

# Senate Cannabis Bill May Give Some Cos. A Competitive Edge

By **Andrew Kline, Barak Cohen, Tommy Tobin and Jasmine Wetherell** (August 15, 2022)

On July 21, the Cannabis Administration and Opportunity Act was introduced by sponsoring Sen. Cory Booker, D-N.J., and co-sponsors Senate Majority Leader Chuck Schumer, D-N.Y., and Sens. Ron Wyden, D-Ore., Patty Murray, D-Wash., and Gary Peters, D-Mich.[1]

If passed, the CAO A would deschedule and federally legalize cannabis. Importantly, while a few legalization bills have been introduced in the U.S. House of Representatives, this is the first proposal to deschedule cannabis introduced in the U.S. Senate.

Furthermore, the bill was introduced by the Senate majority leader — a fact that should not be lost on anyone, given that it's rare that any majority leader sponsors legislation, nevermind cannabis legislation.

Critically, this bill is also important because, unlike the Marijuana Opportunity Reinvestment and Expungement, or MORE, Act[2] — the previous descheduling bill introduced in the House — the CAO A contains a regulatory plan.[3]

This fact alone provides a competitive advantage to companies already operating in highly regulated industries. The CAO A charts a pathway for federal government rulemaking through the U.S. Food and Drug Administration and the U.S. Department of the Treasury via its Alcohol and Tobacco Tax and Trade Bureau, or TTB. The bill also leaves room for states to continue to regulate some aspects of the plant.

Given polarization in the Senate and general ambivalence to cannabis legalization from Republican members,[4] it is highly unlikely that this bill will receive 60 votes and become law, but it sets a key mile marker for eventual cannabis legalization.

Federal cannabis legalization is increasingly a matter of when, not if, it is to occur, and the CAO A helps address how this legalization may take shape.

Thus, the bill's introduction is an important development for all cannabis companies, but particularly for the large companies poised to enter interstate commerce for cannabis goods: multistate operators, or MSOs, and large national and multinational food and beverage companies that are already preparing to commit significant resources to the interstate marketplace for cannabis products.

While imperfect in myriad ways, a few aspects of the draft bill may provide some companies with a first-mover advantage:

- With the FDA taking center stage, compliance with their forthcoming rules likely provides an advantage to large food and beverage companies.



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- New labor law requirements are already familiar to large food and beverage companies.
- Track-and-trace requirements will provide an advantage to large cannabis companies, which are already leveraging cannabis-specific technologies.
- Newly allowed banking, payment processing services and tax deductions will help cash-strapped cannabis companies to compete.

### **Allocation of Regulatory Authority**

The CAO would transfer primary agency jurisdiction over cannabis regulation from the U.S. Drug Enforcement Administration to both the FDA and TTB.[5] This provision also directs the heads of the FDA and the TTB to enter into a memorandum of understanding, or MOU, regarding their respective responsibilities, much like they already have in place in the alcohol context.

Specifically, the FDA would be recognized as the primary federal regulatory authority with respect to the manufacture and marketing of cannabis products, including recreational products.

On the other hand, the TTB would be recognized as the primary federal regulatory authority with respect to the taxation of cannabis products and financial practices of cannabis enterprises, including the collection of federal excise taxes and enforcement of tax laws, tracking and tracing of cannabis products, and prohibitions on unfair competition and commercial bribery.

Accordingly, these agencies would advance important public health and tax collection goals.

The agencies would have dual jurisdiction related to certain aspects of cannabis product labeling and packaging, advertising and other consumer information, so cannabis companies can expect some amount of overlap and duplication as the agencies work to determine their respective roles via the MOU.

Notably, the FDA would also be provided with expansive regulatory authority to protect the public health through rulemaking, putting the agency at the center of how cannabis is marketed and sold in the U.S.[6]

### ***FDA and the Center for Cannabis Products***

At the FDA, cannabis would be regulated under a newly created Center for Cannabis Products.[7] This new Center for Cannabis Products would be responsible for the regulation of the production, labeling, distribution, sales, and other manufacturing and retail elements of the cannabis industry across the country.

Pursuant to this new regulatory authority, the FDA would establish standards for labeling cannabis products. Under this new FDA oversight, cannabis labels would need to contain at least:

- A prominent statement that the product contains cannabis;
- The name and place of business of its manufacturer;
- An accurate statement of quantity;
- A statement of its form;
- The amount of THC in the product;
- Directions for use; and
- Directions against use by children.[8]

The FDA would also have recall authority over cannabis products when it found that a cannabis product would cause serious adverse health consequences or death.[9]

Cannabis companies making food, drug and supplement products would see new regulations under the CAOA.

Companies making cannabis products as foods could continue to do so, provided all other applicable FDA requirements are met.[10]

The CAOA allows for a transition period of 18 months to new federal regulations for cannabis products currently regulated at the state level and a period of three years for medical cannabis products marketed as drugs.[11]

Food and beverage companies already operating under existing FDA food and beverage rules will be well positioned to take advantage of translating their knowledge and experience into the cannabis space.

The CAOA also addresses the regulation of CBD products. Cannabis companies marketing CBD would see immediate changes to how CBD is regulated at the federal level. Under the CAOA, CBD would be allowed as a dietary supplement,[12] and the FDA would be required to issue draft guidance describing criteria the agency would use to evaluate the safety of CBD as a food additive.[13]

The advantage here goes to the companies that have a head start manufacturing these products.

Cannabis companies new to FDA oversight may find the FDA process burdensome and sluggish. One need only look to how the FDA has regulated CBD to date — while the agency may claim it has moved slowly and deliberately in regulating CBD, many in the industry see inaction at the federal level, with states taking the lead.

Large food and beverage companies already operating under federal standards may find comfort in the familiar. While FDA oversight may be onerous for others, large food and beverage companies are already accustomed to the rules of the road, have invested in significant agency expertise, and have developed relationships with agency decision makers.

## ***Treasury and TTB***

### *New Federal Permitting Requirement*

The CAO would require companies operating in the cannabis space to obtain permits from the Treasury Department to operate as a producer, processor, importer or wholesaler of cannabis products before commencing business.[14]

These permits would be conditioned on compliance with applicable law, including certain labor laws and regulations, such as the National Labor Relations Act, the Fair Labor Standards Act and the Occupational Safety and Health Act.[15]

Depending on the severity of a violation, an MSO or other cannabis company could find its federal permit denied, suspended or revoked.[16]

The CAO also requires the Treasury Department and federal labor regulators to establish standards for federal cannabis permit holders regarding enforcement of federal labor laws.

These labor laws will be familiar to large food and beverage companies with established compliance departments and protocols, which may find themselves once again with an advantage, while cannabis companies play catch-up with newly applicable — yet long-established — federal requirements.[17]

### *Federal Track and Trace*

Additionally, the CAO provides the TTB with oversight over a national track-and-trace system for cannabis and cannabis products to prevent illicit trade, smuggling or counterfeiting of cannabis products, and tax evasion.[18]

The provision would require manufacturers of cannabis products to place identifiable codes, designs or devices on the label of cannabis products to monitor movements of such products between the point of production and sale, and would impose new record-keeping requirements related to cannabis transactions to prevent tax evasion.

Here, there is a direct conflict between the new federal track-and-trace system and the numerous state-level systems currently in place across the country.

The CAO directs the TTB to consider current state practices.[19] Elsewhere, the CAO details that cannabis transported into any state is subject to state laws.[20] It is therefore unclear how or if state-level track-and-trace programs would operate once interstate commerce is permitted.

MSOs should ensure continued compliance with state-level requirements in light of the ambiguity, as retaining mandatory electronic tracking requirements at the state level is critical to ensuring public safety.

This could put large food and beverage companies at a disadvantage as they work to establish and comply with state track-and-trace requirements, should they remain in place.

### *Cannabis Financing and Banking*

Currently, cannabis is a controlled substance, meaning that cannabis businesses, including their back-office financing, banking and payment processing services, are operating in violation of federal law, namely the Controlled Substances Act.[21]

Although the Treasury Department's Financial Crimes Enforcement Network, or FinCEN,

publishes guidelines for providing banking services to the cannabis industry, many banking, financing and payment processing service providers are understandably reticent to provide such services to cannabis-related businesses because the funds could be considered violations of federal law.

Federal restrictions on cannabis have therefore prompted only a limited number of financial institutions to take on the risk of providing banking services to cannabis companies, and those that do provide such services often charge exorbitant fees and costs that foreclose the services to many — predominately affecting small businesses and social equity licensees.[22]

As a result, many cannabis businesses have resorted to using cash only in their operations, increasing safety concerns on the storage and use of this cash.

Because the CAOA makes clear at the federal level that cannabis-related financial transactions and services are legal, MSOs can expect easier access to capital and fewer issues with electronic payment and depository services.

Of course, large food and beverage companies would not have previously experienced such obstacles outside of cannabis.

The CAOA guarantees fair banking access for cannabis businesses.[23] Specifically, the bill requires FinCEN to update its guidance or issue new regulations that:

- Are consistent with the CAOA's statutory intent to decriminalize cannabis;
- Address deposits and cash movements by cannabis-related legitimate businesses and cannabis-related service providers; and
- Do not significantly inhibit the provision of financial services to cannabis-legitimate businesses and cannabis-related service providers.[24]

It would also require other arms of the Treasury Department to develop uniform examination procedures for depository institutions that provide financial services to cannabis-related legitimate businesses and service providers consistent with FinCEN's updated guidance.

The changes proposed by the CAOA would help reduce confusion among financial institutions and dramatically reduce any risk, whether real or perceived, in providing financial services to cannabis companies.

These provisions would also ameliorate reported public safety issues and provide cannabis businesses with easier and more reliable access to capital, and also provide regulatory agencies with greater insight into how to detect and prevent diversion and criminal enterprises.

MSOs or other cannabis companies operating across state or federal borders would see new

opportunities regarding financial services. These payment processing, banking and reporting provisions will go a long way to putting cannabis companies on equal footing with established food and beverage companies.

### *Taxation and Section 280E*

Under current law, cannabis businesses are subject to federal income tax. However, they are also subject to the limitation on deductions and credits under Internal Revenue Code Section 280E as businesses that traffic in Schedule I or II controlled substances. As a result, cannabis businesses pay taxes on their gross income without the ability to deduct business expenses, in some cases being taxed more than their business profits.

Given that the CAOA specifically deschedules cannabis, the prohibitions under Section 280E will no longer apply to cannabis businesses. This would ensure that cannabis businesses are taxed fairly, giving them a greater ability to reinvest their profits and grow.

Removing the limitations of Section 280E would also dramatically lower the barrier of entry for new cannabis businesses as they would be permitted to deduct startup expenses.

MSOs may find that they no longer need to hoard cash in preparation for tax payments, freeing up capital for other endeavors. Large food and beverage companies have not had to contend with these archaic rules and may therefore have more cash on hand at the outset, providing both with different competitive advantages.

### **Conclusion**

Notwithstanding the potentially significant imperfections not discussed here, the CAOA promises a sea change in how the federal government regulates cannabis and cannabis products, and to a lesser extent, hemp.

While the bill's prospects for passage appear bleak in the current Congress, the proposal marks a clear path as to how leading federal lawmakers aim to deschedule and legalize cannabis.

The way that federal lawmakers propose to do so suggests that large food and beverage companies may have a structural advantage as they are already operating in highly regulated industries with FDA oversight.

Existing MSOs would be poised for further growth upon the introduction of interstate commerce under the CAOA, given their operational knowledge of track-and-trace systems and new access to capital.

The key question remains: How long will it take until federal legalization of cannabis happens? Until that question is answered, the CAOA is an important bellwether.

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[1] S. 4591, Cannabis Administration and Opportunity Act. All references to the bill text are to the as-introduced version available at: <https://www.congress.gov/bill/117th-congress/senate-bill/4591/>.

[2] H.R. 3617, Marijuana Opportunity Reinvestment and Expungement Act. Text available at: <https://www.congress.gov/bill/117th-congress/house-bill/3617>.

[3] Of course, Representative Nancy Mace's (R-SC) States Reform Act also contains a regulatory plan. See H.R. 5977, States Reform Act. Text available here: <https://www.congress.gov/bill/117th-congress/house-bill/5977>.

[4] Although some notable Republicans on hemp and cannabis issues include Sen. Rand Paul (R-Ky.) and Rep. Nancy Mace (R-SC).

[5] CAO A, § 102.

[6] See CAO A § 501.

[7] See CAO A § 501.

[8] See CAO A § 501. The FDA may also mandate any information that it determines to "be necessary for the protection of the public health."

[9] See CAO A § 501.

[10] See CAO A § 501.

[11] CAO A § 505.

[12] CAO A § 504(a).

[13] CAO A § 504(g).

[14] See CAO A § 511.

[15] CAO A § 511.

[16] CAO A § 511.

[17] Of course, federal courts have already extended certain labor laws to the cannabis industry, such as the Fair Labor Standards Act (FLSA). See *Kenney v. Helix TCS, Inc.*, 939 F.3d 1106 (10th Cir. 2019). The CAO A would make federal permits contingent on continued compliance with the FLSA and other federal employment and labor standards.

[18] CAO A § 112(b).

[19] CAO A § 112(b)(6)(B).

[20] CAO A § 111(a).

[21] 21 U.S.C. 801 et seq.

[22] Barak Cohen, Andrew Kline, Tommy Tobin, & Elizabeth Gustafson, Where is the SAFE Banking Act? Cannabis Legal Highlights (Jun. 1, 2022). <https://www.cannabislegalhighlights.com/2022/06/where-is-the-safe-banking-act/>.

[23] See CAO A § 706.

[24] CAO A §§ 702, 703.