afflicted with sudden and acute lung damage that has hospitalized scores of people and lead to a number of deaths. Victims have reported using a wide array of vaping products including THC, nicotine, or both. The illness has shown up in 49 states, many of which have no legal marijuana programs at all. In Oregon, victims reported having purchased and used products from OLCC licensed retailers. It is still unknown if they used other products acquired informally.

The CDC has been working with state health authorities all over the country and has released some preliminary findings, most notably from a study done in Illinois and Wisconsin, which found that over 85 percent of victims had used THC vapes not purchased through a legal, regulated system. Though the investigation is ongoing, this seems to be the highest correlation between usage patterns and sickness.

Pressure from the Oregon Health Authority

Teen nicotine vaping rates have increased at an alarming speed over the last several years. Both in Oregon and nation-wide, nearly a quarter of all high school students have vaped nicotine in the last 30 days. This massive wave of nicotine addiction has rightly alarmed health advocates who have pointed to the popularity of flavored nicotine vape products as evidence of effective marketing to underage users. As such, the use of flavorings in vape products has been drawn into the center of the political fight over the best policy approach for the crisis. In late September, the Oregon Health Authority issued a recommendation to the Governor's office that sale of *all* vaping products in Oregon be banned for six months.

One major concern with the full ban is that it could have pushed users of legal, tested vaping products to instead purchase them on the black market. As recent tests of black market cartridges turned up dangerous levels of cyanide (resulting from pesticide use by unregulated farmers), the risk of turning users away from the regulated market led to a compromise.

The Flavoring Ban

On October 4, 2019, Oregon Governor Brown issued Executive Order 19-09, directing state agencies

to ban sales of all flavored vaping products, including both those with THC and those with nicotine, for 180 days. After a week of emergency rule making, the OLCC released its emergency rule in accordance with the Governor's directive, and immediately banned sale of all vaping products with any flavoring other than terpenes (the naturally occurring essential oils that give cannabis its smell and taste) derived from cannabis.

Non-Cannabis Derived Terpenes

Over the last two years, much of Oregon's now infamous oversupply has been transferred to processors. The resulting THC distillate, the component of vape cartridges that contains the psychoactive compounds from the cannabis plant, can be distilled from just about any marijuana biomass in nearly any condition. Marijuana with mold, poor bag appeal, or just older product that has degraded with time can be "blasted" down to distillate regardless of its quality. This led to a large supply of "crude oil," or unflavored distillate. In order to monetize this inventory, cartridge manufacturers have developed processes to introduce flavoring additives to distillate, either to mimic the terpene profiles or create unique flavors.

For example, the terpene limonene, which is prominent in many citrusy cannabis strains, can be extracted either from cannabis or from a lemon. Pinene can be gotten from weed or from wood. As it is more cost effective to get these terpenes from non-cannabis sources, much of the cartridge market has moved in that direction as constant price pressure has demanded more cost-effective production methods.

Manufacturer Risk Disclosures

Though chemically there is no difference between limonene from a lemon and limonene from cannabis, the manufacturers and sellers of botanically (non-cannabis) derived terpenes often introduce other components into their flavoring blends that act to stabilize the volatile terpenes. As vaping is a relatively new concern, and as federal prohibition makes research difficult, little is known about the effect these blends may have on users when inhaled. Last month, Oregon authorities came into possession of disclosure documents coming from some manufacturers of botanically derived terpenes, stating that they were not suitable for vaping consumption and may cause symptoms similar to those described by victims of the vaping illness. Though many pointed to the fact that these same companies have been marketing these products for exactly that purpose for years, those disclosures no doubt influenced the decision to ban such flavoring additives from legal cannabis vape products.

Moving Forward

As part of her Executive Order, Governor Brown instructed that an emergency advisory committee be convened to address ongoing issues relating to vaping and help establish long term rules to take over after the 180-day ban expires. In addition, the Oregon Liquor Control Commission is in the process of creating an approval process for specific non-cannabis derived terpenes should they be proven safe for vaping use. While there is no doubt that the ban will have significant consequences for the Oregon cannabis industry, including a possible re-shuffle of the deck when it comes to vaping market share, there is a path forward to approve and redeploy many of the products that have been so abruptly excluded from the market.

Conclusion and Implications

Of the many frustrations faced throughout this process by regulators, health officials, and policy makers, the lack of access to testing facilities is at the top of the list. Even if authorities are able to get their hands on the cartridges that may be making people sick, there is no clear way to get them tested for various adulterants because the very possession of them by laboratories is a federal crime. Were this an outbreak of listeria in cabbage, federal agencies would have isolated the source, recalled and quarantines suspect product, and issued a massive nationwide awareness campaign, all in a matter of days. Since it involves cannabis however, the CDC has taken months to become meaningfully involved and states have been largely left to fend for themselves and conduct complex epidemiology research for which they are not equipped. As of yet, there are no good policy solutions to this crisis because we know so little about its root cause. Let's hope that changes before too many more people get sick.
(Mia Getlin)

SOCIAL EQUITY PROGRAMS IN CANNABIS-LEGAL STATES AND CORPORATE PROFIT

In August of 2019, the Business Roundtable (https://www.businessroundtable.org/business-roundtable-redefines-the-purpose-of-a-corporation-to-promote-an-economy-that-serves-all-americans) announced a paradigm shift on corporate governance by changing the purposes for which companies exist from creating benefit for its shareholders to its stakeholders. The Business Roundtable represents CEOs from America's leading companies like JPMorgan Chase, Johnson & Johnson, and Vanguard.

The Road to Profit May Be Social Equity

This shift from beating on the top and the bottom line to maximize shareholder profit to one that puts customers first and invests in their employees are going from the boardrooms to the legislatures. Illinois' social equity provisions of the new cannabis laws is creating dozens of new companies that have to blend maximizing stakeholder value over that of the shareholders.

Putting specific criteria for getting a higher score on an application will make the newly formed corporate entities move toward that goal in its pursuit of a cannabis license. Of course, the risk is that the company's efforts to maximize value for the stakeholders, or social equity applicants, will be window dressing with no substance behind the facade. Such concern appears warranted when reviewing some of the States' and municipalities' approach to social equity.

Delays in Licenses

Unlike in California where Los Angeles gets to hand out licenses to social equity candidates based on what the city and the Department of Cannabis Regulation say qualify, Illinois mandates the requirements for points on an application's score based on specific criteria and evidence presented by a company trying to win a license. And unlike Los Angeles, the people of Illinois are not having to wait more than a year and a half. Illinois released the dispensary application without formulating rules and by taking questions about the application in the weeks between its release and submission window.

Factors of Race May Face Challenges of Discrimination

Ohio did not create a legislative framework for scoring social equity into the application itself. Instead Ohio mandated that 15 percent of cannabis licenses were to go to economically disadvantaged groups, which the state listed as: "Blacks or African Americans, American Indians, Hispanics or Latinos, and Asians." The statute arguably discriminates on the basis of race alone which may be problematic. If Ohio did not receive any or enough of such applications, then the licenses were to be awarded according to the usual procedures. Opponents of this style of social equity practice argue that it's pretty easy to disregard the social equity component when it is optional. Constitutional challenges to such a regimen are likely to follow.

Illinois' version of the New Capitalism of Cannabis not only avoids the constitutional issue of discrimination purely based on a person's race, but also makes the social equity component of their stautory framework optional. Applicants ignore the social equity option at their own peril because 20 percent of the possible score comes from being a social equity applicant.

Like Illinois, Massachusetts also focused its social equity program on the same type disproportionately impacted areas and victims of cannabis arrests. However, it treated both its social equity applicants the same as its regular cannabis license applicants and only helped with economic empowerment assistance and training after the award of the license. By June of 2019, only ten people had applied for the 123 licenses earmarked for certified Economic Empowerment Applicants in the state. Apparently, the social equity benefits do not help attract new participants in the industry when those benefits only come after competing for the same license.

Maryland and Illinois have methods to inject social equity into the cannabis licensing process that appears to keep demand up. Putting social equity into the scoring of the application itself forces traditional equity holders to partner up with the social equity talent to create a winning application. These social

equity requirements in the applications do not appear to be chilling the competition. Maryland closed its application window for medical cannabis grower licenses in June of 2019 and received over 200 applications—for only four licenses.

Fifteen percent of their scores are related to social equity and diversity in the business applying for the cannabis license. The application required documentation of good faith efforts to have a percentage of the business ownership held by disadvantaged equity applicants, even if they could not find anyone that wanted it. The application goes on to state that it could be possible to score all the diversity points despite not sharing ownership if your good faith explanation is compelling enough.

The Maryland grower license application provided a break down of possible point scoring depending on the applicant's diversity makeup and plans that may prove illustrative to Illinois regulators and whatever state goes into the competitive cannabis licensing game next. Maryland has a lot of close neighbors eyeing full legalization in 2020.

Conclusion and Implications

As Illinois's law also contemplates, Maryland publishes demographic data regarding the industry. If the public policy objective is to allow the industry to reflect the diversity in the population of the state as a whole, then we should probably look at a given state's demographics to give us the base rates for the particular state in question. From that data, the demographics of any state's cannabis industry could be compared to its general population to determine if it is consistent with the state's demographic diversity.

The results of the push for social justice and diversity in the legal cannabis industry will take years to bear fruit and data that charts the demographics of the industry. New capitalism's intent to benefit all stakeholders should inject social equity into the points for the applications to create a diverse industry that reflects the general population. Arguably, if you do not require those with capital and those allegedly harmed by cannabis prohibition to work together to win a license, you will see organizations and management agreements that appear to provide the state what it wants on paper, while not actually accomplishing the intentions of the laws.
(Thomas Howard)

LEGISLATIVE DEVELOPMENTS

U.S. HOUSE OF REPRESENTATIVES VOTES TO BLOCK DOJ FROM ENFORCING FEDERAL MARIJUANA LAWS IN STATES THAT HAVE LEGALIZED RECREATIONAL USE—SENATE DECLINES

In June of this year, the U.S. House of Representatives approved a measure—"Amendment To Division A Of Rules Committee Print 116-18"—with a vote of 267-165 to prevent the Department of Justice (DOJ) from interfering with state cannabis laws for all purposes, including for recreational use. The measure was offered by Representatives Tom McClintock (R-CA), Earl Blumenauer (D-OR), and Del. Eleanor Holmes Norton (D-DC). The measure prohibits the DOJ from using funds to interfere in the implementation of state laws that allow the use, possession, cultivation and distribution of cannabis.

Background

Rep. McClintock, in a letter circulated to colleagues prior to the vote, wrote that:

> The issue at hand is whether the federal government has the constitutional authority to dictate policy to states on an issue which occurs strictly within their own borders.

In a floor debate on the amendment, Rep. Blumenauer said:

> We're watching the growth of this industry, a multibillion-dollar industry. We're watching state after state move forward…I strongly urge that we build on the legacy that we've had in the past, that we move this forward to allow the federal government to start catching up to where the rest of the states are.

Steven Hawkins, executive director of the Marijuana Policy Project views the approval by the House as "the most significant step Congress has ever taken toward ending federal marijuana prohibition." NORML Political Director Justin Strekal concurred in this opinion. Strekal stated that this action by Congress:

> . . .highlights the growing power of the marijuana law reform movement and the increasing awareness by political leaders that the policy of prohibition and criminalization has failed.

The House Measure

The scope of this year's amendment is much broader than the 2014 Rohrabacher-Farr amendment, which only prohibited the DOJ from spending funds to interfere with the implementation of state medical cannabis laws. This year's measure drew support from all but eight Democrats and almost a quarter of Republicans.

The House considered a nearly identical measure in 2015 which ultimately came nine votes short of passing. This year, 20 members switched their "no" votes to "yes" votes. However, at least seven members changed their votes from "yes" to "no." Fewer Republicans voted in favor of the measure as compared to 2015, perhaps due to the loss of pro-marijuana Republican members in the 2018 midterm election. For example, Dana Rohrabacher (R-CA), a longtime proponent of cannabis, lost the midterm election to Harley Rouda (D-CA) in California's 48th district. Rohrabacher, along with former members Carlos Curbelo (R-FL) and Mike Coffman (R-CO) all voted in 2015 in favor of the measure. Additionally, the new measure is much broader, extending protections to Washington D.C. and U.S. territories, which may have contributed to this flip on the part of some members. Another consideration is that there are simply fewer Republican members in the House, as Democrats are now in control.

The Senate Declines to Join the House

While it was expected that the Senate would take up companion legislation, in September 2019, the Senate Appropriations Committee declined to take up the new amendment. On the other hand, the Rohrabacher-Farr amendment was approved for

the FY 2020 spending bill. Several reasons may have caused the Committee's decision to decline to take up the new amendment. For example, congressional appropriators made a "gentleman's agreement" earlier this year not to add new policy-related riders to spending legislation. The concern was that inserting such policy-riders could jeopardize passage of the overall bills.

Conclusion and Implications

Obviously, those observing the political meanderings were disappointed in the Senate's refusal to move forward on a companion bill. NORML Political Director Justin Strekal Strekal expressed his disappointment over the Committee's decision stating, "The Senate Appropriations Committee refuses to acknowledge their role in the perpetuation of marijuana prohibition. The continued allowance of taxpayer dollars to be used to perpetuate criminalization is a failed policy." Sen. Tim Kaine (D-VA) stated that the Senate should pass a spending bill that includes cannabis protections, while noting that he does not think we need federal marijuana laws. "At this point, we should leave it up to the states," Sen. Kaine said. The Amendment is available online at: https://amendments-rules.house.gov/amendments/BLUMEN_072_xml618191421192119.pdf
(Brittany Ortiz)

REGULATORY DEVELOPMENTS

UNITED STATES DEPARTMENT OF AGRICULTURE RELEASES INTERIM FINAL RULE ON HEMP PRODUCTION PROGRAM

Background

In late October 2019, the U.S. Department of Agriculture (USDA) released its Interim Final Rule (Final Rule) on the "Establishment of a Domestic Hemp Production Program"; 7 CFR Part 990.

The United States and hemp have a long history. The Final Rule acknowledges "hundreds of years" of historic use, in utilitarian such as "numerous industrial and horticultural purposes including fabric, paper, construction materials, food products, [and] cosmetics. . . ." But it's clear that with demand for CBD oil, everything seemed to change. CBD would seem to have been a major driving force for the Farm Bill and Final Rule.

The Final Rule defines hemp (and by that it also defines CBD extract) as follows:

> . . . the term "hemp" means the plant species *Cannabis sativa* L. and any part of that plant, including the seeds thereof and all derivatives, extracts, cannabinoids, isomers, acids, salts, and salts of isomers, whether growing or not, with a delta-9 tetrahydrocannabinol concentration of not more than 0.3 percent on a dry weight basis. Delta-9 tetrahydrocannabinol, or THC, is the primary intoxicating component of cannabis. Cannabis with a THC level exceeding 0.3 percent is considered marijuana, which remains classified as a schedule I controlled substance regulated by the Drug Enforcement Administration (DEA) under the CSA.

The USDA seem to be entering the world of the regulating hemp and CBD with some skepticism (and perhaps a note of resentment) that demand for these products, especially demand for CBD will be a fad or a true growth industry. In the end it all seems to be about CBD:

> Hemp production in the U.S. has seen a resurgence in the last five years; however, it remains unclear whether consumer demand will meet the supply. High prices for hemp, driven primarily by demand for use in producing CBD, relative to other crops, have driven increases in planting. Producer interest in hemp production is largely driven by the potential for high returns from sales of hemp flowers to be processed into CBD oil.

The Interim Final Rule

With passage into law of the Farm Bill the U.S. dipped its proverbially toe into the waters that are cannabis. The Interim Final Rule followed as a necessary part of the bill's passage and:

> . . . requires USDA to promulgate regulations and guidelines to establish and administer a program for the production of hemp in the United States. Under this new authority, a State or Indian Tribe that wants to have primary regulatory authority over the production of hemp in that State or territory of that Indian Tribe may submit, for the approval of the Secretary, a plan concerning the monitoring and regulation of such hemp production. For States or Indian Tribes that do not have approved plans, the Secretary is directed to establish a Departmental plan to monitor and regulate hemp production in those areas. . . .With the publication of the interim rule, USDA will begin to implement the hemp program including reviewing State and Tribal plans and issuing licenses under the USDA hemp plan. There is also a 60-day comment period during which interested persons may submit comments on this interim rule.

General Points of Regulation

A good starting point is distinguishing hemp from marijuana. Hemp is defined as:

> *Cannabis sativa* L. and any part of that plant,

> including the seeds thereof and all derivatives, extracts, cannabinoids, isomers, acids, salts, and salts of isomers, whether growing or not, with a delta-9 tetrahydrocannabinol concentration *of not more than* 0.3 percent on a dry weight basis. (Emphasis added)

The Interim Final Rule is divided into sections that include: State and Tribal Plans; Department of Agriculture Plan; Definitions; Appeals; Interstate Commerce; and Outreach. Each section has extensive subsections providing a fair amount of detail. The rule states:

> . . .a State or Indian Tribe that wants to have primary regulatory authority over the production of hemp in that State or territory of that Indian Tribe may submit, for the approval of the Secretary, a plan concerning the monitoring and regulation of such hemp production. For States or Indian Tribes that do not have approved plans, the Secretary is directed to establish a Departmental plan to monitor and regulate hemp production in those areas.

There are similar requirements that all hemp producers must meet. These include: licensing requirements; maintaining information on the land on which hemp is produced; procedures for testing the THC concentration levels for hemp; procedures for disposing of non- compliant plants; compliance provisions; and procedures for handling violations.

Federal Preemption

In implementing the Farm Bill, the Final Rule makes clear that states and tribes may decide to maintain *stricter* standards of regulation than are promulgated by the Final Rule—something that is very different from, for example, the federal Clean Air Act where ongoing efforts by California to establish state standards more stringent than federal regulation lately are met with stern resistance from the United States.

The Final Rule states:

> Nothing preempts or limits any law of a State or Tribe that regulates the production of hemp and is more stringent than the provisions in the 2018 Farm Bill. State and Tribal plans developed to regulate the production of hemp must include certain requirements when submitted for USDA approval.

States and Tribes

Under the section, States and Tribes, the Interim Final Rule is divided into subsections of: Land Use for Production; Sampling and Testing; Disposal of Non-Compliant Plants; Compliance with Enforcement Procedures Including Annual Inspections; Information Sharing; Certification of Resources; and Plan Approval. Each subsection contains extensive details that go beyond the scope of this summary.

Department of Agriculture Plans

This section addresses the need and availability of Department of Agriculture Plans that would regulate hemp production in areas where production is legal *but not covered* by a State or Tribal Plan. This would include a path to obtaining a Department of Agriculture "Hemp Producer License."

Conclusion and Implications

The 2018 Farm Bill legalized hemp and hemp by-products, and mandated that the Department of Agriculture establish working regulations to implement growing and product production. The Interim Final Rule, which is still subject to a comment period and may be changed due to comments, in a Final Rule and published in the Federal Register, reflects extensive details in the regulation of hemp with the Department of Agriculture in the lead of such regulation. The Interim Final Rule is available online for review and comment, at: https://www.ams.usda.gov/sites/default/files/media/AMS_SC_19_0042_IR.pdf

The 2018 Farm Bill is available online at: https://www.agriculture.senate.gov/imo/media/doc/Agriculture%20Improvement%20Act%20of%202018.pdf

With this proposed Final Rule, the federal government officially moves into the world of the regulation of hemp. We will report on the Final Rule once published in the Federal Register.
(Robert Schuster)

CALIFORNIA BUREAU OF CANNABIS CONTROL ANNOUNCES LOCAL EQUITY GRANT FUNDING RECIPIENTS

The California Bureau of Cannabis Control (Bureau) has announced the ten local jurisdictions that will receive equity grant funding to be used for local programs that focus on inclusion of communities or persons negatively impacted by cannabis criminalization. The equity grant funding is authorized by the California Cannabis Equity Act of 2018, established by Senate Bill 1294 and the Budget Act of 2019, Item 111-490 – Re-Appropriation.

The Equity Grant Funding

In order to qualify, local jurisdictions were required to submit applications by August 30, 2019, that met criteria and requirements set forth in the Bureau's Local Equity Grant Guidelines, which were released in July 2019. Fund awards were determined based on the Guidelines, up to the total amount requested by the local jurisdiction, but not less than $100,000.

The Bureau awarded a total of $10 million in equity grant funding to local jurisdictions in order to provide assistance and services to local applicants and licensees. The award recipients and corresponding equity grant funding are broken down below:

- City of Los Angeles - $1,834,156.38
- City of Oakland - $1,657,201.65
- City of Humboldt - $1,338,683.13
- City and County of San Francisco - $1,338,683.13
- City of Sacramento - $1,197,119.34
- City of Long Beach - $913,991.77
- City of San Jose - $560,082.30
- County of Santa Cruz - $560,082.30
- City of Coachella - $500,000
- City of Palm Springs - $100,000

The noticeable cities are those at the top of the list: Los Angeles and Oakland—each slated to receive nearly $2 million to help implement their local social equity programs. This funding is especially significant for jurisdictions like the City of Los Angeles, which has hit several road blocks while trying to get its program off the ground. The grants will also undoubtedly help other cities that face trouble with insufficient funding to get their social equity programs started.

Program Goals

The interesting part about the social equity program being implemented on the state level and by individual cities and counties is the purpose of such programs. The goal is to help people who were negatively affected by the prior criminalization of cannabis. Because cannabis was only recently legalized by many states, there are many individuals who faced criminal punishment related to the drug that has now become widely legalized. Social equity programs are intended to offer these individuals with an advantage in the commercial cannabis market. This is a proclamation by jurisdictions that allow cannabis activities that reparations should be made to those harmed in the past by the "war on drugs." The paradox is that our country has not fully decriminalized cannabis yet because the federal government still considers cannabis to be a Schedule I controlled substance.

Additional Requirements

There are several additional requirements involved with the Bureau's Local Equity Grant Funding Program. To receive the grant funding, the governing bodies for these ten local jurisdictions must pass a resolution authorizing the jurisdiction to enter into an agreement with the Bureau. Once the Bureau receives the resolution and signed agreement, it plans to distribute grant funds directly to the locality in one lump sum. Grant recipients must also comply with certain reporting requirements. For example, local jurisdictions must submit annual reports to the Bureau that contain information demonstrating how grant funds were expended for eligible uses, and records detailing expenditure of all grant funds must be maintained for seven years.

Conclusion and Implications

Many states that have legalized recreational cannabis, such as Illinois, for example, have included social equity aspects of legalization in an effort to rebalance the scales of perceived inequity caused by the "war on drugs." California is another one of those states.

Additional information about the Bureau of Cannabis Control's Equity Grant Funding Program may be found at the following link: https://www.bcc.ca.gov/about_us/equity_grant.html (Nedda Mahrou, Brittany Ortiz)

NEVADA GOVERNOR ASSEMBLES MARIJUANA TASK FORCE

The State of Nevada continues to find its way in a robust marijuana market that produced nearly $70 million in tax revenue in its first year. Governor Steve Sisolak, following incidents and reports of less-than-stellar dealings between individuals and some facilities, has created a multi-agency marijuana task force to find, identify and eliminate ongoing wrongdoings within the state's legal cannabis industry. The task force has already conducted unannounced inspections at several testing laboratories, and is expected to continue increasing its influence throughout the Silver State.

Background

No federal standards are in place for regulating legal cannabis, and as such, policymaking is left up to the states—aside from the issue of hemp and CBD by products, now regulated by the U.S. Department of Agriculture. Nevada is aspiring to frame itself a leader among legalized states, and has touted that its regulating and testing processes are among the strictest, and most beneficial for end users.

Despite the efforts, actual incidents of marijuana products sold in dispensaries with unsafe levels of mold, yeast and other microbials has forced the state to investigate some of its marijuana testing facilities. Those incidents have given way to allegations of manipulated product testing at some labs and agencies.

At the same time, a recent federal indictment has charged four men in a now-failed plot that would have otherwise permitted an unidentified Russian investor to enter the state's legal cannabis market through illegal means.

Sisolak has been vocal about taking his responsibility managing the state's maturing marijuana industry seriously. "Any marijuana entity—licensed or unlicensed—that violates the law will see swift and severe criminal and regulatory action," he said through a statement.

The Task Force in Action

Following the recent concerns, Sisolak created the statewide task force, consisting of members from multiple agencies, to conduct spot inspections at its 11 licensed testing facilities. The governor has not revealed the names of the agencies involved.

The group has already shown up unannounced at several facilities to begin the processes, each time collecting samples of various marijuana products. Managing members of those facilities have been vocal that the requests by the task force have so far been well within reason, and that they believe the current situation is a necessary part of ensuring long-term compliance in the state.

The task force has also been assigned to investigate ongoing issues surrounding the state's licensing processes, which have previously been buried in litigation. This also includes license transfers, which have been a hot-ticket item in the state—four cannabis businesses were sold in the second half of 2018, with price tags ranging from $40 million to nearly $300 million.

Federal Indictment a Major Influence

A recent federal indictment was a major catalyst in the creation of the task force. According to documents, funds that originated with an unnamed Russian investor made their way as donations to recent Nevada Republican gubernatorial and attorney general candidates Adam Laxalt and Wes Duncan. The indictment states that this individual was conducting a now-failed attempt to illegally enter the Silver State's lucrative marijuana industry, with a

goal of working to elect new state officials who might green-light future bids with different rules.

Both Laxalt and Duncan lost their political campaigns, and have agreed to return the money.

Stringent Requirements for Testing

According to the Nevada Department of Taxation, the state modeled its laboratory regulations based on some of the strictest guidelines available. Labs must follow standards by leading authority American Herbal Pharmacopoeia, and the processes must be overseen by a scientific director in possession of a doctorate in chemical or biological sciences. Each lab must go through an accreditation process, and ongoing lab inspections are scheduled regularly throughout the year.

Labs collect raw samples of all products from its cultivators. If a sample possesses an unacceptable level any of one of a number of contaminants, the cultivator must destroy the entire product batch.

Labs must also remain forever independent from all other parties involved in the cannabis industry.

Conclusion and Implications

In the end, the governor's anger at recent events prompted his office to declare that: "The Governor is disappointed in the lack of oversight and the inaction from the state over many years that led us to this critical juncture – including the apparent absence of a single criminal referral by the Marijuana Enforcement Division since the inception of licensed marijuana sales, medical or recreational, in Nevada. Governor Sisolak's administration is taking immediate action in order to protect the health and safety of Nevadans, the jobs created by the industry, and the long-term sustainability of education funding generated from the legalized marketplace." (*See:* http://gov.nv.gov/News/Press/2019/Governor_Sisolak_Statement_on_Legalized_Marijuana_Market_Issues_and_Immediate_Formation_of_Special_Task_Force/)

With the very recent formation of the task force there isn't much yet to report on by way of measures and actions. However, the task force has already recommended that the state extend its review period for cannabis license transfer and change of ownership applications. The Nevada Department of Taxation, based on the recommendation, has announced it will not be processing new nor existing license transfers or change of ownerships until a more thorough review process has been put into place.
(Matthew Seltzer)

CANNABIS LAW™
& REGULATION REPORTER

Cannabis Law & Regulation Reporter
Argent Communications Group
P.O. Box 1135
Batavia, IL 60510-1135

CHANGE SERVICE REQUESTED

FIRST CLASS MAIL
U.S. POSTAGE
PAID
AUBURN, CA
PERMIT # 108