Cannabis 2021 - A Year in Review

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Porzio Business Law Update

2021 was a historic year for the New Jersey cannabis industry. In this article, we will explore the past, present, and future of the growing New Jersey cannabis market, along with certain unresolved issues, such as use of Workplace Impairment Recognition Experts ("WIRE") and banking and zoning issues.

CANNABIS PAST – HOW DID NEW JERSEY GET HERE?

On November 3, 2020, New Jersey voters approved New Jersey Public Question 1, an amendment to the state constitution to legalize the recreational use of cannabis by people ages 21 and older, with 67% voting yes and 33% voting no. The amendment allows the state to establish a regulated market for the cultivation, distribution, and sale of cannabis.

On February 22, 2021, Governor Phil Murphy signed into law the New Jersey Cannabis Regulatory, Enforcement Assistance, and Marketplace Modernization Act ("CREAMMA"), which, among other things, legalized the recreational use of marijuana in New Jersey for adults 21 and older. In addition, CREAMMA imposed on employers certain obligations with respect to marijuana and the workplace, including anti-discrimination and drug testing provisions.

<u>The Current Regulations</u>

On August 19, 2021, the Cannabis Regulatory Commission ("CRC") established the first set of rules and regulations regarding the recreational cannabis industry, and began the process of handing out licenses to businesses. The new rules covered several categories ranging from personal possession to business regulations. The following is a synopsis of important points covered by the new regulations under CREAMMA:

1. Personal Consumption

- Consumers at least 21 or older may purchase and possess up to one ounce of cannabis, or an equivalent amount of cannabis products.
- Driving under the influence is prohibited.
- It is illegal for anyone under 21 to purchase, possess, or consume cannabis products.
- People and entities engaged in activities authorized by the statute and rules are protected from criminal prosecution.
- Home cultivation is prohibited.

2. Equity

The new rules established three types of cannabis businesses that will receive priority review and approval in application processes:

- Social Equity businesses;

- Diversely-Owned businesses; and
- "Impact Zone" businesses. The state definition of "Impact Zone" can be found here.

CREAMMA also prioritize small businesses, also known as "microbusinesses" (which are stores limited to 10 employees and 2,500 square feet), as a way to allow for greater integration from underrepresented communities into the cannabis industry.

The CRC further established a Social Equity Excise Fee, which is a fee on cultivation that is supposed to increase as consumer prices decrease. The funds generated from this fee will go toward educational support, economic development, and social support services in Impact Zones.

3. Municipal Authority

CREAMMA codifies the ordinances that municipalities are authorized to pass, including ordinances that:

- Authorize certain types of cannabis businesses;
- Set numerical limits to the types of businesses operating within their jurisdiction;
- Restrict hours of operation and locations of cannabis businesses, such as banning locations near school zones or places of worship;
- Create local licensing requirements and penalties;
- Restrict the type of cultivation allowed;
- Establish a 2% transfer tax on cannabis products transferred within their jurisdiction; and
- Communicate the municipality's preference for licensure to the CRC.

Notably, however, municipalities are not allowed to pass certain ordinances, such as those that would restrict cannabis delivery services or transportation.

Municipal Banning of Marijuana Shops

Around 71% (roughly 400) of New Jersey municipalities have already declined or banned the opening of cannabis businesses within their jurisdictions. Municipalities were given until August 2021 to determine if they wanted to "opt-in" to cannabis businesses or "opt-out"; municipalities who opt-in are not allowed to opt-out for a set number of years, while those that have opted-out are allowed to reverse their decision at any point.

4. Business Regulation

The Licensing Framework

Technically, there are no limits on licenses, except for the retention of the 2-year cap on cultivator licenses at 37, which expires on February 22, 2023. Social Equity businesses, Diversely-Owned businesses, and Impact Zone businesses are prioritized for licensing approval, regardless of when they submit applications. Applications are to be reviewed on a pass/fail rolling basis. CREAMMA also works to prevent predatory lending, regulates the framework of management services and financial services, and requires disclosures of all sources of income and players in the company.

There are several types of licenses, each with different requirements:

- Conditional licenses

- Annual licenses
- Expanded alternative treatment centers

Additionally, there is also a Microbusiness License, which can be applied for on a Conditional or Annual track.

Fees

Application fees are set at a low price to reduce barriers to entry, with application prices starting as low as $100. Only applicants who are approved pay the full application price, with only 20% of the fee due at the time of submission of the application, and the remaining 80% being due upon approval. Total cost for an approved application runs anywhere between $500-$2,000. Annual license fees are connected to size, with microbusinesses paying as little as $1,000 per year, cultivators with a canopy of 150,000 square feet paying $50,000 per year, and Alternative Treatment Centers paying a conversion fee of $300,000 - $1,000,000, depending on size. Cannabis business employees are required to register with the CRC and pay an annual $25 fee for a Cannabis Business ID Card, with employees being required to undergo a training course.

Product Regulations

There is a restriction on what types of cannabis products are allowed to be produced, with permissible products including:

- Cannabis concentrates, including extracts and resins;
- Vaporized formulations;
- Drops, tinctures, and other sublabial and sublingual forms;
- Oral lozenges and other buccal forms;
- Edibles that can only be in the form of syrups, pills, tablets, capsules, and chewables; and
- Topical formulations and transdermal forms.

Packaging and labeling must be childproof, and have a universal warning symbol, other required warning labels, a summary of product testing results, a list of ingredients used in cultivation or production, potency, and serving size.

CANNABIS PRESENT – CULTIVATORS AND TESTING LABS

On December 15, 2021, the CRC began accepting applications for Class 1 Cultivators (grow recreational use cannabis), Class 2 Manufacturers (produce recreational use cannabis), and Testing Laboratories. Within the first 4 hours, there were over 500 applicants, and it is estimated that there are presently around 1,000 applicants for this current open round of licensing for cultivation, manufacturing, and testing.

As mentioned earlier, under the CRC's rules, Social Equity businesses, Diversely-Owned businesses, Impact Zone businesses, microbusinesses, and conditional license applicants will be prioritized over annual applicants in their review and scoring. A complete list of the priority of applications can be found here.

The regulations require the CRC to make a determination on the application within 90 days of submission of the application. Therefore, by the end of the first quarter of 2022, there should be some movement on the Cultivator, Manufacturing, or Testing applications. Any conditional license applicants that are approved will then have 120 days to comply with the remainder of the application requirements to obtain their license.

CANNABIS FUTURE

The Beginning of Retailer Applications

On March 15, 2022, the CRC will begin accepting applications for Class 5 Retailers, which are retailers that purchase recreational use cannabis from licensed cultivators, manufacturers, or wholesalers and sell those items to consumers in a retail store. Applications for cannabis distributors, wholesalers, delivery companies, or medical marijuana dispensaries looking to convert to recreational sales will not be accepted until a later date.

Zoning Issues Remain a Liability for Potential Operators

It was not until days before the cultivator applications opened that the CRC addressed the question of whether one can operate a licensed cannabis facility in a strip mall, or in a place where there are food or alcohol establishments in the vicinity. On December 13th, 2021 the CRC issued a revised FAQ which provided that: "The CRC does not prohibit cannabis businesses from being located in strip malls, as long as the cannabis business premises is self-contained without any access between the cannabis business and other businesses."

There is another issue that remains a hot topic: the 1,000-foot school zone rule. Under the federal Controlled Substances Act, “distributing, possessing with intent to distribute, or manufacturing a controlled substance in or on, or within 1,000 feet of, the real property comprising a public or private elementary, vocational, or secondary school or a public or private college, junior college, or university, or a playground, or housing facility owned by a public housing authority, or within 1,000 feet of a public or private youth center, public swimming pool, or video arcade facility,” remains a Federal criminal offense. While cannabis is no longer considered a controlled dangerous substance under New Jersey law, Federal law continues to identify all forms of marijuana, including medicinal marijuana, as a Schedule 1 controlled substance that has potential for abuse and diversion pursuant to the Controlled Substances Act, 21 U.S.C. §§ 801 *et seq.* Therefore, while applicants are shielded from liability under State Laws, there does remain some potential liability and uncertainty until cannabis is addressed on a federal level.

Employment Implications - WIRE and DRE

While CREAMMA allows employers to conduct numerous forms of drug testing for marijuana, the law limits an employer's ability to rely on a positive marijuana test result in making employment decisions. The law requires that a drug test include both a “physical evaluation” and “scientifically reliable objective testing methods and procedures, such as testing of blood, urine, or saliva.” The physical evaluation must be conducted by an individual certified to provide an opinion about an employee's state of impairment, or lack of impairment, related to the use of marijuana. The law tasked the CRC with adopting standards for a “Workplace Impairment Recognition Expert” (WIRE), who must be trained to detect and identify an employee's use of, or impairment from, marijuana or other intoxicating substances, and to assist in the investigation of workplace accidents.

The CRC published its “Personal Use Cannabis Rules” on August 19, 2021. However, these rules say virtually nothing about employer drug testing practices. According to the CRC, until it “develops standards for a Workplace Impairment Recognition Expert certification” in consultation with the Police Training Commission (the Commission responsible for developing procedures and policies regarding police training and practices), “no physical evaluation of an employee being drug tested in accordance with [the new law] shall be required.” On top of the uncertainty regarding standards for use of a WIRE within the workplace, the actual science behind this is also currently being challenged in court.

In the case of State of New Jersey v. Michael Olenowski, Defendant Michael Olenowski was convicted of Driving While Intoxicated under N.J.S.A. 39:4-50 based on the use of a Drug Recognition Expert ("DRE").

On November 18, 2019, the New Jersey Supreme Court issued a ruling remanding the matter to a Special Master to determine whether DRE evidence is generally accepted in the scientific community and therefore satisfies the standard to be admitted into evidence at trial under the New Jersey Rules of Evidence. In short, Olenowski could have a significant

impact on how drug DUI cases are prosecuted throughout New Jersey. A determination that DRE testimony is not sufficiently based in scientific evidence, will directly impact CREAMMA's physical evaluation requirements for a drug test and creates potential liability issues for employers.

At this time, it remains to be seen when the CRC will issue another set of regulations and whether the CRC will clarify some of the law's unanswered questions, most importantly how the law impacts employers with employees in safety-sensitive positions. Until then, New Jersey employers should consider working with experienced employment counsel to determine whether to:

- Modify their drug testing practices, including the possibility of eliminating marijuana testing either pre-employment or for certain types of positions;
- Provide training to managers tasked with making reasonable suspicion determinations; and
- Determine the best person to serve as the employer's potential WIRE.

Cannabidiol ("CBD") and Isolates like Delta-8 and Delta-9

It has now been almost two years since the U.S. Food & Drug Administration ("FDA") asserted regulatory oversight of CBD, which has generally been regulated by the Department of Agriculture as it is derived from growing hemp, but as of this writing it does not appear that the FDA's ongoing rulemaking is anywhere near the finish line. In the meantime, states have begun to independently address CBD. In 2019 and early 2020, states were largely focused on health claims and the addition of CBD to food and drinks. As states stepped in with their own guidance on these topics, attention shifted to Delta-8 THC made from hemp-derived CBD oil. Delta-8 is a type of isolate, which is created by isolating the THC out of the CBD, resulting in a psychoactive product. Because Delta-8 is derived from hemp/CBD, this is a grey area that has already resulted in bans in certain states (the federal government has not yet determined whether such product falls within the definition of "cannabis"). Indeed, just a few months ago, New York banned the sale of Delta-8, specifically.

Banking and Pressure for Congress To Act in 2022

With state-level legalization in full swing and nationwide support for legalization at an all-time high, with roughly 60% of adults believing that marijuana should be legal for both medical and recreational use, pressure is building on Congress to act. While some level of protection exists due to a Congressional Budget rider, commonly known as the Rohrabacher Amendment, for its original sponsor, which prohibits the Department of Justice from prosecuting medical cannabis operators, access to things like banking and insurance remains limited.

Over the last few legislative cycles, several bills were introduced to address those bottlenecks. The most well-known is the Secure and Fair Enforcement ("SAFE") Banking Act, which has been passed by the House five times (although it has never made it through the Senate). The SAFE Act would provide protections to financial institutions doing business with state-legal cannabis businesses. Its insurance-oriented companion bill is the Clarifying Law Around Insurance of Marijuana Act, which would do the same thing for the insurance industry. These bills are backed by established industries and are likely to pass in some form (if not in 2022, then perhaps in 2023 or 2024).

There are also two longer-shot legalization bills that may reappear during the next legislative session. The first is the Marijuana Opportunity Reinvestment and Expungement Act of 2021, which was introduced in the House. It would remove cannabis from the Controlled Substance Act, expunge cannabis convictions, and bring in federal tax revenue by imposing an initial 5% tax on retail sales of cannabis (which would increase to 8% over three years). Its analogue bill in the Senate is the Cannabis Administration Opportunity Act. While ambitious, these bills are largely symbolic, as there doesn't appear to be sufficient bipartisan backing for them to make it through the Senate, and President Biden appears lukewarm to adult-use cannabis legalization at the federal level.

Nevertheless, there are some signs that legalization is becoming a bipartisan issue, as a Republican Representative (Nancy Mace of South Carolina) introduced the States Reform Act ("SRA"), which would shift cannabis oversight to states.

CONCLUSION

While it does not appear that full federal legalization is around the corner for cannabis, the reality is that both voters and local governments are coming around to the idea that cannabis is here to stay. The questions looming in 2022 and beyond is what form will legalization take, both at the state and federal levels. We will continue to monitor whether the CRC issues further guidance to address known issues identified herein, and whether New Jersey's social equity initiatives for cannabis are likely to succeed where previous iterations have failed.