
Reading the Leaves: What's in Store for Cannabis in 2021

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

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Executive Summary

On the heels of a year beset by turmoil and the myriad challenges caused by the global pandemic, the cannabis industry nevertheless entered 2021 poised for significant growth amid a landscape teeming with opportunity. Public acceptance of both medical and recreational adult-use marijuana has continued to grow, with public polls showing that the overwhelming majority of U.S. adults support its legalization. This support has translated into action, as voters in several states passed ballot measures in November. Despite the economic disruptions of the pandemic, the cannabis industry persevered; deemed “essential” in many states where it is legal, cannabis businesses continued to operate and saw remarkable growth, with overall U.S. cannabis sales increasing by more than 40% from 2019. This has translated into increased access to equity and debt capital for parts of the industry, pointing to a more robust M&A market for 2021.

Although cannabis remains illegal at the federal level, political and regulatory developments over the past year offer a basis for cautious optimism. On the political side, for the first time in years there appears to be a path forward for Congress to de-schedule marijuana as a controlled substance and potentially loosen the laws and regulations that have made it nearly impossible for the industry to access the banking and financial services sectors. Federal agencies and regulators also appear to be taking steps to address unique health, safety, environmental, and even intellectual property issues faced by the industry.

But existing challenges persist, with new ones on the horizon. Marijuana businesses still face challenges obtaining insurance coverage; businesses impacted by the economic distress of the past year still lack access to the protections under federal bankruptcy laws; and even businesses that have thrived face a changing legal landscape as employers grapple with issues created by greater state-level legalization.

So what is in store for the cannabis industry in 2021? In the following pages, our Foley & Lardner colleagues will share their legal perspectives across ten business sectors and highlight the hot trends, critical issues and inherent challenges facing this exciting and burgeoning industry.

Regards,

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Legislation and Government Affairs

Delisting

Currently, because of marijuana's status as a Schedule I drug under the Controlled Substances Act (CSA), the production, distribution, and sale of cannabis is criminalized. "Delisting" or "descheduling" refers to the process of Congress voting to remove marijuana and its derivatives, including THC, from the CSA. Most states have legalized some form of medical cannabis, and increasing numbers of states have changed their laws to regulate adult-use cannabis in a manner similar to alcohol. Moreover, Congress recently removed hemp from the CSA, legalizing a subset of cannabis plants and derivatives that contain less than 0.3% THC. The stage is set for Congress to deschedule cannabis. In fact, the House of Representatives has passed a bill doing just that, and Sen. Chuck Schumer (D-NY) has promised to pursue the same now that the Democrats control the Senate.

Even if that is achieved, descheduling cannabis will not be the end of the fight – the government will still need to determine how to properly regulate it. Cannabis will likely be highly regulated by the government agencies that currently regulate most food and drugs, primarily the Food and Drug Administration (FDA) and the Alcohol and Tobacco Tax and Trade Bureau (TTB) within the U.S. Department of the Treasury.

Banking

Banking remains a challenge under federal law. In states that have liberalized the use of cannabis, hundreds of licensed and regulated cannabis businesses do not have access to the banking industry and are unable to accept credit cards, deposit revenues, access loans, or write checks to meet payroll or pay taxes. The cannabis industry faces financial security issues with respect to transportation, issuing payroll, accessing credit, and paying taxes without access to banks or other financial institutions. The Secure and Fair Enforcement Banking Act (SAFE Banking Act), would allow state-licensed marijuana-related businesses to engage freely in relationships with banks and other financial institutions. If enacted, banks would no longer face the threat of federal sanctions for working with marijuana-related businesses and entrepreneurs.



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In September, the SAFE Banking Act passed the U.S. House of Representatives by a bipartisan vote of 321-103. Afterward, the act's journey continued in the more conservative, Republican-controlled Senate, where then-Banking Committee Chairman Mike Crapo (R-ID) announced his objection to cannabis policy reform — including the SAFE Banking Act as it's currently written. But remedying the banking issue is more likely now that Democrats control the Senate. Regardless of what happens in the Senate, there is opportunity for the Treasury Department in a Biden administration to liberalize banking rules as well.

Tax Implications

Section 280E of the Internal Revenue Code prohibits businesses engaged in the trafficking of Schedule I or Schedule II controlled substances in contravention of state or federal law from deducting normal business expenses, such as payroll and rent, from gross income. Originally intended to apply to illegal drug dealers when first enacted in 1982, the provision is now primarily applied to medical and adult-use cannabis dispensaries operating legally under state law.

Our congressional sources tell us that making this change on its own is unlikely to happen legislatively due to the congressional budget scoring process because it would cost the government significant revenue. However, because section 280E only applies to scheduled substances, descheduling cannabis would effectively solve the issue. Consideration may be given by the Biden administration regarding remedying this issue through unilateral administrative action.

Insolvency

Where Do Distressed Marijuana Companies Go?

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

Unfortunately, these federal benefits are not available to adult use and medical marijuana companies ([hemp companies can file for Chapter 11](#)). U.S. Trustees remain vigilant gatekeepers, quickly disposing of such Chapter 11 debtors with motions to dismiss and courts most often oblige. Indeed, some bankruptcy courts have shut the door on not just the operators themselves, but [companies that have even “tangential” dealings with marijuana companies](#). With federal legalization, that will likely change; however, in the meantime, distressed marijuana companies must look to “pseudo-bankruptcy” proceedings that offer some of the benefits that a federal bankruptcy can.

Is a State Receivership a Good Restructuring Vehicle for Distressed Marijuana Companies?

The number one option for many distressed marijuana companies will be state receivership. Much like a Chapter 11 bankruptcy, the receivership can provide for a “stay” of actions against the company’s assets, i.e., the breathing space it needs to hatch a plan for rehabilitation or exit the game as painlessly as possible. For example, the Washington Receivership Act supplies a similar stay against collection efforts, though only for 60 days. The receiver will be empowered to run the business while ironing out its operational/cash issues or conduct an orderly sale of the assets, usually through an auction process, during which the secured lender will be afforded the right to credit bid. The costs associated with that sale may be charged to the sale proceeds. Thus, in many ways, the state receivership can act like a federal bankruptcy.



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How Is a State Receivership Different From a Federal Bankruptcy?

First, the court-appointed receiver (often handpicked by the company’s primary secured lender) will be calling most of the shots from an operational, transactional, and financial perspective. That receiver may not have the kind of operational know-how of running a marijuana company that a typical debtor-in-possession might, making any major transaction more challenging. Even if the receiver has some background in the cannabis industry, he or she will still have a steep learning curve when it comes to the company’s specific business.

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

Capital Markets, M&A and Finance

State of the Current Market

2020 was a year in which the sustainability and inevitable growth of the market for cannabis as a consumable product proved out. Despite the challenges posed by the pandemic, overall U.S. cannabis sales increased by over 40% from 2019. However, this across-the-board growth in cannabis sales so far has not translated into across-the-board valuation growth for cannabis companies, particularly producers and retailers. Access to equity and debt capital has notably improved from the “nuclear winter” days of 2019 and early 2020, but capital flows have overwhelmingly favored funding expansion (organically and via acquisition) for larger multistate operators that have already achieved significant operating cash flow.

The end of 2020 saw combinations between large U.S.-based MSOs and international companies, as well as high-dollar value straight debt financings for MSOs operating in attractive state and local markets and companies having proven proprietary brands. For smaller and midsize operators in the early stages of operational development, as well as new license holders requiring funding for build-out to achieve operations and operators in “second-tier” markets, capital has remained scarce - and expensive. As a consequence, companies at the lower end of the market have found it challenging to remain in operation or launch and expand operations, and exit valuations for companies with early-stage revenue streams (or pre-revenue) have remained unattractive, often with barely enough to cover sunk costs.

Developments in 2021

With valuations for companies at the top of the market improving and institutional investors participating in these transactions to a much greater extent, opportunities for well-managed midsize, smaller and earlier-stage producers and operators should begin to improve - particularly as smaller noninstitutional and family office investors still attracted by the fundamentals of the sector, but squeezed out of



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investment opportunities at the top end of the market - look for new avenues to deploy capital. Investors who sat out the first wave of cannabis “bubble” investing and subsequent crash to earth in 2018 and 2019 should find ample opportunities to partner with smaller operators hungry for capital who are nonetheless focused on the fundamentals of business execution, albeit on a smaller scale.

With the advent of a new administration that is less overtly hostile to cannabis, there is also strong anticipation that any sort of concrete positive movement at the federal level could lead to a loosening of the current policy of the top U.S. securities exchanges to exclude all listings of companies with “plant-touching” assets in the United States. Such a shift would open the floodgates for even more institutional capital to flow into the top end of the market and provide additional impetus for more traditional cannabis investors to return to midsize and smaller companies, ultimately leading to a more robust M&A market for these companies as larger (and public market capitalized) players increasingly look to achieve growth through acquisition!

Insurance

Increased Carrier Capacity Due to Removal of Banking Restrictions

One silver lining to the havoc caused by the global COVID-19 pandemic is that it creates an incentive for politicians to look past views that were once almost an orthodoxy and focus on practical actions that will serve an unquestionable economic purpose. Specifically, politicians will likely find the incentive they need to remove financial restrictions that currently cripple the cannabis industry in the United States. More specifically, Congress may finally have the political cover it needs to finally and permanently provide protection to financial institutions that do business with the cannabis industry, and possibly eliminate the impact of Section 280E of the tax code.

Once Congress allows financial markets to participate in the U.S. cannabis industry, it will most likely lead to a tremendous increase in underwriting capacity for insurers, who are now reticent to devote meaningful portions of their capital to these markets – under fear that federal agencies could seize the funds. It is no secret that the insurance industry requires tremendous amounts of capital. By finally allowing cannabis businesses (and the businesses that support the cannabis industry) access to banking and capital markets, we can expect to see dramatic increases in capacity, a dramatic reduction in costs, and more stabilization and commoditization of insurance products.

Maturation of the Hemp Markets Will Lead to Insurer Specialization

The federal legalization of hemp in the 2018 farm bill led to an explosive growth of related businesses. Overnight, there were thousands of new CBD products, hemp products, and all of the various industries supporting those efforts. All of this was despite a murky patchwork of inconsistent (and often completely illogical) state and local regulations. Licenses were hard to come by. Seeds were hard to source. Product was hard to get certified and out to market. As these problems have slowly been resolved, the amateurs have been weeded out (no pun intended), and the professionals have consolidated and survived.



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This leads to a lot of clear road ahead, and we now have well-financed businesses in need of sophisticated (and specialized) insurance products to cover everything from transportation risks to growing risks to product liability. Insurers will likely jump at the opportunity to establish a footprint in this rapidly growing market.

Product Liability Suits Will Increase, and We May See New Exclusions

With the explosive popularity of new cannabis products will come a wave of product liability litigation. We have already seen the tip of the iceberg with litigation related to vape cartridges, and we can only expect more of the same. Whether those suits come in the form of class actions alleging unknown health consequences or as individual liability suits for accidents that occur while someone is using cannabis, we cannot predict. But they will come. As a direct result of this litigation, we can expect increases in rates for liability protection (even if there is material new capacity due to relief from banking restrictions). Additionally, we can expect to start seeing exclusions in cannabis-related policies. These exclusions may be as simple as a broad cannabis exclusion in an ISO CGL form, or as focused as specific vape product exclusions being added to cannabis-specific manuscript policies. As with any wave of litigation, we can be assured that the insurance industry will look to protect itself from these heretofore unknown liabilities.

FDA / CBD

Hemp-derived CBD

When 2020 began, most industry and FDA legal experts predicted that 2020 would be the year that (1) FDA rolled out an enforcement discretion policy regarding the use of hemp-derived CBD in food and dietary supplements, as required by legislation, (2) issued detailed regulations regarding the same, or (3) both. However, possibly delayed by the COVID-19 pandemic, neither was forthcoming. The FDA did submit its draft CBD policy to the Office of Management and Budget in July 2020, but that policy has not been cleared for publication to date. There were several reasons for hope when the year began including FDA informing the public that it was affirmatively sampling and testing products making CBD marketing claims as well as statements from former FDA Commissioner Hahn in March 2020 that attempting to prevent consumers from acquiring over-the-counter CBD was a “fool’s errand.” Instead, at present, industry remains caught between the explicit FDA policy that CBD is prohibited as a lawful ingredient in food or dietary supplements and weak enforcement against violators. The FDA has only sought to enforce against those making unapproved serious disease claims or those marketing to vulnerable populations such as teens. While we still cannot predict when the FDA will act in the absence of CBD legislation from Congress, we do know that the number and quality of research projects for hemp-derived CBD has increased exponentially.

CBD and FDA’s Real-World Data Proposal

In January 2021 FDA announced that it will be taking steps in the coming months to fill gaps in research about the safety and efficacy of CBD. In a new letter, Former-FDA Commissioner Stephen Hahn and Principal Deputy Commissioner Amy Abernethy noted the “rapid increase in the interest and availability” of the products but pointed out that “we still have a limited understanding of the safety profile of CBD and many other cannabis-derived compounds, including potential safety risks for people and animals.” As a result, the agency plans to enhance data collection in the new year. It is also in the process of conducting a “two-phase marketplace sampling and testing



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study.” The agency was mandated under appropriations legislation enacted in 2019 to provide an update on its regulatory approach to CBD, and it did so in March 2020.

New legislation was enacted which grants FDA \$5 million to support its regulatory activities with respect to CBD, and the accompanying report states that the agency must work with the White House to issue “policy guidance in a timely manner regarding enforcement discretion.” We expect this to be a continued push in 2021.

Continued FDA Enforcement Activities

In December 2020, FDA issued warning letters to five companies for violations of the Federal Food, Drug, and Cosmetic Act related to the sale of cannabidiol (CBD) products. FDA stated the companies’ had illegally marketed CBD products for the treatment or prevention of medical conditions, including COVID-19. Certain products were described as “especially concerning from a public health perspective” due to the method of administration including nasal, ophthalmic, and inhalation methods of administration. FDA stated its priority continues to be products that “pose the greatest risk of harm to the public.” FDA issued 21 warning letters related to CBD products in 2020, 13 of which were also related to COVID-19. We expect that FDA will continue to aggressively enforce against companies that cross the line in terms of claims.

Trademark

USPTO's Inconsistent Treatment of Services Adjacent to the Cannabis Industry

Use of a trademark in commerce must be lawful to support federal registration. The complicated status of cannabis' legality cause cannabis-related trademark applications to receive inconsistent treatment. This is especially true for financial services. Cannabis is a Schedule I controlled substance under the Controlled Substances Act ("CSA"), which prohibits maintaining a drug-involved premises. Further, proceeds from cannabis-related activities are subject to anti-money laundering laws such as the Money Laundering Control Act and the Bank Secrecy Act.

Frequently, when cannabis services covered in a trademark application relate to banking, an Examiner will request more information on how the mark is used. The applicant may have to enter an amendment clarifying that the services are only provided with legal forms of hemp or CBD. However, Examiners have refused or approved applications without question, even where the description covers services used in connection with federally illegal cannabis products.

This inconsistent treatment will continue until there is legislative guidance. For financial services, this may come soon because the SAFE Banking Act, which passed in the House of Representatives, aims to bar federal regulators and prosecutors from penalizing banks and credit unions for providing banking services to cannabis-related businesses.

Marijuana Prior Rights Dilemma

The federal court decision, *Kiva Health Brands, LLC v. Kiva Brands Inc., et al.*¹ shed light on issues of priority for trademarks used in connection with cannabis. In granting a motion for partial summary judgement, the Court held that defendant marijuana edibles manufacturer could not challenge plaintiff's federal trademark registration based on prior common law trademarks rights established in CA because marijuana is illegal under federal law. The Court held that the illegality of defendant's products under federal law renders defendant unable to challenge plaintiff's federal trademark because "to hold otherwise would be to put the government in the 'anomalous position' of extending the benefits of trademark protection to a seller based upon actions the seller took in violation of that government's own laws."



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Implications for cannabis companies include: (1) they may not rely upon earlier common law trademark rights for challenging federal trademark registrations, and (2) they may be deemed the infringer of a federal trademark registration, even if their use of the mark predated that of the federal registration. This decision emphasizes the importance to cannabis companies to seek strategic state and federal trademark protection.

Roadblocks for Trademark Registrations covering Dietary and Nutritional Supplements including CBD

In its recent decision in *Stanley Brothers Social Enterprises, LLC*, the Trademark Trial and Appeal Board ("Board") upheld a refusal to register the mark "CW" for use in connection with hemp oil extracts sold as dietary and nutritional supplements. However, the Board declined to address the legality of the products under the CSA. Instead, even though the Stanley Brothers' food additives and supplements at issue contain CBD rather than THC, the Board held that the supplements were still *per se* illegal under the Food, Drug & Cosmetics Act ("FDCA") and thus ineligible for trademark protection. The FDCA bans food to which has been added a drug or biological product for which substantial clinical investigations have been instituted. FDCA's definition of "food" includes products marketed as "dietary supplements" and CBD qualifies as a "drug or biological product." The Board found that the product was under substantial clinical investigation, thus concluding the goods are banned under the FDCA.

¹ Additional Discussion:

<https://www.law360.com/articles/1226543/attachments/0>

<https://harrisbricken.com/cannalawblog/kiva-lawsuit-highlights-the-cannabis-industrys-ongoing-trademark-troubles/>

Patent

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

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

Plant Patent Protection/Plant Breeders' Rights Protection for Hemp/Cannabis Plants Will Expand

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

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

In addition to narrowly covering a plant variety, utility patent protection in the cannabis industry will continue to see rapid expansion of:

- Methods of using cannabinoids to treat diseases
- Technology surrounding formulation of cannabis-related products
- Agricultural devices and methods for improved growth of varieties



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

Patent Enforcement – The first lawsuits enforcing IP in this technology area are beginning and the fight to protect market share will naturally extend to the courtroom as companies rely on their IP portfolios to keep competitors off the market. For example, the Canadian company Canopy Growth has sued GW Pharmaceuticals for infringing a patented CBD-extraction technology to make the CBD drug Epidiolex.

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

Labor

The continuing trend of legalization, especially for the recreational use of cannabis, has placed employers in a quandary. As recently as a few years ago, surveys showed that a majority of employers in America were drug testing job candidates and employees, almost always for THC metabolites. However, unlike virtually all other drug tests, there is not currently an easy-to-use test that measures current levels of THC in the body or that chemically measures current impairment. Also, while the initial laws legalizing cannabis did not have anti-retaliation provisions (meaning employers could refuse to hire or even terminate employees who lawfully used cannabis off-duty) the law is rapidly changing.

The developing trend reflected in the more recent legalization laws and through court cases is to limit employers from taking action against lawful off-duty use. This would seem to be a more logical policy result, as opposed to telling employees you can legally use cannabis, but you might not get hired or you might get fired if you do. This is even truer when it comes to medical use of cannabis, where the user, in order to get approved for medical use, likely has demonstrated to a physician that he or she has some form of disability. Under the anti-discrimination laws, qualified individuals with a disability are entitled to a “reasonable accommodation.” Thus, employers are increasingly hearing, “Why isn’t it reasonable for you to accommodate my lawful, off-duty use of medical cannabis to treat my disability?” The lack of uniformity in the laws across state lines makes it even harder for multistate employers to successfully navigate this process.

At the same time, all employers have legitimate concerns about workplace safety and, in fact, no law anywhere requires an employer to allow cannabis use on the job or allow impaired employees to work. Employers with safety- and security-sensitive positions have even greater concerns in keeping out impaired employees. Thus, employers need to rethink blanket prohibitions of employees’ lawful, off-duty use of cannabis. As the legal trend continues to offer cannabis users greater



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protections, moral opposition will likely get an employer in legal trouble. Instead, employers need to stay tuned for improvements in drug-testing methodologies, as there are companies seeking to develop tests that chemically measure current impairment. Employers should also consider training supervisory employees how to measure current impairment by using techniques adopted by law enforcement for roadside sobriety testing. There are also other behaviorally-based systems that purport to measure current impairment.

The legal trend is clear: In the next few years, more states will legalize and more people will be using cannabis. Employers need to come to grips with this trend and start thinking of cannabis more like they do alcohol, as a legal but intoxicating substance.

Securities and Government Enforcement

Maturing Scrutiny by the SEC

In recent years, the SEC has largely focused on fraud by bad actors looking to exploit the market frenzy for cannabis-related stocks. The SEC has warned the public about the possible risks of investing in “marijuana-related companies” (see https://www.sec.gov/oiea/investor-alerts-bulletins/ia_marijuana.html and https://www.sec.gov/oiea/investor-alerts-and-bulletins/ia_marijuana), but these alerts have focused on investment fraud and market manipulation in penny-stocks. In 2020, the SEC was reportedly looking into certain revenue recognition practices at Cronos Group Inc., seemingly the first such inquiry involving a publicly-traded cannabis company. The SEC’s interest in issuers’ revenue recognition practices is not new, but its application to the cannabis industry is, and it could signal an expansion of the kinds of investigations and enforcement actions the industry should expect as its participants continue to develop and mature.

Status quo at DOJ?

Following the 2016 election there was concern that AG Sessions, a vocal opponent of marijuana legalization efforts, would use the federal law enforcement powers of the DOJ to stymie the growth of the legal cannabis industry. Despite rescinding the Cole Memo in January 2018, DOJ’s enforcement posture against the cannabis industry remained largely unchanged – largely due to the unwillingness of individual U.S. Attorneys to crackdown on state-licensed cannabis businesses in their districts. President Biden’s pick for AG, Judge Garland, appears unlikely to crackdown against the industry, even if DOJ does not immediately take action to revive the Cole Memo and other policies discouraging enforcement of federal laws against legally operating state-licensed cannabis businesses. The passage of various marijuana ballot measures in several states further reduces the likelihood of adverse federal action. As these and other states work to adopt and implement regulatory frameworks for legal marijuana, however, interactions



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with state and local regulators and licensing authorities can be risky, illustrated by the federal indictment of a Massachusetts mayor who allegedly solicited hundreds of thousands of dollars in bribes to help marijuana vendors obtain licenses and regulatory approvals. With DOJ focused on other enforcement priorities, it is likely that federal criminal enforcement against the cannabis industry will continue along the same path until the administration and Congress are able to focus on marijuana legalization.

Increased cannabis fundraising opportunities in light of SEC rule changes

Federal law requires securities offerings to be registered with the SEC or qualify for an exemption. In an attempt to “harmonize, simplify, and improve” the framework of registration exemptions, the Commission voted to amend its rules governing this patchwork system (see <https://www.sec.gov/news/press-release/2020-273>). The purpose of the amendments is to “promote capital formation and expand investment opportunities while preserving or improving important investor protections” across industries. But for cannabis companies, which have historically faced challenges in other forms of fundraising, these amendments, in combination with the expanded definition of accredited investor (<https://www.sec.gov/news/press-release/2020-191>), could result in additional and different avenues for investment.

Environmental

Environmental Requirements for Operations

Cannabis cultivation, processing and extraction activities are currently subject to a myriad of environmental regulatory requirements. These arise not only under state cannabis licensing requirements, but traditional state and federal environmental regulations as well, the latter of which are often overlooked by cannabis operations. In 2020, cannabis suppliers faced enforcement activity related to management of biomass, air emissions and odors, pesticide use, and wastewater management. In addition, certain states, notably California, Colorado, Michigan, Pennsylvania and Tennessee, have conducted outreach to the cannabis community on the various obligations affecting these operations.

As the industry continues to grow, and with the increased number of states legalizing cannabis, the regulated community should expect to see an uptick in inspection and enforcement activity in 2021. Key compliance areas to be prepared for include air emission permitting, pesticide usage, wastewater and stormwater reporting, and waste storage, destruction, and disposal requirements.

Land and Energy Use

Similar to operational requirements, there are environmental regulations and permitting schemes that must be met before siting new cultivation, processing and extraction facilities. There has been various enforcement activity at the state, federal and local agency level, as well as private actions regarding environmental impact assessments, land use restrictions, disturbance of wetlands or other regulated areas, and water extraction rights. With the incoming administration focus on environment and climate change and increased state activity, 2021 is expected to bring greater attention to the permitting and approval process for new installations.



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Mergers and Acquisitions

2020 ended on a high note for mergers and acquisitions in the cannabis industry. With the growing number of states legalizing cannabis for recreational use and the continued growth of the industry, this trend is expected to continue in 2021. Due diligence in these transactions plays an important role to identify risks and allocate liability for those risks in advance of closing. Evaluation of environmental liabilities and compliance are an important component of transactional due diligence, but have been given less consideration in cannabis transactions. As a result, in this past year, purchasers have seen post-closing discovery of environmental contamination of property, missing permits, unauthorized uses of land and water, noncompliant discharges of air and wastewater, and understaffed environmental programs.

With the growing attention to environmental requirements and liabilities, anticipate a stronger focus on environmental due diligence in these transactions going forward. Such activities will likely include not just investigation of real property conditions, but also an environmental compliance assessment of operations to identify both historical liabilities and current compliance gaps and risks.

ABOUT FOLEY & LARDNER LLP

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ABOUT FOLEY'S CANNABIS TEAM

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

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

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

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

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