



Reading the Leaves:

Cannabis Mid-Year Update 2022

**PREPARED BY THE FOLEY & LARDNER TEAM IN THE AREA OF:
CANNABIS**

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Executive Summary

Well into the third year of the global pandemic, with record inflation and the uncertain outcomes of geopolitical issues roiling global markets, the cannabis industry has nevertheless continued upon a similar path as recent years. Public polling continues to show that the overwhelming majority of U.S. adults support the legalization of marijuana for both medical and recreational adult-use. Yet, legislative solutions are unlikely due to Congressional dysfunction and the shift in focus to the midterm elections. Although various efforts to legalize marijuana and end the cannabis industry's inability to access the financial system have been introduced in Congress, nothing appears imminent. Additionally, employers around the country are being squeezed by the competing pressures of increasing legalization, availability of cannabis, and increased protections for the employees who use it.

The cannabis industry is not immune from market forces. As more states legalize marijuana, there will no doubt be an increase in distressed cannabis businesses as companies grapple with new and complex regulations while also potentially facing the effects of a global economic downturn. Cannabis companies, unable to access the benefits under the federal bankruptcy code, may need to consider new "escape valves" if facing insolvency.

There are bright spots such as the edibles market, which is expected to do even better in 2022 than in prior years. However, federal illegality will likely continue to complicate regulatory efforts by the U.S. Food and Drug Administration to provide much-needed rules and guidance in this area.

Other agencies may yet choose to tackle issues that could reverberate within the cannabis industry. The U.S. Patent and Trademark Office, for example, has increasingly been granting cannabis-related patents and is also involved in litigation that could impact companies' ability to obtain trademarks under federal law.

Halfway through the year, where do things stand and what is coming down the road? In the following pages, members of Foley & Lardner's nationally recognized Cannabis Industry Team will share their perspectives and offer insights on the critical issues and inherent challenges facing this exciting and developing industry.

Regards,

The Cannabis Industry Leadership Team



Rohan Virginkar

Partner
Washington, D.C.
rvirginkar@foley.com



Ron Eppen

Partner
Boston
reppen@foley.com



Mark Neuberger

Of Counsel
Miami
mneuberger@foley.com

Legislation and Government Affairs

Infrastructure Investments

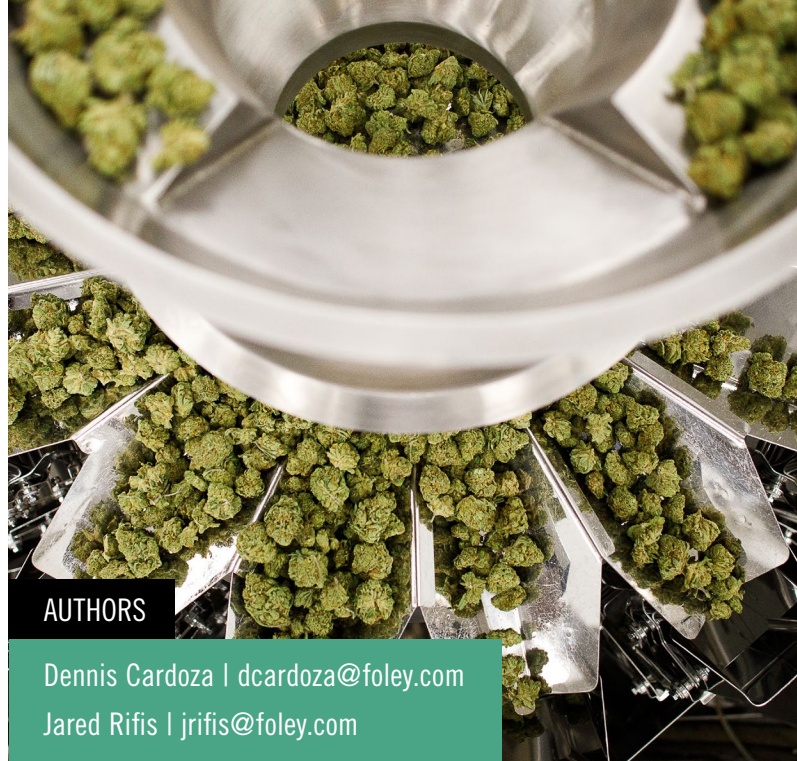
In its first year, the Biden Administration has invested heavily in improving physical infrastructure through the Infrastructure Investment and Jobs Act, known colloquially as the bipartisan infrastructure package. Within the bill, there are several carve-outs that focus on cannabis research. Specifically, provisions allow for researchers to study marijuana from state-sanctioned dispensaries. Additionally, the bill requires the development of a public report with recommendations on allowing scientists to access retail-level marijuana to study its impacts on impaired driving.

The Biden Administration has pushed its own recommendations on research. Specifically, the DEA recently proposed a massive increase in the production of marijuana for research purposes. This would include expanding federal cannabis cultivation beyond the University of Mississippi, which is currently the only approved facility for cannabis cultivation.

The Biden Administration also has pushed a \$2.2 trillion social spending package, the Build Back Better Act (BBB). The BBB passed the House of Representatives in November, but has since stalled in the Senate. Negotiations are ongoing, and there are no cannabis updates within the bill.

Appropriations Spending

As Congress negotiates FY 2022 appropriations, multiple amendments have been added and removed regarding cannabis. Notably, President Biden included the Rohrabacher-Farr amendment, which bars the Department of Justice (DOJ) from interfering with the implementation of state medical marijuana laws, in his budget proposal for FY 2022. The amendment was included with the two latest continuing resolutions that have funded the government. The latest continuing resolution funds the government through February 18, 2022, after which Congress will need to pass a funding measure or face a government shutdown.



AUTHORS

Dennis Cardoza | dcardoza@foley.com

Jared Rifis | jrifis@foley.com

The Harris Rider, a provision originally introduced in 2014 by Rep. Andy Harris (R-MD-01) that blocked the District of Columbia from regulating and taxing recreational marijuana, was not included in the initial round of appropriations bills released by Senate Appropriations Chairman Patrick Leahy (D-VT). It is unknown whether or not the amendment will be included in the final appropriations bills.

Major attention will be on the Blumenauer-McClintock-Norton-Lee amendment, which removes the word “medical” from the Rohrabacher-Farr amendment and would prohibit the DOJ from intervening in state-legalized cannabis programs. The measure passed the House last year, but died in the Senate. The original co-sponsors of the bill wrote a letter of support to the Appropriations committees, but there has been no indication on its inclusion in the final bill.

National Defense Authorization Act

Congress recently passed the National Defense Authorization Act (NDAA) prior to the end of 2021. An amendment included within the Senate version of the bill allows the Department of Veteran Affairs (VA) to recommend medical marijuana to patients and requires the VA to increase research efforts on medical marijuana. The VA has resisted efforts to expand research in the past; these developments will be monitored closely.

The House-passed version of the NDAA added the SAFE Banking Act. However, it was removed from the Senate-passed version of the bill, despite 24 governors across the United States sending a letter to congressional leaders urging its addition to the bill.

Legalization Efforts

The House passed the MORE Act in the 116th congress with little bipartisan support. The MORE Act would decriminalize marijuana and would make the decriminalization retroactive by expunging all previous charges. In addition to a 5-8 percent tax to help with social services related to cannabis, it also had a number of banking, research, tax, and equity-related provisions. It was reintroduced in the 117th congress, but there has been no action since its reintroduction.

The Senate represents a tougher landscape for legalization efforts. Majority Leader Chuck Schumer (D-NY) has a plan to decriminalize and deschedule cannabis. His plan has been regarded as significantly broader than the House plan, but has no bipartisan buy-in from Republican senators. With the control of the Senate likely being decided in the swing states of

Georgia, North Carolina, and Wisconsin, all of which have not legalized medical or recreational usage, Schumer is unlikely to force any tough votes on Democratic incumbents.

Republican senators still hold strong opposition towards any legalization efforts. In July, POLITICO polled a dozen GOP senators who represent medical or recreational cannabis markets, and none indicated that they would vote to remove cannabis from the Controlled Substances Act. Sens. Steve Daines (R-MT) and Mike Rounds (R-SD), who represent states that recently legalized recreational usage, have nonetheless voiced their opposition to federal legalization efforts. Only one senator from a fully legal state is up for reelection in 2022, Sen. Lisa Murkowski (R-AK), and she said in an interview that removing federal penalties from cannabis may end up being the “cleanest” way to break down the many hurdles facing cannabis businesses.

Finally, there has been a push to have the DOJ deschedule cannabis. While this route is not particularly likely as President Biden has been a notable opponent of federal legalization, it is an option to monitor should all legislative angles fail.



Insolvency

Where Do Distressed Marijuana Companies Go?

Ordinarily, distressed companies requiring capital restructuring look to the U.S. Bankruptcy Code. The broad injunctive relief afforded by the automatic stay affords ailing companies the breathing room necessary to line up “debtor-in-possession” financing while they prospect feasible long-term exit strategies (through a reorganization, asset sale, or some combination of the two).

Unfortunately, these federal benefits are not available to recreational use and medical marijuana companies (hemp-only companies that do not have ties to marijuana businesses can file for chapter 11). Trustees remain vigilant gatekeepers, quickly disposing of such chapter 11 debtors with motions to dismiss. Courts most often oblige, finding that bankruptcy courts cannot administer assets that are related to marijuana because those assets were obtained in violation of federal law. Indeed, some bankruptcy courts have shut the door on not just the operators themselves, but companies that have even “tangential” dealings with marijuana companies. Even individuals whose income is derived from a marijuana business are not entitled to declare bankruptcy, and in the case of chapter 13 bankruptcy cases, to fund plan payments with assets, including salaries, obtained from such businesses. If the federal government legalizes marijuana, that will likely change; however, no such changes are currently proposed, and there is no timeframe in which they may occur. In the meantime, distressed marijuana companies must look to “pseudo-bankruptcy” proceedings that offer some of the benefits that a federal bankruptcy can.

Is a State Receivership A Good Restructuring Vehicle For Distressed Marijuana Companies?

At this time, the number one option for many distressed marijuana companies is state receivership. Much like a chapter 11 bankruptcy, the receivership can provide for a “stay” against actions taken affecting the company’s assets (i.e., the breathing space it needs to formulate a plan for rehabilitation or exit as



AUTHORS

Katherine Catanese | kcatanese@foley.com

Tamar Dolcourt | tdolcourt@foley.com

painlessly as possible). For example, the Washington Receivership Act supplies a stay against collection efforts, though only for 60 days. The receiver will be empowered to run the business while working through its operational/cash issues, or it will have the opportunity to conduct an orderly sale of the assets, usually through an auction process, during which the secured lender will be afforded the right to credit bid. The costs associated with that sale may be charged to the sale proceeds. Thus, in many ways, the state receivership can act like a federal bankruptcy. However, not all state statutes have a receivership option for marijuana businesses. A growing number of states have started to include receivership options in their marijuana licensing statutes and regulations. These include Oklahoma (which currently only allows medical marijuana use), Oregon, Washington, Colorado, and Michigan. Other states such as California simply allow marijuana businesses to operate under existing receivership statutes. Nevada has recently updated its marijuana statute to include a receivership provision after a successful state court receivership proceeding led to the orderly sale of assets.

How is a State Receivership Different from a Federal Bankruptcy?

First, the court appointed receiver (often handpicked by the company’s primary secured lender) makes most of the decisions from an operational, transactional, and financial perspective. That receiver may not have the kind of operational know-how to run a

marijuana business, making any major transaction more challenging. Even if the receiver has some background in the cannabis industry, they still have a steep learning curve when it comes to the company's specific business and the particular regulations that impact that business. In addition, any receiver selected to run a marijuana business may need to be licensed by the state or obtain such licensing on an expedited basis, limiting the pool of potential receivers for these businesses.

Second, the laws vary state-by-state on whether and for how long a “stay” arises, thwarting potential litigation, upon the appointment of a receiver. The laws also vary on whether a receiver can sell assets “free and clear” of any and all liens, claims, and encumbrances without the consent or satisfaction of those claims. Accordingly, buyers of distressed marijuana assets will want to take a close look at potential successor liability risks on a state-by-state basis.

Third, even where a receiver can be appointed over a marijuana business, they not have the powers of a bankruptcy trustee or debtor-in-possession. For example, generally state law receivers are not able to reject or assume contracts or seek recovery of preferential transfers, which are all powers permitted under the Bankruptcy Code. Also, receivers; generally only permitted to liquidate assets; they do not have the ability to restructure operations as could occur in a bankruptcy proceeding.

Conclusion

As more states legalize marijuana, there will be an increase in distressed businesses as new participants grapple with a new market and complex regulations. States are beginning to recognize that there is a need for some sort of “escape valve” for these businesses, including receiverships. However, even among states that have marijuana receivership laws, the rules are varied and complicated. Investors, lenders, vendors, and distressed asset buyers will all need to be aware of the particular state laws and regulations that govern marijuana businesses in their state in order to protect themselves from any negative consequences should the marijuana business go into distress.



FDA/CBD Trends

Pending Bipartisan CBD Legislation

In December 2021, Congress introduced bipartisan legislation to require the Food and Drug Administration (FDA) to regulate food products containing cannabidiol derived from hemp (CBD). The CBD Product Safety and Standardization Act of 2021 (H.R. 6134) would implement a maximum amount of CBD per serving, establish labeling and packaging requirements, and specify conditions for intended use (See [H.R. 6134](#).) The bill would create a limited carve out for CBD from the list of certain prohibited acts in interstate commerce under the Federal Food, Drug, and Cosmetic Act (21 U.S.C. 331(II)) and establish conforming amendments to existing provisions related to adulteration and misbranding of food products.

H.R. 6134 follows a similar bill, H.R.841, introduced in the House in February 2021, which would allow the use of hemp-derived CBD in dietary supplements (The Hemp and Hemp-Derived CBD Consumer Protection and Market Stabilization Act of 2021). (See [H.R. 841](#).) Both bills sit with the Energy and Commerce Committee and are expected to face substantial challenges in the Senate, despite widespread sentiment in favor of federal regulation of CBD and recent legalization of CBD by numerous state legislatures. Many states such as California with existing cannabis regulatory schemes have recently introduced expanded legislation to incorporate hemp-derived CBD into cannabis supply chains. California's Assembly Bill 1656 proposes to add a provision to the existing statutory framework to allow cannabis license holders to use compliant industrial hemp, and CBD derived therefrom, in cannabis products manufactured within the state.

The FDA has been reluctant to regulate consumer products containing CBD as long as cannabis remains a scheduled substance under federal law.



AUTHORS

Nate Beaver | nbeaver@foley.com

Matt Kiel | mkiel@foley.com

Spirits and Infused Beverages

In 2021, U.S. consumers expressed a strong interest in edible products, including non-alcoholic beverages infused with CBD. The increased popularity of infused beverages is projected to continue its rapid growth through 2022. Some industry participants and investors expect an uptick of consumption in lounge-style venues and a loosening of state and local regulations surrounding alcohol-cannabis beverage infusions.

In December 2021, global consumer packaged goods and cannabis lifestyle brand Tilray (NASDAQ:TLRY) announced its acquisition of Breckenridge Distillery in a strategic move to position its alcohol beverage portfolio in anticipation of the expected eventual federal legalization of cannabis. In its announcement, Tilray stated that the acquisition was intended to commercialize innovative products through the development of (initially) non-alcohol distilled spirits infused with cannabis. (See [Tilray Announcement](#).) Tilray's move is indicative of a broader industry trend towards infused beverages and an expectation that consumers' demand for spirit-cannabis infusions and other beverage products will continue to spike into 2022.

Trademark

Kid's Clothing Company Sues Cannabis Companies.

Brand owners of non-cannabinoid products are not sitting by as cannabis companies are naming their products after their well-known brands. Garan Inc. and Garan Services Corp. (collectively Garan) brought an action against Med For America, Inc. in federal court in California for federal and state dilution and unfair competition under state law arising out of defendant's sale of cannabis-derived goods bearing the GARANIMALS mark. Garan introduced the GARANIMALS children's clothing brand in the early 1970s and has had over \$4 billion in retail sales in the last five years. Garan alleges that by using the GARANIMALS mark to sell cannabis-derived products that are controversial and in some cases illegal, defendant tarnishes and damages the reputation of the GARANIMALS brand by affiliating it with products that are inconsistent with the wholesome sentiments that underlie the GARANIMALS brand. Interestingly, Garan has not alleged trademark infringement, presumably because it recognizes that consumers are unlikely to believe that the defendant's products emanate from or are in some way authorized/sponsored by Garan. Instead, Garan claims that the GARANIMALS mark will be diluted by the use of cannabis products. To prevail on its dilution claim, Garan will have to establish that the GARANIMALS mark is famous (like the GOOGLE, NIKE, and COKE marks).

Appeal Argues USPTO Should Grant Trademarks Pre-Legalization

The United States Patent and Trademark Office (USPTO) refuses any application, including those filed based on an "intent to use," for products that are not lawful. In the Trademark Trial and Appeal Board (TTAB) decision affirming the refusal of the FOR JOY application covering hemp-derived CBD-based beverages, the USPTO stated, "The lawfulness of the goods is determined at the time the application is filed and not what may or may not be lawful at the federal level years from now."



AUTHORS

Rob Weisbein | rweisbein@foley.com

Lindsey Birch | lbirch@foley.com

Joy Tea argued at the TTAB that the current rules run counter to the purpose of an intent-to-use application, which is to block a third party from swooping in and beating a business to the trademark office. Further, there is an existing carve-out for pharmaceutical companies to protect marks for products that are not yet FDA-approved. Rejecting these arguments, the USPTO said the comparison is "misleading because pharmaceuticals are not per se unlawful." Joy Tea is appealing the rejection to the Federal Circuit Court of Appeals.

If the appeal is unsuccessful, it will continue to be difficult for cannabis companies to obtain and enforce federal trademark rights.

Prior Rights Dilemma

In *Wunderwerks, Inc. v. Dual Beverage Company LLC*, a California federal judge recently denied plaintiff's preliminary injunction request, reasoning defendant was more likely to suffer irreparable harm when plaintiff was unlikely to win on the merits. Plaintiff, Wunderwerks, sells infused beverages under the brand WUNDER; defendant, Dual Beverage, obtained a federally registered trademark for W*NDER for uninfused beverages. This reaffirms the general position among courts not to allow prior mark owners for federally illegal products, despite prior common-law state trademark rights, to challenge another party's federal trademark registration.

Patent

IP Cannabis Trends

The emergence and growth of the cannabis industry will continue the development of technologies to support the industry. These technologies will include agricultural processes and devices focused on hemp/cannabis growth, new species of plants that produce high levels of particular cannabinoids, and other medicinal and recreational uses for the cannabinoids.

In parallel, the easing of regulatory rules surrounding the industry will create more comfort in pursuing and enforcing Intellectual Property (IP) in the industry. We foresee continued growth in the following areas:

Plant Patent Protection | Plant Breeders Rights Protection for Hemp | Cannabis Plants Will Expand

The USPTO has already granted numerous hemp and cannabis plant patents. In 2021 alone, the USPTO granted at least 13 plant patents to cannabis varieties. Internationally, the system of plant variety protection is focused on Plant Breeders Rights (PBR). Similar to other agricultural areas, companies, breeders, and academics will look to protect their novel hemp and cannabis with the IP schemes that cover plant varieties.

Companies Will Pursue Broad Utility Patent Portfolios Covering Compositions and Uses of the Cannabis Technology

At the USPTO, almost 200 patents granted in 2021 included the word “cannabis” in the claims. In addition to narrowly covering a plant variety, utility patent protection in the cannabis industry continues to see rapid expansion of:

- methods of using cannabinoids to treat diseases,
- technology surrounding formulation of cannabis-related products, and
- agricultural devices and methods for improved growth of the varieties.

With the maturity of the cannabis industry, every aspect of the cannabis development chain is being protected by IP. Many companies focus on the agricultural aspects of cannabis growth, improving yield, genetic



AUTHOR

Benny Berkowitz | bberkowitz@foley.com

studies, cultivation, and harvesting of cannabis. Further along the development chain are patents covering extraction as well as formulation of cannabis and cannabinoids. Finally, protection of medical cannabis products and delivery systems for treatment of diseases also will be filed in the upcoming years.

Patent Litigation and Challenges at Patent Offices on Cannabis IP Will Increase

Patent Enforcement – The first lawsuits enforcing IP in this technology area are beginning, and the fight to protect market share will naturally extend to the courtroom as companies rely on their IP portfolios to keep competitors off the market. For example, the Canadian company Canopy Growth has sued GW Pharmaceuticals for infringing a patented CBD extraction technology to make the CBD drug Epidiolex. The lawsuit has progressed to a judge interpreting important claim terms, but the ultimate resolution of this dispute is still unclear.

Challenges at the Patent Offices – With additional patents being issued from patent offices around the world, we will see more challenges by competitors to request invalidation of patents. In the United States, these proceedings are generally held through Inter-partes Review (IPR) or Post-grant Review (PGR) procedures. In Europe, competitors can file opposition proceedings. Other countries have similar procedures, and we are going to see competitors try to avoid patent infringement by proactively looking for ways to undermine IP rights around the world.

Labor

Pre-Employment Cannabis Testing: Is It Still Worth It?

For years, most employers and employees alike assumed a clean drug test was a prerequisite for getting hired. These pre-employment drug testing panels included a list of illegal drugs, and almost always included tetrahydrocannabinol (THC), the key psychoactive compound found in cannabis. But the times have changed as it relates to cannabis—from both social and legal perspectives. These changes beg the question: is it even worth testing for cannabis still? Perhaps even more concerning, is such testing even legal?

In addition to medical cannabis being legal in 37 states, recreational cannabis is now legal in 18 states and the District of Columbia. Considering that just 10 years ago there were only two states with legal recreational cannabis, it is not hard to see where the trend is heading. Perhaps recognizing this trend and more commonplace usage, certain jurisdictions have adopted protections for employee candidates surrounding drug testing, including outright bans on testing for cannabis. For example, [New York City prohibits all employers from requiring employment candidates to submit to testing for THC](#). Most recently, [Philadelphia enacted a similar law, effective January 1, 2022, prohibiting employers from requiring job applicants to submit to cannabis testing](#). At the state level, [Nevada has prohibited pre-employment cannabis testing since January 2020](#).

Setting aside these explicit prohibitions surrounding testing, though, there are some practical considerations as well. As we [previously discussed](#), there are risks in states like Illinois for discriminating against recreational cannabis users because cannabis is now a “lawful product” under Illinois law. Other states such as New York and New Jersey protect off-duty cannabis use even more broadly. There can be real consequences for violating these protections, too. Amazon recently settled a [proposed class action](#) alleging it discriminated against



AUTHOR

Patrick McMahon | pmcmahon@foley.com

New Jersey recreational cannabis users. Amazon also dropped cannabis from its drug screening shortly after this suit was filed. And while these statutory protections are notable, employers that require testing would still feel the impacts of legalized cannabis in other respects. [One Illinois employment agency noted](#) that an astounding 40 percent of recent applicants had failed drug tests for cannabis use. In an era of a generally contracted employee pool, that can lead to a prohibitively small group of candidates.

So with all these factors in mind, is testing for cannabis even worth it? Of course, the answer is not a “one-size-fits-all” issue. The decision will depend on a number of factors, including some exceptions to statutory prohibitions on testing listed above, laws requiring drug testing for certain jobs, and position-specific questions surrounding job duties (e.g., desk job versus operating heavy machinery). Still, what many employers may have considered as a best practice for years is one that should be reconsidered in light of these rapid developments.

Securities and Government Enforcement

As the cannabis industry continues to grow, so has the scrutiny that players in the market face from regulators. Despite Sen. Chuck Schumer's (D-NY) promise to introduce a federal bill to legalize marijuana before August 2022, the prospect of Congressional action in the near future still seems incredibly unlikely. This leaves the industry reading the tea leaves left by the Department of Justice (DOJ).

The U.S. Securities and Exchange Commission (SEC), for example, continues to keep an eye on cannabis-related investment and financing. Beyond a focus on the unscrupulous corners of the industry, however, the SEC has been investigating cannabis companies for more traditional securities law violations, including those involving some of the hottest trends that the cannabis industry has turned to when looking for investment.

Initial Public Offerings (IPO) have been a particular area of interest for the SEC, especially when they involved so-called “blank check” companies. These shell companies – formally known as special purpose acquisition companies (SPACs) – are listed on a stock exchange with the purpose of raising public capital in order to then acquire a private company. In the first half of 2021 alone, SPACs looking to purchase cannabis businesses raised more than \$3 billion from investors. The frenzy appeared to cool in the second half of the year as a result of delays in efforts to federally legalize marijuana. But, because SPAC transactions let companies go public without the comprehensive diligence and effort traditionally required during an IPO, they are of particular interest to enforcement authorities looking to protect the investing public and capital markets.

Beyond the public markets, the SEC also has begun to crack down on another popular source of investment option for cannabis companies: crowdfunding. In a September 2021 press release relating to the SEC's first case involving Regulation Crowdfunding, Director of the SEC's Division of Enforcement Gurbir S. Grewal emphasized the importance of “full and honest disclosure” in connection with crowdfunding because such offerings “enable issuers to cast a wide net for potential investors.” As a result, Director



AUTHORS

Rohan Virginkar | rvirginkar@foley.com

Brooke Clarkson | bclarkson@foley.com

Elizabeth Nevle | enevle@foley.com

Grewal explained, “[a]s companies continue to raise funds through crowdfunding offerings, we will hold issuers, gatekeepers, and individuals accountable and enforce the protections in place for all investors.” This underscores the need for cannabis companies – which face increased scrutiny because of their industry – to ensure that the information provided to investors not only is accurate but also is complete such that it presents a comprehensive picture of the business and the risks of investing.

Looming in the background, of course, is the DOJ. Since former Attorney General Jeff Sessions rescinded the Cole Memorandum in 2018, there has been no action to reinstate it; Attorney General William Barr made statements during his confirmation suggesting he did not view criminal enforcement against the industry as a priority. During Attorney General Merrick Garland's confirmation in 2021, he did not confirm whether the DOJ would reinstate the Cole Memorandum. Comments he made during those proceedings, however, essentially echoed the Cole Memorandum. For example, he stated that he did not believe it “a useful use of limited resources” to go after companies complying with state law. Attorney General Garland made similar statements in April 2022 at a hearing before the Senate Appropriations Subcommittee. Again, however, he fell short of confirming any reinstatement of the Cole Memorandum. With Congress continuing to include the “Rohrabacher-Blumenauer” amendment on appropriations bills and continuing resolutions, DOJ's détente with the industry is likely to continue.

Environmental

Sustainability and ESG: Planting the Seeds

As a result of increasing concerns of climate change impacts, social inequities, and the overall health of our society, sustainability and Environmental, Social, and Governance (ESG) issues will continue to be a major focus in 2022. With the expected high level of M&A activity, and consumers' desire to support brands with aligned values, the cannabis industry should anticipate an increased demand for defined and meaningful sustainability programs.

In general terms, ESG is a collection of information that describes a company's impact on natural resources, employees, and society at large, and the controls it uses to manage its internal affairs. The specific ESG measures incorporated into a sustainability program will vary depending upon the operations, company values, and stakeholder expectations. Measures that cannabis operators should consider include: reduction of energy consumption, water use, carbon emissions, and waste; environmentally friendly packaging; employee diversity, pay equity, and employee relations; support of environmental, social, and community programs; and internal controls for ethical behavior. Cannabis operators should actively pursue development and integration of a sustainability program as an essential component of everyday operations.

Water Use Challenges

Sustainable water use is emerging as a hot-button issue, as severe drought conditions have resulted in water use restrictions. Companies should keep in mind that there may be regulatory requirements applicable to alternative sources of water. For example, the California Department of Food and Agriculture requires pre-approval of all water sources (including water hauling services) used in cannabis cultivation, as well as any additions or changes to sources. Cultivators the use unapproved water sources may be subject to fines or license revocation.

The benefits to compliance with water conservation requirements may run beyond simply avoiding fines and business disruption. Savvy consumers



AUTHOR

Nicholas Johnson | nrjohnson@foley.com

are increasingly becoming attuned to corporations' impacts on the environment, and cannabis companies that can demonstrate good water management and conservation practices may find an added benefit: the ability to speak genuinely about sustainability in their marketing efforts.

Real Property Contamination

With vigorous M&A activity expecting to continue through 2022, we want to reemphasize the importance of environmental due diligence in M&A transactions and real property acquisitions, and particularly in the context of contaminated real property. Cannabis growing and processing operations pose a potential risk of environmental contamination due to the use of certain solvents in extraction processes. Further, cannabis processing operations may be sited in industrial areas with histories of environmentally intensive operations, increasing the risk to cannabis operators of environmental liabilities for past activities.

Comprehensive Environmental Response, Compensation, and Liability Act (and similar state cleanup laws) impose strict liability upon owners and operators of contaminated real property, even if the owner/operator did not cause or contribute to the contamination. To minimize the potential for environmental successor liability, cannabis companies should formulate a risk mitigation strategy that addresses the transaction structure, due diligence activities, and privilege protections for investigation and cleanup plans.

Social Equity

As the legalization of medical and adult-use recreational marijuana proliferates through the United States, social equity continues to be a hot button item in the industry. With a current valuation of \$20 billion, the cannabis market is projected to grow to a \$197 billion industry by 2028; yet, the industry remains quite insular and overwhelmingly white.

The National Association of Cannabis Businesses (NACB) recently issued a comprehensive examination of current state and local social equity plans with the goal of understanding their unique approaches and identifying common keys to success. NACB also released a model social equity program that seeks to benefit those who live in geographical areas adversely affected by the criminalization of cannabis.

There is no one solution to effectuating diversity and equity in the cannabis industry. Some states with newer legal cannabis programs have from the outset incorporated various social equity policies into their programs, such as Illinois. Other states with more mature legal cannabis programs, such as Colorado, which did not have social equity policies in place when its cannabis programs went live, have adopted and continue to adopt social equity policies. Though each state takes a unique approach to social equity, a common theme of social equity programs is to address the inequity in massive profits being raked in for a substance that has historically put underserved Americans behind bars – and one that nearly 40,000 Americans are still incarcerated for. In general, social equity programs consist of a mix of the following: (i) licensing; (ii) expungement; and (iii) reinvestment.

Social Equity Licensing

One of the main ways in which states seek to prioritize social equity is through social equity-specific licenses for those entering the cannabis industry. The approach significantly differs from state-to-state. For example, Illinois law expressly defines a “social equity applicant,” calls on such applicants to receive preferential treatment when compared to non-equity applicants for cannabis licenses, and establishes programs that are made available to social equity applicants and designed to help with the oft-burdensome costs associated with entering the cannabis industry. Other states designated



AUTHORS

Lauren Carboni | lcarboni@foley.com

Daniel Bencivenga, J.D. Candidate,
University of Florida, Levin College of Law

a specific number of licenses for social equity applicants, such as Arizona which earmarked 26 such licenses applicants who qualify under the Social Equity Ownership Program. Likewise, New Jersey law calls for 25 percent of the total licenses issued to be awarded to applicants who live in “impact zones,” defined as municipalities with higher levels of police activity, unemployment, and/or poverty.

Cities and local municipalities across the country have also created social equity licenses. For example, in 2021 the City of Denver, Colorado made significant changes to its cannabis laws and, among other things, granted exclusive access to social equity applicants for new licenses. Denver also now requires every licensee to submit a “Social Impact Plan” which identifies the applicant’s plans to promote diversity and inclusion in its workplace, foster participation in the cannabis industry by people who have been disproportionately impacted by cannabis enforcement, and implement environmental sustainability practices. Our prior summary of Denver’s new cannabis laws can be found [here](#).

Regardless of the precise licensing structure, these laws aim to ensure that people from disproportionately impacted communities are included in the new, thriving legal cannabis industry. These licensing structures generally require that applicants live in designated geographical areas that historically have high rates of arrest and incarceration for cannabis-related offenses; likewise, the designated geographical areas will often have higher than average poverty and unemployment rates. Some programs give preferential treatment to

applicants who themselves have been arrested or convicted of a cannabis-related offense, or plan to hire employees who have been subject to cannabis-related offenses. Social equity license applicants are generally given priority consideration in the licensing process, receive reduced rates for application and licensing fees, and may be able to secure low-interest loans that help secure the finances necessary to enter the cannabis industry.

Expungement

With the countless barriers imposed by a prior conviction, such as challenges to obtain public benefits, secure meaningful employment, or receive student or business-related loans, etc., expungement functions as a powerful tool in the fight for social equity. With respect to the cannabis industry specifically, many states limit licenses to individuals without prior criminal records. Thus, because cannabis-related convictions and arrests disproportionately impact communities of color, expungements function as a necessary and impactful mechanism to ensure that those most acutely affected by cannabis prohibition are able to access the benefits attributed to its legalization.

Numerous states have enacted legislation explicitly permitting or facilitating the process of expungement for cannabis-related offenses. Though the process differs state by state, there are generally certain criteria that limit the availability of the expungement process. Most states require that the prior conviction: (i) did not involve distribution, endangerment to, or neglect of someone less than eighteen years old; (ii) was not connected to a violent crime; and (iii) was not connected to the operation of a motor vehicle while under the

influence. Likewise, states will generally limit the expungement process to cases in which the individual was arrested or convicted for an amount of cannabis that now falls below the state's new legal limits

Reinvestment

Some states and localities are making a concentrated effort to focus on reinvesting some of the funds raised through legalized cannabis into underserved communities, which often have alarmingly high incarceration rates for cannabis-related offenses. For example, Illinois' legalization law established the Restore, Reinvest, and Renew (R3) Program, whereby 25 percent of cannabis tax revenue is allocated to fund grants for violence prevention, reentry, youth development, economic development, and civil legal aid services in areas of the state that have been acutely affected by cannabis prohibition and the War on Drugs. Similarly, Arizona's legalization law calls for allocating 7 percent of cannabis tax revenue to the Justice Investment Fund, which aims to provide grants to health programs and nonprofit organizations that work to support communities disproportionately harmed by cannabis prohibition.

Conclusion

As the legalization of both medical and recreational cannabis continues to spread throughout the country, social equity will continue to be a major issue facing the industry. Thus far, the approaches to achieving social equity are varied, as are the results. Like many other aspects of the cannabis industry, effectiveness is hampered by the lack of uniform standards and programs.



Cannabis Industry Team

Established in 2014, Foley's Cannabis Industry Team is one of the most experienced legal teams focused on the cannabis industry, bringing together significant experience from multiple practice disciplines to comprehensively advise clients involved in the space, as well as clients within supporting and peripheral industries. Our Cannabis Industry Team includes a deep bench of more than 60 attorneys nationwide and in Mexico City.

We appreciate the opportunities presented by the emerging cannabis industry and are committed to helping clients navigate the complexities of federal, state, and local laws and regulations. Our dedicated legal team develops creative and agile business solutions that allow businesses, lenders, investors, cultivators, processors, caregivers, transporters, landlords, and others to address current contradictions between agencies and jurisdictions, without limiting future options, when those contradictions are resolved. Foley has played a key role in some of the highest profile transactions in the industry to date.

Foley's Cannabis Industry Team advises clients on best practices regarding corporate formation and finance, joint ventures, tax strategies, industry-focused compliance programs, patent and intellectual property protections, real estate leasing, multistate licensing, SEC compliance, and in connection with government investigations involving the Department of Justice, the SEC, and other enforcement authorities.

Our attorneys serve as insurance counsel for both cannabis businesses seeking coverage and insurers weighing risk management concerns, and as employment counsel for non-cannabis companies managing drug-testing policies that address their staff's off-duty usage. Our team is particularly mindful of the health care industry's interest in marijuana, and regularly advises hospitals and long-term care facilities on legal compliance during patient care.

Value We Deliver

- Multidisciplinary team harnessing decades of experience to produce predictive solutions in the absence of precedent
- Collaborative approach to counsel, designed to address challenges with our clients' business goals in mind
- Experienced representation in handling a variety of interactions with the FDA, DEA, DOJ, EPA, and other federal, state, local, and tribal governing bodies
- Skilled representation in property leasing negotiations for dispensaries
- Intellectual property counsel, including patent protection, for biomedical and other products
- Practical risk management and mitigation counsel
- Legal and IP due diligence, including FTO reviews
- Zealous advocacy in litigation and government investigations
- Advise employers on duties toward employees, job applicant drug testing, and ADA compliance in connection with medical and recreational cannabis use.
- Advise health care providers on their roles as caregivers to patients using medical or recreational cannabis, including policies and procedures and liability/risk issues

Core Areas of Counsel

- Banking & Finance
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- Government Investigations
- Health Care
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- Intellectual Property
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