

Cannabis Moneyball Has Begun, And The Game Is Heating Up

By **John Oberle and Kristina Dahmann** (May 31, 2022)

With baseball season underway, we are starting to see which teams have promise. The same can be said for the cannabis industry.

Baseball got its start in the 1800s. The teams were often startup clubs and were limited to playing in a few states. As with anything popular, the baseball industry grew, professionalized and became the national pastime we know today.

The modern U.S. cannabis industry also started small, with California legalizing medical cannabis use in 1996. Just like baseball, the first businesses were startups and were located in a handful of states early on.

Then spring training was over, and as with anything popular, the industry grew, and now the game is on. Currently, nearly 40 states have legalized cannabis in one form or another.[1]

Players to Watch

There are several states with markets that are working to come online:

- Kentucky's House passed a medical cannabis bill on March 17, but it has not gotten very far since being sent to the Senate, and the legislative session is over for 2022.
- Iowa only allows low-THC sales, but reported \$6.2 million in cumulative sales in 2021.
- Texas also only allows low-THC cannabis and restricts sales to medical use.
- Georgia is also having a hard time getting into the game because the General Assembly's Hope Act legalizing low-TCH oil possession has stalled in the Superior Court of Fulton County.[2] In Cumberland Curative LLC v. The Georgia Access to Medical Cannabis Commission, disappointed bidders sued the commission, claiming the evaluation and scoring of applications was "arbitrary, capricious, clouded by substantial conflicts of interest, and otherwise unlawful."
- South Dakota is having a hard time, too, because its November 2020 voter initiative was voided in its entirety by the South Dakota Supreme Court in Thom v. Barnett last November.[3]
- Delaware has not had recent success expanding its programs. Most recently, an effort to legalize recreational cannabis failed to pass the Delaware House of Representatives.[4]



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Markets to watch include Connecticut, Montana, Mississippi, Ohio, South Carolina and Vermont:

- Connecticut expects recreational sales to begin in late 2022.
- Montana allowed adult use sales starting on Jan. 1.
- Mississippi just legalized medical cannabis in February.
- Vermont is expecting its first recreational sales this fall.
- Ohio may expand its medical marijuana program through S.B. 261. Also in Ohio, there is a pending adult use ballot issue in the state that will make the ballot in November 2023 as a result of a settlement between the industry and state leadership.
 - The Coalition to Regulate Marijuana Like Alcohol, a ballot issue committee in Ohio, filed a declaratory judgment action in the Franklin County Court of Common Pleas in order to get clarity on timing issues needed to place the issue on the ballot.[5] The parties to the LaRose litigation reached a settlement on timeline issues that will allow the ballot issue to proceed in 2023.[6]
- South Carolina's medical cannabis bill passed the state Senate but did not pass the House of Representatives. The bill is expected to be reintroduced in 2023, and there is a lot of momentum going into next year.

Medical cannabis markets provide room for growth in a number of states.[7]

Moneyball Strategies

Moneyball, a term used in sports on key decision elements needed for success, will likely be utilized for players and teams to make it to home base. The skill of company valuations and obtaining talent will drive success and profitability. Further, the skill of winning new licenses and entering new markets will continue to drive low-cost growth.

At the end of the day, cannabis operations still must play the game and compete hard to win the game — i.e., market share and customer loyalty.

One critical legal issue is the type of procurement utilized for new licenses and the litigation strategy of applicants. Many states are shifting away from qualifications-based license applications and moving to lottery selections, where applicants only need minimal qualifications and a bit of luck to win a license.

This lottery shift is often made by states in an effort to reduce litigation based on how they grade qualifications-based applications and to level the playing field for applicants with fewer resources.

The result has been mixed, and numerous states' lottery model, such as that of Illinois, are the subject of lawsuits.

In addition, the pool of applications winning lotteries often leads to less-sophisticated operators and problems for the states and consumers on the back end.

Litigation will continue to play a large role in new cannabis states or when states expand

applications. The legal processes that states take to set up programs and licensing processes on the front end can pay great dividends to reduce legal costs and allow new operators to more quickly enter the market.

Season Is Gaining Momentum

Now that we have already had opening day at the park, it is time for the cannabis teams and players to settle in, and we can see who already has momentum.

There is a lot of consolidation in the industry, with teams merging and players being traded. There is almost too much product on the field in some states, which is hurting revenue growth, such as in California and Michigan.

A lot of this will adjust in the near term as consolidations continue and as we see new states come online.

This will increase the overall market, which should affect the acceptance of the industry in our nation's capital. As more cannabis businesses come online and create jobs and revenue for the states, their collective voices will get louder in Washington, D.C.

There is a lot of game left to be played, and the rules of the game discussed below are examples of issues that need to be resolved before the playoffs commence, and we make it to the World Series. We will know we are in the late stage of the season when there is true long-term growth of the industry.

Umpires' Role

The federal enforcers have been quiet since the hot streak of the U.S. Department of Justice's Obama-era Cole Memorandum and other federal guidance.[8]

Instead of taking action to reinstate those policies after the Trump administration rescinded them, the Biden Department of Justice has opted for the status quo, but has acted consistent with the Obama administration's policies to let the states run their programs.

In good news, the U.S. Congress has continued to limit the federal government's spending power to prosecute state-compliant medical cannabis operators in the Rohrabacher-Farr, or Rohrabacher-Blumenauer, amendment. The amendment limits the DOJ's spending relating to enforcement activity that targets legal cannabis state regulatory regimes. The amendment states:

None of the funds made available in this Act to the Department of Justice may be used ... to prevent [states] ... from implementing their own laws that authorize the use, distribution, possession, or cultivation of medical marijuana.

The amendment was signed into law on Dec. 16, 2014, and has been renewed through Sept. 30, 2022.

But that is about it. Cannabis issues continue to polarize Congress: Progressives want significant reform, conservatives oppose rescheduling and want to keep the status quo, and even practical measures such as banking reform have not made it out of the dugout in the U.S. Senate.

It is likely that we will indeed have to go into extra innings before the umpires will make their presence known, and hopefully they will call more balls than strikes.

That said, like in most games, sometimes it's better when the umpire just lets the teams play.

Rules of the Game

Federal legalization will eventually occur, and banks will be able to provide the needed additional capital to fuel industry growth. How the federal law is passed will be critical to dealing with important issues such as states' rights; border issues including transportation; banking; taxation; and other issues that are affecting the rules of the game.

Banking is one of the difficult legal issues currently in the industry. Major financial institutions are unwilling to underwrite or provide banking services to the cannabis industry because of legal uncertainty.

In Congress, the Secure and Fair Enforcement, or SAFE, Act would provide legal certainty by prohibiting banking regulators from penalizing financial institutions for providing banking services to cannabis-related businesses in states where cannabis has been legalized.

If enacted, the SAFE Act should clear the way for banking and financing cannabis like any other business. Cannabis companies, like players in any other industry, need the full suite of services.

If and when the federal government reschedules cannabis, the current restrictions on interstate transportation of cannabis will lift, and operators will likely have the ability to freely transport legal product throughout the U.S., so long as its destination is a legal state.

Recall that after the 2018 Farm Bill, Idaho originally prohibited the growth, processing and sale of hemp and hemp-derived products. It also attempted to ban the transportation of hemp and hemp-derived products, including CBD, through its borders. The issue came to a head when a truck filled with hemp was seized at the Idaho border.

After the total ban was lifted, the state promulgated rules to govern the transportation of hemp and hemp-derived CBD products across and within its border. The rules were strict, but permitted the plant and products to move through the state.

This is a valuable case study of what rules an operator should expect when transporting cannabis products through a state where cannabis is not legal. Operators will have to follow strict guidelines, register, follow a fixed route through the state, and risk seizure of the goods by state officials.

Today, operators must source products from a supply chain located entirely within its resident state. In the future, multistate operators may find that today's reward is tomorrow's burden, since their models depend on vertical integration in multiple markets, which may prove inefficient when those market's borders disappear.

Another state protectionist issue is residency requirements for licensure, which have been disfavored after court challenges by out-of-state operators.

Missouri, Michigan and Maine courts have each determined that state or local laws that favor residents in the recreational or medical cannabis context are likely unconstitutional.

As we look ahead to a freer market after the federal government reschedules cannabis, state-protectionist considerations will continue to be a hot topic.

Home Run — or Strike Out

The home run — or strike out, depending on how it affects an operator — is whether an operation can sell a product grown legally in one state in another legal state. This topic will likely not come into play until after federal legalization.

A legal principal that will weigh heavily on the ability of states to limit the free sale of out-of-state cannabis products is the dormant commerce clause.

The commerce clause empowers Congress to regulate commerce among the states. The negative implication of this power is that a state may not discriminate against interstate commerce.

A discriminatory state law is virtually per se invalid, and a discriminatory state law will only survive if it advances a legitimate local purpose that cannot be adequately served by reasonable nondiscriminatory alternatives.

Thus, it could be argued that a legal cannabis state's ability to restrict the sale of cannabis products grown and processed legally in another state is severely limited.

It could also be argued that states should at least be permitted to regulate product coming into their borders for sale from out of state so long as those laws are justified by legitimate state interests. Those interests may include protecting consumers or revenue, or they may flow from the kinds of traditional regulations characterizing the cannabis market.

Similar to what has happened in the gaming industry, where internet wagering, such as mobile sports wagering, cannot cross state borders as determined under state law, internet sales of cannabis from an out-of-state operator directly to a consumer in a different state may be similarly controlled.

All in all, the cannabis industry will continue to change, develop and grow. How and in what ways will be largely driven by the success of industry advocacy, and the timing and manner of federal legalization.

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[1] Those states include Alabama, Alaska, Arizona, Arkansas, California, Connecticut, Delaware, District of Columbia, Florida, Hawaii, Illinois, Louisiana, Maine, Maryland, Massachusetts, Michigan, Minnesota, Mississippi, Missouri, Montana, Nevada, New Hampshire, New Jersey, New Mexico, New York, North Dakota, Ohio, Oklahoma, Oregon, Pennsylvania, Rhode Island, Utah, Vermont, Virginia, Washington, and West Virginia.

[2] Civil Action File No. 2022CV363900.

[3] Thom v. Barnett , 2021 S.D. 65, 967 N.W.2d 261.

[4] Other states that are still trying to get at bat include: Idaho, Indiana, Kansas, Nebraska, North Carolina, South Carolina, South Dakota, Tennessee, and Wyoming.

[5] See Lynaugh v. Frank LaRose, Secretary of State ("LaRose"), Case No.22CV-2851 (Franklin County C.P.).

[6] Id., Settlement Order (May 12, 2022).

[7] Those states include Alabama (which is set to issue its first medical cannabis license as soon as this fall), Arkansas, Delaware, District of Columbia, Florida, Hawaii, Louisiana, Maryland, Minnesota (which still only allows medical sales after a recent initiative failed to pass the Minnesota senate), Mississippi, Missouri, New Hampshire, North Dakota (which currently has 7,368 patients), Ohio (with \$724.5 million in medical cannabis product sales), Oklahoma (experiencing \$4,827,391 in tax revenue from legalized medical cannabis sales), Pennsylvania (certifying 406,454 active patients as of March 2022), Rhode Island (selling \$3,195,625 of medical cannabis in January 2022), and Utah (which has 44,392 patients in 2022).

[8] Under 2013 Cole Memorandum, the federal government will not seek prosecution if a cannabis business complies with the eight federal enforcement priorities of preventing distribution of cannabis to minors, funding of criminal enterprises, diverting of legal cannabis to states where it is not legal, using cannabis activity as pretext for other criminal activity, illegal use of firearms and violence in cultivation and distribution of cannabis, drugged driving and other adverse public health consequences, the cultivation of cannabis on public lands, and the use or possession of cannabis on federal land. The 2014 Cole Memorandum applies 2013 Cole Memorandum guidance to financial institutions and provides that investigations and prosecutions of financial institutions should be guided by the same eight federal priorities. A memorandum issued by FinCEN in 2014, relied on 2013 and 2014 Cole Memorandums and placed the following obligations on financial institutions: enhanced due diligence, additional rules specific to cannabis related businesses, and additional filing requirements ("Marijuana-Related" SARs). It advises each financial institution to develop a BSA/AML compliance system and additional customer due diligence that accounts for guidance from Justice Department.