Volume 1, Number 1
May 2019

CANNABIS LAW™
& REGULATION REPORTER

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WWW.ARGENTCO.COM

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

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FEATURE ARTICLE

MORE MONEY, MORE PROBLEMS—CANNABIS FACES CALIFORNIA'S GAUNTLET OF WATER AND ENVIRONMENTAL LAWS

By Hanspeter Walter, Esq.

For decades California's cannabis industry operated in the proverbial shadows, but the state's recent enactment of comprehensive legislative schemes for both medical and recreational cannabis heralds the advent of an entirely state-legal regime. Stepping forward into the sunshine, however, carries with it, regulatory compliance issues. Indeed, one of the policy reasons behind California's legalization efforts has been compliance with and enforcement of environmental and water laws to avoid and mitigate resource impacts. This article discusses environmental and water laws, some old and some new, with which cannabis operators in California must now comply.

Introduction

Since enactment of the Medical Cannabis Regulation and Safety Act (MCRSA) [Bus. & Prof § 19300 *et seq*., repealed] and the people's election day passage of the Adult Use of Marijuana Act (AUMA) [California Proposition 64 (2016) adding Bus. & Prof. § 26000 *et seq*.], much of the industry's focus has been on business matters such as corporate formation, investing, taxation, and banking. [California initially had two different statutory schemes separately addressing medical and adult-use cannabis; however, on June 27, 2017 the Governor signed the Medicinal and Adult-Use Cannabis Regulation and Safety Act (MAUCRSA), which harmonized various provisions of MCRSA and the AUMA so that medicinal and adult-use licensees would be regulated similarly.]

However, would-be participants in this new cannabis market should not ignore California's water and environmental laws, notorious for being among the most stringent in the nation. As the ones directly working the land, cultivators will be among the most affected, and they (like every cannabis market participant) will need to scrupulously comply with all requirements. Failure to adhere to any rule, regulation, or requirement for protection of natural resources, stream flows, or water quality could result in denial or loss of a cultivation license, not to mention state criminal liability. (*See e.g.*, Bus. & Prof. § 26057(b)(1).)

Overview of California Water Rights

Cultivators need water and California water rights are, to put it bluntly, complex. Many doctrines and principles were forged in the early days of California's history, when gold miners squabbled over water sources. It is therefore fitting, perhaps, that California's new "green rush" will also be heavily influenced by water.

Surface Water

California operates under a "dual" or hybrid system of water rights that recognizes two distinct doctrines: riparian and appropriation. The riparian rights doctrine originated under English common law. It confers upon owners of land adjacent to a waterbody the right to divert natural water flowing by the land for use upon the land, without regard to when such use was initiated or how much is used. (*See*, *Miller & Lux v. Enterprise C. etc. Co.* (1915) 169 Cal. 415.) In times of shortage all riparians must reduce their usage proportionately and share the available water under a theory called "correlative rights." (*Prather v. Hoberg* (1944) 24 Cal.2d 549, 559-560.)

As mining increased, water was diverted for use on distant nonriparian lands, requiring that California establish and incorporate a new doctrine: the

doctrine of appropriation. (*Irwin v. Phillips* (1855) 5 Cal. 140.) Unlike riparians, appropriators need not own land contiguous to a watercourse to use water from it, but their rights are subordinate to riparians so that in times of shortage riparians are entitled to fulfill their needs first. (*Meridian, Ltd. v. San Francisco* (1939) 13 Cal.2d 424, 445-447.) Between appropriators, the rule is "first in time, first in right," meaning during shortages that the earlier "senior" appropriator is entitled to fulfill her needs before a later-arriving "junior" appropriator. (*U.S. v. State Water Resources Control Board* (1986) 182 Cal.App.3d 82, 102.)

Before 1914, appropriative water rights were generally acquired filing notice with the county clerk. Since 1914, however, a statutory scheme has provided the exclusive method of acquiring appropriative water rights. (*People v. Shirokow* (1980) 26 Cal.3d 301, 308.) Applications must now be made to the State Water Resources Control Board (SWRCB) for a permit or license authorizing the diversion and use of a specified quantity of water, during a specified period, for a particular use. (Water Code § 1201 *et seq.*) Riparian rights still require no such permit, but there is enforcement risk if a riparian right is claimed without proper documentation.

Over time, these somewhat simple principles for surface water rights have become muddied by many additional legal principles and exceptions. Appropriative rights can be lost (*i.e.*, forfeited) through five consecutive years of nonuse, a troublesome prospect for a person claiming a pre-1914 right unless use has been consistent and good documentation of that historical use is available. Similarly, subdivision of larger riparian lands into smaller parcels can severe (*i.e.*, eliminate) riparian rights that once existed. Analysis of title documents is therefore the only way to verify a claimed riparian right.

Groundwater

The three main groundwater rights are overlying, appropriative, and prescriptive. (*See*, *City of Barstow v. Mojave Water Agency* (2000) 23 Cal.4th 1224, 1240.) An overlying right is analogous to a riparian right in surface water; the land owner has a right to take water from the ground underneath for use on the land above. As between overlying owners, their rights, like those of riparians, are correlative (*i.e.*, each must reasonably share with other overliers when water is insufficient to meet all overliers' needs). Any water not needed by those having overlying rights is surplus. Surplus may be pumped and used on other lands—even outside the basin—as an appropriative groundwater right. Between groundwater appropriators, the one first in time is first in right. Generally, therefore, overlying rights trump appropriative groundwater rights, except that an appropriator may acquire rights against overliers or more senior appropriators through prescription, which is established by continued groundwater pumping while a basin is in overdraft.

Groundwater has generally been encumbered by fewer state and local regulations. Disputes were traditionally settled by courts. However, in 2014 California enacted the Sustainable Groundwater Management Act (SGMA), which will likely bring significant new rules and regulations regarding measurement, reporting, fees, and pumping. (Water Code § 10720 *et seq.*) Cultivators relying on groundwater should therefore check, and if applicable, monitor SGMA implementation in their area.

Other General Water Law Principles and Requirements

Some rules apply broadly to most uses of water in California. Water use is subject to the reasonable use and the public trust doctrines. Both are malleable concepts allowing the state to essentially regulate water rights and water use on a changing and subjective basis for aesthetic, recreational, and environmental purposes, among others, according to the needs and priorities of society. (*See e.g.*, Cal. Constitution Art. 10 § 2; *Nat. Audubon Society v. Sup. Court* (1983) 33 Cal.3d 419.) California's recent drought spurred additional legislation requiring increased monitoring and reporting by water users, and increased penalties for failure to report and noncompliance with water laws.

Water and Environmental Laws Applicable to Cannabis Cultivators

Documenting Water Rights

To obtain either a medicinal or adult-use cultivation license, applicants must identify and describe their source of water. (Bus. & Prof. Code § 26060.1.) Cultivators supplied by retail water suppliers (*e.g.*, city water) need only name their retail supplier. (Bus. & Prof. Code § 26060.1(a)(1)(A).)

If groundwater is the proposed source, applicants need to identify the well location and the maximum amount to be used annually for cultivation. (Bus. & Prof. Code § 26060.1(a)(3).) For others, applications for state cultivation licenses submitted before January 1, 2019, must include one of the following:

- A registration, permit, or license issued by SWRCB.
- A statement of water diversion and use, filed before July 1, 2017.
- A pending application for a permit to appropriate water, filed before July 1, 2017.
- Documentation, submitted to SWRCB before July 1, 2017, establishing the diversion is a small spring, a permitted, licensed, or adjudicated right, or specific water use under Water Code § 4999 *et seq*.
- Documentation, submitted to SWRCB before July 1, 2017, establishing the diversion is authorized under a riparian right that was not exercised between January 1, 2010 and January 1, 2017. (Bus. & Prof. Code § 26060.1(a)(2)(A)(i-v).)

In sum, if the intended source of water is natural surface water, then unless an applicant already had a SWRCB permit or license to use surface water, they may have had to take steps to confirm, file, or apply for a water right before July 2017 to submit a state application in 2018. Those that failed to do so have similar but different requirements when submitting their applications in 2019 and later. (*See*, Bus. & Prof. Code § 26060.1(a)(2)(B)(i-iv) [specifying water rights filing requirements for applications submitted after December 31, 2018].) The SWRCB has created the forms to file for each kind of water source. (*See*, www.waterboards.ca.gov/water_issues/programs/cannabis/cannabis_water_rights.shtml

Protecting Streams, Fish, Wildlife, and Water Quality

Under the original terms of MCSRA and AUMA, the SWRCB had to consult with the California Department of Fish & Wildlife (DFW) and the California Department of Food & Agriculture (CDFA) to:

> . . .ensure that individual and cumulative effects of water diversion and discharge associated with cultivation of cannabis do not affect the instream flows needed for fish spawning, migration, and rearing, and the flows needed to maintain natural flow variability. (Bus. & Prof. Code § 19332(d); former Bus. & Prof. Code § 26067(c)(1) [repealed by MAUCRSA].) The SWRCB was directed to adopt "principles and guidelines for diversion and use of water for cannabis cultivation in areas where cannabis cultivation may have the potential to substantially affect instream flows," which may include instream flow objectives, limits on diversions, and requirements for screening of diversions and elimination of barriers to fish passage. (Water Code 13149(a)(1)(A).) The SWRCB has done so, and released its draft Cannabis Cultivation Policy and Principles and Guidelines for Cannabis Cultivation on July 7, 2017. These include dozens of specific regulatory requirements, too numerous to review here, that will apply to most cultivators in some form. (www.waterboards.ca.gov/water_issues/program/cannabis) The SWRCB's Policy and related General Order for cannabis cultivation became effective upon approval of the State Office of Administrative Law on December 18, 2017. (*See*, SWRCB Resolution No. 2017-0063 and Order No. WQ 2017-0023-DWQ)

Cultivation licenses will also not be effective:

> . . .until the licensee has complied with Section 1602 of the Fish and Game Code or receives written verification from the Department of Fish and Wildlife that a streambed alteration agreement is not required. (Bus. & Prof. Code § 26060.1(b)(3))

Section 1602 requires those substantially diverting surface waters to contact DFW to ensure their diversions are not "substantial" and will not affect fish and wildlife, or alternatively obtain a Lake and Streambed Alteration agreement. Some diversions might be insubstantial, but the determination is very fact specific and best left to DFW; those that do not contact DFW are taking a huge risk. (*Rutherford v. California* (1987) 188 Cal.App.3d 1267, 1279-80.)

Cultivators must also comply with state and federal water quality laws intended to prevent adverse effects from earth moving activities and water discharges. These were originally administered through California's Regional Water Quality Boards (RWQCBs). For instance, the North Coast and Central Valley RWQCBs adopted orders and a regulatory system to permit cannabis cultivators with other regions close behind. (North Coast RWQCB Order R1-2015-0023; Central Valley RWQCB Order R5-2015-0113.) These orders require site mitigation, implementation of best management practices, and annual monitoring and reporting requirements.

Applicability of the California Environmental Quality Act

No discussion of California environmental laws would be complete without reference to the California Environmental Quality Act (CEQA). CEQA requires an analysis and disclosure of the potential environmental effects of any discretionary government action that could affect the environment. Granting licenses for cultivation fits the bill (as do others). The scope of the CEQA effort depends on the nature and severity of potential impacts. CDFA issued a Programmatic Environmental Impact Report (PEIR) on its proposed cannabis cultivation permitting program to provide the public, state, and local agencies with information on the potential environmental effects associated with the adoption of a statewide medical cannabis cultivation program. (https://www.cdfa.ca.gov/is/mccp/) Cultivation licenses must include any mitigation requirements identified in the PEIR. (Bus. & Prof. Code § 26060.1(b)(2).) For its part, the Bureau of Cannabis Control prepared and certified a Negative Declaration for its commercial cannabis licensing program. (*See*: https://bcc.ca.gov/law_regs/ceqa_initial_study.pdf) Other state and local agencies issuing permits will also likely have to comply with CEQA at the local, site-specific level when issuing discretionary local permits for cannabis. CEQA litigation regarding cannabis licensing issues has been brought by both pro- and anti-cannabis stakeholders, and the California Supreme Court currently is reviewing a case regarding whether local agency zoning decisions about cannabis are *per se* subject to CEQA. (Cal. Supreme Ct. Case No. S238563), reviewing *Union of Medical Marijuana Patients, Inc. v. City of San Diego* (2016) 4 Cal.App.5th 103.)

Implementing Other Environmental Requirements

Depending on location, a cultivation project may be subject to many other state or local laws. For example, most local jurisdictions require a host of other grading and site permits for cultivation as well as building inspections, pesticide registrations, energy conservation, fire standards, and approvals from water and power utilities. Most cities and counties open to cannabis are proceeding by way of applications for conditional use permits or individual development agreements. Full compliance with all other State and local laws for both indoor and outdoor cultivators is required. (Bus. & Prof. Code § 26066.) Cultivators would be wise to carefully review local requirements and consult local officials before investing too much into a proposed project.

Federal Water Not Available for Cannabis

Finally, the federal government plays a significant role in California water operations and policy through its ownership and administration of several large-scale water projects, which annually deliver water to hundreds of water districts or other entities in many parts of the state. It is therefore significant that because of the continued federal illegality of cannabis, the U.S. Bureau of Reclamation has adopted an official policy that it "will not approve use of reclamation facilities or water in the cultivation of marijuana." (Reclamation Manual Policy PEC TRMR-63.) This could prevent lands or persons served by federal water projects from growing cannabis with that water. This policy could be an impediment to cultivation activities in some areas, but the current policy states it is only effective through May 2019, and with the federal legalization of hemp production official and other pending legislation, the Bureau will likely have to refine or change this policy soon.

Conclusion and Implications

Cultivators are the foundation of the entire cannabis industry, and the success of State-legal and regulated cannabis in California will be closely linked to the ability of cultivators to navigate and comply with California's water and environmental laws. Any cultivator's business plan should therefore ensure legally valid and documented water rights and provide

for satisfying (and paying for) compliance with the numerous other state and local environmental laws and procedures required to obtain state and local licenses.

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CANNABIS NEWS

STATEWIDE CANNABIS DELIVERY IN CALIFORNIA FACES OUTRAGE FROM CERTAIN MUNICIPALITIES

Since the California Bureau of Cannabis Control's (BCC) Permanent Regulations (Permanent Regulations) took effect on January 16, 2019 in California, one of the fiercely contested debates is over the new allowance for statewide delivery. The battle lines are being drawn with respect to local control.

The Debate Unfolds with Adoption of the Permanent Regulations

Specifically, whether the allowance of expanded statewide delivery violates and undermines the foundational dual-parallel licensing structure set forth first by the Medical Marijuana Regulation and Safety Act, and preserved by the Adult Use Marijuana Act (AUMA or Prop 64) approved by the state's voters in 2017 and currently reflected in the Medicinal Adult Use Cannabis Regulation and Safety Act (MAUCRSA).

Section 5416 subsection (d) of the Permanent Regulations is the crux of the debate:

> (d) A delivery employee may deliver to any jurisdiction within the State of California provided that such delivery is conducted in compliance with all delivery provisions of this division.

The inclusion of §5416(d) was celebrated by a majority of the cannabis industry as a monumental success. As reported in the media, large stretches of California where cannabis is banned locally has created cannabis "deserts" for residents in those areas. (*See, Associated Press*, 25 cities suing California over marijuana policy that allows unrestricted delivery statewide, April 5, 2019, *available at* https://www.nbcnews.com/news/us-news/25-cities-suing-california-over-marijuana-policy-allows-unrestricted-delivery-n991621.)

Last year, it was reported that residents in about 40 percent of the state had to drive 60 miles or more to find a licensed dispensary to purchase legal cannabis, which includes medical patients. (*See,* Brad Branan and Nathaniel Levine, *Weed is legal. But this map shows just how much of California is a 'pot desert,'* March 22, 2018, *available at* https://www.sacbee.com/news/state/california/california-weed/article205524479.html.)

It was the BCC's position that this section's inclusion in the Permanent Regulations was merely a clarification of existing law. Proponents' perspective is that the provision effectively ensures safe and direct access to cannabis to those qualified residents in areas where municipalities have banned delivery. Its inclusion is particularly noteworthy as the BCC undertook drafting of the Permanent Regulations after State Senator Ricardo Lara's SB 1302 (which aimed to preempt a local government from adopting or enforcing an ordinance that banned cannabis deliveries within its jurisdiction) failed to secure the required two-thirds vote necessary for enacting an amendment as required by Prop 64. Assemblyman Ken Cooley again made an attempt to overturn the BCC's regulation supporting statewide delivery with AB 1530, however the bill with a deadlock vote of 7-7 failed to pass out of the Assembly Business and Professions Committee.

Some Municipalities Are Not Pleased

The League of Cities (League) has been vocal in its opposition since the release of the draft Permanent Regulations in July 2018. The League on behalf of its members submitted public comments to the BCC:

> Section 5416(d), would drastically preempt local control and regulatory authority by authorizing cannabis delivery anywhere in the state regardless of conflicting local regulations or bans.

The League has the support of the California Police Chiefs Association, the United Food and Commercial Workers Western States Council and even some cannabis industry groups.

The Importance of Local Decision-making in Proposition 64

Prop 64's purpose and intent provisions expressly recognized the value of local control in regulating

commercial cannabis activity. In short, Prop 64 provided that:

> . . .[i]t is the intent of the People in enacting this Act to … [a]llow local governments to ban nonmedical marijuana businesses … (Initiative Measure (Prop. 64), §3(d), approved Nov. 8, 2016, eff. Nov. 9, 2016)

Therefore, an argument can be made that under existing law—as articulated in Prop 64 and now, the MAUCRSA—local governments can adopt and enforce local ordinances to ban or regulate some, all or no commercial cannabis activity. Would this include *deliveries*, within their borders?

The Position in San Francisco

Shortly after the release of the Permanent Regulations, San Francisco's City Attorney's office (City) issued a strongly-worded memorandum expressing the City's position that the BCC's actions via §5416(d) are in direct conflict with local regulation of commercial cannabis deliveries resulting in unlawful preemption of expressed local control. The City was so adamant in their position that it stated it was:

> . . .prepared to vigorously defend the [its] authority to enforce the City's ordinances regulating cannabis deliveries. (*See,* Deputy City Attorney, City of San Francisco Matthew Lee, (February 1, 2019) Memo to Nicole Elliot, Director Office of Cannabis "Validity of State Administrative Rule Purporting to Preempt Local Regulation of Cannabis Deliveries")

The foundational argument elucidated by the City was that §5416(d) goes beyond the statutory limitations of Prop 64 and MAUCRSA exceeding the BCC's authority. The City bolsters its position referring to California's Business and Professions Code (B&P Code) §26013, which expressly limits the regulatory authority of the BCC to enacting rules and regulations that are "*consistent* with the purposes and intent of [Prop 64]." The allowance of deliveries into every jurisdiction in California, without regard for the local municipalities' own governance, the City argues is inconsistent with Prop 64 not simply clarifying existing law.

The City's memo further highlighted the distinction between using roadways for "transportation" versus "delivery" as the B&P Code §26080 provides, in relevant part, that:

> [a] local jurisdiction shall not prevent transportation of cannabis or cannabis products on public roads by a licensee. (Bus. & Prof. Code§ 26080(b))

The City's interpretation of §26080 is to prohibit a local jurisdiction from obstructing cannabis shipments passing through a particular jurisdiction while in transit to destinations elsewhere (*i.e.* business to business transactions not "delivery" sales from businesses to consumers).

'Customized' Regulations for Health and Safety?

In connection with a locality's right to ban deliveries altogether, the rationale supporting local control is the inclusion of *customized* regulations to protect the health and safety within a municipality's boarders with reasonable regulations. As in the case with San Francisco, the City imposes specifics delivery regulations for storage in secure lock-boxes; delivery in child-resistant containers; verification of customers' ages and identities upon receipt, and confirm that each customer received the correct product; detailed records of each delivery; ensuring that deliveries are conducted by operators' own employees, (*See,* S.F. Police Code § 1622(b)(9) and related sections).

A Lawsuit from Local Governments

In furtherance of such rationale, 25 local governments made good on their threats to the state and filed a lawsuit against the BCC and Chief Lori Ajax to overturn the delivery rule. (*See,* Complaint, *County of Santa Cruz; City of Agoura Hills; City of Angels Camp; City of Arcadia; City of Atwater; City of Beverly Hills; City Of Ceres; City of Clovis; City of Covina; City of Dixon; City of Downey; City of Mcfarland; City of Newman; City of Oakdale; City of Palmdale; City of Patterson; City of Riverbank; City Of Riverside; City of San Pablo; City of Sonora; City of Tehachapi; City of Temecula; City of Tracy; City of Turlock; and City of Vacaville v. Bureau of Cannabis Control; Lori Ajax, in her official capacity as Chief of the Bureau of Cannabis Control; and DOES 1 through 10, inclusive* (filed April

4, 2019), *available at:* https://static1.squarespace.com/static/5c895dff92441b9dea2ba362/t/5ca6abacf4e1fc9d47b784ea/1554426801954/SIMPL_complaint.pdf)

Though San Francisco is not a party to the lawsuit, the central legal argument articulated in the complaint is fundamentally the same as the City's memo: The BCC's regulation conflicts with the MAUCRSA, which grants local jurisdictions the authority to establish and enforce commercial cannabis regulations. The complaint, like the City's memo, cites to the consistency requirement of B&P Code §26013. The lawsuit was filed shortly before Assembly Bill 1530, a bill aiming to overturn the BCC delivery rule sponsored by Assembly Member Ken Cooley, was defeated in committee. (AB-1530 Unauthorized cannabis activity reduction grants: local jurisdiction restrictions on cannabis delivery, Introduced by Assembly Member Cooley February 22, 2019, *available at:* http://leginfo.legislature.ca.gov/faces/billNavClient.xhtml?bill_id=201920200AB1530)

Conclusion and Implications

The municipalities involved in the suit have all adopted ordinances related to commercial cannabis activity in their jurisdictions, with most prohibiting retail dispensaries. However, many of the governments in the lawsuit currently allow retail dispensaries such as Santa Cruz and have various concerns about the BCC rule, including disadvantaging the permitted dispensaries within their jurisdictions.

The lawsuit will have a precedent-setting impact on the playing field of municipal versus state control, generally. For the commercial cannabis rhetoric, the issue tests the strength of one of its core tenants—local contro. How statewide delivery develops remains a quagmire with complex issues compounded by strong public policy concerns related to both consumer and patient protection and access. For those advising non-storefront retailers or storefront retailers with delivery operations it is wise to build in contingencies as this critical issue continues to develop.
(Pamela Epstein)

THE STATE OF RECEIVERSHIP LAW IN COLORADO AS APPLIED TO THE MARIJUANA BUSINESS

Background on Receivership in Colorado

Under Colorado law (and the law of most states), a court can order appointment of a receiver if certain factors are established and instill in her a wide array of powers including, generally, the right to take possession of the property of a business and to manage, operate, maintain, repair, and otherwise control the business so as to preserve its value.

The appointment of a receiver, however, is not without disadvantages. First, the process in a contested proceeding can be lengthy and costly, and the standard for obtaining a receiver is difficult. Further, if the court appoints a receiver, all owners lose control of the business and the party who procured appointment may later disagree with the receiver's actions. Once the receiver is appointed, the receiver will stay in place until her authority expires under the order appointing her or until the court orders otherwise. Receivers can be expensive, particularly if the appointing order is broad enough to encompass complete operation of the business. If a business is distressed enough to require a receiver, and such distress has also caused the business to become financially weak, the appointment of a receiver may cause business insolvency, rather than business protection.

These issues are compounded by the additional layer of regulatory scrutiny imposed on marijuana businesses. The primary point of contention has been the conflict between the court's authority to order appointment of a receiver and take possession of the business's assets and the rules promulgated by Colorado's Marijuana's Enforcement Division (MED, a division of the Colorado Department of Revenue) which provide, in pertinent part, that anyone taking possession of salable marijuana or operating a marijuana business be vetted and licensed by the MED.

At least one Colorado District Court wrestled with the issue, and the Colorado Court of Appeals held that, under appropriate circumstances, a court can appoint a receiver in connection with a marijuana business. This article examines the law and policy that led to this decision and articulates the current state of Colorado law with respect to appoint of receivers in connection with marijuana businesses.

Trial Court Proceedings— *Garcia v. Botica Del Sol*

In *Garcia v. Botica* Del Sol LLC, et al., District Court, City and County of Denver, Case No. 2016CV30777 (Mar. 7, 2016), Rico Garcia was a secured creditor of Botica del Sol, which was a marijuana business engaged in the cultivation and retail sale of medical marijuana. Subsequently, Garcia filed a lawsuit against Botica del Sol and numerous of its owners and operators, alleging that they were committing waste with respect to the collateral securing Garcia's note (the collateral included marijuana, marijuana licenses, and marijuana-related products). Garcia further alleged that, as a result thereof, the collateral securing his note was being impaired. Garcia thus moved the court for a receiver pursuant to Colorado Rule of Civil Procedure 66 and Colorado Revised Statute § 7-80-812(2). Rule 66 provides, in pertinent part, that a court may appoint a receiver when the applying party:

> . . .establishes a *prima facie* right to the property, or to an interest therein which … is in the possession of the an adverse party and [is] in danger of being … materially injured or impaired. (*See also*, Colo. Rev. Stat. § 7-80-812(2) (same)).

Subsequently, the Executive Director of the Colorado Department of Revenue, as the State Licensing Authority for medical marijuana licensure and regulation (SLA) successfully moved to intervene and then filed a substantive motion opposing Garcia's motion for a receiver arguing, in the main, that appointment of a receiver (under the terms proposed by plaintiff Garcia): 1) would violate the Separation of Powers provision contained in Article III of the Colorado Constitution; 2) would contravene the Colorado Medical Marijuana Code, Colo. Rev. Stat. § 12-43.3-101, et seq.; and 3) would contravene other provisions of Colorado law, including certain criminal provisions.

The trial court agreed with the SLA and denied Garcia's motion for a receiver, holding that:

> The Court agrees with Intervenor that the Court does not have authority, under the separation of powers doctrine, over the State Licensing Authority.

The court noted that Garcia's proposed order appointing a receiver had been narrowed since his application but was still overbroad. In this connection, the court noted:

> Plaintiff requests that the court order that the receiver 'take immediate control of the property, of Botica del Sol, and to 'manage, operate and protect the property' subject to the supervision and exclusive control of this Court. … As defined, because 'property' includes [marijuana licenses], again the Court is without authority to grant this request … [as] only a licensed person may operate, manage or control a medical marijuana business (citing Colo. Rev. Stat. § 12-43.3-310(8)).

Notably, the court did not hold that it was without power to grant a receiver with respect to a marijuana business. It held that the power that would be vested in the receiver, *in this case*, under Garcia's motion and proposed order, exceeded the court's authority. Garcia appealed the denial, however, the appeal was dismissed before it proceeded to briefing.

The Colorado Court of Appeals Weighs in— *Yates v. Hartmann*

As of the issuance of the Botica del Sol order, there were no published Colorado appellate opinions providing guidance on this subject. That changed recently with the published Colorado Court of Appeals decision in *Yates v. Hartman*, 2018 COA 31 (Colo. App. 2018). In *Yates*, the court considered, as a matter of first impression:

> . . .whether a court may appoint a receiver for a marijuana business if that receiver does not possess the licenses required by Colorado's marijuana licensing laws. Id. at *2.

The court held that:

> . . .although courts have the equitable power to appoint receivers, they must make such appointments in compliance with the marijuana licensing laws enacted by the General Assembly.

Background

In that case, the petitioner and appellee Kelsey Yates (Ms. Yates) filed a petition to dissolve her marriage to respondent-appellant Kiri Humphrey. In connection with this filing, Ms. Yates requested the

appointment of a receiver over the marital property which included a group of marijuana businesses. The trial court granted the request for a receiver and issued an order authorizing the receiver to:

> . . . 'take immediate control of the [businesses] and operate the [businesses] on the Court's behalf in custodia legis.' The Receiver had the 'powers and duties' to 'manage, operate, maintain, repair, and otherwise control the [businesses] as necessary to preserve [them].' Id. at *2-*3.

It was undisputed that, when the trial court entered this order, neither the proposed receiver not his employees held the licenses required under Colorado law to "own, operate, manage, control, or work in a licensed marijuana business Id. at *3.

The SLA intervened and moved to modify the trial court's receivership order by removing the putative receiver until he and his employees obtained the requisite licenses. The trial court denied this motion and the SLA appealed.

Defining the Scope of the Review on Appeal

The Colorado Court of Appeals first defined the scope of the case, noting that:

> . . .the SLA does not challenge the district court's authority to appoint receivers for marijuana businesses. Instead, the SLA only challenges the court's authority to appoint receivers who are not licensed to operate marijuana businesses. Id. at *4.

The court then began its analysis by noting that "[c]ourts of equity have the inherent power to appoint receivers." Id. (citations and quotations omitted). The court further clarified, however, that:

> . . .[c]ourts of equity can no more disregard statutory and constitutional requirements and provisions than can courts of law. The courts of a jurisdiction cannot authorize violation of that jurisdiction's laws …. It is fundamental tenet of [the] separation-of-powers doctrine that a court's enforcement powers are restricted by the dictates of the legislature. Id. (citations and quotations omitted).

State Regulatory Authority over Professions and Businesses

The Court of Appeals then explicated the history of the Colorado legislature's regulatory authority over professions and other business up to the point when:

> . . .[t]he General Assembly exercised this authority when it prohibited the operation of both medical and recreational marijuana businesses unless the businesses' owners and employees hold the licenses prescribed by statute (citing Colo. Rev. Stat. §§ 12-43.3-103(2)(e), 12-43.4-104(4)).

The court then detailed the regulation of marijuana in Colorado, concluding that "under both the Colorado Medical Marijuana Code and the Colorado Retail Marijuana Code, no person may operate a marijuana establishment without the required licenses" (citing Colo. Rev. Stat. §§ 12-43.3-313(3), 12-43.4-312(2)). Id. at *6. "To operate these businesses without these licenses is a criminal offense" (citing Colo. Rev. Stat. §§ 12-43.3-901(2), 12-43.4-901(2)(a)).

Appointment of a Receiver was in Error

Based upon this historical exegesis of marijuana regulation in Colorado, the Court of Appeals held that the trial court's appointment of a receiver was erroneous. The Court of Appeals first rejected the trial court's holding that "its power to appoint a receiver trumped the laws requiring persons operating marijuana businesses to be licensed." Id. at *7. The Court of Appeals rejected this argument, holding that:

> . . .[b]ecause the court's powers to appoint receivers for marijuana businesses is not in conflict with the licensing laws … [and] 'it is not an appropriate function of the court to act as a licensing agency … and undertake the agency's role in determining who may operate marijuana businesses. Id. at *8 (citation and quotation omitted).

The Court of Appeals determined "that the district court may only appoint a receiver who complies with Colorado's marijuana licensing laws." Id. at *9. The Court of Appeals reversed the trial court's order appointing the receiver and further concluded that:

The district court, in the exercise of its discretion, may appoint a substitute receiver who complies with the licensing requirements of the Colorado Medical Marijuana and Retail Marijuana Codes. Id.

Conclusion and Implications

The Colorado Court of Appeals issued its mandate in *Yates* on November 20, 2018, and no party thereto appealed. Yates, and the guidance it provides, is thus the current state of Colorado law on receivers for marijuana businesses. *Yates* does provide helpful guidance as it draws certain clear conclusions, to wit: A court may appoint a receiver in connection with a marijuana business, provided that the appointing order requires that the receiver complies with all Colorado marijuana licensing and other laws, regulations, and rules.

However, given the constant state of flux of these laws, regulations, and rules, the careful practitioner is also counseled to keep constantly abreast of these strictures and ensure her knowledge is consummately current in the event she is seeking or opposing a receiver for a marijuana business. A party seeking a receiver is well-advised to then apply this current state of the law to the motion for and proposed order appointing a receiver to ensure that the motion and order strictly comply with all then-applicable Colorado laws, regulations, and rules pertaining to marijuana.

Finally, this legal framework raises issues to be considered for potential receivers. For example, the requirement that a receiver obtain state licensure in order to function may raise issues for the many receivers who are licensed professionals (often Certified Public Accountants and/or attorneys) whose licensure might be impacted by the fact that marijuana is currently illegal under federal law. Additionally, once a receiver is appointed, that person will likely have the independent obligation to keep abreast of all Colorado laws, regulations, and rules pertaining to marijuana, which can be a daunting task.

Practitioners and potential receivers are advised, both during the process of seeking a receiver and if one is appointed, to carefully craft and understand any order appointing a receiver and to monitor the state of Colorado law on this point so as to ensure continued compliance with any such order.
(Eric Liebman)

ALLOCATION OF OREGON RECREATIONAL CANNABIS TAXES AND LACK OF FUNDING FOR RURAL COUNTIES

Oregon's recreational cannabis tax is bringing tens of millions more tax dollars to the state than predicted. Yet the police departments that provide enforcement of the law against illegal cannabis players in rural counties do not have enough money to fulfill their enforcement requirements.

Tax Allocation Formulation

In 2014, when Measure 91 passed to legalize recreational cannabis in Oregon, it also set the allocation of the projected tax revenue to various agencies and programs. Recreational cannabis tax revenue is distributed to recipients that are tasked with combating illegal marijuana production and trafficking, and to other worthy, but more tenuously related programs and agencies. The current allocation is the result of careful calculus as to what was needed to gain support for the legalization process. These slices of the pie were designed to win votes, especially the slice allocated to Oregon schools.

Current Allocation

Oregon statute provides for a 17 percent retail sales tax on recreational cannabis items. (O.R.S. § 475B.705 2017). The tax revenue is allocated through the Oregon Marijuana Account, separate and distinct from the General Fund. (O.R.S. § 475B.759 2017). Local jurisdictions can and do impose an additional 3 percent tax on recreational cannabis sales. The Oregon Marijuana Account funds are distributed as follows:

Tax Revenue Allocated to Cities and Counties

Twenty percent of Oregon recreational cannabis tax revenue is allocated to cities and counties that have not opted out of allowing businesses licensed

under the Oregon Liquor Control Commission (OLCC) recreational cannabis program to operate within their jurisdictions.

Cities
Seven and one-half percent of the funds are allocated to cities based on their population and 2.5 percent is allocated based on the number of recreational cannabis businesses located therein.

Counties
Counties receive 5 percent of the funds based on the square footage of production canopy they contain, and another 5 percent based on the total number of recreational cannabis businesses within their borders.

Tax Revenue Allocated to State Programs
Forty percent of recreational cannabis tax goes to the State School Fund; 20 percent to mental health treatment or for alcohol and drug prevention, early intervention, and treatment; 15 percent to the State Police Account; and the final 5 percent of the funds are allocated specifically to alcohol and drug abuse prevention, early intervention, and treatment services.

Local Tax on Retail Sales

In addition to the 17 percent tax, cities and counties can elect to impose an additional 3 percent tax on retail sales of recreational cannabis. (O.R.S. § 475B.491 2017). All jurisdictions that have not opted out of the recreational cannabis program do impose this tax. However, because retail shops are concentrated in cities, it is the incorporated areas of the state that are the chief beneficiaries of local tax. Unincorporated counties, which contain most of the state's production infrastructure but few taxable retail stores, bring in less local recreational cannabis tax.

Tax Revenue Is Far Exceeding Expectations

Oregon recreational cannabis sales, and resulting tax revenue, has far exceeded projections. According to data released by the Oregon Department of Revenue for the 2018 fiscal year, the Oregon Marijuana Account took in $82,203,729, more than double the original annual estimate of about $40 million. (Oregon Department of Revenue, *Oregon Marijuana Tax Statistics: Accounting Information*, (2019), *available at:* https://www.oregon.gov/DOR/programs/gov-research/Documents/Financial-reporting-receipts-public.pdf

Even as recreational cannabis receipts and disbursements exceed expectations, enforcement costs for rural counties continue to exceed their tax revenue receipts.

Black and Grey Market Sales

For many decades, Oregon has been home to a robust black-market cannabis economy. This includes participants in all levels of production and distribution. Though the legal cannabis industry, working hand in hand with lawmakers and regulators, has taken a sizeable chunk out of the black market, illicit production and sale remains a major problem in Oregon.

Oregon's is amongst the most mature and well-functioning recreational cannabis programs in the country. Still, according to the OLCC's 2019 Recreational Marijuana Supply and Demand Legislative Report, only 55 percent of cannabis consumption in Oregon by adults 21 years of age and older comes from the licensed retailers. The other 45 percent, along with the overwhelming majority of the recreational cannabis exported from Oregon, is supplied by the black market. Despite widespread speculation and concern about the state's ongoing oversupply problems, there is little evidence of large-scale diversion from OLCC licensees.

Illegal Grows Concentrated in Rural Counties

While illegal recreational cannabis production and trade spans the state, the comparative open space and lack of law enforcement in rural southern and eastern Oregon make it a hotbed for illegal grows and a primary source for black market cannabis. "Large swatches of rural Oregon are the Wild Wild West… it's easier to hide there. It just is," said Rob Bovett, Legal Counsel for the Oregon Association of Counties. Thus, the burden of policing illegal cannabis activity in these areas is onerous. Because of the collapse of Oregon's timber industry in the 1990s, governments in many of these areas are generally already underfunded, and their small share of the recreational cannabis tax does little to make up the difference.

Lack of enforcement allows illegal cannabis production and trafficking to flourish, increasing access

for minors, reducing the market for legal businesses, and distributing to the public cannabis that has not been tested for potency or chemical contaminants.

The roadblocks to providing more funds to counties for enforcement vary from partisan politics to the deficit in the state's Public Employee Retirement System (PERS).

Timber Revenue Declines

Many rural counties' budgets were built around timber revenue which dropped dramatically with changes in environmental protection laws in the 1990s. The resulting economic collapse in some rural parts of the state has left some counties with budgetary woes from which they have hardly begun to recover nearly 30 years later. As such, the cost of conducting meaningful enforcement activity against illegal cannabis is a hardship in many of the exact areas in which that production is concentrated. Complicating the situation is a hesitancy among some democratic lawmakers to prop up counties whose budgetary woes have gone on for decades by giving them a larger share of new recreational cannabis tax-esgenerated by the very program which many of those same counties opposed during the legalization fight.

Schools Revenues Increase

The largest recipient of recreational cannabis tax funds is also the least popular place from which to take money back. According to data released by the Oregon Department of Revenue, in 2018, the Oregon Marijuana Account distributed almost $30 million to the State School Fund. (Oregon Department of Revenue, *Oregon Marijuana Tax: Distribution Information*, (2019), *available at:* https://www.oregon.gov/DOR/programs/gov-research/Pages/research-marijuana.aspx

While this is significantly more than expected, it is also an extremely small amount as compared to the overall school budget. If this allocation were adjusted down to the projected amount, (roughly half of what it currently hauls in) the funds freed up could be provided to counties for enforcement without a meaningful hit to school coffers. Still, it is a politically difficult proposition.

The State Budget Deficit

The state deficit is nearly $2 billion, driven in part by the enormous PERS deficit. Oregonians' opposition to sales taxes has combined with effective corporate lobbying against business taxes to make the task of balancing the budget exceedingly difficult. In the grand scheme of things, the impact of reallocating recreational cannabis tax revenue to local jurisdictions that need it to fund better cannabis enforcement would be minimal. Still, in the charged environment surrounding Oregon's budgetary troubles, efforts to redirect tax revenue from schools—or anywhere else—to support cannabis enforcement have been a tough sell.

Conclusion and Implications

In short, rural counties in Oregon need more funds to fight the illegal cannabis market and the Oregon Marijuana Account is the logical source of those funds. But partisan politics, hesitancy to divert funds from current recipients, and the state's budget deficit are major obstacles to near term reallocation of recreational cannabis tax revenue. Oregon's legal framework is built around a promise to the federal government and the public that the state will enforce the law against illegal players and licensed businesses that are not in compliance. Rural Oregon does not have the resources to do this. Regardless of how we got here and the arguments against reallocation, the current lack of enforcement activity against the black market is a problem that needs fixing.
(Mia Getlin)

LEGISLATIVE DEVELOPMENTS

THE AGRICULTURE IMPROVEMENT ACT OF 2018 AND ITS IMPACT ON THE STATE OF 'HEMP BANKING'

In December 2019, the federal Agriculture Improvement Act of 2018, also known as the 2018 Farm Bill, was passed into law by Congress. It was widely touted as legalizing hemp, but hemp businesses are still having trouble finding bank accounts. Did banks not read the Farm Bill, or is there something else going on?

Is Hemp Legal?

The first question a bank needs to understand is if hemp is actually legal. The 2018 Farm Bill changed the definition of marijuana in the Federal Controlled Substances Act to exclude Cannabis sativa L. with delta-9 tetrahydrocannabinols (THC) levels of less than 0.3 percent. On a federal level, hemp is now legal. Does this mean that hemp is also legal in all states? Most states adopted their own version of the Controlled Substances Act (CSA), but they did it in different ways. For example, when Ohio enacted their version of the CSA, they copied the federal definition of marihuana and wrote that into their law. Despite the change in federal law, Ohio law wasn't changed, so hemp is still classified as marijuana and is illegal.

Oregon on the other hand, when they enacted their Controlled Substances Act, rather than copy the federal definitions, they referenced the specific federal statute. As a result, when the federal definition was changed, Oregon automatically adopted the new definition.

Despite the passage of the Farm Bill, each state's laws are written differently and must be evaluated on an individual basis.

Are Hemp Businesses Legal?

Just because hemp is legal in a state, that doesn't mean that hemp businesses are legal to operate. The 2018 Farm Bill requires states to submit a plan on how the state will regulate the production of hemp. The plan must include collecting land information, testing procedures, disposal procedures and enforcement procedures. Once received by the U.S. Department of Agriculture (USDA), they have 60 days to approve or reject the plan. If a state doesn't submit a plan, a business can still operate, but they will be subject to oversite by the USDA directly.

The USDA was given authority to draft regulations consistent the Farm Bill and also regulations to evaluate state plans. These regulations have yet to be drafted, according to the USDA Secretary, Sunny Perdue, he is hoping the regulations will be ready for the 2020 growing season. Until those regulations are available, there will be no legal hemp businesses under 2018 Farm Bill.

Fortunately, that is not the end of the story. The 2014 Farm Bill allowed state departments of agriculture or state universities to establish pilot programs for research of industrial hemp. Many states, including Oregon and Kentucky, established robust hemp pilot programs and are producing significant quantities of industrial hemp. The 2018 Farm Bill recognizes the validity of these programs. However, the 2014 Farm Bill industrial hemp pilot program is repealed effective December 20, 2019. This could leave many businesses in legal limbo until the USDA issues its hemp regulations.

Compliance for Banks

Banks are required to know their customers and have processes in place to ensure that those customers are not engaged in illegal activities. Because hemp is so closely related to marijuana, a scheduled 1 controlled substance, hemp businesses have a higher potential of engaging in illegal activities. Based on this risk alone, some banks will choose not to be part of this industry.

For banks that are considering serving the hemp industry, they must develop industry expertise in order to identify potential risks and develop a compliance program to address those risks. This is a new industry so a bank is unlikely to be able to hire an expert, they will need to spend the time to develop they own expertise.

A typical compliance program would include backgrounds checks of the business owners and key em-

ployees to ensure there is no history or affiliation with criminal activity. The bank will also want to verify that a business has a valid hemp license and operates within that license. This is a difficult task because this information is only available from the USDA, and they don't typically have a process to share that type of information. The bank will also need to verify test results to ensure the customer is growing or processing hemp and not cannabis. Finally, if a test result is over 0.3 percent THC the bank must ensure that the product is properly disposed. Banks have never before been required to conduct this type of monitoring, so it is a challenge for them to put the checks and balances in place to ensure they can adequately monitor these results and disposal.

Despite the cost of program development and compliance, there is a significant pressure for the cost of these account to be low. Most cannabis businesses understand that accounts are expensive because cannabis remains federally illegal. However, hemp customers feel that since hemp is legal their account should cost the same as any other legal business.

Hemp Banking Might Not Look Any Different than Cannabis Banking

Because of all of these factors, observers suggest that hemp banking will be similar to cannabis banking. There will be a small number of community banks and credit unions in each state that will specialize in hemp banking. This will allow these institutions to have a significant number of accounts to gain an economy of scale for an efficient program. These accounts will be more expensive that a typical business account, but the institutions will keep the cost as low as possible to discourage new financial institutions from entering the market.

Large national or regional financial institution are not likely to participate in the industry. Each state will have their own unique features to their laws, a multi-state institution will need to have a compliance program to address these features, so the larger the program the more complex it becomes. From the perspective of a large financial institution, this is a small industry and will not generate the fee income necessary to justify the risk and expense.

Conclusion and Implications

Ultimately, hemp banking will remain difficult until mid to late 2020. Banks will want the certainty of the USDA regulations, and then the time to develop a compliance program.

This article does not address medical hemp programs or CBD/hemp oil derived from cannabis. These products may be available in some states but are done so though a cannabis licensing program and banks will treat them as cannabis.
(Alan Hanson, Mia Getlin)

NEW JERSEY'S PROPOSES TO LEGALIZE RECREATIONAL CANNABIS

Due to "ineffective and wasteful past marijuana enforcement priorities," New Jersey has proposed the New Jersey Cannabis Regulatory and Expungement Aid Modernizations Act (Act), which, among other things, would legalize the possession and personal use of marijuana, in regulated quantities, for persons 21 years of age and over. The following is a brief overview of the Act's current provisions.

The Cannabis Regulatory and Expungement Aid Modernizations Act

Age Restrictions, Quan

Most significantly, the current version of the Act would permit persons 21 years of age or older to possess, display, purchase, or transport: 1) cannabis paraphernalia; 2) one ounce or less of cannabis; 3) one ounce or less of cannabis infused products in solid, liquid, or concentrate form; and 4) five grams of cannabis resin. The same section also permits the transfer of marijuana (in the same amounts) so long as the transfer is for non-promotional, non-business purposes. However, the Act forbids the consumption of marijuana products in a public place and the growth of cannabis at home without state approval.

The Cannabis Regulatory Commission and Industry Parameters

The Act would also create the Cannabis Regulatory Commission (Commission)—which would

generally be responsible for setting the parameters of the industry—as well as establishing four different types of licenses: 1) Class 1 Cannabis Grower license; 2) Class 2 Cannabis Processor license; 3) Class 3 Cannabis Wholesaler license; and 4) Class 4 Cannabis Retailer license. Although the Act does not include a limit on the number of licenses that the Commission could issue, the Act provides that: 1) 35 percent of the licenses shall be "conditional licenses" (a 120-day license with more narrowly tailored application requirements); 2) at least 25 percent of the licenses must be issued to "microbusinesses" (generally smaller cannabis operations with no more than 10 employees); and 3) an applicant must have at least one significantly involved New Jersey resident for at least two years, and provide proof that such a person is at least 21 years old. Moreover, and similar to other jurisdictions, the Act requires owners (generally only those owners with more than a 5 percent ownership interest) to undergo and pass a criminal background check. When determining whether any conviction should disqualify an applicant, the Act requires the Commission to disregard certain convictions involving cannabis.

Cannabis Use Locations

The Act also contains some unique provisions involving where cannabis may be used, as well as the potential availability of cannabis delivery services. In most states with cannabis programs, the only place to lawfully consume cannabis is at a private residence. But, as it stands now, the Act would allow New Jersey businesses with a marijuana retail license to apply for a "cannabis consumption area," on the same premises as, but separated from, their dispensary. Retailers would have to secure local approval for the consumption space in addition to obtaining permission from the state. Similarly, a hotel, motel, or "other lodging establishment" owner can allocate up to 20 percent of its guest rooms to permit the smoking of cannabis. With respect to delivery services, and similar to the regulations in California, Nevada, and Oregon, the Act would permit businesses with cannabis retail licenses to seek state authorization to deliver cannabis products to customers. New Jersey Governor Phil Murphy has indicated that he supports delivery services.

The Workplace

The Act further contains provisions on the interaction of lawful cannabis use and the private workplace. This interaction has been a topic of frequent writings and debate. The Act expressly provides that it does not require employers:

> . . .to permit or accommodate the use, consumption, being under the influence, possession, transfer, display, transportation, sale, or growth of cannabis or cannabis items in the workplace, or to affect the ability of employers to have policies prohibiting cannabis use or intoxication by employees during work hours.

That said, the Act does provide some level of protection for employees, and prospective employees, that use cannabis:

> No employer shall refuse to hire or employ any person or shall discharge from employment or take any adverse action against any employee with respect to compensation, terms, conditions, or other privileges of employment because that person does or does not smoke or use cannabis items, unless the employer has a rational basis for doing so which is reasonably related to the employment, including the responsibilities of the employee or prospective employee.

These protections are consistent with many other states that have passed laws on the use of cannabis in the private workplace.

Taxation

The most hotly debated portion of the Act involves how cannabis and cannabis products will be taxed. On one end of the spectrum, Stephen M. Sweeney, the New Jersey Senate president and one of the sponsors of the Act, has stated that he desires an excise tax of 12 percent. On the other end of the spectrum, however, Governor Phil Murphy has wanted an excise tax of 25 percent. The Act, in its current form, proposes a sliding scale approach:

> . . .in year one following the enactment of [the Act], the excise tax shall be 10 percent; in year two, the tax shall be 15 percent; in year three, the tax rate shall be 20 percent; and

> in year four and beyond, the tax shall be 25 percent.

If passed, the initial 10 percent tax would be the lowest in the country. However, a *New York Times* article recently reported that a new compromise with respect to cannabis taxation has been reached. This compromise would tax cannabis not on a percentage basis, but on a product weight basis. Specifically, according to this report, the compromise would involve a tax of $42 per ounce. The issue of how to properly tax cannabis has unquestionably been the most significant hurdle in passing the Act.

Conviction Expungements

Finally, the Act offers good news for those individuals who have been convicted for certain cannabis related crimes that would otherwise be lawful under the Act:

> Any person convicted of marijuana possession as defined in paragraph (4) of subsection a. of N.J.S.2C:35-10 prior to the effective date of [the Act] shall, following the enactment of [the Act], be eligible to present an application for expungement to the Superior Court pursuant to the provisions of chapter 52 of Title 2C of the New Jersey Statutes.

This provision has been an important point for advocates of criminal justice reform.

Conclusion and Implications

At bottom, New Jersey is on track to be one of the newest members of the recreational cannabis community. That said, New Jersey legislative leaders recently said that they need to reach an agreement on other aspects of legalizing marijuana, including the initial number of licenses to be distributed and how many public consumption sites would be allowed. New Jersey should move quickly, however, as the economic benefits may begin to dissipate as neighboring states, including New York, consider and ultimately pass their own forms of legalization.
(Joshua Horn, Jesse M. Harris)

REGULATORY DEVELOPMENTS

CALIFORNIA'S NEW CANNABIS REGULATIONS APPROVED BY THE STATE OFFICE OF ADMINISTRATIVE LAW, NOW IN EFFECT

On January 16, 2019, California's three state cannabis licensing authorities announced that the Office of Administrative Law officially approved state regulations for cannabis businesses across the supply chain, from cultivation to retail.

Background

California's new cannabis regulations went into effect immediately, replacing previously adopted emergency regulations. The previous emergency regulations were drafted after California voters approved Proposition 64, commonly known as the Adult Use of Marijuana Act, which legalized recreational cannabis use in California. The emergency regulations, adopted by the Bureau of Cannabis Control, California Department of Public Health and California Department of Food and Agriculture in December 2017 and readopted in June 2018, were originally issued through the emergency rulemaking process to meet the legislative mandate to open California's regulated cannabis market on January 1, 2018. Now that the new regulations have been approved, the emergency regulations are no longer in effect.

The Regulations

California's cannabis regulations are found in Title 16 of the California Code of Regulations, Division 42. The regulations provide licensing and enforcement criteria for commercial cannabis businesses in California, including distributors, retailers, microbusinesses, temporary cannabis events, and testing laboratories. The regulations are also meant to inform licensing applicants about the meaning of key statutory terms, and to provide specific clarification about conditions and prohibitions for complying with the Medicinal and Adult-Use Regulation and Safety Act (MAURSA).

The regulatory changes included clarifying sections and provisions of the regulations that were impacted by recent legislative changes to MAURSA, such as expanding the locations that temporary cannabis events can be held at and preventing the sale and transport of cannabis goods that are labeled with terms that would create a misleading impression that the product is an alcoholic beverage. Additional changes included clarifying which individuals in a multi-layer business structure must be disclosed as owners or financial interest holders in an application for a commercial cannabis business and expanding on a distributor's ability to label or re-label cannabis goods with the amounts of cannabinoids and terpenoids after receiving a certificate of analysis for regulatory compliance testing.

Deliveries of Cannabis

Although there were many changes made to the regulations, the area getting perhaps the most attention relates to deliveries, as the regulatory changes made noteworthy changes to rules governing cannabis deliveries. The most significant, § 5416, subdivision (d), was amended to clarify that a delivery employee may deliver to *any jurisdiction within the State of California* provided that such delivery is conducted in compliance with all delivery provisions of the regulations. This change is particularly important because local jurisdictions, cities and counties in California, are given wide discretion over whether to allow recreational cannabis activities. For example, some cities and counties prohibit any cannabis dispensaries from operating within their borders. Despite this, the new regulations would allow licensed businesses to deliver cannabis products to customers within any California city or county.

Technology Platforms

Section 5415.1 is a new section that was added to the regulations to clarify the use of technology platforms by licensed retailers in the sale and delivery of cannabis goods. This is an important area of regulation because technology platforms, such as mobile apps, are a growing way to facilitate commercial transfer of cannabis goods to customers. These platforms are akin to commonly used food apps, like "Uber Eats" or "DoorDash," allowing a customer to

download the app, place an order for a cannabis product, and get it delivered straight to their door. On a related note, subsection (a) of § 5418 was amended to specify that the value of cannabis goods carried in the delivery vehicle cannot exceed $5,000 at any time.

Conclusion and Implication

The permanent new regulations are an important step towards establishing the cannabis industry as a thriving part of California's economy. Chief of the Bureau of Cannabis Control, Lori Ajax, expressed that "These approved regulations are the culmination of more than two years of hard work by California's cannabis licensing authorities … Public feedback was invaluable in helping us develop clear regulations for cannabis businesses and ensuring public safety."

Each licensing authority's final regulations and rulemaking documents have been posted to the California Cannabis Portal and are accessible online at the following link: https://cannabis.ca.gov/cannabis-regulations/
(Nedda Mahrou)

LAWSUITS FILED OR PENDING

ENVIRONMENTAL ADVOCACY GROUP IN CALIFORNIA SUES HUMBOLDT COUNTY OVER CANNABIS REGULATIONS PURSUANT TO THE CALIFORNIA ENVIRONMENTAL QUALITY ACT

Friends of the Eel River (Friends), an environmental advocacy group based in Eureka, California is pushing back against Humboldt County's (County) new cannabis regulations that would allow the County to issue thousands of permits for cannabis cultivation. [*Friends of the Eel River v. County of Humboldt, et al.* (Filed in Humboldt County Superior Court).]

On June 6, 2018, Friends petitioned the Humboldt County Superior Court for a writ of mandate (Petition) to stay and vacate the County's decision approving Ordinance No. 2599 entitled Commercial Cannabis Land Use Ordinance—Outside the Coast Zone (Ordinance). The Ordinance, through adoption of Resolution No. 18-43, allows a specified number of permits and cultivated acres for new cultivation sites (Project) and certifies the Project's Environmental Impact Report (EIR) [pursuant to the California Environmental Quality Act (CEQA)].

Challenging Humboldt County's Ordinance 2599 under CEQA

Friends alleges that the EIR for the Ordinance is deficient under the California Environmental Quality Act. According to the Petition, Friends is challenging Humboldt County's purported failure to "disclose, analyze, and mitigate" certain impacts on water quality, water quantity, and wildlife habitat in the Ordinance's environmental evaluation. Friends' main concern is that the Ordinance will result in "grading and disturbing land," which will impact watersheds by increasing sediment and turbidity (or cloudiness), dewatering salmon-bearing streams, and introducing toxic pesticides and fertilizers. Friends claims that these watersheds include critical habitats for salmonids and Steelhead fish which have already been listed as threatened under the California and federal Endangered Species Acts.

Friends further alleges that the EIR:

> . . .makes no attempt to document baseline watershed conditions from which the County could determine whether any additional sediment loadings or water diversions could be allowed without exceeding water quality standards or adversely affecting salmonid habitat.

The EIR as currently written concludes that cumulative impacts to water quality will be less than significant after the Ordinance's mitigation measures are implemented. Friends alleges that this not supported by the evidence, since the EIR's assessments fail to identify and evaluate all past, present and future sediment-producing projects within each of the watersheds affected by the Ordinance.

Friends is mainly concerned that the number of permits being proposed are too high, even in the most conservative proposal, which would provide for 3,000 additional permits across the County. According to Scott Greacen, Conservation Director in a March 28, 2018 letter to the Humboldt County Board of Supervisors:

> Some 1600 of these 3000 permits would be issued in tributaries to the Eel River. Absent the meaningful analysis of cumulate watershed impacts we have repeatedly requested be conducted before additional cultivation permits are issued, it is impossible to support the County's implicit assertion that watersheds like Salmon Creek and Redwood Creek will be able to support critical public trust resources like clean water and viable fisheries habitat—and avoid take of listed species—with the proposed level of permitting.

Greacen estimates that Humboldt County alone could produce half of the state's demand for cannabis with the number of permits that have already been issued. He states that there is no real rationale behind the County's decision to issue 3,000 additional permits.

Impacts to the Eel River

Friends' stated purpose is to protect and restore the Eel River, which has a size of approximately 3,700 square miles and is located just south of Humboldt Bay. Eel River used to be home to about 1 million salmon and steelhead in an average year. This number has decreased due to industrial fishing, logging and road building. Coho salmon and steelhead are being driven extinct in this watershed due to black-market growing activities. The concern is that the Ordinance will allow too much growing-related development activity in areas that are already heavily affected by black-market growing. Greacen says that the main concern for the affected watersheds is sediment and describes it as "cancer," because its effects are chronic and difficult to clean up. The lesser, but still important concerns, are withdrawals from water streams and the use of toxicants and pesticides during cultivation. To highlight the already-existing environmental impacts on the watersheds, Greacen says that Salmon Creek has not had salmon in over 20 years and Redwood Creek is also losing salmon. The County's position, according to Greacen, is that it is not responsible for the environmental impact of illegal cannabis operations. Greacen feels that the reason behind this position is because the County has benefited economically from the illegal cannabis industry for decades.

Conclusion and Implications

The case is still in its beginning stages and it is unclear at this time how a court will ultimately rule on the Friends' Petition. The Petition may be accessed online at: https://eelriver.org/wp-content/uploads/2018/06/2018.06.05-Petition-for-Writ-of-Mandate-Humboldt-County-Pot-Ordinance-Final.pdf (Brittany Ortiz, Nedda Mahrou)

CANNABIS AND THE CALIFORNIA ENVIRONMENTAL QUALITY ACT—TRINITY ACTION ASSOCIATION SUES TRINITY COUNTY

On January 3, 2019, a group called the Trinity Action Association (TIA) sued Trinity County (County), its planning department, and unnamed cannabis licensees. [*Trinity Action Association v. County of Trinity*, et al., Case No. 19CV001 (2019)] TIA argued in its petition for writ of mandate that the County failed to complete environmental analysis required under the California Environmental Quality Act (CEQA) for the licenses issued by the County to cannabis cultivators. While the case is currently pending, the County has recently commenced with a large-scale CEQA effort in the form of a Programmatic Environmental Impact Report (PEIR) for its entire cannabis program, including cultivation.

Background

The Medicinal and Adult-Use Cannabis Regulation and Safety Act (MAUCRSA) provides for a limited statutory CEQA exemption, which sunsets on July 1, 2019. (*See*, BPC § 26055(h).) It allows for a temporary exemption for local jurisdictions adopting cannabis ordinances that require discretionary review and approval of permits, licenses, or other authorizations to engage in commercial cannabis activity, and applies CEQA review for those future discretionary actions. (*See*, BPC §26055(h).)

Trinity County enacted its current cannabis ordinance and subsequent amendments pursuant to this limited statutory exemption. (Trinity County Cannabis Cultivation Ordinances 315-823, 315-829, 315-830, 315-841) The County had originally enacted an urgency ordinance and several extensions in 2016 into 2017. After the urgency ordinance expired, the County sought to enact a permanent ordinance and prepared associated CEQA analysis in the form of an Initial Study and Mitigated Negative Declaration (IS/MND) in September 2017. However, the County eventually adopted the ordinance and amendments pursuant to the statutory exemption it remains unclear if the County certified the IS/MND.

TIA is a coalition of residents and property owners in the County who have been active in challenging the proliferation of cannabis in the area. The group submitted comments to the County urging it to prepare a more substantive PEIR instead of relying on either the IS/MND or the statutory exemption. (Trinity Action Association Comments on Project Initial

Study-Environmental Checklist and Evaluation of Environmental Impact for the Trinity County Commercial Cannabis Cultivation Ordinance, October 27, 2017.) The group argued that relying on future individual CEQA review for each one of the hundreds of cultivation licenses it intended to issue was inefficient and expressed concerns that such efforts would "overwhelm the County's planning capacity." (Ibid)

Despite TIA's comments the County elected at that time to proceed with the ordinance relying on the statutory exemption for CEQA compliance. However, the exemption required that licenses and permits issued pursuant to the exempted ordinance were required to go through individual CEQA analysis, which TIA argues that County failed to do when it issued hundreds of licenses. TIA subsequently filed a lawsuit. Around the same time as the initial filing, the County issued a Notice of Preparation (NOP) of a PEIR to cover its entire cannabis program, including cultivation. (Trinity County Notice of Preparation of an Environmental Impact Report and Notice of Public Scoping Meeting for the Trinity County Cannabis Program Project, December 21, 2018, https://www.trinitycounty.org/sites/default/files/Planning/Cannabis%20CEQA%20Notice%20of%20Preparation_0.pdf)

The Lawsuit

It is unclear whether knowledge of an impending lawsuit prompted the County to begin the PEIR process, or if that was always the plan, regardless the timing may still prove problematic. Perhaps TIA's strongest argument contention is that the County has already issued hundreds of licenses to cultivators without proper CEQA review. It is unclear if the County may try to retroactively apply the PEIR to the previously issued permits, but if TIA's claims are proven, the County remains in a position to answer for alleged improper application of CEQA. At a scoping meeting for the PEIR in January 2019, the issue of timing arose, and the County insinuated that they were always planning to complete CEQA review as the exemption would be sunsetting in July.

Not all TIA's claims are as clear, however. TIA also argues in the complaint that if and when the County does make CEQA determinations for individual licenses, it would be prohibited from applying any exemptions for those licenses. Specifically, TIA argues that several of the general exceptions to categorical exemptions under CEQA would be applicable to cultivation licenses including where the cumulative impact of successive projects of the same type, in the same place, over time, is significant (CEQA Guidelines§ 15300.2 (b)). However, TIA is apparently addressing all cultivation licenses as a monolith, and not as individual projects that require varying analysis, which is proven would not be not prudent.

Indeed, the California Department of Food and Agriculture (CDFA), the state agency responsible for issuing state permits for cultivation projects, has accepted exemption determinations from local agencies for some qualifying cultivation projects. [For example, for the cumulative impacts exception, there is case law that finds that an impact cannot be cumulatively considerable if there are no significant impacts associated with it in the first place, which theoretically could be the case for a small indoor cultivation project ("When there is no substantial evidence of any individual potentially significant effect by a project under review, the lead agency may reasonably conclude the effects of the project will not be cumulatively considerable" *Hines v. California Coastal Com.* (2010) 186 Cal.App.4th 830, 857-858). In addition, given that the California Department of Food and Agriculture (CDFA) found through its own programmatic CEQA analysis that cultivation impacts around the state would not be cumulatively considerable, where does that lead the cumulative impacts exception to exemptions? (CDFA PEIR, https://www.cdfa.ca.gov/calcannabis/PEIR.html)

In any event, it is possible the County's initiation of a PEIR will moot the case, given that is what TIA originally wanted according to their comments on the ordinance. Results of the February 19, 2019 petition hearing are pending at the time of this publication.

Conclusion and Implications

This case is one of several cannabis-related CEQA cases that have been filed around the state. Some cases challenge completed PEIRs on environmental or procedural grounds, [*Friends of the Eel River v. County of Humboldt* (2018) Case No. CV180495 (merit of petition hearing on June 28, 2019); *Calaveras Cannabis Legal Defense Fund v. Calaveras County*, et. Al (2018) Case No. 18CV43043 (dismissed in December 2018 on procedural grounds).]. Others are similar to TIA's claims that a local agency failed to complete CEQA analysis altogether, [*SMC Marijuana*

Moratorium Coalition v. County of San Mateo (2018), Case No. 18CIV00206 (voluntary dismissal after case was mooted)] and some are related to fundamental CEQA questions such as the qualifications of a project. [*Union of Medical Marijuana Patients, Inc. v. City of San Diego* (2016) 4 Cal.App.5th 103 (accepted for review by the California Supreme Court.] Amongst the cases filed some have been mooted or dismissed, but it is important to pay close attention to these cases and others such as Kern County cases, (*see, County of Kern v. TCEF, Inc.* (2016) 246 Cal. App.4th 301; *T.C. v. County of Kern*, 2016 Cal. App. Unpub.) as they are indicative of the kinds of claims the industry may see in the future. In particular, as more counties and cities adopt their own PEIR after the statutory exemption sunsets in July, we will likely see more direct challenges to those PEIRs on classic CEQA grounds such as baseline (especially regarding prior illegal operations) and cumulative impacts. Local jurisdictions must also be careful with previous adoption of ordinances pursuant to the exemption, as they are required to complete some level of CEQA analysis, whether it be an exemption determination, IS/MND or even an EIR, for each individual license or permit issued, as is the central issue in Trinity County's case. As the presence of CEQA in the California cannabis world grows, so too will this specific body of case law.
(Pamela Epstein)

JUDICIAL DEVELOPMENTS

U.S. DISTRICT COURT HOLDS EMPLOYER DOES NOT NEED TO EXCUSE COMPLIANCE WITH DRUG TESTING POLICY FOR MEDICAL MARIJUANA USER

Cotto v. Ardagh Glass Packing, Inc., ___F.Supp.3d___, Case No. 18-1037 (D. N.J. 2018).

In *Cotto v. Ardagh Glass Packing, Inc.* the U.S. District Court for the District of New Jersey dismissed the Complaint of a medical marijuana user who refused a drug test mandated by his employer. The Court held that the New Jersey Compassionate Use Medical Marijuana Act (CUMMA) and the New Jersey Law Against Discrimination do not require employers to waive drug testing requirements for employees who use medical marijuana.

Background

Plaintiff Daniel Cotto worked as a forklift operator for Ardagh Glass Packing for several years. During his employment, Cotto used medical marijuana to treat neck and back injuries he suffered in 2007. At the time of his hiring in 2011, the plaintiff informed his employer that he used medical marijuana recommended by a doctor to treat these injuries, and provided his employer with medical documentation showing it as safe for him to work and use medical marijuana. He suffered another work injury in November 2016, and was placed on "light duty" as a result. The plaintiff was told that no "light duty" work was available at that time.

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

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

The District Court's Decision

The LAD Claim

The LAD prohibits:

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

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

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

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

The CUMMA Claim

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

The court noted that it was constrained by the language of the CUMMA, which contains no provision requiring employers to make any accommodation for the use of medical marijuana. Indeed, the law provides just the opposite:

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

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

Conclusion and Implications

Courts across the country have recently been faced with the question of whether employers must provide reasonable accommodations for employees who use medical marijuana. Employers, too, have had to decide whether and how to continue enforcing employee drug testing policies. These questions are complicated by the dichotomy between federal and state law concerning the legal status of marijuana. However, the language of the state statute at issue is paramount in making such decisions. In *Cotto*, the applicable statute—New Jersey's Compassionate Use of Medical Marijuana Act—lacks any provision requiring employers to make such an accommodation. But as the *Cotto* court noted, several states do contain provisions protecting employees from certain adverse employment actions based on their medical marijuana use. Therefore, before making any employment decisions concerning medical marijuana users, employers and practitioners would be wise to examine the language of any applicable laws, including marijuana statutes and state anti-discrimination laws, to ensure any such action will comply with both. (Joshua Horn)

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