

Cannabis Industry Civil Litigation and ADR

ADR Services, Inc.

International Cannabis Bar Association

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KATY YOUNG

Katy represents both plaintiffs and defendants in business disputes, real estate claims and intellectual property litigation, with a unique focus on matters for cannabis industry litigants. Katy is one of the most experienced cannabis-focused civil litigators in the country. She is passionate about the industry and enjoys the challenges inherent in litigating cases on the cutting edge, thereby shaping policy. Katy is graduate of University of San Francisco School of Law and University of the Pacific where she was a scholarship athlete. She has been named a Northern California Super Lawyer Rising Star for 2014 through 2021. In 2018-2021, she was named to Benchmark Litigation's top 40 under 40 list. She is the Managing Partner of the Ad Astra Law Group, LLC in San Francisco. She also the President of the InterNational Cannabis Bar Association.

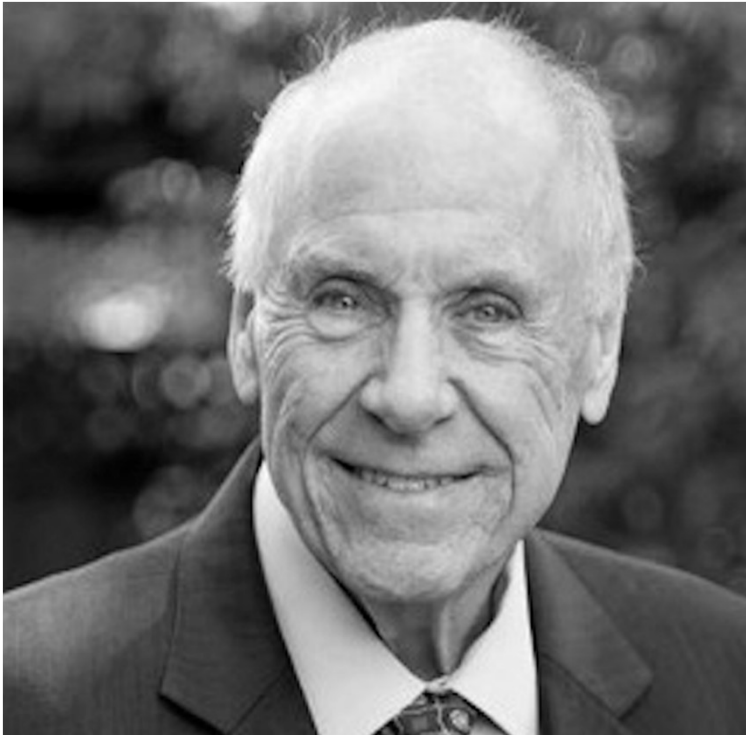
IAN STEWART



Ian is the regional managing partner of Wilson Elser's Los Angeles office. He has defended complex litigation in state and federal courts for 25 years with a diverse practice that includes product and professional liability, cannabis law, data privacy and cybersecurity, complex general casualty and intellectual property litigation.

Ian has achieved a national reputation as a preeminent cannabis attorney and has been named to the prestigious Chambers USA 2020 and 2021 guides in Cannabis Law. As co-chair of the firm's national Cannabis Law Practice, Ian leads a national multidisciplinary team of lawyers who serve all aspects of the cannabis and hemp industries, as well as financial institutions and insurance companies that service those industries.

Ian is a graduate of Washington University in St. Louis, and Saint Louis University School of Law.



FRANK BURKE

Frank is a full time neutral with ADR Services, Inc. and handles mediation and arbitration matters on Zoom and in offices in San Francisco, San Jose and Oakland. He focuses on business, commercial, real estate, cannabis, commercial and residential leases, technology, trade secrets, patents, corporate governance, employment and personal injury matters.

He applies his 42 years of experience as a business trial lawyer in national law firms having handled a diverse range of business disputes involving varied business sectors in federal and state courts and administrative agencies in 26 states, China and Canada. He is a 1972 graduate of Cornell University (Magna Cum Laude in Economics) and a 1975 graduate of Harvard Law School. He is recognized in Best Lawyers for Arbitration, Mediation and Commercial Litigation and in California Super Lawyers for Alternative Dispute Resolution

Cannabis Business Litigation Disputes

- Just as in the widget business, civil litigation runs the gamut
- Most common of all are partnership disputes, breach of contract, landlord-tenant and real property issues
- Other very common types are corporate governance fights, securities issues, tax, intellectual property disputes, and employment matters
- Environmental and Water law
- Product liability matters

Partnership Disputes

- In California, the newly-passed MAUCRSA does not limit vertical integration the same way that former MCRSA statute did, so there is an uptick in mergers and acquisitions.
- Industry pioneers and non-cannabis business professionals are forming entities together rather quickly.
 - They need each other, but there is a culture clash between industry pioneers and capital investors.
 - Many transactional practitioners don't build in dispute resolution procedures, many entrepreneurs don't consider what to do when things fall apart.
 - The entity suffers while the founders fight. Receiverships are hard to obtain.

THE CULTURE CLASH

Industry Pioneers

- Cowboy Personality or Kumbaya/Can't we all just get along
- Varying levels of sophistication
- Varying levels of capitalization

Business Community

- The Movement or the Money
- Generally more sophisticated, easily frustrated by some industry pioneers
- Generally better capitalized

Breach of Contract Actions

- Emerging businesses contract with and rely on industry professionals to guide entry through the regulatory process, or established businesses contract to purchase goods or services.
- Industry specific problem: speculative damages in a new industry
- California's Civil Code section 1550.5 provides that compliant commercial cannabis activity is a lawful object of a contract and increases the availability of attorney-client privilege (similar statutes in Colorado, Illinois, Massachusetts, Michigan, Nevada and Oregon)

Corporate Disputes

- Businesses formed before 2017 operated as non-profit mutual benefit corporations, replete with a Board of Directors and Officers. Most have been converted to for-profit entities. There is gross misunderstanding of the fiduciary duties of officers and directors to the company and its stockholders.
 - Transactional lawyers must educate their clients on Director and Officer duties, chiefly fiduciary duties: self-dealing, loyalty, care.
 - California's prior medical marijuana regulatory scheme has been loose and regulated county by county, will tighten with Department of Cannabis Control regs

Investor Fraud Disputes

- California's Prop 64 includes a high monetary barrier to entry, thus forcing cannabusinesses to raise funds through investors. There are few publicly traded companies, so private placement securities reign supreme.
 - Taking investment money from passive investors with no management responsibility constitutes a security. Businesses seeking investors need an Offering Memorandum or Private Placement Memorandum.
 - Follow Rule 506 of Regulation D and state securities laws, especially Cal. Corp Code §§ 25101.1 and 25102, and understand the accredited investor requirements: noncompliance can lead to rescission.
 - Canadian publicly traded companies present a whole new category of risk-engage competent Canadian counsel.
 - Industry pioneers ALL think their products are “the best,” but attorneys must temper their excitement, especially in PPMs.

Landlord/Tenant Disputes

- Common for landlord to have an interest in the business
- When reviewing leases, make sure that your client negotiates out of the covenant not to use the space to violate laws
- Make sure the landlord knows what the tenant will be doing with the space
 - Beware of forfeiture laws
- Fixtures: grow facilities require building in equipment, get clarity on whether the landlord gets to keep the lights, irrigation system, fans, etc.
- Live/Work Arrangements- resident farmers reluctant to leave, employment contracts should be accompanied by a lease

How to Cannabis-ize a Real Estate Lease- 1

- Due Diligence
- Check for encumbrances/mortgages – will they accelerate?
- Confirm water and energy use/limits
- Include representations and corresponding indemnities
- Clearly define the “Permitted Use” – cite regulatory authority and the type of license(s) the Tenant will hold
- Consider Tenant modifications (processing equipment, HVAC, environmental controls, etc.)
- Exclude compliance with any law that classifies the possession, cultivation, or sale of cannabis as a criminal offense (including, without limitation, the Federal Controlled Substances Act) – careful not to disclaim “all Federal laws”
- Make sure the landlord knows what the tenant will be doing with the space
- What will happen if U.S. initiates a forfeiture proceeding?
- Concerns of refinancing that the tenant is obligated to cooperate with (estoppels and SNDAs)
- Limit Landlord’s (or any Visitor’s) right of re-entry/re-possession – subject to regulatory requirements/restrictions

How to Cannabis-ize a Real Estate Lease- 2

- Allow for payment of rent in cash (or other currency) – keep it flexible
- Tenant must handle all disposal issues
- Insurance requirements should reflect what is customary in the cannabis industry
- Remedies upon default must be sensitive to regulatory requirements with respect to disposal of inventory
- Check for regulations that allow Landlord to take possession of inventory
- Customize assignment provisions (many affiliated entities)
- Consider appropriateness of profit share or percentage lease (ownership requires approval)
- Termination provisions tied to licensure (or approval thereof), forfeiture
- Fixtures: grow facilities require building in equipment, get clarity on whether the landlord gets to keep the lights, irrigation system, fans, etc.
- Live/Work Arrangements- resident farmers reluctant to leave, employment contract should be accompanied by a lease

Tenant Oriented Provisions Regarding Potential Civil Forfeiture

- ▶ Agreed Use: Medical and Recreational Cannabis Dispensary
- ▶ Indemnification: Lessee shall indemnify the Lessor from any claims resulting from Lessee's use or occupancy of the property.
- ▶ In the event that a forfeiture action against the property is filed by the United States Department of Justice, lessee agrees to defend and indemnify the lessor in that action, using experienced counsel of lessee's choice
- ▶ Also note: civil abatement actions by City Attorneys' Offices

EMPLOYMENT DISPUTES

- Each state's employment laws and federal employment law all apply.
- As an employer, cannabis businesses must follow:
 - wage and hour laws (MedMen class action filed in LA)
 - local ordinances (like San Francisco's sick leave ordinance),
 - Independent contractor vs employee rules (Dynamex changed the landscape dramatically), and
 - anti-discrimination rules.
- Extra challenges for cannabis employers:
 - Shop talk at the trim table/culture
 - Friends taking advantage of friends
 - Promises of equity in exchange for work
 - Reluctance to be paid through payroll

The Vicious Cycle

How do Cannabis Businesses obtain operating capital and what problems does it cause those businesses and their insurers?

- ▶ Private investment through:
 - ▶ Private loans
 - ▶ Equity raises through VC firms, family offices, private placements
 - ▶ Equity raises through public markets (foreign exchanges, RTOs, SPACs)
 - ▶ Real-estate deals (REITs, lease-backs)
- ▶ Disclosure of known risks to prospective investors is difficult
- ▶ Pressure from Investors on operations and profit is dangerous
 - ▶ Compliance vs growth
 - ▶ 280E and other obstacles to profitability
- ▶ Operators exposed from no Bankruptcy protection
- ▶ Lack of D&O coverage compounds the problem
 - ▶ Prevents top talent from joining management and boards
- ▶ End Result? Conflict and Lawsuits!

D&O and Other Management Liability

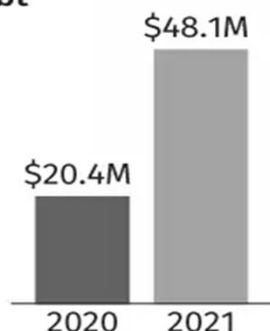


Cannabis Capital Raises Expand in 2021

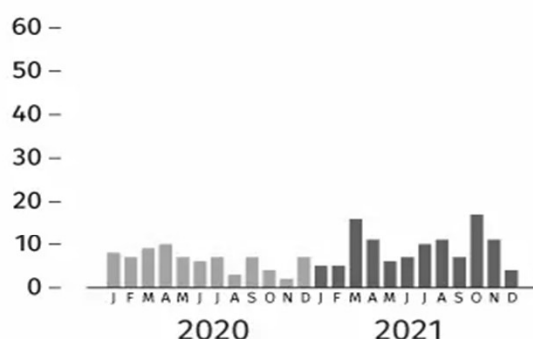
Total cannabis capital raises, both debt and equity, outpaced 2020 this year but fell short of the 2018 peak by \$2 billion

Average raise

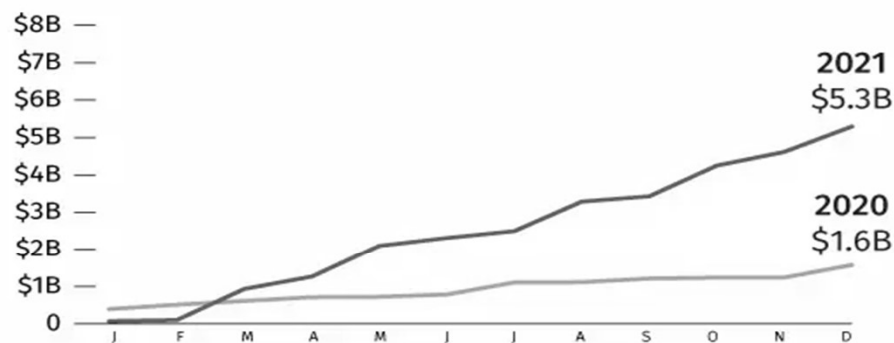
Debt



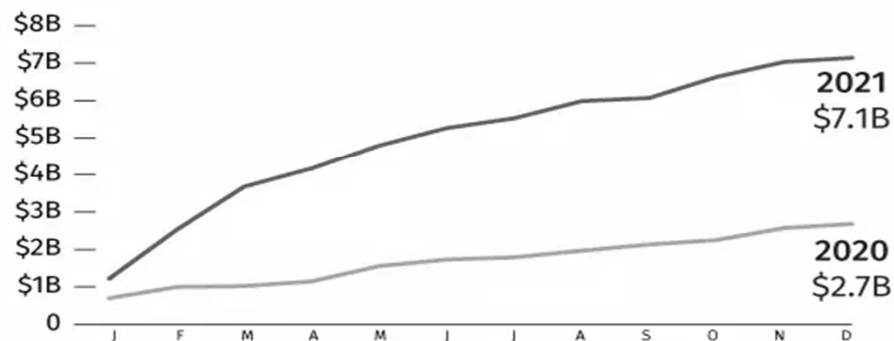
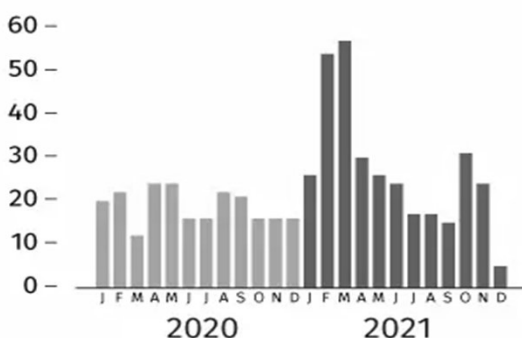
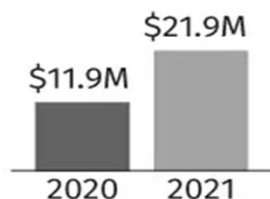
Raises per month



Cumulative raise total



Equity



NOTE: 2021 numbers as of Dec. 15.

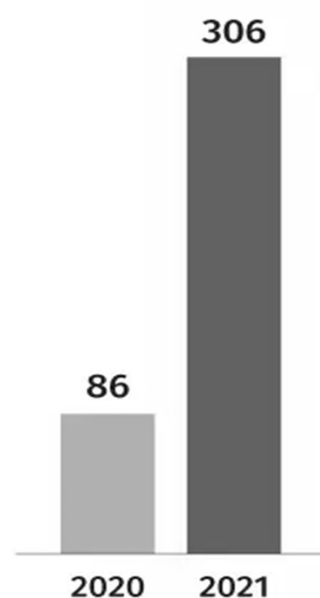
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Source: Viridian Capital Advisors, MJBizDaily research

Notable Cannabis Acquisitions in 2021

Merger and acquisition activity heated up in 2021, with almost 3½ times as many transactions through Dec. 17 as during the same period in 2020. Public companies were buyers in 86% of the deals.

M&A transactions



Deals

Acquirer	Target	Deal Value*
Jazz Pharmaceuticals	GW Pharma	\$7.2 billion
Trulieve	Harvest Health	\$2.1 billion
PharmaCann	LivWell	Not disclosed
Hexo	Redecan	\$766 million
TerrAscend	Gage Cannabis	\$545 million
Canopy	Supreme Cannabis	\$346 million
Canopy	Wana Brands (right to buy)	\$297 million
Curaleaf	Emmac Life Sciences	\$286 million

* Value at the time of announcement

Source: Viridian Capital Advisors, MJBizDaily research

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TRENDS IN CANNABIS LITIGATION: PRODUCTS LIABILITY

- Few product liability cases have been filed based on bodily injury arising from cannabis consumption, design defect, manufacturing defect or failure to warn. Few that have been filed are primarily based on:
 - contamination with pesticides, mold/mildew or heavy metals.
 - injuries from machinery during manufacturing/extraction.
- In California, there are two “tests” on which the jury is instructed, including:
 - the risk-benefit test
 - the consumer expectations test
- Problems to solve:
 - Lack of uniform standards for serving size, labels and warnings.
 - Lack of consumer awareness around cannabis products
 - Testing variability
 - Quality control issues

ADVISING CLIENTS ON PRODUCT RISK MANAGEMENT

- Distinguish between risk of traditional product liability versus “product ancillary” risks
- Regulatory compliance with labels and warnings
- Quality assurance, testing and documentation
- Vetting the chain of distribution
 - The unique role of the cannabis testing lab
- Product liability insurance
- Risk transfer strategies with vendors/suppliers/distributors
 - indemnity and additional insured endorsement

Are Cannabis Businesses Prepared to Defend Product Liability Litigation?

SPECIAL INTERROGATORY NO. 26:

Describe any and all bodily effects that are caused by ingestion of products that are the same make and model as the PRODUCT.

SPECIAL INTERROGATORY NO. 30:

Within ten years before the INCIDENT, did YOU warn consumers, including but not limited to Plaintiff, about the dangers and/or risks of the PRODUCT or products of the same make and model?

SPECIAL INTERROGATORY NO. 104:

DESCRIBE YOUR knowledge at the time of the INCIDENT of the bodily effects caused by orally consuming edible marijuana products versus inhaling marijuana smoke.

SPECIAL INTERROGATORY NO. 137:

IDENTIFY any and all experts that YOU consulted within ten years before the INCIDENT to the present regarding health and/or safety warnings for marijuana products that YOU sold.

- ▶ Similar Interrogatories are common in litigation involving most consumer products.
- ▶ Companies in other industries can handle these questions with relative ease. Can the same be said for the cannabis industry?

“Product-Ancillary” Claims and Litigation

- ▶ Most claims and litigation around cannabis products to date are based on allegations of contamination, mislabeling and testing failures that have resulted in:
 - ▶ Product recalls
 - ▶ Consumer class actions
 - ▶ Competitor suits
 - ▶ State regulatory violations and resulting civil abatement actions
 - ▶ Violations of consumer protection statutes

Product Contamination

- ▶ Most product contamination is through:
 - ▶ Pesticides (as well as herbicides and fungicides)
 - ▶ No assistance from EPA or Department of Agriculture
 - ▶ Solvents
 - ▶ Heavy metals
 - ▶ Microbiological contaminants
 - ▶ Common contaminants like E. coli and salmonella
 - ▶ Less common contaminants like mycotoxins
 - ▶ cGMP standards

Cannabis Testing Laboratories – A Trust Gap?

- ▶ There are many well-respected cannabis lab operators
- ▶ But there are also reports of troubling business practices by some that include:
 - ▶ Lab Shopping
 - ▶ Quid pro quo arrangements
 - ▶ Cherry Picking
 - ▶ “Kiefing”

Cannabis Testing Labs – Varying Methods and Equipment

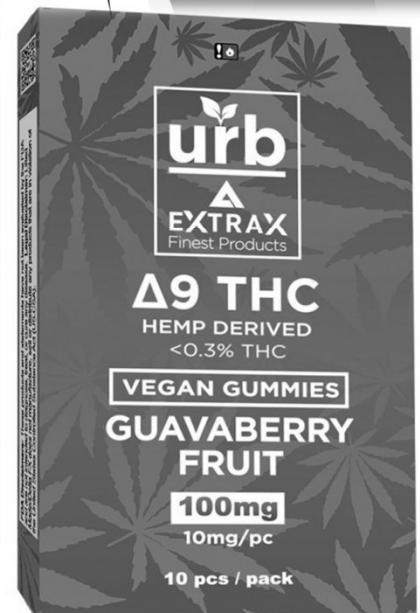
- ▶ States have varying standards
- ▶ Testing methods and validation procedures vary widely even by labs within same state
 - ▶ California is developing mandatory uniform standards for its 41 licensed labs
- ▶ Additional divergence in training of staff and quality of equipment used by laboratories to isolate contaminants and to separate/measure cannabinoid content
 - ▶ gas chromatography (GC)
 - ▶ high-performance liquid chromatography (HPLC)
 - ▶ mass spectrometry and diode-array detection
- ▶ Result is environment where it's difficult to validate accuracy of test reports
 - ▶ This is a particular problem for MSOs that expect consistency with their branded products across multiple states

Cannabis Testing Labs – What Changes are Needed?

- ▶ What is needed to help close the testing laboratory trust gap?
 - ▶ Uniform standards
 - ▶ Striking the right balance means adopting standards that allow some degree of flexibility for a still-emerging industry while keeping customers safe
 - ▶ Mandatory full accreditation
 - ▶ Objective demonstration of proficiency
 - ▶ Better investment in state-of-the-art equipment
 - ▶ Adoption and enforcement of ethical business practices
 - ▶ Resolve the problem of federal illegality to allow traditional food labs that maintain DEA licenses to enter the space

Intoxicating Hemp-Derived Products

- ▶ Delta 8 THC products
 - ▶ Chemical isomer of Delta-9 THC
 - ▶ Psychoactive and intoxicating
 - ▶ Antiemetic, anxiolytic, appetite-stimulating and neuroprotective properties
 - ▶ Marijuana does not express Delta-8 in adequate concentration to make it commercially viable
 - ▶ Delta-8 may be chemically converted from hemp-derived CBD
- ▶ Delta 9 THC products
 - ▶ Even limited to 0.3% THC concentration by weight:
 - ▶ 4 gram gummy may have 10 mg $\Delta 9$
 - ▶ Typical energy bar of 60 grams may have 180 mg $\Delta 9$!!



Trends in Cannabis Litigation: CONSUMER CLASS ACTIONS

- ▶ As the cannabis industry continues to grow, we are seeing more consumer class action litigation, especially in California
- ▶ Common causes of action:
 - ▶ Consumer Legal Remedies Act (Cal. Civ. Code Section 17250 *et seq.*)
 - ▶ Unfair Competition (Cal. Bus. Prof. Code Section 17200 *et seq.*)
 - ▶ False Advertising (Cal. Bus. Prof. Code Section 17500 *et seq.*)
 - ▶ Negligent Misrepresentation
 - ▶ Unjust Enrichment
 - ▶ PAGA Actions

Trends in Cannabis

Consumer Cannabis Class Action Litigation

► ***Dan Spitzer v. Central Coast Agriculture, LLC dba Raw Garden (San Francisco Superior Court)***

- Raw Garden is a licensed cannabis cultivator and manufacturer of “Live Resin” cannabis vaporizer cartridges
- Plaintiff alleges that “rather than converting Live Resin sauce into a liquid for use in its ‘Live Resin’ vape cartridges, Raw Garden creates these cartridges by making Live Resin and then distilling the Live Resin” and that “Raw Garden’s ‘Live Resin’ is not Live Resin because it has been distilled...and does not contain all of the organic compounds that are in a true Live Resin.”
- Complaint filed July 29, 2020

► ***Tina Lambert v. Kiva Brands, Inc. (San Diego Superior Court)***

- KBI is a licensed cannabis manufacturer of cannabis-infused confectionary products, including KIVA Bars, PETRA Mints, CAMINO Gummies, and TERRA Bites.
- Plaintiff alleges that KBI misrepresents the THC content on the packaging for its products
- Complaint filed in 2018 and OSC why case should not be dismissed issued in July 2020 for hearing in September 2020

INSURANCE ISSUES FOR CANNABIS LITIGANTS

- ▶ Historically, insurers would not insure any business related to cannabis.
- ▶ Some insurance companies are open to it, depending on the business.
- ▶ Practical tips: be clear with the broker and on the applications that the business involves cannabis and in what manner.
 - ▶ Insist that your client at least try to obtain D&O insurance, product liability, commercial general liability, title insurance, other insurance as needed.
 - ▶ Always tender a claim to an existing insurer anyway, you never know what they might agree to cover.

Insurance Marketplace – Property Coverage

- ▶ What is “Covered Property”?
 - ▶ Building
 - ▶ Business Personal Property
 - ▶ Tenant Improvements and Betterments
 - ▶ Stock/Inventory
 - ▶ Living Plants/Harvested Plant Material/Finished Product
 - ▶ Property of Others
- ▶ Equipment Breakdown
- ▶ Business Income
 - ▶ Lack of business history
 - ▶ Questionable accounting
- ▶ Valuation
 - ▶ Per Plant Value
 - ▶ Lack of data and market fluctuations
- ▶ Co-Insurance Penalties

Theft Claims – Protective Safeguard Requirements



How is Product Stored?



15 15-024 Date Taken: 8/12/2021
Vault room. Solid reinforced concrete with 2" solid steel door.



36 39-056 Date Taken: 8/12/2021
Product storage cages.

Security Personnel Failures and “Inside Jobs”



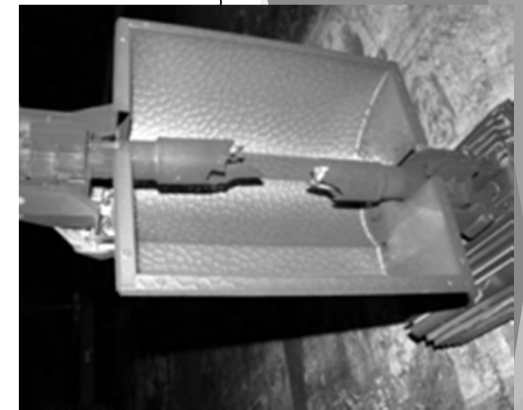
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Civil Unrest – Losses from Theft/Vandalism



Fire Losses –High Intensity Discharge (HID) Lighting



- ▶ Bulb/ballast incompatibility is the leading cause of fire losses in cultivation facilities
- ▶ HID bulbs are also high maintenance and require diligent standard operating procedures to maintain their safe operation

CANNABIS & FEDERAL INTELLECTUAL PROPERTY: ENFORCEMENT DEPENDS ON WHAT RIGHT IS BEING CLAIMED

- Trademarks/Copyright
- Patents



Trends in Cannabis Trademark Litigation

- ▶ Federal Lanham Act trademark infringement actions against cannabis companies have increased in recent years.
- ▶ The law as to registration of federal trademarks for cannabis goods with the USPTO is clear:
 - ▶ The Trademark Trial and Appeal Board has “consistently held that, to **qualify for a federal ... registration, the use of a mark in commerce must be ‘lawful’.**” *In re JJ206, LLC*, 120 USPQ2d 1568, 1569 (TTAB 2016) (affirming refusal to register trademark in connection with cannabis vaporizing and delivery services for lack of lawful use in commerce).
- ▶ USPTO reaffirmed in 2019 guidance that will not grant trademarks on cannabis products that are illegal under the CSA
- ▶ USPTO office will grant trademarks on legal hemp, hemp derived CBD products, hemp oil and other hemp derived goods with less than .3% THC, are not edible and claim no medicinal benefits which are lawful under the 2018 Farm Bill. Hemp oil extracts used as a dietary or nutritional supplements may not be trademarked.

Alternative Trademark Strategies

- ▶ Alternative method is to trademark ancillary products such as a line of clothing, ashtrays, lighters, vaporizer pipes, rolling papers or glassware or websites.
- ▶ As an alternative a Cannabis business may seek a state trademark which covers only the state in which it has been filed. California allows state trademark filings for Cannabis products that are lawfully in use in commerce. Upon issuance it can be labeled with a superscript “TM”.
- ▶ As an alternative a cannabis business may establish a common law trademark which is enforceable only in the geographic area in which the business operates or may expand, and may use superscript “TM”.
- ▶ When working with others, a Cannabis business should consider contract language that the Company retains an ownership interest in all intellectual property concerning the company’s products.

Issues in Trademark Litigation

- ▶ As trademark litigation in the cannabis industry continues, other issues and/or trends have developed:
- ▶ Determining likelihood of confusion (LOC) on same or similar marks
- ▶ Determining the senior user of the mark when cannabis company was using the mark in commerce *before* the non-cannabis company
- ▶ Litigation against unlicensed, “copycat” cannabis companies

Trends in Cannabis Trademark Litigation

The LOC Analysis in Cannabis Trademark Litigation

- ▶ **LOC Test for Infringement:** whether the defendant's use of the trademark is likely to cause confusion about the source of the plaintiff's or the defendant's goods.
- ▶ **The *Sleekcraft* Factors Considered in Determining LOC:**
 1. Strength or Weakness of the Marks
 2. *Relatedness of the Goods/Services**
 3. Similarity of the Marks
 4. Evidence of Actual Confusion
 5. *Marketing Channels Used**
 6. Degree of Consumer Care
 7. Defendant's Intent in Selecting the Mark
 8. Likelihood of Expansion of Product Lines

AMF Inc. v. Sleekcraft Boats, 599 F.2d 341, 348-49 (9th Cir. 1979).

See further case law in Appendix

Trends in Cannabis Trademark Litigation

Who is the Senior User?

- ▶ What is the significance of the “senior user” in trademark law?
 - ▶ Senior user generally has superior rights to the mark over junior users, including the right to register the mark with the USPTO
 - ▶ Prior use is a defense to infringement claims
 - ▶ Prior use can be a basis for cancelling a federally registered mark

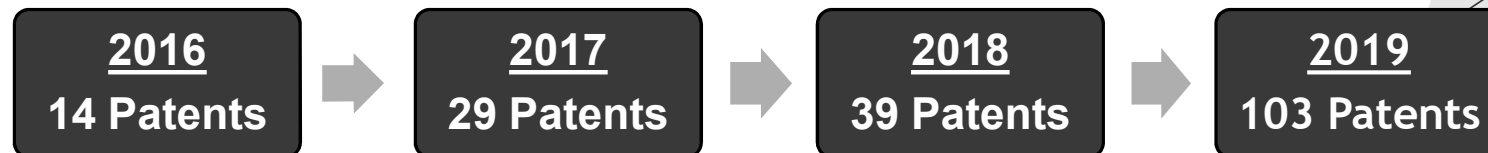
Trends in Cannabis Patent Litigation

- The USPTO is willing to issue patents on cannabis irrespective of its legality because patent rights are merely negative rights; a patent is the right to exclude others from the invention claimed therein rather than a license to make, use, or sell the invention.
- Most claim secondary technologies, e.g., cultivation methods, processing and extraction techniques, cannabis-derived products, consumption devices, and medical treatments, some claim new strains of the cannabis plant itself.

• ***United Cannabis Corp. v. Pure Hemp Collective, Inc***

- First patent infringement case, filed in Colorado District Court on July 30, 2018.
 - United Cannabis (UCANN) owns U.S.P 9,730,911, which protects “liquid cannabinoid formulation, wherein at least 95 percent of the total cannabinoids is cannabidiol (CBD).”
 - PHC sells a tincture with a CBD level of at least 95%, allegedly infringing UCANN’s patent.
- PHC moved for partial summary judgment that the ‘911 is invalid under an *Alice* challenge as it is “directed to” an unpatentable law of nature, a natural phenomenon, or an abstract idea – the Court rejected this challenge.
- BUT → “To be clear, the Court sees reason to question whether the 911 Patent claims anything novel, useful, or nonobvious.”
- Can avoid *Alice* by claiming only genetically modified strains, compounds, formulations, dosage forms, methods of treatment, and methods of extraction/purification.

Cannabis-Related Patents are on the Rise!

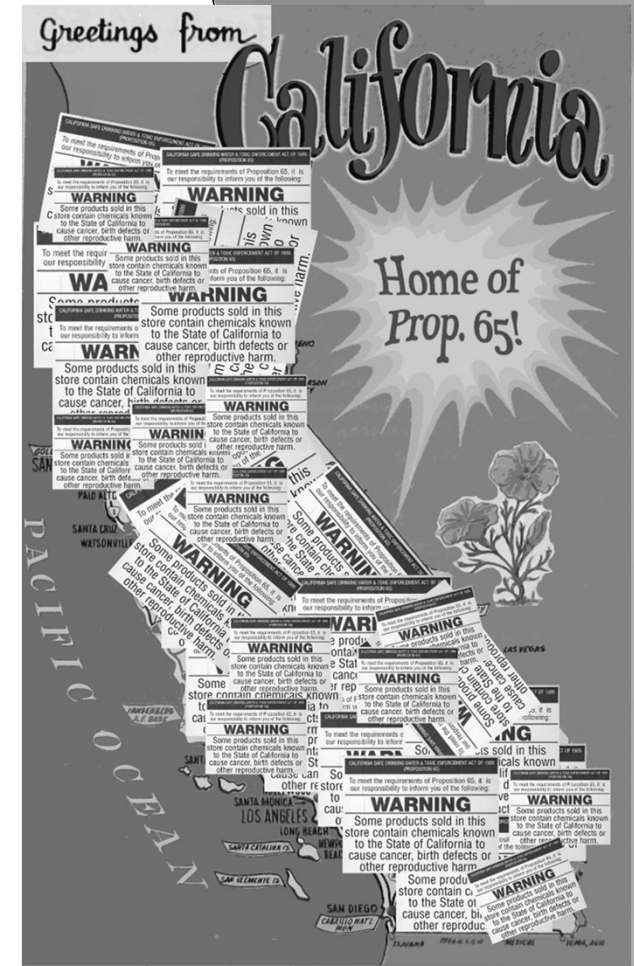


PROP 65- ENVIRONMENTAL LITIGATION

- Prop 65:
 - Under the Safe Drinking Water and Toxic Enforcement Act of 1986 (Prop 65) the Office of Environmental Health Hazard Assessment (OEHHA) publishes a list of chemicals known to cause cancer, birth defects or other types of reproductive harm. In 2009, marijuana smoke was added to the Prop. 65 list of chemicals known to cause cancer.
- Environmental Litigation :
 - Nuisance claims (smell)
 - CEQA
 - Water rights
 - Air quality issues
 - Pesticide use


California's Prop 65

- ▶ THC has been added to the list of Prop 65 chemicals as known to cause birth defects or reproductive harm
- ▶ Became effective on January 3, 2021
- ▶ No safe harbor limit
- ▶ Impact on CBD products?



Required Content of a Prop 65 Warning for THC

- ▶ Seek legal advice before determining what Prop 65 warning should be used for any particular product!
 - ▶ With that important caveat, an exemplar standard Prop 65 warning for THC looks like this:

 **WARNING:** This product can expose you to Δ9-Tetrahydrocannabinol (Δ9-THC), which is known to the State of California to cause birth defects or other reproductive harm. For more information go to www.P65Warnings.ca.gov.

- ▶ Alternatively, a *short-form warning* may be provided on the product label, BUT it must be in a type size no smaller than the largest type size on label and no smaller than 6-point type:

 **WARNING:** Reproductive Harm – www.P65Warnings.ca.gov.



CANNABIS IS A REGULATED LAND USE

State license applications generally require the following:

- Proof of a local use permit or authorization
- Proof of compliance with CEQA
- Proof of compliance with other state agency permit requirements (i.e., LSAA, General Order enrollment);
- Detailed site plan;
- Name and ownership structure of applicant, as well as financial interest holders;
- Description of criminal convictions;
- Description of water source, power source, waste treatment, chemical handling;
- Cultivation and/or operations plan;
- Security plan;
- Inventory handling and storage plan;
- Other? Who knows.

LOCAL GOVERNMENT FIGHTS

- Local Government Fights:

- The complex regulatory system in place is carried out by your local government employees
- Small town problems: favoritism, conflicts of interest, missing deadlines, borderline incompetence
- Tough choice whether to name local government in a complaint
- Be nice, make friends with your local regulators

CANNABIS IS A REGULATED LAND USE

- State law (MAUCRSA) authorizes local governments to allow **all**, allow **some**, or **prohibit all** commercial cannabis activities.
- Many local governments (counties and cities) have adopted ordinances allowing commercial cannabis activities once a **permit** is obtained.
- Humboldt County, for example, requires either a zoning clearance certificate, a special use permit, or a conditional use permit for all cultivation, processing, and manufacturing operations.
- Local permits often are “discretionary,” meaning the local government **is not required to approve the permit**.

CANNABIS ANTITRUST CLAIMS

- ▶ *Richmond Compassionate Care Collective v. Richmond Patient's Group et al, Contra Costa Superior Court, Case No. MSC16-01426*
- ▶ A cannabis company alleged that it was prevented from opening in Richmond by a conspiracy among a rival group of dispensaries seeking to control the local cannabis market. They attempted to prevent it from leasing or buying a storefront before its pending permit expired that complied with Richmond's location requirements regarding proximity to schools, of which there was a limited inventory. The competitors were alleged to have engaged in an unlawful group boycott to tie up the landlords with a deluge of papers, including presenting bogus leases, letters of intent to lease or purchase, and purchase agreements to owners and landlords. The jury found \$5 million in damages which was trebled to \$15 million under the Cartwright Act.

ALTERNATIVE DISPUTE RESOLUTION

Mandatory initial meeting of the principals?

Mandatory non-binding mediation as a prerequisite to litigation or arbitration?

Consider adding “teeth”: no pre-litigation mediation means no attorneys’ fees even if you later prevail

Mandatory arbitration vs litigation?



ENFORCEMENT OF ILLEGAL CONTRACTS IN FEDERAL COURT:

U.S. Supreme Court:

- “Illegal promises will not be enforced in cases controlled by federal law. . . . It is also well established . . . that a federal court has a duty to determine whether a contract violates federal law before it enforces it.” *Kaiser Steel Corp. v. Mullins*, 455 U.S. 72 (1982).

BUT, this rule is not absolute:

- “Nuanced approaches to the illegal contract defense, taking into account windfalls or forfeitures, deterrence of illegal conduct, and relative moral culpability, remain viable in federal court and represent no departure from *Kaiser Steel* . . . as long as the relief ordered does not mandate illegal conduct.” *Bassidji v. Goe*, 413 F.3d 928 (9th Cir. 2005).
- “The defense of illegality . . . is not automatic but requires . . . a comparison of the pros and cons of enforcement. *NIPISCO v. Carbon City Coal Co.*, 799
- **Severability**
- Can the illegal portion of a contract be “severed” such that the court can enforce its other terms?
- Generally controlled by state law.

Case Law Not Applying Illegality as a Defense

- ⌞ *Mann v. Gullickson*, No. 15-cv-03630-MEJ, 2016 WL 6473215 (N.D. Cal. Nov. 2, 2016)(enforcing a promissory note relating to shares in an ancillary goods and services business)
- ⌞ *Green Earth Wellness Center, LLC v. Atain Specialty Insurance Co.*, 163 F. Supp. 3d 821 (Dist. Col. 2016)(denying motion for summary judgment brought by insurance carrier due to losses to plants in fire and theft)
- ⌞ *Ginsburg v ICC Holdings LLC*, Case No. 3:16-cv-2311 (N.D. Texas 2017)(enforcing PPM contract)
- ⌞ *Williams v. Eaze Solutions Inc.*, No. 3:18-cv-02598 (N.D. Cal. Oct. 21, 2019)(arbitration clause severable and enforced)
- ⌞ *Left Coast Ventures Inc.*, 2:19-cv-01297 (W. Dist. WA Dec. 6, 2019)(abstention)

Case Law Applying Illegality as a Defense

- ⌄ *Tracy vs. USAA Casualty Insurance Company* 2012 U.S. Dist. LEXIS 35913 *; 2012 WL 928186 (denying claim for breach of insurance contract seeking proceeds for replacement of medical cannabis plants)
- ⌄ *Polk v. Gontmakher*, 2:18-cv-01434 (W. Dist. WA May 21, 2020)(denying profits in breach of contract action)
- ⌄ *Lilly LLC v. Clearspan Fabric Structures International Inc.*, 3:18-cv-01104 (Dist. OR April 13, 2020)(denying profits to landlord payable under a lease)
- ⌄ *Bart Street III v. ACC Enterprises LLC, et al.*, 2:17-cv-00083 (Dist. NV Apr. 1, 2020)(refusal to enforce multimillion dollar expansion loan)

Dealing with Federal Court Split on Illegality

Defense 1

- The Problem: Federal Court decisions are split on whether to allow an illegality defense to bar contract and other claims brought by cannabis companies (see cases in Appendix)
- The Solution: Force Disputes into Arbitration or State Courts
- Use arbitration clauses in all contractual and lease documents
- Use forum selection clauses to select state courts, including contracts containing arbitration clauses. These should select state courts even for provisional remedies and enforcement of arbitral awards.

Dealing with Federal Court Split on Illegality Defense 2

- Use choice of law provisions to elect state laws where cannabis is fully legalized.
- Include waiver of removal to federal court.
- Ensure that cannabis entities are incorporated in states where cannabis is fully legalized
- Include severability clauses in contracts
- Invoke federal abstention doctrine on matters brought in federal court

NON-CONTRACT CLAIMS-RELIEF DOES NOT REQUIRE VIOLATION OF THE CSA

- ▶ ***Kenny v. Helix TCS Inc.***, 939 F.3d 1106 (10th Cir. 2019): Cannabis security company subject to Fair Labor Standards Act's requirements.
- ▶ ***SIVA Enterprises v. Ott et al***, No. 2:18-cv-06881 (C.D. Cal. Nov. 5, 2018): A case brought under the federal misappropriation statute could proceed because the dispute did not involve the actual production or sale of cannabis, but rather concerned the actions of defendants in allegedly misappropriating plaintiffs' confidential business information and passing themselves off as SIVA to take SIVA's clients.
- ▶ ***Tarr v. USF Reddaway, Inc.***, No. 3:15-cv-02243-PK, 2018 WL 659859 (Dist. Or. Feb. 1, 2018): Plaintiff in a personal injury action could seek an award of lost-profit damages sustained by a cannabis operation, despite federal illegality.
- ▶ ***Noffsinger v. SSC Niantic Operating Co. LLC***, 273 F. Supp. 3d 326, 334 (Dist. Conn. 2017): Because the CSA does not regulate the employment relationship, antidiscrimination provision of Connecticut's medical cannabis law does not conflict with the CSA.
- ▶ ***Value Linx Services LLC v. Linx Card Inc.***, No. 3:18-cv-02126, 2019 WL 3502895 (Dist. Or. Aug 1, 2019) (breach of contract action involving the sale of gift cards sold at kiosks within cannabis dispensaries that allow customers to purchase cannabis without cash was allowed to proceed).
- ▶ ***Headspace International LLC v. New Gen Agricultural Services LLC***, No. 2:16-cv-03917, 2017 WL 2903181 (C.D. Cal. June 19, 2017) (ruling on plaintiff cannabis manufacturer's motion for default against competitor for Lanham Act and state trademark violations).

Bankruptcy

- Usually an effective tool to deploy while settling cases, but cannabis-based businesses that touch the plant have no recourse in bankruptcy court.
 - Practical advice: advise clients about corporate hygiene and commingling assets
- *Arenas v. U.S. Trustee (In re Arenas)*: bankruptcy relief is unavailable to debtors whose business activities violate federal law.
 - Some cracks in this edifice for landlords:
 - *Garvin v. Cook Investments NW*-the bankruptcy court will consider the proposal of the plan, not the illegality of its terms

State Remedies for Distressed Businesses

- ← Workout
- ← Assignment for the Benefit of Creditors
- ← Receivership
- ← Dissolution

Questions?

**Seriously, we love talking about
this.**

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Appendix

Trends in Cannabis Trademark Litigation

The LOC Analysis in Cannabis Trademark Litigation

- ▶ ***Lochirco Fruit & Produce Co., Inc. v. Tarukino Holdings, Inc.*, No. C18-763-RAJ, 2019 WL 157939 (W.D. Wash. Jan. 9, 2019)**
 - ▶ No LOC at PI stage
 - ▶ “While both products are sold in the State of Washington, Defendants’ products contain cannabis [and] cannabis containing beverages can only be distributed and sold by retail stores licensed and regulated by the Washington [SLCB]. These retail stores may only sell marijuana...[so] Defendants’ products and Plaintiffs’ products are not likely to be sold in close proximity to each other.”
- ▶ ***Kiva Health Brands LLC v. Kiva Brands Inc.*, 402 F. Supp. 3d 877 (N.D. Cal. 2019)**
 - ▶ No LOC at PI stage
 - ▶ “At a high enough level of abstraction, the goods are related: they are both food items, sold to people looking for food. But upon any closer examination, they are quite different. One is candy combined with a recreational drug, the other is health food...KHB's products are available on the internet, while KBI's products are only available to adults over 21 years old and/or approved medical marijuana users, and then only through state-licensed dispensaries and delivery services.”
 - ▶ “This factors weighs heavily against confusion.”

Trends in Cannabis Trademark Litigation

The LOC Analysis in Cannabis Trademark Litigation

- ▶ **Woodstock Ventures LC v. Woodstock Roots, LLC**, 387 F. Supp. 3d 306 (S.D.N.Y. 2019)
 - ▶ No LOC at PI stage
 - ▶ “[E]ven if the parties' products are marketed through the same or similar trade channels, this fact does not suggest a likelihood of confusion, because Plaintiffs' products either constitute or are intended for use with recreational marijuana, while Defendants' “smokers' articles” are not intended for use with recreational marijuana.”
 - ▶ Appeal pending
- ▶ **White Hall Pharmacy LLC v. Doctor's Orders RX Inc.**, No. 4:19-CV-00366-KGB, 2019 WL 3939357 (E.D. Ark. Aug. 20, 2019)
 - ▶ Likelihood of success as to LOC at PI stage
 - ▶ “White Hall Pharmacy argues that, since medicinal marijuana is directed at medical ailments, medicinal marijuana and pharmaceutical services are related....[T]he Court concludes that the parties' services and products do overlap to some extent. The Court therefore finds that this factor weighs in favor of White Hall Pharmacy.”

Trends in Cannabis Trademark Litigation

Who is the Senior User?

Kiva Health Brands LLC v. Kiva Brands Inc., 439 F. Supp. 3d 1185, 1195 (N.D. Cal. 2020)

- ▶ Dec 2010: KBI began selling cannabis-infused chocolate confections under KIVA mark, but cannot register the mark with the USPTO
- ▶ Feb. 2013: KHB began selling natural foods and health supplements under KIVA mark
- ▶ April 2014: KHB obtains federal registration for KIVA mark
- ▶ KBI asserted prior lawful use in commerce in California as defense to trademark infringement
- ▶ Judge Breyer: “[W]hile KBI's product is legal under California law, its illegality under federal law means that KBI cannot have trademark priority.” *Id.* at 1195.

ADR Services, Inc. Cannabis Dispute Specialty Panel

