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CANNABIS LAW™

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CLR

CANNABIS NEWS

NEW MEXICO GOVERNOR CALLS FOR MARIJUANA LEGALIZATION TO FUND MEDICAID

The path to state legalization is often not straight or clear. This is especially true when state leaders desire to legalize cannabis but face a hostile legislation. Sometimes, the lure of tax revenue is enough, but sometimes, a further push is required. Recently, the Governor of New Mexico proffered a new benefit to state legalization—Medicaid funding. And the Covid pandemic also helps justify the need for revenue.

Background

Governor Michelle Lujan Grisham (D) of New Mexico has again called for cannabis legalization, calling it an economic opportunity for the state. During a press briefing, Governor Lujan Grisham said that the state needs "to look for innovative ways to increase economic activity," particularly amid budget shortfalls as a result of the coronavirus pandemic.

During a coronavirus update, Governor Lujan Grisham said:

> Recreational cannabis is one of those areas where that's $100 million. It doesn't fix it, but it plugs one of those holes [and] potentially would be enough to do a whole lot in the Medicaid gaps.

Formation of a Working Group

In June of last year, the Governor formed a working group to study the impact of legalization. The group released its recommendations in October of last year. "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. Davis added:

> 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.

From this study, the group came up with the $100 million estimate that the Governor cited to during the Covid update. The group also estimated that the state would gain 11,000 jobs and sales would reach $620 million by the fifth year of legalization's implementation. The group has recommended policies for automatic expungements of marijuana possession convictions, putting patients first by exempting medical cannabis from taxes, setting product requirements and funding a low-income patient subsidy program to lower the cost of marijuana.

In the recommendations for marijuana legalization issued by the group, City Councilor Davis stated:

> We intend to protect patient access and affordability with a 'patient first' supply model. It requires licensees to build a maintain strong medical programs before entering the recreational market. We listened to concerns from law enforcement that officers need new training and tools to identify and investigate drugged driving and that New Mexico should tread lightly in adopting policies form other states that had unintentionally created strong illicit markets. And we propose using new revenue to reinvest in low-income and communities of color, including access to new cannabis licenses and jobs that create new wealth.

Recommendations

The following is a summary of some of the topics and recommendations:

- Clear labeling and testing for THC products;
- Making cannabis and cannabis products unenticing to children;
- Invest in law enforcement programs early; avoid creating "illicit market" communities;

•Opt-out communities become illicit markets overnight.

•Create social equity and economic opportunity;

Questions posed by the group include:

•How do we use cannabis revenue to help rebuild communities disproportionately impacted by older drug prohibition policies?

•How do we ensure that low-income declining, and communities of color statewide share in the opportunities available from this new multi-million dollar industry over the long term?

•How do we ensure equity in the new marketplace (racial, economic, gender, geographic, etc.)?

The group made further recommendations in terms of adding in medical care, as follows:

•Maintain and enhance a robust medical cannabis program;

•Putting patients first;

•Lower patient and producer costs for the medical program;

•Expanding access to medical products.

Other practical issues were raised, as follows:

•Local control, employment issues and other sticky widgets;

•Allowing counties and municipalities to enact local time, manner and place restrictions (zoning, licensing);

•Allocate a portion of new revenue to local communities to apply to local programs

•Help employers navigate off-duty use of cannabis?

•Worker's compensation administration would continue to apply rebuttable federal impairment standards when evaluating accidents involving cannabis (no legislation required).

Conclusion and Implication

Clearly, the Governor is lobbying for legalization but faces a Legislature that seems not ready to support legalization. A strategy of replacing hostile legislators might be the plan of the administration. During regular session, Governor Lujan Grisham indicated that she might actively campaign against lawmakers who blocked her legislation bill. "We have an opportunity. I think all of our policymakers need to think clearly—and they should expect me to be supporting in the next general election—we have to pass recreational cannabis in the state. We need to diversify our economy, we need to increase opportunity for recurring revenue and we have to rebuild an economy that has suffered dramatically during this public health crisis," Lujan Grisham said.
(Brittany Ortiz)

AUGUST COMPLEX WILDFIRE IN CALIFORNIA THREATENS THE LARGEST CANNABIS REGION IN THE U.S.

It's been an awful summer in California for wildfires which have burned tens of thousands of acres of land, destroyed structures and worst still, has taken lives. California also has extensive legal cannabis growth farms and the wildfires have burned in areas of this growth. The largest wildfire in recorded California history, the August Complex Fire is spreading westward towards the Emerald Triangle, the largest cannabis cultivation region in the United States. The fire's spread threatens the peak harvest, which will occur in the fall.

Background

The August Complex Fire originated as 38 separate fires started by lightning strikes. Four of the largest fires, the Doe, Tatham, Glade and Hull fires,

joined together. As of September 9, the Doe fire, the main fire of the August Complex, surpassed the 2018 Mendocino Complex to become the single-largest wildfire and the largest complex fire in recorded California history. The area burned to date is larger than the state of Rhode Island, having burned a combined total of over 755,603 acres.

The fires have largely burned the Mendocino National Forest, with portions spilling over to the Shasta-Trinity National Forest and Six Rivers National Forest in the north, as well as private land surrounding the forests.

The Emerald Triangle is a region on the West Coast of northern California, named for its reputation as the largest cannabis-producing region in the United States [which predates legalization in the state]. The region includes three counties—Humboldt County on the coast, Trinity County inland, and Mendocino County, to the south—which geographically form an upside-down triangle.

Cannabis cultivation has been a dominant feature of the Emerald Triangle since at least the 1960s, with the region becoming known during San Francisco's Summer of Love. Cannabis cultivation is considered a way of life in the Emerald Triangle, and locals often claim that everyone in the region is either directly or indirectly reliant on the cannabis industry.

The industry exploded with the passage of California Proposition 215 in 1996, which legalized medicinal cannabis in California. The passage of Prop. 64 in 2016 legalized the general sale and distribution of cannabis for recreational purposes, leading to even more cultivation in the region.

Traditionally, thousands of people migrate into the Emerald Triangle every year to assist with the harvest. Migrant workers tend to be less familiar with the territory and less prepared for the threats posed by a massive fire creeping closer to the crops.

An Ominous Spread of the Wildfire

The fire reportedly skirted the community of Kettenpom in southern Trinity County, burned the ridges outside of Covelo in northern Mendocino County, and is pushing closer to Alder Point in Humboldt County. As this article went to press, the wildfire was only 28 percent contained [as of September 14].

While Covelo has an official population of roughly 1,500, Mendocino County Sheriff Matt Kendall indicates more than 10,000 people live and work on surrounding cannabis farms during harvest season. The fast-moving fire threatens not only the crops, but could overtake workers before they have time to evacuate.

The Emerald Triangle is to California cannabis what Napa Valley is to California wine, and much like the Tubbs Fire in 2017, both the blaze itself and the smothering smoke pollution that surrounds it will undoubtedly affect at least part of the crop. Wildfire can contribute to a smoky flavor in cannabis, just like it did in wines affected by the Tubbs Fire.

Conclusion and Implications

Should the fires reach the core cultivation acreage of the Emerald Triangle, they could have devastating effects on California's already struggling cannabis industry. However, even if the flames never reach the crops, the smoke may affect the flavor of this year's harvest, which could have devastating financial implications for cultivators in the Emerald Triangle.

The fires threaten the lives of the thousands of people working on harvesting this season's crop, and could cause smoke inhalation issues for those cultivators even if the fires never come close to the plants themselves. The Emerald Triangle is in for a trying harvest season in what is becoming a growing pattern in California, where industries must remain constantly vigilant to protect themselves against a fire season that is increasing in severity. The wildfires have been devasting to life and property within the state. Now the cannabis industry watches for the impact to cannabis farms in the state.

(Jordan Ferguson)

SUMMARY UPDATE ON CANNABIS LEGALIZATION IN THE UNITED STATES

The legalization of cannabis in the United States, whether it be medical or recreational, is a moving target. Due to the schism between state rights to legalize cannabis in some form and the federal government's position that cannabis is a dangerous Schedule 1 drug, states continue to explore legalization in a hostile environment. Tax revenue is certainly one important factor in the decision-making process but states also have come to some realization that cannabis can be legalized and regulated much as alcohol is treated within their jurisdiction.

Below, we offer a summary of new developments at the state and tribal level on legalization.

The Oglala Sioux Tribe of South Dakota

The *Associated Press* has reported that members of the Oglala Sioux Tribe as approved a referendum measure to legalize both medical and recreational cannabis on the Tribe's Pine Ridge, South Dakota Reservation. Interestingly, a similar measure to allow alcohol to be served and consumed in the Tribe's casino operations did not receive approval.

The measure passed large margins: 82 percent of voters approved medical cannabis use and 74 percent of the voting members approved legalizing recreational cannabis.

Cannabis is illegal in South Dakota and this is reported to be the first Native American Tribe to set up cannabis sales [and consumption] within a state that doesn't recognize legal cannabis in any form.

Elsewhere in the state, the Flandreau Santee Sioux Tribe began growing and selling cannabis in 2015 only to reverse its decision in the face of a hostile state and federal government.

Tribal elders have pushed for legalization as another means of producing income to the Tribal members. (*See:* https://www.leafly.com/news/politics/oglala-sioux-tribe-approves-medical-recreational-marijuana)

Nebraska Voters Don't Get to Decide on Legalization of Cannabis for Now

As is the case with nearly every state that has legalized cannabis, the move comes in the form of a ballot initiative as legislatures are loath to decide the matter for their constituents. This was the case recently in Nebraska where a ballot measure was in play for the November 2020. *Forbes* reports that 180,000 signatures were secured for the ballot measure. Then the state Supreme Court stepped in to quash the measure. The Supreme Court decided that the ballot measure, which sought to legalize medicinal cannabis as well as recreational cannabis was found to have violated the state's "single subject rule" for ballot initiatives. (*See:* https://nebraskalegislature.gov/laws/articles.php?article=XVI-1)

The proposed language for the initiative, which would amend the state's constitution, appears here: (https://www.nebraskamarijuana.org/initiative/) The initiative allowed for anyone aged 18 or over to obtain a physician or nurse practitioner's consent to "use, possess, access, purchase and safely and discreetly produce an adequate supply of cannabis. . .to alleviate a serious medical condition." The proposed amendment to the constitution would also have permitted the right to "access or purchase cannabis . . .from private entities."

The Supreme Court found that the ballot initiative violated the state's single subject rule:

> "As proposed, the [Nebraska Medical Cannabis Constitutional Amendment] contains more than one subject–by our count, it contains at least eight subjects . . . .In addition to enshrining in our constitution a right of certain persons to produce and medicinally use cannabis under subsections (1) and (2), in subsections (3) and (4), the NMCCA would enshrine a right and immunity for entities to grow and sell cannabis; and in subsections (6), (7), and (8), it would regulate the role of cannabis in at least six areas of public life. . . .As such, they constitute logrolling. . . .The decision of the Secretary of State is reversed. We issue a writ of *mandamus* directing him to withhold the NMCCA from the November 2020 general election ballot. (https://mgretailer.com/cannabis-news/nebraska-supreme-court-strikes-down-medicinal-cannabis-ballot-initiative/)

So, for now, there will be no cannabis initiatives on the General November 2020 ballot in Nebraska.

Vermont Dwells on Taxation of Legalized Cannabis

In 2018 the State of Vermont made legal the possession and personal cultivation of cannabis. Legalization was for both recreational and medicinal cannabis. The law was signed by the governor and went into effect July 1, 2018.

As is often the case, once cannabis is approved by the regulatory framework must later be established and fine-tuned. In 2019, the Vermont Legislature passed Senate Bill 54 which established that framework was established to regulate the industry. (https://legislature.vermont.gov/bill/status/2020/S.54)

But there was more work to be done. Recently, in September 2020, a legislative committee agreed upon a bill that would legalize the commercial production and retail sales of cannabis—and establish a framework for levying and collecting taxes on sales. A proposed ban on advertising was a sticking point but that requirement in the bill was dropped and instead, the bill would look to state regulators to also establish advertising rules and standards. The proposed bill would also provide for local government to receive funds from license fees and not from sharing in the proposed 14 percent tax on sales. This was another sticking point within the committee. Things now seem to be ironed out and new proposed legislation on taxation should be forthcoming. (https://hightimes.com/news/vermont-legislative-panel-agrees-cannabis-retail-sales-bill/)
(Robert Schuster)

LEGISLATIVE DEVELOPMENTS

CONGRESSIONAL COMMITTEE APPROVES BILL THAT WILL ALLOW RESEARCH ON STATE DISPENSARY CANNABIS

On September 9, 2020, a United States House of Representatives committee approved a cannabis bill that allows scientists to study cannabis from state-legal dispensaries.

The Congressional Bill

The bill, HR 3797, was introduced in July of last year by a bipartisan group of House members of the Energy and Commerce Committee. The bill is sponsored by Reps. Earl Blumenauer (D-OR), Andy Harris (R-MD), Zoe Lofgren (D-CA), Morgan Griffith (R-VA), Debbie Dingell (D-MI) and Rob Bishop (R-UT). The bill proposes to accomplish two goals. First, it would establish a "less cumbersome registration process" for researchers interested in studying marijuana by "reducing approval wait times, costly security measures, and additional, unnecessary layers of protocol review," according to a summary. Second, it would allow certified scientists to obtain research-grade cannabis from private manufacturers.

Originally, the bill proposed only allowing researchers to access marijuana from additionally federally approved private manufacturers. However, an amendment this month was approved by the committee allowing researchers with access to cannabis from state-legal businesses under certain circumstances.

Representative Morgan Griffith (R-VA), who filed the amendment language, said:

> I believe there are signs that medical marijuana can be beneficial when used the proper setting for treatment of certain medical conditions. But the truth is, we don't really have enough research and we don't really know what it's about.

Limited Federally Authorized Research Facilities

Prior to this bill, the University of Mississippi housed the only federally authorized facility in which researchers could obtain products for testing. This bill is partially a result of pressure from researchers and lawmakers who have long complained that the University of Mississippi facility is difficult to access and the products harvested at the facility are chemically closer to hemp than the cannabis available on the commercial market.

Representative Earl Blumenauer stated in a press release:

> [Forty-seven] states have legalized some form of cannabis, yet the federal government is still getting in the way of further progress on the potential for research. We owe it to patients and their families to allow for the research physicians need to understand marijuana's benefits and risks and determine proper use and dosage.

Not All the Bill's Sponsors Support Legalized Cannabis

Perhaps most interestingly, not all of the bill's sponsors support legalized cannabis. For example, Representative Andy Harris, a physician and a long opponent of cannabis legalization emphasized the importance of this "critical this legislation is to the scientific community" in determining cannabis' potential, legitimate medicinal properties:

> Our drug policy was never intended to act as an impediment to conducting legitimate medical research. If we are going to label marijuana as medicine, we need to conduct the same rigorous scientific research on efficacy and safety that every other FDA-approved treatment undergoes. This legislation will facilitate that research by removing the unnecessary administrative barriers that deter qualified researchers from thoroughly studying medical marijuana," Harris said.

More Details on the Bill

The bill stipulates that nothing about the legislation precludes the Health and Human Services secretary from enforcing Food and Drug Administra-

tion restrictions on the method of administration of marijuana, the dosage or number of patients involved in approved studies. Further, there is no limit on the number of entities that can register to cultivate marijuana for research. However, the HHS would be required to submit a report to Congress within five years after enactment to review the results of the research and recommend whether they warrant marijuana's rescheduling under federal law.

Supporters Chime In

"This proposed regulatory change is necessary and long overdue," NORML Deputy Director Paul Armentano said in a press release. "In fact, NORML submitted comments to the US Federal Register in April explicitly calling for this change."

He went on to state:

> Rather than compelling scientists to access marijuana products of questionable quality manufactured by a limited number of federally licensed producers, federal regulators should allow investigators to access the cannabis and cannabis-infused products that are currently being produced in the legal marketplace by the multitude of state-sanctioned growers and retailers. Doing so will not only facilitate and expedite clinical cannabis research in the United States and provide important data regarding the safety and efficacy of real-world products, but it will also bring about a long overdue end to decades of DEA stonewalling and interference with respect to the advancement of our scientific understanding of the cannabis plant.

Conclusion and Implications

Bills have a way of "getting lost" in the process so those interested in the slow march forward for cannabis at the federal level, this important bill should be tracked. In addition to this major stride for the cannabis industry, later in September, there will be a floor vote on the Marijuana Opportunity, Reinvestment and Expungement (MORE) Act, to federally legalize marijuana. The full text of HR 3797 is available online at: https://www.congress.gov/bill/116th-congress/house-bill/3797/text.

(Brittany Ortiz)

JUDICIAL DEVELOPMENTS

SEVENTH CIRCUIT FINDS INJUNCTION ISSUED UNDER THEORY OF CONFLICT PREEMPTION BARRING STATE BAN ON 'SMOKABLE HEMP' WAS TOO BROAD

C.Y. Wholesale, Inc., et al., v. Eric Holcomb, et al, ___F.3d___, Case No. 19-3034 (7th Cir. July 2020).

In July 2020 the Seventh Circuit Court of Appeals issued its decision on appeal from the U.S. District Court for the Southern District of Indiana. The issue that was before the U.S. District Court was whether a State of Indiana statute, signed into law by Governor Holcomb, was federally preempted by the U.S. Farm Bill of 2018 and by the Commerce Clause of the U.S. Constitution. While the District Court found little merit to the Commerce Clause argument, it did find a likelihood of success on the merits as to federal preemption by the Farm Bill and on that basis, issued an injunction. Perhaps strangely, the injunction was not issued in the form of a stand-along order. Instead, the injunction was issued as part of the court's ruling on the motion for injunctive relief. On appeal before the Seventh Circuit, the Court of Appeals held that while plaintiffs may well have been entitled to enjoin portions of the Indiana law, the injunction issued by the District Court "sweeps too broadly." The Seventh Circuit vacated the lower court injunction and remanded the matter back to the District Court for further proceedings. The Seventh Circuit also chastised the District Court for not issuing a stand-alone order of injunction.

Background

This is a lawsuit challenging the constitutionality of a recent state statute that conflicts with federal law by impermissibly narrowing the federal definition of hemp and criminalizing the manufacture, financing, delivery, or possession of smokable hemp despite federal laws declaring all hemp derivatives to be legal. On May 2, 2019, Governor Holcomb signed into law Senate-Enrolled Act 516 (SEA 516), which became effective on July 1, 2019.

SEA 516, in part, exempts "smokable hemp" (which includes derivatives hemp bud and hemp flower) from the definition of "hemp" supplied by federal law, and renders it a crime to manufacture, finance, deliver, or possess smokable hemp even though it is a legal hemp derivative under federal law. SEA 516 also criminalizes the transport of smokable hemp despite federal law explicitly stating that states have no power to do so.

On December 20, 2018, President Donald Trump signed into law the Agriculture Improvement Act of 2018, Pub. L. 115-334 (2018 Farm Bill).The 2018 Farm Bill acknowledges that the production of hemp in a state remains legal and that states are prohibited from interfering with the interstate commerce of hemp and hemp products if produced in accordance with other federal laws, like the 2014 Farm Bill, and the state does not otherwise prohibit hemp production. The 2018 Farm Bill explicitly removes hemp from the Controlled Substances Act and requires the U.S. Department of Agriculture to be the sole federal regulator of hemp production. The Federal Drug Administrator retains jurisdiction over ingestible and topical hemp products.

The 2018 Farm Bill expands the definition of hemp by defining it as 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.A. § 1639p(1) (emphasis added).

Thus, the 2018 Farm Bill broadly defines hemp as including all products derived from hemp, so long as the THC concentration is not more than 0.3 percent.

On May 2, 2019, in direct response to the 2018 Farm Bill, Governor Eric Holcomb signed into law

SEA 516, P.L. 190-2019, which purports to utilize the same definition of "hemp" as the 2018 Farm Bill. However, SEA 516 arguably defined "hemp" more narrowly than the 2018 Farm Bill by carving out "smokable hemp."

SEA 516 defines "smokable hemp" as:

> . . .a product containing not more than three-tenths percent (0.3%) delta-9-tehtrahydrocannabinol (THC), including precursors and derivatives of THC, in a form that allows THC to be introduced into the human body by inhalation of smoke. . .[and includes]. . . 'hemp bud' and 'hemp flower.' Ind. Code § 35-48-1-26.6 (effective July 1, 2019).

Although the 2018 Farm Bill legalized all hemp products and extracts with a THC concentration of not more than 0.3 percent, SEA 516 criminalizes the manufacture or possession of smokable hemp.

At the District Court

Plaintiffs filed a motion for preliminary injunction on June 28, 2019 before the U.S. District Court. The plaintiffs sought to have Governor Holcomb and the State of Indiana enjoined from enforcing certain provisions of of SEA 516. In particular, the provisions that regulate "smokable hemp" and derivatives "hemp bud" and "hemp flower." The court granted plaintiffs' motion for injunctive relief on September 13, 2019. The court found merit to plaintiffs' argument that the Farm Bill preempted portion of the SEA 516. (*See:* https://hempindustrydaily.com/wp-content/uploads/2019/09/Indiana-hemp-decision.pdf)

The Seventh Circuit's Decision

The Court of Appeals retraced the history of the 2014 Farm Bill allowing states to continue to prohibit the production of industrial hemp and of the 2018 Farm Bill, which:

> expands the definition of industrial hemp to include not only all parts of the cannabis plant with a low THC concentration but also all low-THC cannabis derivatives. The 2018 Law excludes industrial hemp from the federal definition of marijuana, thus removing it from the DEA's schedule of controlled substances. Pub. L. No. 115-334, § 12619 (codified at 21 U.S.C. §§ 802(16)(B)(i), 812). Nonetheless, the 2018 Law expressly provides that the states *retain the authority to regulate the production of hemp*. 7 U.S.C. § 1639p (citations omitted).

The Court of Appeals pointed out that:

> Of interest here, the 2018 Law forbids the states from 'prohibit[ing] the transportation or shipment of hemp or hemp products ... through the State (citations omitted). Days before Act 516 was to go into effect, C.Y. Wholesale filed this suit, seeking a preliminary injunction against the provisions of the law that criminalized the manufacture, financing, delivery, and possession of smokable hemp. C.Y. Wholesale argued that 516's prohibition on the possession and delivery of smokable hemp was preempted by the Farm Bill's mandate that states allow all forms of industrial hemp to be *transported* through their territories.

The Seventh Circuit found that the District:

> . . .issued an injunction blocking 'the portions of [Act] 516 that criminalize the manufacture, financing, delivery, or possession of smokable hemp.' The [lower] court did not address the plaintiffs' arguments under the Commerce Clause, but it did comment that it found this point 'less convincing.'

Significance of a Failure to Issue a Stand-Alone Order of Injunctive Relief

The Seventh Circuit began its analysis by looking to the possible significance of the lower courts failure to issue a stand-along order of injunctive relief. The Seventh Circuit found that despite that parties briefing on the issue, suggesting the omission was harmless, the Court of Appeals held:

> Nonetheless, the district court's failure to abide by the separate-document command is not, at least in this case, [merely] a technical nit that we can disregard. *Instead, it has an effect on the clarity of the injunction*. (Emphasis added).

The Seventh Circuit focused on this argument that the lower court's omission impacted the nature of the injunctive relief issued:

> . . .[the District Court] enjoined the portions of Act 516 that criminalize *much more than transportation*, including the manufacture, financing, delivery, or possession of smokable hemp. It did so *without any explanation of why that breadth was necessary*. It seems to us that there is a missing step in the district court's reasoning. The failure to enter an independent injunction requires one to infer the scope of the injunction from the opinion, and regrettably, the opinion's conclusion is not fully supported by its analysis. The discipline of the separate-order rule would likely have averted this problem, and so we once again remind district judges not to overlook it.

Transportation of Hemp

The court looked to Indiana's argument that the Farm Law does not expressly preempt Act 516, because the Farm Law expressly permits the states to continue to regulate hemp production. Even if manufacture differs from production, Indiana pointed out that the law is silent on the question whether states are authorized to prohibit the manufacture of smokable hemp. Silence, it urged, did not give rise to express preemption. Moreover, Indiana pointed out that the Farm Bill does not address possession at all. Indiana contended that this omission reveals that Congress has not expressly preempted Act 516's prohibition on possession of smokable hemp. Indiana finally argued that one can transport smokable hemp through the state without violating its prohibition on possession of smokable hemp.

The Seventh Circuit found:

> This argument requires drawing a distinction between possession of something and 'moving it around.' Even a driver travelling through Indiana with a load of smokable hemp in the vehicle would, on this view, not be "in possession" of the hemp. We are not persuaded by the last argument: hundreds of criminal cases under federal laws prohibiting possession of controlled substances, or possession with intent to distribute, have involved highway stops of loaded trucks. A defense that 'I was just moving the heroin around' would have been laughed out of court.

The Court of Appeals went on articulate the breadth of the injunction as follows:

> . . .we conclude that the district court read the Farm Law's express preemption clause too broadly. The Farm Law authorizes the states to continue to regulate the production of hemp, and its express preemption clause places no limitations on a state's right to prohibit the cultivation or production of industrial hemp. Thus, the part of Act 516 prohibiting the manufacture of smokable hemp does not fall within the ambit of the Farm Law's express preemption clause.

Conflict Preemption

The Court of Appeals went on to distinguish express preemption, addressed above, from a theory of conflict preemption:

> C.Y. Wholesale has not, however, put all of its eggs in the express preemption basket. It also argues that the Farm Law preempts Act 516 through conflict preemption. In order to show conflict preemption, a plaintiff 'must show either that it would be 'impossible'. . .to comply with both state and federal law or that state law. . .[which] constitutes an 'obstacle' to satisfying the purposes and objectives of Congress.' *Nelson v. Great Lakes Educ. Loan Servs., Inc.*, 928 F.3d 639, 650 (7th Cir. 2019).

The Court of Appeals found that a court should not find conflict preemption "unless that was the clear and manifest purpose of Congress." *Arizona v. United States*, 567 U.S. 387, 400 (2012). The challenger must show that applying the state law would do "major damage" to clear and substantial federal interests. *Patriotic Veterans, Inc. v. Indiana*, 736 F.3d at 1049; see also, *id.* at 1046 ("We ascertain the intent of Congress, however, through a lens that presumes that the state law has not been preempted.").

Here, the Court of Appeals found that the lower court had determined that plaintiffs demonstrated some likelihood of success on its conflict preemption argument. The lower court held that the Farm Law showed a clear intent on the part of Congress to le-

galize all forms of low-THC hemp and that the hemp sellers had shown at least some likelihood of succeeding in their claim that Act 516 frustrated Congress' purpose. The lower court concluded that the portions of Act 516 that criminalize smokable hemp reach well beyond growing restrictions and thus do not qualify as regulations on hemp production that come within the 2018 Farm Law's express anti- preemption provision.

The Court of Appeals found the lower court's reasoning sound, but not in support of a blanket injunction:

> Here, too, although there is much that is sound in the district court's reasoning, *it does not support a complete injunction of Act 516*. Although Congress may have relaxed federal restrictions on low-THC cannabis in order to facilitate a market for hemp, the Law indicates that the *states were to remain free to regulate industrial hemp production within their own borders*. Despite legalizing industrial hemp on the federal level, *the Farm Bill expressly permits the states to adopt rules regarding industrial hemp production that are "more stringent" than the federal rules*. Pub L. 115-334 § 10113 (codified at 7 U.S.C. § 1639p).

In the end, the Seventh Circuit found nothing in the 2018 Farm Law that supports the inference that Congress was demanding that states legalize industrial hemp, apart from the specific provisions of the express preemption clause.

Conclusion and Implications

Although Seventh Circuit found the District Court's injunction was too broad, it emphasized that its ruling "should not be misunderstood as saying that a properly tailored injunction is not warranted." The Seventh Circuit was not going to offer an opinion on the ultimate determination as to whether Indiana, in proscribing the possession of industrial hemp, "has illegally prohibited the transportation of interstate shipments of industrial hemp." The court found that *should* that be the case the District Court *may appropriately* issue an injunction preventing Indiana from enforcing its law against those transporting smokable hemp through Indiana in interstate commerce. A state cannot evade the Farm Law's express preemption of laws prohibiting the interstate transportation of industrial hemp by criminalizing its possession and delivery. The Seventh Circuit remanded the matter back to the District Court to make the determinations as to the state statute, and if appropriate, to carve out a [stand-alone] order of injunction that was only as broad as we required. The opinion of the Seventh Circuit is available online at: http://media.ca7.uscourts.gov/cgi-bin/rssExec.pl?Submit=Display&Path=Y2020/D07-08/C:19-3034:J:Wood:aut:T:fnOp:N:2542549:S:0.
(Robert Schuster)

TENTH CIRCUIT ADDRESSING PROPRIETY OF IRS AUDIT OF A COLORADO-LEGAL CANNABIS BUSINESS, AFFIRMS THE BROAD POWERS OF THE FEDERAL GOVERNMENT AND ITS MINIMAL BURDEN OF PROOF

Standing Akimbo, LLC v. United States of America, ___F.3d___, Case No. 19-1049 10th Cir. 2020).

The Internal Revenue Service performed an audit of a cannabis business [investigating business deductions] operating legally within the State of Colorado. The audit included issuance of summonses from the IRS agent in order to compel the taxpayer to produce documentation. The cannabis business argued that the IRS lacked a legitimate purpose to support to summons. The implied argument was that the federal-state schism of the legality of taxpayer's business was at the core motivation of the IRS actions. The Tenth Circuit Court of Appeal reviewed the U.S. District Court's support of the summonses *de novo*, and as any other business applying well-established legal precedent which the Court of Appeals classified as a very low bar of justification by the IRS which would then shift the burden of proof to the taxpayer who failed to

demonstrate anything the IRS did wrong. The summonses were upheld.

Background

The Taxpayers own Standing Akimbo, and Samantha Murphy is its business manager. Standing Akimbo is a Colorado Limited Liability Company operating a medical-marijuana dispensary in Denver, Colorado. Though such dispensaries are legal under Colorado law, marijuana is still classified as a federal "controlled substance" under Schedule I of the Controlled Substances Act.

The Internal Revenue Service (IRS) is responsible to enforce the federal tax code against marijuana businesses operating legally under state law as with all other businesses. This led to a civil audit of Peter Hermes, Kevin Desilet, Samantha Murphy, and John Murphy (collectively: Taxpayers) to verify their tax liabilities for their medical- marijuana dispensary, Standing Akimbo, LLC. The IRS was investigating whether the Taxpayers had taken improper deductions for business expenses arising from a "trade or business" that "consists of trafficking in controlled substances." 26 U.S.C. § 280E. But claiming to fear criminal prosecution, the Taxpayers declined to provide the audit information to the IRS. This left the IRS to seek the information elsewhere—it issued four summonses for plant reports, gross-sales reports and license information to the Colorado Department of Revenue's Marijuana Enforcement Division (Enforcement Division), which is the state entity responsible for regulating licensed marijuana sales.

The Taxpayers own Standing Akimbo, and Samantha Murphy is its business manager. Standing Akimbo is a Colorado Limited Liability Company operating a medical-marijuana dispensary in Denver, Colorado. Though such dispensaries are legal under Colorado law, *see* Colo. Rev. Stat. Ann. § 44-10-102, as is well understood, the federal government's position on cannabis is that it is an illegal substance.

In May 2017, the IRS began investigating whether Standing Akimbo had claimed business deductions that were improper. That month, IRS Revenue Agent Tyler Pringle provided Standing Akimbo written notice (in a letter) that the IRS was auditing its return for the 2014 tax year.

Because Standing Akimbo is a pass-through entity, its audit would necessarily affect its owners' tax returns. So, Agent Pringle also sent letters to Hermes and the Murphys, notifying them that the IRS would be examining their personal-income-tax returns for the 2014 and 2015 tax years.

The IRS, as part of its audits sent requests for documents that were deemed "minimal and incomplete." The IRS responded by issuing four third-party summonses to the Enforcement Division.

At the District Court

In the U.S. District Court for Colorado the Taxpayers filed a petition to quash the summonses. They asserted that none of the summonses satisfied the U.S. Supreme Court's requirements for enforcement as announced in *United States v. Powell*, 379 U.S. 48 (1964). Specifically, the Taxpayers argued that the summonses lack a legitimate purpose, are deficient because the IRS failed to follow necessary administrative steps, exceed the IRS' authority by forcing the Enforcement Division to create reports, and impermissibly seek the identity of third-party taxpayers. The Taxpayers also requested an evidentiary hearing to determine whether the summonses satisfied the *Powell* requirements.

The District Court referred the matter to a magistrate who did not convert the motion to dismiss into a motion for summary judgment, but she still relied on Agent Pringle's declaration—and ultimately, concluded that the IRS had met *Powell*'s requirements. As such, the magistrate recommended to the District Court to deny the petition to quash the summonses and grant a motion to dismiss—which the District Court adopted in toto.

The Court of Appeals' Decision

On appeal from the U.S. District Court, the Tenth Circuit applied a well-established analysis of the actions of the IRS under the *Powell* elements and had problem with the IRS' actions.

IRS Authority and the Initial Burden of Proof

The court went through a legal review of the broad statutory powers the IRS are given and case law addressing the outer limits of those powers. The court pointed out that:

> As a threshold matter, the IRS must first show that it has not made a referral of the taxpayer's case to the Department of Justice (DOJ) for

> criminal prosecution. (citation omitted). Then the IRS 'need only demonstrate good faith in issuing the summons. (citations omitted). . . .[This] means establishing what have become known as the *Powell* factors. . . .(citations omitted)

The *Powell* Factors

The Tenth Circuit summarized the *Powell* factors as follows:

> *Powell* requires that the IRS establish: (1) "that the investigation will be conducted pursuant to a legitimate purpose," (2) "that the inquiry may be relevant to the purpose," (3) "that the information sought is not already within the [IRS's] possession," and (4) "that the administrative steps required by the [Internal Revenue] Code have been followed." 379 U.S. at 57–58.

The court emphasized that the burden on the IRS in light of these factors is "slight:"

> . . .because the statute must be read broadly to ensure that the enforcement powers of the IRS are not unduly restricted. *United States v. Balanced Fin. Mgmt., Inc.*, 769 F.2d 1440, 1443 (10th Cir. 1985) [and that the IRS] generally meets this burden with an affidavit of the agent who issued the summons.

Once this "slight" burden on the part of the IRS is met:

> The burden then shifts to the taxpayer to factually refute the *Powell* showing or factually support an affirmative defense—conclusory allegations are insufficient. *See id.* at 1444 (quoting *Garden State*, 607 F.2d at 71). This is a *heavy burden*. *Id.* (citing *Garden State*, 607 F.2d at 68, emphasis added). If the taxpayer cannot meet this burden, 'the district court should dispose of the proceeding on the papers before it and without an evidentiary hearing'. . .a hearing may be granted only if the burden is met. *Id.* at 1444 & n.2 (quoting *Garden State*, 607 F.2d at 71)

Standard of Review—Summary Judgement

The court stated that the matter must be reviewed *de novo* because the issue is one of law and that:

> In determining whether the IRS met *Powell*'s requirements, we must consider something outside the pleadings (i.e., Agent Pringle's declaration). Because we are considering Agent Pringle's declaration, the IRS' motion to dismiss 'must be treated as one for summary judgment under Rule 56.' Fed. R. Civ. P. 12(d). . . . Thus, we will apply our traditional Rule 56 summary-judgment standard in assessing this case.

The Court of Appeals then went through each of the *Powell* factors, discussed below.

A Legitimate Purpose

The court quickly resolved this "slight" burden by looking to the IRS agent's letters to the taxpayers and Agent Pringle's declaration to dispose of this issue finding a legitimate purpose for the audit and for the summonses:

> . . .the IRS' obligation to determine whether and when to deny deductions under § 280E[] falls squarely within its authority under the Tax Code. *Green Sol. Retail*, 855 F.3d at 1121 (citing 26 U.S.C. §§ 6201(a), 7602(a); *Clarke*, 573 U.S. at 249).

Relevance

The second *Powell* factor requires the IRS to establish that "the inquiry may be relevant to the [investigation's] purpose." 379 U.S. at 57. Agent Pringle explained that the Standing Akimbo summons sought METRC data "account[ing] for all marijuana plants and products" and that this information "can establish whether a marijuana business properly reported its gross receipts and allowed deductions for cost of goods sold."

According to Agent Pringle, he issued the Taxpayers summonses seeking a list of the Taxpayers' licenses "to verify that these individuals own Standing Akimbo" and to "determine the correctness of the[ir] federal tax returns and federal tax liabilities." *Id.* at 74–75. With this explanation, Agent Pringle's declaration was found by the court to satisfy the IRS' slight burden to establish that the information summoned may be relevant to its federal tax investigation.

Does the IRS Not Already Possess the Information Sought?

Powell's third factor is whether the IRS already possess the information that was subject to the summons. Here, the court found that:

> Agent Pringle declared that the IRS did not already possess the information sought in the summonses. The summonses are also specific in what they request—licenses held by the Taxpayers and specific METRC reports for tax years 2014 and 2015. Agent Pringle explained that the Taxpayers had only partially responded to his Document Requests and that their production did not include any information reported to the Enforcement Division, including METRC data. This satisfies the IRS's slight burden.

Did the IRS Follow Required Administrative Steps?

As to the next *Powell* factor, the court quickly found that Agent Pringle's declaration satisfied the slight burden when he:

> . . .stated that he 'complied with the administrative steps that the Internal Revenue Code requires' in issuing the summonses. App. vol. 1 at 74–75. [Also], The Taxpayers do not contest on appeal. . . .

The Taxpayers Failed to Meet Their Burden of Proof

Once the *Powell* factors were established, in its "slight" burden, the court went on to address in length each of the arguments raised by the Taxpayers who now bore the "heavy burden" of proof:

> Taxpayers raise five arguments against enforcement: (1) the IRS' ability to share the collected information with law enforcement constitutes bad faith, (2) enforcing the summonses would improperly force the Enforcement Division to create documents, (3) the summonses seek information that the Fourth Amendment protects, (4) the summonses are overbroad, and (5) enforcing the summonses would compel a violation of Colorado law. We ...conclude that all five arguments fail.

The Court of Appeal easily disposed of each of the five arguments proffered by the Taxpayers and found the Taxpayers failed in their burden to support any of their arguments.

Conclusion and Implications

The Tenth Circuit affirmed the decision of the District Court. The Court of Appeals pointed out that the district court thus correctly ruled that the Taxpayers are not entitled to an evidentiary hearing or discovery and enforced the summonses. The case is important for several reasons. First, it reminds businesses that deal in cannabis in "legal" states that the such businesses will be treated as any other business in enforcing the federal tax code. Second, the case reminds the reader of the broad investigative powers of the IRS is provided by federal tax code. Finally, the case is a caution to those subjects to an IRS audit and IRS summons—cannabis business or not—that failure to fully cooperate only subject the taxpayer to judicial review where the IRS' burden is "slight" and the taxpayers is substantial. Arguably, those who operate in legal cannabis-related businesses may feel that they are "red flagged" by a federal government hostile to their state-legal activities. Whether that is the case or not, the powers of the IRS remain mighty while its burden to show a legitimate interest under *Powell* is only "slight" and failure to cooperate, despite feeling "targeted," is not the best tactic to employ.

The court's opinion is available online at: https://www.ca10.uscourts.gov/opinions/19/19-1049.pdf. (Robert Schuster)

CALIFORNIA COURT OF APPEAL FINDS LOCAL GOVERNMENT MAY NOT RETAIN SEIZED CANNABIS AND RELATED PROPERTY THAT IS NOT ILLEGAL

Granny Purps, Inc. v. County of Santa Cruz, ___Cal.App.5th___, Case No. H045387 (Cal.App. Aug. 5, 2020).

Granny Purps, Inc. (plaintiff) is a medical cannabis grower and retailer operating in Santa Cruz County (defendant). Plaintiff holds valid state cannabis licenses and distributes its products to 20,000 members. In 2015, Santa Cruz County seized 2,200 cannabis plants from plaintiff as part of an enforcement action for violations of local cannabis cultivation regulations.

Background

Plaintiff filed suit against defendant seeking monetary damages for conversion, trespass, and inverse condemnation, and sought a declaration that county may not lawfully seize cannabis plants from a dispensary operating in compliance with state law. Defendant also filed a writ of mandate seeking to have the 2,200 cannabis plants returned.

At the trial court, defendant successfully demurred on the basis that plaintiff's complaint failed to state a valid cause of action and that plaintiff's claims were not made within the applicable statute of limitations.

Possession of medical cannabis has been legal since the adoption of the Compassionate Use Act in 1996. In 2003, the California Medical Marijuana Program Act expanded cannabis legalization to cover cultivation, transportation, storage, and sale of medical cannabis. Subsequent legalization expanded the allowable cannabis activities beyond the medical context.

Santa Cruz County restricts commercial cannabis cultivation for medical cannabis businesses to no more than 99 plants. The court found that these regulations are a lawful exercise of the county's police powers. Enforcing this cultivation limit let defendant to seizing 1,800 plants from plaintiff during the first raid and an additional 400 plants at a second raid several months later.

Plaintiff appealed and on August 5, 2020, the Sixth District California Court of Appeal partially found in favor of plaintiff, concluding that the claim to have the 2,200 plants returned survived the demurrer.

The Court of Appeal's Decision

In general, the government may not seize property without due process. Absent such due process, property may be sought to be returned through legal action. However, there is an exception to property being returned once seized by the government: where the property is itself illegal. Therefore, the question of whether the plants should be returned to plaintiff turned on whether they were *per se* illegal to possess.

Here, defendant argued the property in question—2,200 cannabis plants—ought not have been returned to plaintiff because the plants were cultivated in violation of the county regulation limiting cultivation of medical cannabis to 99 plants. Plaintiff argued the plants should have been returned because under California law, and more specifically their state licenses, it is not illegal for them to possess the 2,200 plants. The Court of Appeal found that while state cannabis law does not restrict the ability of local jurisdictions issuing land use regulations such as the 99-plant limit in Santa Cruz County, the possession of cannabis plants is legal under state law. Therefore, the court concluded that plaintiff's claim seeking the return of the plants ought to have survived demurrer.

Other Claims

On the claim seeking damages for trespass, conversion, and inverse condemnation under the Government Claims Act, the court found that the action was timely filed. However, the court also found that plaintiff, as a corporation, had its corporate status suspended by the Secretary of State for failure to pay taxes at the time the action was filed. The court therefore found that this claim failed and was not saved by the corporate revivor doctrine because that only retroactively ratifies procedural actions undertaken by lapsed corporations rather than remedying substantive shortcomings such as the application of a statute of limitations.

The court further found that the inverse condemnation claim failed. Inverse condemnation only pro-

vides an avenue for damages where the government takes or damages private property for a public use or in the course of a public work improvement. Here, the court found that the seizure was for law enforcement purposes and that there was no evidence the seized plants had been put to a public use.

Conclusion and Implications

Cannabis businesses and their advisors should keep in mind the following takeaways:

- Seized property may only be retained by the government at the conclusion of its law enforcement activities where that property is *per se* illegal.

- Lapses in corporate status can have cascading effects on an entity's legal rights.

- Inverse condemnation actions typically require a showing of public use of the property taken and therefore are a difficult claim to prove.

Another takeaway from this decision is keeping in mind the court's reasoning about the relationship between cannabis' legal status under state law and the scope of power to regulate cannabis that rests with local jurisdictions. This decision may well factor into the decision in *County of Santa Cruz et al. v. Bureau of Cannabis Control*, Case No. 19CECG01224 (Fresno County Superior Court) where the plaintiffs are seeking to have § 5416(d) of Title 16 of the California Code of Regulations declared invalid and prevent the state from enforcing § 5416(d)'s provisions allowing for the statewide delivery of cannabis, including jurisdictions that have not authorized cannabis activity, namely cannabis delivery. The Sixth District Court of Appeal's opinion in this matter is available online at: https://www.courts.ca.gov/opinions/documents/H045387.PDF.
(Andreas L. Booher)

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