Volume 1, Number 8
January 2020

CANNABIS LAW™

& REGULATION REPORTER

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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.

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FEATURE ARTICLE

ARE CALIFORNIA'S TAX AND REGULATORY SYSTEM KILLING LEGALIZED CANNABIS IN THE STATE?

By Robert M. Schuster

On January 10, 2020 California Governor Gavin Newsom announced plans to address the complexity of legalized cannabis sales in the state, while a state report offers guidance.

Background

In 1996, California became the first state to legalize cannabis for medical use when voters approved Proposition 215. While Proposition 215 legalized the medical use of cannabis, it did not create a statutory framework for regulating or taxing it. As a result, for roughly 20 years after the measure passed, most regulation and taxation of medical cannabis in California happened at the local level through ordinances and permit requirements. (Like other businesses, medical cannabis businesses were subject to broadbased state taxes, such as income taxes and sales taxes.) In recent years, the California Legislature passed a series of laws—most notably, in 2015, Chapter 688 (AB 243, Wood), Chapter 689 (AB 266, Bonta), and Chapter 719 (SB 643, McGuire)—to provide a statutory framework to regulate medical cannabis.

In November 2016, California voters approved Proposition 64. At the time, Washington, Colorado, Oregon, and Alaska were the only states that had legalized cannabis for adult use. Under Proposition 64, adults 21 years of age or older can legally grow, possess, and use cannabis for nonmedical purposes, with certain restrictions. Since the passage of Proposition 64, the Legislature has passed laws amending the measure, including Chapter 27 of 2017 (SB 94, Committee on Budget and Fiscal Review), which brought the state's medical and adult-use regulatory structures into conformity.

Under Proposition 64, state agencies issue licenses to several types of cannabis businesses, including cultivators, manufacturers, distributors, testing labs, and retailers. To hold a state license, cannabis businesses must pay fees and meet numerous other requirements, including ones related to security protocols, product testing, and product labeling. For example, cannabis products must be tested for THC and CBD content before the last distributor transfers the products to the retailer. Additionally, state-licensed businesses must participate in the state's "trackandtrace" system by attaching unique identifier tags (similar to bar codes) to each plant and product. These tags allow the state to track the movement of cannabis products through the entire supply chain, from cultivation all the way to retail sale.

Proposition 64 authorizes local governments to impose requirements on cannabis businesses, to limit where they can locate, or to ban them altogether.

The California Constitution does not allow the Legislature to amend a measure passed by the voters unless the measure itself authorizes the Legislature to do so. Proposition 64 authorizes the Legislature to amend the measure's tax provisions with a two-thirds vote. These changes must be consistent with the measure's intent and further its purposes. In many cases, whether a proposed change to Proposition 64 would meet these criteria and, therefore, whether the Legislature could enact it without a statewide vote is unclear.

The Current 'Complicated' Taxation Scheme in California

Proposition 64 Imposes two state excise taxes on cannabis. Like other businesses, cannabis businesses

generally must pay broadbased taxes such as income taxes and sales taxes. Additionally, Proposition 64 established two state excise taxes on cannabis. The first is a 15 percent excise tax on retail gross receipts. The second is a cultivation tax on harvested plants. As of January 1, 2020, the cultivation tax rates are $9.65 per ounce of dried flowers, $2.87 per ounce of dried leaves, and $1.35 per ounce of fresh plants. The California Department of Tax and Fee Administration (CDTFA), which administers these cannabis taxes, adjusts the cultivation tax rates annually for inflation.

Cultivators and retailers bear the legal responsibility for the initial payment of the cultivation and retail excise taxes, respectively. However, pursuant to Chapter 27, final distributors—rather than cultivators or retailers—must remit these taxes to the CDTFA resulting in a multistep payment process.

A cultivator determines the amount of cultivation tax it owes by weighing the plants it harvests. It then pays this amount to a distributor when it sells or transfers the harvested plants. In a case in which cannabis travels from the cultivator to just one distributor prior to retail sale, that distributor remits the tax to CDTFA. In many cases, however, the supply chain is more complex, with multiple manufacturers and distributors handling harvested cannabis and the products derived from it. In these cases, each of those businesses must transfer the cultivation tax until the final distributor remits it to CDTFA.

Retailers generally must pay the retail excise tax to final distributors when they make wholesale purchases. These distributors then remit the retail excise taxes to CDTFA. Retailers must make these payments before they sell the products to consumers, so the tax is based directly on the wholesale price that retailers pay to distributors rather than the retail price that consumers pay to retailers. Pursuant to Chapter 27, CDTFA sets the tax based on its estimate of the average ratio of retail prices to wholesale prices—commonly known as a "markup." CDTFA's current markup estimate (as of January 1, 2020) is 80 percent. Due to the 15 percent statutory tax rate and the 80 percent markup estimate, the current effective tax rate on wholesale gross receipts is 27 percent (15 percent x [100 percent + 80 percent]).

State law exempts medical cannabis from certain taxes under two scenarios. First, under a new law that takes effect January 1, 2020 (Chapter 837, Statutes of 2019 [SB 34, Wiener]), medical cannabis products that businesses donate to consumers free of charge (and that meet other conditions) are exempt from the state's cannabis taxes. Second, cannabis is exempt from state and local sales taxes if purchased for medical use with a valid state medical identification card.

Local governments also have taken a variety of approaches to taxing cannabis. These approaches fall into three general categories. First, many local governments impose the same tax rate on all cannabis businesses regardless of type. Second, many local governments impose higher tax rates on retailers than other types of cannabis businesses. Third, a few local governments license cannabis businesses but do not levy taxes specifically on cannabis. Although these three approaches lead to a wide range of local tax rates, the LAO estimates that the average cumulative local tax rate over the whole supply chain is roughly equivalent to a 14 percent tax on retail sales.

The Legislative Analyst's Report and Governor Newsom's Support of a More Streamlined System of Taxation on Cannabis

The non-partisan California Legislative Analyst's Office (LAO), which is charged with looking into the likely impacts of newly proposed legislation took steps to look into California's scheme in place for cannabis taxation. (*See*, https://lao.ca.gov/Publications/Report/4125) The Report was issued on December 17, 2019. Following issuance of the Report, California Governor Gavin Newsom issued a statement announcing his administration's commitment to get legalized cannabis sales in California done right. On Friday January 19, 2020, the Governor announced his intentions to streamline and update California's tax scheme in keeping with recommendations of the LAO report.

The LAO found the current process counter-productive and complicated.

Addressing Taxation and the Impact of/on Black Market Sales

At the onset, however, the LAO addressed critics who have advocated for much lower taxes to compete better with a tax-free black-market:

> One of the goals listed in Proposition 64 is to undercut illicit market prices. However, under

current market conditions, changes in the state tax rate likely would not make legal cannabis less expensive than illicit cannabis. Even if the state eliminated its cannabis taxes entirely, other costs—such as regulatory compliance costs and local taxes—likely would keep legal cannabis prices higher than illicit market prices. (This could change if legal prices decline, as they have in other states.) Accordingly, we instead consider competition between the legal and illicit cannabis markets more broadly. Even if legal cannabis remains more expensive than illicit cannabis, any price change will affect some consumers' choices, which in turn affect the sizes of the legal and illicit markets.

The LAO went on to comment on the effects of lowering taxes in general, as follows:

> . . .the Legislature faces tradeoffs when considering adjustments to the state's cannabis tax rate. Any tax rate change would help the state meet certain goals while likely making it harder to achieve others. On one hand, for example, reducing the tax rate would expand the legal market and reduce the size of the illicit market. On the other hand, such a tax cut would reduce revenue in the short term, potentially to the extent that revenue could be considered insufficient. Furthermore, lower tax rates could lead to higher rates of youth cannabis use—particularly if the state makes progress towards reining in the illicit market.

Possible Tax Schemes to Consider

The LAO report identified several *possible tax schemes* to *consider*, including:

- **Basic *Ad Valorem* Tax**. Under a basic ad valorem tax, the amount of tax due is a percentage of the price. The sales tax and California's current retail excise tax on cannabis are examples of ad valorem taxes.

- **Weight-Based Tax**. Under a weightbased tax, the amount of tax due is based directly on the weight of the product. The rates can vary depending on the part of the plant (for example, flower or leaves) or its condition (for example, dried or fresh). California's current cultivation tax is an example of a weightbased tax.

- **Potency-Based Tax**. Under a potencybased tax, the amount of tax due depends only on the potency of the cannabis product.

- **Tiered *Ad Valorem* Tax**. A tiered ad valorem tax is similar to the basic ad valorem tax, but with multiple rates. These rates could depend on potency and/or the type of product.

The LAO has advised the Legislature that it might consider the following issues when selecting the type of tax to implement and regulate:

- **Harmful Use.** As noted in the "Background" section, the negative effects of cannabis use seem to be particularly high for highpotency products, highfrequency use, and youth use. To score well on this criterion, a tax should impose higher costs on more harmful purchases and lower costs on less harmful purchases. (As noted above, diminished illicit market activity would help make the tax more useful for this purpose.)

- **Raising Stable Revenues.** For any type of tax, the Legislature can set the rate to raise a particular amount of revenue (up to a point) in an average year. However, the revenue raised by some types of taxes could grow at rates that vary unpredictably from year to year, while other taxes could raise more stable revenues. The latter types score better on this criterion than the former.

- **Administration and Compliance.** To score well on this criterion, a tax should be relatively straightforward for tax administrators and taxpayers to implement and enforce.

- **Other Criteria.** In addition to the three main criteria identified above, the Legislature also may wish to consider other criteria, such as: (1) the extent to which a tax could help the legal market compete effectively with the illicit market; (2) the extent to which a tax would create arbitrary cost

differences between very lowTHC cannabis products and similar hemp products; (3) the difficulty of implementing the change.

Other Key Recommendations

The LAO made several recommendations to modify the state's current system of taxation, summarized as follows:

> •**Replace Existing Taxes with Potency-Based or Tiered *Ad Valorem* Tax.** We view reducing harmful use as the most compelling reason to levy an excise tax. Accordingly, we recommend that the Legislature replace the existing retail excise tax and cultivation tax with a potencybased or tiered ad valorem tax, as these taxes could reduce harmful use more effectively. If policymakers value ease of administration and compliance more highly than reducing harmful use, however, the Legislature might prefer to keep the existing retail excise tax. In contrast, we see little reason for the Legislature to retain the weightbased cultivation tax.
>
> •**Specify Taxed Event and Point of Collection to Match Type of Tax**. After the Legislature chooses the type of cannabis tax it wants to levy, we recommend that it specify the taxed event and point of collection to facilitate tax administration and compliance. For example, for an ad valorem tax (tiered or basic), we recommend levying the tax on the retail sale and collecting it from the retailer.
>
> •**Set Specific Tax Rate.** For a potencybased or tiered ad valorem tax, we recommend that the Legislature specify the details of the tax structure in consultation with scientific experts. Such expertise—informed by the state's trackandtrace data—is crucial for determining key details. Currently available information suggests that a potencybased tax in the range of $0.006 to $0.009 per milligram of THC could be appropriate. If the Legislature prioritizes reducing the illicit market, it may prefer a rate closer to the lower end of this range. If, on the other hand, it prioritizes raising revenues, it may prefer a rate closer to the higher end.
>
> If the Legislature decides not to adopt a potencybased or tiered *ad valorem* cannabis tax, we nevertheless recommend that the Legislature eliminate the cultivation tax. In this case, we recommend that the Legislature set the retail excise tax rate somewhere in the range of 15 percent to 20 percent depending on its policy preferences.

Other Possible Changes to Make

The LAO report also addressed other possible changes the Legislature might consider to help the regulatory system:

> . . .changing cannabis tax rates could help the Legislature make progress towards some of the measure's goals, though there are tradeoffs involved. The Legislature could make further progress towards those goals and others by making changes not only to the tax rates, but also to the basic structure of the taxes. . . .we encourage the Legislature to approach cannabis tax policy in three steps: first, choosing what type of tax to impose on cannabis; second, choosing the taxed event and point of collection for the tax; and third, choosing the tax rate.

The Timing of Tax Changes

The LAO report also addressed to the Legislature, the *timing* of tax changes as a key consideration:

> Historically, the Legislature has adjusted excise tax rates very infrequently. If this experience is a guide, the Legislature might want to think carefully about the timing of any changes to the state's cannabis tax structure and rates. On one hand, the sooner the Legislature changes the state's cannabis taxes, the sooner the state will realize any benefits associated with those changes. On the other hand, as discussed below, there are advantages to waiting until more information is available and the market is more stable.

Conclusion and Implications

In conclusion, the LAO summarized its recommendations as follows:

> . . .we recommend that the Legislature make various changes to cannabis taxes. These chang-

es—which could be complemented by changes to nontax policies—include: (1) replacing the state's existing cannabis taxes with a potency-based or tiered ad valorem tax; (2) choosing the taxed event and point of collection to match the type of tax chosen; (3) setting the tax rate to match the Legislature's policy goals; and (4) taking some related actions, such as clarifying access to trackandtrace data and crafting the definition of gross receipts carefully. We recommend that the Legislature enact these changes soon given the benefits they could yield. Additionally, we recommend that the Legislature revisit cannabis taxes periodically to see if further changes are warranted in light of new information from trackandtrace and from scientific research on the effects of cannabis.

The learning curve of regulating legalized cannabis is evident, not only in California but in all states which have sanctioned legalization. It is most certainly not a static process, but one that *reconsiders* approaches as it takes an honest look back at what is working and what is not. The lure of tax revenues remains a key component in the decision-making of process of favoring or rejecting legalization. Getting it right is not as easy as it might appear first appear. But not unlike states which have legalized gaming, the *successful* regulation of recreational cannabis has the potential to produce enormous tax revenue. The burgeoning cannabis industry remains in its infancy and growing pains are most certainly going to be a part of the process.

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CANNABIS LAW NEWS

PRESIDENT TRUMP SUGGESTS HE MAY IGNORE MEDICAL MARIJUANA PROTECTIONS PASSED BY CONGRESS

On December 20, 2019, President Trump signed a large-scale federal funding bill into law. House Resolution 1158, the "Consolidated Appropriations Act, 2020" (the Act), authorizes appropriations to fund the operation of certain agencies in the federal government through September 30, 2020. President Trump then issued a statement on certain provisions of the Act that "purport to restrict the President's constitutional authority." The President specifically addressed Division B, § 531 of the Act which provides that the Department of Justice may not use any funds made available under the Act to prevent implementation of medical marijuana laws by various states and territories. Commenting on this provision, President Trump stated, "My Administration will treat this provision consistent with the President's constitutional responsibility to faithfully execute the laws of the United States."

Background

This is the third time the President has issued a signing statement that his administration does not have to necessarily abide by medical marijuana protections passed by Congress. In February 2019, President Trump signed a federal spending bill into law containing a rider preventing the Department of Justice from interfering in state medical marijuana laws. Similarly, in May 2017, another rider was attached to a spending bill that mirrored the language of the Act's Division B, § 531. With respect to both riders, the President issued a signing statement identical to the signing statement issued with the Act: "I will treat this provision consistent with the President's constitutional responsibility to faithfully execute the laws of the United States."

The vague language of the President's signing statements do not directly assert that the President will ignore medical marijuana protections passed by Congress. However, medical marijuana advocates have interpreted President Trump's statements as an affirmation that his administration can broadly enforce federal drug laws against people complying with state medical marijuana laws, even though Congress has directed him against this. Typically, presidents use signing statements to flag provisions of laws they are enacting which they believe could impede on their executive authorities. PresidentTrump has previously hinted at his position on the issue, stating:

> It's a very big subject and right now we are allowing states to make that decision. A lot of states are making that decision, but we're allowing states to make that decision.

Tension between Congress and the Trump Administration on Medical Cannabis

Former Congressman Dana Rohrabacher (R-CA) described the President's signing statement associated with the 2017 spending bill as "nebulous." At the time, Rohrabacher was the chief sponsor of the medical marijuana rider and Jeff Sessions, an ardent legalization opponent, was in the position of U.S. Attorney General. Rohrabacher made it clear that if the Department of Justice were to crackdown on state medical marijuana protections he would lead the charge in fighting it, stating, "If we have to take it all the way to the Supreme Court, we will win on this."

Despite President Trump's statements on the issue, this does not mean that the administration will be cracking down on those complying with state medical marijuana laws. The Trump administration has not carried out any major enforcement activities against state-legal marijuana businesses since taking office. In fact, during his campaign, President Trump pledged that he would respect the right of states to enact their own cannabis laws without federal interference. This pledge encompassed not only state medical marijuana laws, but also states' policies on recreational marijuana.

With Jeff Sessions no longer in the position of U.S. Attorney General, the threat is even less likely

to come to fruition. Trump's new Attorney General, William Barr, pledged during his confirmation hearing and in writing that he would not go after marijuana businesses operating under state laws, medical or otherwise. However, Barr's position on state marijuana laws is not necessarily benign:

> My approach to this would be not to upset settled expectations and the reliant interests that have arisen as a result of the Cole memorandum. However, I think the current situation is untenable and really has to be addressed. It's almost like a backdoor nullification of federal law. . . .I'm not going to go after companies that have relied on Cole memorandum. However, we either should have a federal law that prohibits marijuana everywhere, which I would support myself because I think it's a mistake to back off marijuana. However, if we want a federal approach—if we want states to have their own laws—then let's get there and get there in the right way.

Conclusion and Implications

For many states, recreational cannabis legalization came upon the heels of medical cannabis legalization. In some states, the decision to fully legalize cannabis may only come to pass if their respective medical cannabis programs go well and without the perceived problems associated with cannabis in general. As the federal government seemingly inches its way towards normalization of cannabis sales, the tension between it and the states remains very active. The threat of enforcement is always present and real. Whether the Trump administration will eventually carry out enforcement activities against state-legal marijuana businesses is uncertain, but the trend so far has been a "hands off" approach.
(Brittany Ortiz)

UPDATE ON THE STATUS OF STATE LEGALIZATION OF CANNABIS IN THE UNITED STATES

States that have not yet embraced the legalization of cannabis are now flirting with the idea. With the federal government not yet decriminalizing cannabis and several states and the District of Columbia have established legalization protocols, the nation remains a patchwork legal/illegal regulation. What follows is a summary of the latest actions by states to address legalization.

Background

Before venturing into what efforts are currently underway to legalize cannabis, it's helpful to be reminded where in the U.S., cannabis is legal and to what extent. As we have previously reported, at the federal level, the legislative efforts at addressing cannabis or hemp was through the 1) 2018 Farm Bill (https://www.congress.gov/bill/115th-congress/house-bill/2); th2) the SAFE Banking Act (https://www.congress.gov/bill/115th-congress/senate-bill/1152); and some traction on the not yet passed Marijuana Opportunity Reinvestment and Expungement Act of 2019 (MORE Act) (https://www.congress.gov/bill/116th-congress/senate-bill/2227/text) which in 2019 was referred to the Senate Finance Committee in July.

As to laws passed by the states (and District of Columbia), the following have adopted full legality of recreational cannabis:

- Alaska, California, Colorado, the District of Columbia, Illinois, Maine, Massachusetts, Michigan, Nevada, Oregon, Vermont (possession and home cultivation is legal), and Washington State,

In other states, medicinal cannabis is legal but recreational cannabis use is either illegal or decriminalized:

- Arizona, Arkansas, Connecticut, Delaware, Florida, Hawaii, Louisiana, Maryland, Minnesota, Missouri, Montana, New Hampshire, New Jersey, New Mexico, New York State, North Dakota, Ohio, Oklahoma, Pennsylvania, Rhode Island, Utah, and West Virginia.

Some states have only authorized CBD Oil use as legal but all cannabis use remains illegal:

- Georgia, Indiana, Iowa, Kentucky, Texas and Virginia.

Cannabis in all forms is illegal in:

•Alabama, Idaho, Kansas, Mississippi, Nebraska, North Carolina, South Carolina, South Dakota, Tennessee, Wisconsin, Wyoming. (https://disa.com/map-of-marijuana-legality-by-state)

All of that makes for quit a patchwork throughout the nation. And despite the United States authorizing hemp byproducts via the Farm Bill, it is evident from above that some states have *not* taken the additional step of legalizing it (and CBD products) via state law.

Where Is Legalizing Heading in 2020

Without a crystal ball, it is difficult to truly know where cannabis legalization will head in 2020—but there is evidence of movement in that direction from several states. These efforts are summarized below.

Vermont

In the State of Vermont, cannabis possession and limited cultivation has been legalized since January 2018 when Governor Scott signed into law H. 511 (*see*, https://legislature.vermont.gov/bill/status/2018/H.511) That law allowed the following:

Possession of up to one ounce of marijuana or five grams of hashish; cultivation of up to two mature and four immature plants in a secure location (the plant limit applies to the entire dwelling unit); and possession of the marijuana produced by the plants at the same secure location.

On February 28, 2019 the Vermont Senate overwhelming passed the bill, S. 54—"An act relating to the regulation of cannabis." (*See*, https://legislature.vermont.gov/Documents/2020/WorkGroups/House%20Ways%20and%20Means/Bills/S.54/S.54~Michele%20Childs~As%20Recommended%20by%20the%20House%20Committee%20on%20Governmen%20Operations~5-9-2019.pdf) The bill would, in summary:

•Establish the Cannabis Control Board;

•Would license cannabis retailers and cultivators;

•Establish a litany of rules governing all aspects of cultivation, labelling and sales;

•Establish THC potency limits for sales;

•Establish advertising rules and restrictions;

•Recommend environmental regulations associated with water quality, waste and energy;

•Establish a priority system for applicants;

•Allow local jurisdictions to opt in for cannabis sales and to develop, if desired, local rules for sales; and

•Create a system of taxation, at 16 percent excise tax on retail sales; allow for up to 2 percent municipal additional taxation; and created a system of tax revenue allocation—including up to $6 million per year into a Substance Misuse Prevention Fund.

On May 3, 2019, the Vermont House, referred the issue of S. 54 (for House adoption) to the Committee on Ways and Means. (*See*, https://legislature.vermont.gov/bill/status/2020/S.54) However, the legislative sessions in Vermont are relatively short, and ended in May 2019 without further formal action. When the 2020 legislative session resumed in January, the Committee on Ways and Means resumed discussion of the bill. House Majority Leader, Jill Krowinski, described her disappointment that the House did not approve their version of S. 54 so it's safe to presume she will push for its passage in 2020.

New Mexico

The State of New Mexico has legalized medical cannabis use but not yet recreational cannabis cultivation, sales and use. The governor is a supporter of state legalized cannabis. The governor established a working group on the issue in June 2019 and it released recommendations on most every aspect of legalization—both pros and cons—but in the end, had thought working solutions were viable:

> Through more than 30 hours of public meetings across the state, and with the help of more than 200 pages of public comment, the members explored every aspect of legalization, both good and bad, [Albuquerque City Councilor Pat

> Davis, chair of the working group, said in a press release.] As our report makes clear, New Mexico can and should learn from missteps in other states and we have both the ingenuity, talent, and healthy level of skepticism required to get it right. (*See*, https://www.marijuanamoment.net/new-mexico-governors-working-group-releases-marijuana-legalization-proposal/)

In November 2019 the New Mexico Legislature's Economic and Rural Development Committee discussed the potential economic impacts of full legalization. The very short 30-day legislative session meant that in 2019, that is where the story ended for the year. However, the legislative session for 2020 began anew in January with the Committee on Economic and Rural Development resuming their efforts.

With the governor in favor of legalization, the advisory committee suggesting legalization is viable, and the legislative committee still working out the issues, we may see legalization of cannabis come to New Mexico in 2020.

New Jersey

In 2019 the New Jersey floated a bill to legalize adult cannabis use. On May 15, 2019 it became obvious that the bill would not pass Senate muster. (*See:* https://ballotpedia.org/New_Jersey_Marijuana_Legalization_Amendment_(2020)#cite_note-overview-1) That however, wasn't the final word on legalization. The Legislature thought a "hybrid type" approach might be what it took to push legalization forward. In New Jersey a ballot measure can be sponsored by the Legislature. In this case, the measure would be seeking a constitutional amendment put directly to the state's residents for legalization. This requires a 60 percent "yes" vote in each house of the Legislature. On December 16, 2019 Senate Concurrent Resolution 183, which passed by a vote of 24 – 16 met the 60 percent vote requirement and the General Assembly followed with a vote of 49 to 24. That put the measure on the ballot for November 2020. (*Ibid*)

The ballot measure would:

> . . .would add an amendment to the state constitution that legalizes the recreational use of marijuana, also known as cannabis, for persons age 21 and older and legalizes the cultivation, processing, and sale of retail marijuana.
>
> The constitutional amendment would take effect on January 1, 2021. New Jersey would be the first state in the Mid-Atlantic to legalize marijuana. The five-member Cannabis Regulatory Commission (CRC), which was first established to oversee the state's medical-marijuana program, would be responsible for regulating the cultivation, processing, and sale of recreational marijuana. The ballot measure would apply the state sales tax (6.625 percent) to recreational marijuana but prohibit additional state sales taxes. The state Legislature would be authorized to allow local governments to enact an additional 2 percent sales tax on recreational marijuana. The ballot measure would not provide additional specifics, such as possession limits, home-grow rules, and retail regulations; rather, the legislature and CRC would need to enact additional laws and regulations. (*Ibid*)

Conclusion and Implications

The States of Connecticut, Rhode Island, and Pennsylvania are all at some stage of exploring if legalized cannabis is the correct path to head. The Governors of all three states have publicly supported legalization. And in New York State, there seems to be more debate about *how* to regulate cannabis more than whether legalization should occur. (*See*, https://www.forbes.com/sites/kriskrane/2019/12/11/marijuana-legalization-could-be-coming-to-these-states-in-2020/#3f06960699b5

2020 might see some or all of these states join the ranks of cannabis legal states. About the most certain thing that can be observed is that legalization in the U.S. via the states has taken on an inertia that will not likely curtail anytime soon. Whether this motivates the federal government to legalize cannabis—or perhaps to merely decriminalize it—is anybody's guess.

(Robert Schuster)

INDEPENDENT STUDY OF NEVADA CANNABIS DATA REVEALS INCONSISTENCIES—GOVERNOR SISOLAK FORMS TASK FORCE TO ADDRESS THE PROBLEM

Marijuana testing facilities act in the interest of the public by reviewing, evaluating and reporting on the quality of cannabis products. A recent independent study of Nevada's publicly-available cannabis data, however, showed that this mission might not always be being fulfilled by some testing facilities. Shortly after the study was released, Nevada Governor Sisolak announced the formation of a state task force to address the issue.

Background

Legal recreational cannabis use in Nevada was voted into law in 2016. Since then, the state has worked to frame itself a regulation and testing-practices leader among cannabis-legal states.

The state has licensed 11 testing facilities, which each play a vital role in that emphasis on quality regulations. Testing facilities check cannabis products for mold and other contaminants, and also measure the various levels of THC and cannabinoids in the product. These actions help ensure safety and quality for end consumers.

Cannabis Consumer Advocate Deems Findings Faulty

In summer of last year, Jim MacRae, a freelance business analyst and blogger from Washington State was interested in seeing how the actual results from Nevada compared with expected findings from normal variability. To accomplish this, he examined roughly 80,00 data points from Nevada's busiest testing labs. The data was collected over 15 months, beginning at the start of 2018.

After reviewing the figures, MacRae found that several of the labs in the study regularly saw failure rates far below the expected baseline results. In one case, a single lab even had zero failures across 14 consecutive months. According to the data, Nevada's cannabis altogether was passing far more tests than it statistically should.

> Expecting a 10 – 15 [percent] sample failure rate, MacRae instead found that some labs routinely had less than 10 percent failure rates and one lab had no fails for a 14-month period, which raised red flags. Many of these same labs reported higher than usual THC rates, according to his report. (*See*, https://www.ganjapreneur.com/evidence-of-inflated-test-results-emerges-in-nevada/)

McRae went on to comment:

> But, Nevada has done more in three days than Washington regulators have done in three years about similar problems in the Washington market, so I applaud what Nevada has done so far. (*Ibid*)

Failure Rates Not the Only Fault

Curious failure rates weren't the only out-of-place finding MacRae discovered. Several of the labs in his examination also reported THC rates well above the expected norm. Three of the labs in the study showed increases in the reported levels of THC over the full time period, while another four showed relatively constant levels.

In aggregate, the largest product categories examined in the study revealed a consistent increase in the reported levels of THC over the life of the dataset.

MacRae Goes to the Nevada Regulators

Concerned by the implications of his findings, MacRae reached out to Nevada's cannabis regulators. His suspicion was that the results, which differed greatly from statistical expectations, were evidence of a lack of proper role fulfillment by the testing labs.

The state allowed MacRae to present his work this past September. The day after, he met with several individuals from a variety of state government agencies to further examine his analysis.

Nevada Takes Action

Nevada has placed special emphasis on operating and regulating its budding cannabis industry with the utmost effectiveness. In character of this approach, the Department of Taxation released a notice to all of its statewide labs the business day following their data review with MacRae.

The state's facilities were informed that the Department of Taxation had been made aware of potential instances of inflation of THC levels and deflation of failure rates by some labs, and went on to emphasize that such actions would not be accepted.

Shortly after the announcement, Governor Sisolak took action by creating a multi-agency marijuana task force, which has since begun conducting surprise inspections of Nevada's testing facilities.

Conclusion and Implications

The data MacRae reviewed was released blind, with the true identities of the testing facilities coded. He has requested a new, non-blind dataset from the Silver State, in hopes of publishing a more thorough analysis to better protect consumers.

Despite the coding, the state itself is aware of which facilities specifically were identified in the study. So far, Nevada has suspended the license for one facility, Certified AG Lab. Nevada consumers have been asked to take caution when purchasing products tested by this facility. Will Adler, executive director of Scientists for Consumer Safety commented on the study that "(The labs) are supposed to be the ethics of the program, the watchdogs. . . .The whole point of the (state) program is the lab testing. What is the point of the program without it? Then you're just buying off the street." (Jenny Kane, *Reno Gazette Journal*, December 30, 2109) As with all states that have legalized recreational (and medical) cannabis, the processes are relatively new. Consistency in THC levels and other important disclosures such as purity will become crucial to maintain the trust of end users and regulators alike.
(Matthew Seltzer)

LEGISLATIVE DEVELOPMENTS

U.S. CONGRESS BEGINS THE DEBATE, ANEW, OF HOW TO TREAT AND CLASSIFY CANNABIS AT THE FEDERAL LEVEL

On Wednesday, January 15, 2020, the U.S. House of Representatives Committee on Energy and Commerce via it's Subcommittee on Health will begin the debate on the state of the Controlled Substances Act and on the state of cannabis research, in connection with the Schedule 1 listing of cannabis and cannabis byproducts.

Background

Cannabis remains mostly an illicit "drug" due to its listing on the federal Controlled Substances Act (CSA). The CSA regulates the manufacture, possession, use, importation and distribution of certain drugs, substances, and precursor chemicals. (*See*, https://legcounsel.house.gov/Comps/91-513.pdf) The CSA differentiates certain drugs by Schedules, with Schedule I drugs and substances being the most restricted due to the perception of Congress at the time that they were also the most dangerous. Schedule I drugs ". . .including heroin, marijuana, and LSD, were deemed to have a high potential for abuse but no accepted medical use." (*See*, https://www.encyclopedia.com/history/encyclopedias-almanacs-transcripts-and-maps/controlled-substances-act-1970)

The state-federal tension over medicinal and recreational cannabis legalization and regulation stem, in large part, from cannabis' listing in the CSA at the highest level of control and illegality. States continue to come onboard for legalization. Many see cannabis as having beneficial medicinal qualities while others see cannabis as a recreational substance that is both controllable and taxable—not unlike alcohol. The Trump administration has remained steadfast in its position, perhaps best viewed through the public position stated by the U.S. Department of Justice, to keep cannabis as a Schedule I classified drug. This tension has cast a pall over state-legal cannabis farming, sales, possession and use—not to mention federal banking, bankruptcy and corporation laws associated with these activities.

The House Committee on Energy and Commerce Begins the Deabte over Several Bills

The Marijuana Opportunity, Reinvestment and Expungement Act

On January 15, the U.S. House Committee on Energy and Commerce will begin its debate over the Marijuana Opportunity, Reinvestment and Expungement Act (MORE Act).

On November 20, 2019, the U.S. House of Representatives Judiciary Committee passed the MORE Act in a vote of 24-10. The approved bill was introduced by Committee Chairman Jerrold Nadler (D-NY). The bill has been addressed with amendments by the Judiciary Committee but not yet put to the full House of Representatives for vote, as of this writing. The support for the bill was initially along party lines, but now, some are encouraged it stands a good chance of passing due to more Republican's expressing some level of support. (*See*, https://www.marijuanamoment.net/watch-live-congress-holds-historic-vote-on-bill-to-federally-legalize-marijuana/)

If passed into law, MORE:

> . . .would federally deschedule cannabis, expunge the records of those with prior marijuana convictions and impose a five percent tax on sales, revenue from which would be reinvested in communities most impacted by the drug war. . . .It would also create a pathway for resentencing for those incarcerated for marijuana offenses, as well as protect immigrants from being denied citizenship over cannabis and prevent federal agencies from denying public benefits or security clearance due to its use. (*Ibid*)

The Marijuana Freedom and Opportunity Act

On January 15, the U.S. House Committee on Energy and Commerce will also begin debate over the Marijuana Freedom and Opportunity Act (MFOA).

The MFOA was introduced by in the House by Representative Hakeem Jeffries (D-NY), and would federally deschedule cannabis, set aside funding for minority and women-owned cannabis businesses and provide grants to help people expunge prior marijuana convictions. (*See*, https://www.congress.gov/bill/116th-congress/house-bill/2843/text)

The Cannabis Research Act

The Medical Cannabis Research Act (MCRA) will also be debated by the Committee on Energy and Commerce. The MCRA was introduced Representative Matt Gaetz (R-Fl-1) as HR 601 (*See*, https://www.congress.gov/bill/116th-congress/house-bill/601/text?q=%7B%22search%22%3A%5B%22medical+cannabis+research+act%22%5D%7D&r=1%27&s=5) The bill, if enacted in its current form would:

> . . . increase the number of manufacturers registered under the Controlled Substances Act to manufacture cannabis for legitimate research purposes, to authorize health care providers of the Department of Veterans Affairs to provide recommendations to veterans regarding participation in federally approved cannabis clinical trials, and for other purposes. (*Ibid*)

The Committee may also take up the similarly titled Medical Marijuana Research Act of 2019, HR 3797, sponsored by Representative Blumenauer (D. Or.-3) which if enacted in its current form, would: ". . .amend the Controlled Substances Act to make marijuana accessible for use by qualified marijuana researchers for medical purposes, and for other purposes." (*See*, https://www.congress.gov/bill/116th-congress/house-bill/3797/text)

The Legitimate Use of Medicinal Marijuana Act

Also on the Committee's agenda for 15 January is consideration of the Legitimate Use of Medicinal Marijuana Act (LUMMA), HR 714, which "provide for the legitimate use of medicinal marihuana in accordance with the laws of the various States." The bill was introduced by Representative Griffith (R-Virgina-9). (*See*, https://www.congress.gov/bill/115th-congress/house-bill/714)

The Veterans Medical Marijuana Safe Harbor Act

Finally, the Committee is also scheduled to begin debate on the Veterans Medical Marijuana Safe Harbor Act (VMMSHA). The VMMSHA (HR 1151) was introduced by Representative Lee (D-Cal-13), and if enacted, would:

> **. . .**allow veterans to use, possess, or transport medical marijuana and to discuss the use of medical marijuana with a physician of the Department of Veterans Affairs as authorized by a State or Indian Tribe, and for other purposes. (*See*, https://congress.gov/bill/116th-congress/house-bill/1151/text)

Conclusion and Implications

The U.S. House of Representatives Committee on Energy and Commerce has quite a few bills to begin debate on January 15, 2020. We will all have to monitor the situation to see what comes of it all. Congress is not known for going from bill introduction to floor vote in a rapid time line. But all in all, those seeking to decriminalize cannabis at the federal level, whether it be solely medicinal cannabis, or perhaps, opening up the nation to recreational cannabis decriminalization have reason to be hopeful. More and more bills in some form continue to be introduced in both the House and Senate and eventually may see some decriminalization take place, thus opening the door widely to state's which have or want to do the same.
(Robert Schuster)

HEMP DERIVED CBD—CALIFORNIA BILL ATTEMPTING TO NORMALIZE AND DEFINE CBD IN FOOD AND BEVERAGE PRODUCTS FAILS IN THE STATE LEGISLATURE

As the legal status of cannabis is changing in an increasing number of states, more and more attention is being given to its various compounds. The most widely known of these compounds is tetrahydrocannabinol (THC), which has the psychotropic effects most commonly associated with cannabis. The second-most known of cannabis' compounds is cannabidiol (CBD) which is being explored for its potential health effects.

Overview of the Legal Status of Cannabis, Hemp, and CBD

Cannabis is a genus of plant that has three species: *Cannabis sativa*, *Cannabis indica*, and *Cannabis ruderalis*. Hemp is a variety of the species of *Cannabis sativa* that contains less than 0.3 percent of tetrahydrocannabinol. THC is the compound found in all species of the cannabis plant that has the psychotropic—or mind-altering—effects typically associated with cannabis use. Under both state and federal law, any of the above-listed species containing greater than 0.3 percent THC are considered cannabis, and those containing less than 0.3 percent THC are considered hemp. CBD is found in both cannabis and hemp.

Both federal and California law have partially deregulated hemp, giving rise to an increase in the market for hemp-derived products. However, food and beverages that contain hemp-derived CBD are still not sanctioned by state or federal laws and regulations. And cannabis-derived CBD products may only be manufactured and sold through licensed cannabis businesses in California.

Under federal law, both cannabis and hemp were classified as controlled substances under the Controlled Substances Act of 1970 based on how cannabis was defined in the Agricultural Marketing Act of 1946. With the Agricultural Improvement Act of 2014, the federal government allowed pilot programs to study the cultivation of hemp on an industrial scale for various uses, including as a source of biomass. The Agricultural Improvement Act of 2018 (2018 Farm Bill) expanded the legal status of hemp under federal law.

The 2018 Farm Bill defines which cannabis plants qualify as hemp and which do not but are instead considered cannabis. It amended the Agricultural Marketing Act of 1946 to define hemp as follows:

The term "hemp" means the plant 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.(7 U.S.C. § 1639o.)

The 2018 Farm Bill further established a framework under which states could regulate the cultivation and production of hemp. As for CBD, the 2018 Farm Bill partially addresses its controlled substance status insofar as it excludes hemp derivatives from the definition of "marihuana" under the Controlled Substances Act. (21 U.S.C. § 802(16).) It is important to note the 2018 Farm Bill did not fully legalize CBD. CBD remains a controlled substance where it is not derived from a hemp plant that was cultivated in compliance with the 2018 Farm Bill. Therefore, only hemp-derived CBD was afforded a limited exempt status from the Controlled Substances Act. The exempt status is limited, because the 2018 Farm Bill only modified hemp's status with respect to the Controlled Substances Act but not its status in the eyes of the Food and Drug Administration (FDA), which is responsible for protecting and promoting public health through the control and supervision of food safety and dietary supplements.

Federal Regulations of CBD in Food and Beverage Products

The 2018 Farm Bill left intact the FDA's power to regulate hemp and hemp-derived compounds in food products from its deregulation of the cultivation and production of hemp. That is important, because the Federal Food, Drug, and Cosmetic Act and the Public Health Services Act prohibit adulterating food and beverages with controlled substances without FDA approval. Such FDA approval can take several forms.

First, FDA approval to include a controlled substance in foods, drugs, or cosmetics can come through

specific testing and approval of a particular product. This is the case for Epidolex, an anti-seizure medication containing cannabis-derived CBD that received FDA approval to be marketed as a drug. An in-depth study of CBD also has been undertaken with respect to another drug, Sativex, though it has not yet received FDA approval.

Second, approval can come more indirectly by producing products using only ingredients that the FDA has "generally recognized as safe." In the case of hemp derivatives, the FDA has thus far only issued "generally recognized as safe" determinations for hulled hemp seeds, hemp seed protein, and hemp seed oil. However, CBD as a compound has not been generally recognized as safe by the FDA. It is therefore illegal under federal law to introduce CBD-infused food or beverage products into interstate commerce. (21 U.S.C. § 331(ll).)

California Regulations of CBD in Food and Beverage Products

California has deregulated hemp in conformance with the 2018 Farm Bill. However, under existing California law, there is no authorization to introduce CBD—whether hemp-derived or cannabis-derived—into food and beverages. This is because CBD is still considered an adulterant as a result of the FDA's regulations and the lack of specific treatment for hemp-derived CBD. The California Legislature considered legislation that would expressly allow the manufacture of food and beverage products containing hemp-derived CBD.

Assembly Bill 228

The most recent effort to do so was through Assembly Bill 228 ("AB 228"), failed to become law. AB 228 would have amended various portions of California law to define food containing any compound derived from hemp as an "industrial hemp product." AB 228 proposed amendments to the Health and Safety Code by adding § 110611 that would have provided that "a food or beverage is not adulterated by the inclusion of industrial hemp, as defined in § 11018.5, or cannabinoids, extracts, or derivatives from industrial hemp." It would also would have provided that:

> . . .the sale of food or beverages that include industrial hemp or cannabinoids, extracts, or derivatives from industrial hemp shall not be restricted or prohibited based solely on the inclusion of industrial hemp or cannabinoids, extracts, or derivatives from industrial hemp.

While AB 228 did not pass during the last legislative session, there continue to be efforts by various state legislators and industry groups to enact a law that substantively accomplishes what AB 228 had intended: enable the manufacture of food and beverage products containing hemp derivatives, including CBD. Therefore, the upcoming legislative session is likely to see AB 228 or similar legislation introduced.

Conclusion and Implications

With the current state of the law, California has no legal avenue for the manufacture and sale of food beverages infused with hemp-derived CBD except through licensed cannabis channels. Federal law currently prohibits introducing such products into interstate commerce and regulates health-related claims made about such products. Until either the federal or state legislature adopts legislation that expressly authorizes the CBD-infused beverages, their production in California is limited to products that comply with California's cannabis regulations.

As a result, unlicensed retailers need to be vigilant in monitoring the CBD products they carry, manufacturers need to be careful about the CBD-derived products they produce, and consumers need to be aware of what products they choose to purchase.

For more information on Assembly Bill 228, *see:* http://leginfo.legislature.ca.gov/faces/billNavClient.xhtml?bill_id=201920200AB228

(Andreas Booher)

REGULATORY DEVELOPMENTS

U.S. DEPARTMENT OF AGRICULTURE ANNOUNCES THAT HEMP WILL QUALIFY FOR NEW CROP INSURANCE PILOT PROGRAM

The U.S. Department of Agriculture Risk Management Agency announced a new pilot crop insurance program for hemp growers for certain counties in 21 states in 2020. The 21 states include: Alabama, California, Colorado, Illinois, Indiana, Kansas, Kentucky, Maine, Michigan, Minnesota, Montana, New Mexico, New York, North Carolina, North Dakota, Oklahoma, Oregon, Pennsylvania, Tennessee, Virginia, and Wisconsin.

Background

The pilot crop insurance program intends to provide Actual Production History coverage under 508(h) Multi-Peril Crop Insurance (MPCI). This coverage means that hemp growers in the select counties in the 21 states will be protected against yield losses associated with natural causes like drought and disease. Crops that are cultivated for fiber, grain or CBD oil will be eligible for this coverage.

"We are excited to offer coverage to certain hemp producers in this pilot program," said RMA Administrator Martin Barbre. "Since this is a pilot program, we look forward to feedback from producers on the program in the coming crop year."

The Pilot Program

To be eligible for the MPCI pilot program, hemp farmers must comply with applicable state, tribal or federal regulations for hemp production, have at least one year of history of producing the crop, and have a contract for the same of the insured hemp. The MPCI provisions state that hemp having THC above the federal statutory compliance level will not be insurable. Additionally, hemp will not qualify for replant payments or prevented plant payments under MPCI. Further, only farmers who have cultivated hemp in accordance with a 2014 Farm Bill pilot program or federal regulations laid out in USDA's interim final rule in October qualify for this coverage. The interim final rule on hemp establishes the U.S. Domestic Hemp Production Program and requirements governing the production of hemp. The interim final rule covers the requirements for where hemp can be grown, THC testing standards, the disposal process for crops that do not meet federal standards and licensing protocols.

Despite the limitations, however, the 2020 pilot program is much broader than previous hemp insurance programs. In August, the USDA announced that hemp could be covered under a separate insurance program, but under the August program, such insurance coverage does not apply if hemp is cultivated for CBD oil. CBD oil represents one of the largest uses of the crop. The the program announced in August is further limited to hemp farmers operating under pilot programs authorized through the 2014 Farm Bill. The August program allows hemp farmers to obtain Whole-Farm Revenue Protection (WFRP), which covers up to $8.5 million in revenue. The expanded coverage under the 2020 pilot program will be in addition to the WFRP.

The USDA also announced that in 2021, hemp farmers will be eligible for a nursery crop insurance program and the Nursery Value Select pilot crop insurance program. The USDA announced:

> Under both programs, hemp will be insurable if grown in containers and in accordance with federal regulations, any applicable state or tribal laws, and terms of the crop insurance policy.

Pressure on Congress to Begin the Process of Easing Up on Hemp

These new insurance programs are likely a result of lawmakers and stakeholders placing pressure on various federal agencies since hemp and its derivatives were federally legalized under the 2018 Farm Bill. The 2018 Farm Bill amended the Controlled Substances Act to address how industrial hemp is to be defined and regulated at the federal level. The Farm Bill defines hemp as containing 0.3 percent or less tetrahydrocannabinol (THC) on a dry-weight basis. Lawmakers and stakeholders have been pushing federal agencies to develop regulations that are more aligned with the crop's potential. The USDA's Octo-

ber interim final rule is a significant stride in response to this push, but farmers have continued to face barriers such as limited insurance coverage options. The 2018 Farm Bill cleared the way for the Federal Crop Insurance Corporation to offer policies.

Conclusion and Implications

The USDA in a press release said that more information on the MPCI pilot program will be available in 2020. Whether efforts by U.S. regulators in normalizing hemp represents first efforts to normalize cannabis in America is anybody's guess. Certainly, states that have legalized cannabis certainly hope so.

Crop insurance is sold and delivered through private crop insurance agents, which can be located online through the USDA's RMA Agent Locator website. (https://www.rma.usda.gov/en/Information-Tools/Agent-Locator-Page; and https://www.rma.usda.gov/en/News-Room/Press/Press-Releases/2019-News/USDA-Announces-Pilot-Insurance-Coverage-for-Hemp-Growers
(Brittany Ortiz)

WASHINGTON STATE WRESTLES WITH WHO IS A 'TRUE PARTY OF INTEREST' THAT MAY OPERATE A CANNABIS BUSINESS

Different states employ varied schema for determining who can operate cannabis businesses within their borders. One of the stickier wickets in Washington State's Administrative Code has been the "true party of interest" designation. The concept is seemingly simple, but ultimately has confused many entrepreneurs looking to start, sell, or change the management structure of a cannabis company. Because every true party of interest must meet administrative muster, unexpected issues arising during background checks can torpedo an important deal.

Background—A True Party of Interest in Washington State

The Revised Code of Washington asserts that no "license of any kind may be issued to" a business "unless all of the members thereof are qualified to obtain a license." (*See*, https://app.leg.wa.gov/rcw/default.aspx?cite=69.50.331)

True parties of interest are defined in the Washington Administrative Code and vary by the type of business. For example, a limited liability company (LLC) cannot be issued a license unless every member is individually qualified to obtain a license.

The state considers: proprietors, partners, members, financiers, managers, stockholders, and corporate officers as true parties of interest.

Cannabis Businesses

The Washington administrative system serves to allow for the Washington State Liquor and Cannabis Board (WSLCB) to regulate who can own and operate businesses within the legal cannabis field. More specifically, because so much of what defines a true party of interest is tied to receipt of a part of the gross or net profits of a business, true party of interest requirements regulate who receive the ownership or financier related profits. The WSLCB's investigation is in-depth and includes a Federal Bureau of Investigation (FBI) background check. After the investigation, the WSLCB compares any criminal behavior against a points scale; too many points and the license will be denied.

Policy decisions limiting previously convicted felons' rights and behaviors are not new in Washington. When it comes to the ownership of cannabis businesses however, the justification to limit true parties of interest based on past criminal convictions aligns with the defunct "Cole Memo of 2013." [Recall that the Cole Memo was a memorandum issued by the U.S. Department of Justice on August 29, 2013 by then Attorney General James Cole, sent out to all the U.S. Attorneys regarding the prosecution of crimes related to cannabis. The memo basically instructed the U.S. Attorneys to not prosecute certain cannabis related crimes in states that had legalized cannabis sales, use and possession. *See*, https://archive.org/stream/781914-cole-memo/781914-cole-memo_djvu.txt]

The WSLCB was clear in its Executive Summary (*See*, https://lcb.wa.gov/sites/default/files/publications/WSLCB%20Home%20Grows%20Study%20Report%20FINAL.PDF) examining regulatory structures

that it "ultimately dismissed any considerations not consistent with the Cole Memo." While limitations to obtaining cannabis licenses based on past criminal activity may be expected, being denied a license because of the criminal record of a spouse is often a surprise.

The Spousal Addendum

Attached to every one of the roles defined under true party of interest is "and their spouse(s)." (*See*, WAC 314-55-035, https://apps.leg.wa.gov/wac/default.aspx?cite=314-55-035) For purposes of obtaining a marijuana license, the spouse of anyone qualifying as a true party of interest is also a true party of interest, regardless of how connected to the business they actually are. The Washington State Liquor and Cannabis Board has even begun expanding their application of "spouse" to include live-in partners and others appearing to be operating in a spouse-like role. There is no way to disclaim a spousal interest in the business.

The *Hanes-Marchel* Decision

Washington-state resident Libby Haines-Marchel was denied a cannabis license because of her spouse's felony record. He is currently incarcerated and has completely disavowed any personal or legal interest in the proposed business. Even so, the Administrative, Superior, and Appeals courts *all* held that the denial of her license was proper and that holding spouses to the same standards as applicants is "'a narrowly tailored means to further the State's compelling interest' in closely regulating the sale of marijuana" and "'screening out criminal involvement in the marijuana industry.'" *Haines-Marchel v. Washington State Liquor & Cannabis Bd.*, 406 P.3d 1199, 1207 (Wash. App. 2017), *review denied*, 191 Wn.2d 1001, 422 P.3d 913 (2018), and *certiorari* denied, 139 S. Ct. 1383, 203 L. Ed. 2d 617 (2019). In 2019, the Supreme Court of Washington denied *certiorari* and will not address this case further.

'Criminality' and Licensure in Washington State

The true party of interest vetting process is, in the eyes of the Washington State Attorney General's office, important because of the "long history of criminality" around cannabis and because of the potential for a spouse to apply to the business in name only and act as a straw person for their unqualified spouse. This concern is in line with the treatment of financiers, who are also true parties of interest despite their lack of direct business control. But what about those who fail to comply with Washington State cannabis regulations in applying for a cannabis license?

Legislation has been passed into law, Washington State Bill 5318 (*see*, https://www.washingtonvotes.org/2019-SB-5318) arguably seeks a softer approach to punitive enforcement. Under SB 5318, signed into law by Governor Inslee on May 13, 2019, the definition of what constitutes a true party of interest is still a barrier to many wishing to operate in the cannabis market— but, the bill shifts towards correcting mistakes in regard to regulatory compliance with reduced, or eliminated, penalties has been stated to be more in line with legislative intent. This arguably, allows businesses to steer back into compliance without loss of their license. However, true party of interest violations have not been viewed favorably at any point and the RCW requirement that all parties involved be qualified to obtain a license leaves little wiggle room for violators.

Conclusion and Implications

Recently the Washington State Legislature introduced House Bill 1963, which looks to better define who falls into the definitions of true party of interest under some narrow circumstances, the overall effect of the regulation is slow to shift. (*See*, http://lawfilesext.leg.wa.gov/biennium/2019-20/Pdf/Bill%20Reports/House/1963%20HBA%20COG%2019.pdf) Coverage of HB 1963 is the subject of a separate article.

As more voices call for equity and fairness in Washington State's cannabis market, we may see changes allowing for some leniency to licensees. Ultimately, policies have been relatively slow to change and violations of true party of interest regulations can easily lead to the revocation of a license or completely bar an applicant.
(Mia Getlin)

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