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Election Results and the Prospects for Cannabis Reform

I. Cannabis Legalization and Risk Management

Insurance professionals who work with cannabis-related businesses face similar legal and risk management considerations that confront other businesses that service the cannabis industry. Ultimately, any company's decision to provide direct or indirect service to an otherwise state-compliant cannabis-related business is a risk-based decision that requires an assessment of the *likelihood* of federal prosecution. It is increasingly evident as time passes that momentum will continue to swing toward broad cannabis legalization and that the federal government has no interest in prosecuting plant-touching or ancillary companies engaged in state-legal commercial cannabis activity. The risk-benefit calculus is shifting to a conclusion of *de facto* legalization that justifies a decision to enter the market based on sound business judgment detached from unreasonable fear of prosecution. One should nevertheless proceed with caution. Despite growing public support and the lack of federal enforcement, some degree of risk remains present for any plant-touching or ancillary business in the cannabis industry in the absence of Congressional action.

A. Controlled Substances Act of 1970

The Controlled Substances Act ("CSA"), Title II of the Comprehensive Drug Abuse Prevention and Control Act of 1970, is the United States' federal drug policy that regulates the manufacture, importation, possession, and distribution of controlled substances in the United States. All controlled substances must obtain approval from the Food and Drug Administration ("FDA") before they may be prescribed or sold in the United States. The CSA confers upon the DEA further regulatory authority over certain drugs that have been deemed controlled substances.

1. Drug Schedules under the CSA

The CSA, signed into law by President Richard Nixon, provides for the classification of substances into five Schedules based on the substance's currently acceptable medical use and its abuse or dependency potential. Schedule I substances have been determined to have "a high potential for abuse," "no currently accepted medical use in treatment in the United States," and "a lack of accepted safety for use of the drug or other substance under medical supervision." 21 U.S.C. § 812(b)(1). Accordingly, Schedule I controlled substances cannot be prescribed and it is a federal

crime to possess, distribute or dispense them. Marijuana is classified as a Schedule I controlled substance, along with heroin, LSD and ecstasy.

Classification under Schedule II is reserved for substances with currently accepted medical uses but with a “high potential for abuse” with severe psychological or physical dependence. Schedule II substances include methamphetamines, cocaine and oxycodone. They may be dispensed only with the written prescription of a medical practitioner and refills are disallowed. Substances categorized under Schedules III through V are marked by decreased potential for abuse relative to the drugs or other substances in the preceding schedule and range from a moderate/low to limited likelihood of physical or psychological dependence.

2. *Reclassification of Marijuana under the CSA*

The DEA has authority to reclassify a drug to a different schedule if new evidence becomes available. The protocol requires the DEA to obtain from the FDA a scientific and medical evaluation of available information and a scheduling recommendation as to whether the controlled substance should be rescheduled. The FDA must consider eight factors, including: (1) the substance’s actual or relative potential for abuse, (2) scientific evidence of its pharmacological effect, if known, (3) the state of current scientific knowledge regarding the substance, (4) its history and current pattern of abuse, (5) the scope, duration, and significance of abuse, (6) what, if any, risk there is to the public health, (7) its psychological or physiological dependence liability, and (8) whether the substance is an immediate precursor of a substance already controlled under the subchapter. 21 U.S.C. § 811(c).

At the federal level, marijuana can legally exist in the United States only if it is reclassified; until such change occurs, marijuana remains illegal for anyone to grow, prescribe, dispense or distribute. Advocates have repeatedly tried to get marijuana reclassified to a different Schedule and a number of bills have been introduced in Congress without success.

Private lawsuits have also sought assistance of the courts with mandating the DEA to reschedule cannabis under the CSA. On May 30, 2019, the United States Court of Appeals for the Second Circuit made history by refusing to dismiss a case challenging marijuana’s status under Schedule I of the CSA. This decision marks the first time a lawsuit challenging the constitutionality of the CSA has survived dismissal. The case is brought by a group of medical marijuana patients and advocates who allege that marijuana’s prohibitive Schedule I status poses serious health risks and unfair economic disadvantages. In its opinion, the Second Circuit has retained jurisdiction over the matter to pressure the DEA into conducting a “speedy administrative review” of the issue. The Court expressed concern with the “DEA’s history of dilatory proceedings” after some plaintiffs “plausibly alleged the current scheduling of marijuana poses a serious, life-or-death threat to their health.” The Court found that the DEA has historically taken approximately nine years to issue a decision on the reclassification of a drug under the CSA, and noted that two child plaintiffs would be unduly prejudiced by this delay.

The Second Circuit believes the federal government’s own involvement in medical marijuana research and its acceptance of medical marijuana treatment requires the DEA to reexamine marijuana’s Schedule I status. Procedurally, the Second Circuit will continue to monitor the case and “take whatever action might become appropriate if the DEA does not act with adequate

dispatch.” Therefore, the Court is acting in the role of a supervisory authority over the DEA to ensure the agency timely addresses whether reclassification is needed.

B. Bank Secrecy Act of 1970 and FinCEN Guidance

It is important for insurance entities that operate in the cannabis space to understand additional requirements mandated by the Bank Secrecy Act of 1970 (“BSA”) requiring U.S. financial institutions – a term defined to include an insurance company – to assist U. S. government agencies in detecting and preventing money laundering.

The BSA establishes a series of recordkeeping and reporting requirements for financial institutions that help monitor and police the financial system by establishing customer due diligence programs. Under the BSA, depository financial institutions are required to file reports disclosing cash transactions that exceed \$10,000, keep records of cash purchases of negotiable instruments, and report suspicious activity that could signify money laundering, tax evasion, or illegal activity.

The Financial Crimes Enforcement Network (“FinCEN”) is the official bureau created by the Secretary of the Treasury to enforce the provisions of the BSA. On February 14, 2014, FinCEN issued a memorandum of guidance to clarify the continuing obligations of financial institutions seeking to provide services to marijuana-related businesses in light of the widespread state-level legalization of medical and recreational marijuana. FinCEN states that its guidelines are meant to “enhance the availability of financial services for, and the financial transparency of, marijuana-related businesses.” The FinCEN guidelines make it clear that a financial institution’s obligation to report suspected violations of federal law under the BSA is not affected by any state legalization of marijuana-related business activity. The guidance memorandum is not law and does not provide an explicit safe harbor, but it sets forth an explanation of the intent of the regulations.

FinCEN acknowledges the limited enforcement priorities established by the Cole memo¹ and instructs financial institutions to refer to these enumerated priorities in determining how to

¹ The Cole Memo, which was issued in 2013, provided Obama-era guidance to DOJ attorneys and law enforcement to focus their enforcement resources on persons or organizations whose conduct interferes with any one or more of the following important priorities (the “Cole Memo priorities”):

- Preventing the distribution of marijuana to minors;
- Preventing revenue from the sale of marijuana from going to criminal enterprises, gangs, and cartels;
- Preventing the diversion of marijuana from states where it is legal under state law in some form to other states;
- Preventing state-authorized marijuana activity from being used as a cover or pretext for the trafficking of other illegal drugs or other illegal activity;
- Preventing violence and the use of firearms in the cultivation and distribution of marijuana;
- Preventing drugged driving and the exacerbation of other adverse public health consequences associated with marijuana use;
- Preventing the growing of marijuana on public lands and the attendant public safety and environmental dangers posed by marijuana production on public lands; and
- Preventing marijuana possession or use on federal property.

work with cannabis-related businesses. The Treasury Department has clarified that the FinCEN guidelines remain in place despite the rescission of the Cole memo in January 2018.

In sum, there are two primary aspects to the FinCEN guidance, including a customer due diligence component and potential obligations to make Suspicious Activity Report (“SAR”) filings.

There is an important limitation to the requirement of insurance companies to file SAR’s. The BSA defines an “insurance company” as any person who underwrites or issues covered products. (31 C.F.R § 1025.100.) This limitation excludes an underwriter or issuer that does not offer covered products, which are defined as a permanent life insurance policy, an annuity contract or any other insurance product that features a cash value. Accordingly, the reporting requirements for insurance companies will only be implicated if the insurance company offers covered products. An insurance carrier that only offers cannabis-related property, casualty, professional liability and other specialty lines coverage should have no obligation to file SAR’s pursuant to the guidelines.

With regard to the due diligence aspect of the guidelines, the FinCEN guidelines state in relevant part as follows.

“In general, the decision to open, close, or refuse any particular account or relationship should be made by each financial institution based on a number of factors specific to that institution. These factors may include its particular business objectives, an evaluation of the risks associated with offering a particular product or service, and its capacity to manage those risks effectively. Thorough customer due diligence is a critical aspect of making this assessment.

In assessing the risk of providing services to a marijuana-related business, a financial institution should conduct customer due diligence that includes: (i) verifying with the appropriate state authorities whether the business is duly licensed and registered; (ii) reviewing the license application (and related documentation) submitted by the business for obtaining a state license to operate its marijuana-related business; (iii) requesting from state licensing and enforcement authorities available information about the business and related parties; (iv) developing an understanding of the normal and expected activity for the business, including the types of products to be sold and the type of customers to be served (e.g., medical versus recreational customers); (v) ongoing monitoring of publicly available sources for adverse information about the business and related parties; (vi) ongoing monitoring for suspicious activity, including for any of the red flags described in this guidance; and (vii) refreshing information obtained as part of customer due diligence on a periodic basis and commensurate with the risk. With respect to information regarding state licensure obtained in connection with such customer due diligence, a financial institution may reasonably rely on the accuracy of information provided by state licensing authorities, where states make such information available.

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As part of its customer due diligence, a financial institution should consider whether a marijuana-related business implicates one of the Cole Memo priorities or violates state law. This is a particularly important factor for a financial institution to consider when assessing the risk of providing financial services to a marijuana-related business. Considering this factor also enables the financial institution to provide information in BSA reports pertinent to law enforcement’s priorities.”

Despite this guidance, many financial institutions have been reluctant to take on policing duties with respect to the legality of potential cannabis-related business clients. The guidelines also do not address how rigorous an institution’s anti-money laundering program must be to achieve a level of compliance deemed acceptable to FinCEN.

C. Current Status of Marijuana Enforcement at the Federal Level

The use, possession, cultivation, distribution, transportation and sale of cannabis remain illegal under federal law pursuant to the Controlled Substances Act of 1970. As noted above, the Cole memo was rescinded on January 4, 2018, though since that time, the DOJ and DEA have taken no aggressive action against the cannabis industry. In fact, the level of enforcement activity seen under the Trump administration has not differed in material respect from the Obama administration. This may be due in part to the continuing protections of the Rohrbacher-Blumenauer amendment to the federal budget, discussed below.

Public opinion is also partially responsible for the lack of enforcement at the federal level. Public support continues to swing toward legalization and against federal action. Current polling of self-identified registered voters shows 66 percent of all respondents who favor making marijuana legal, compared with just 33 percent who are opposed. A surprising finding from recent polls is the overwhelming public support for the use of medicinal cannabis for patients, with 93 percent of all respondents in favor of medical use and a mere 5 percent opposed. There also is strong public support for the decision on legalization being reserved to the states. Only 23 percent of respondents in a recent Quinnipiac poll were in favor of the federal government enforcing federal laws, with 70 percent opposed to the idea.

The so-called Rohrbacher Blumenauer protections are written into the federal budget for the current fiscal year. These protections limit the ability of the DOJ or DEA to expend federal monies enforcing federal law against state-legal *medical* cannabis commercial activity. These protections do not apply to adult use cannabis activity, though the U.S. House passed a bill in October 2019 that extends the protections to all state-legal cannabis activity. A floor vote is unlikely in the Senate in the short term, however.

There are also several significant bills pending in Congress, most notably the Secure and Fair Enforcement (SAFE) Banking Act,² which was passed by the US House of Representatives with

² The SAFE Banking Act would create a safe harbor for depository institutions, including banks and credit unions, to the extent that they would not be liable or subject to forfeiture under federal law for providing financial services to a CRLB. Such businesses include not only manufacturers, producers, or any person or company engaging in a cannabis-related business pursuant to the law of a state or

broad bipartisan support on September 25, 2019. The most significant hurdle for the bill is achieving a floor vote in the Senate.

II. The NJ Cannabis Legalization Ballot Question: Get Out the Vote by Staying at Home?

Poll results demonstrate that support for adult use legalization is strong in New Jersey, and that the support does cross party lines to some extent. Early states that legalized adult use cannabis through a ballot initiative followed by voter-mandated legislation made costly errors that can be avoided in New Jersey.

After a tricky run in the New Jersey Legislature, the question of legalization of marijuana for all adult use is coming to the people in the form of a ballot question on Nov. 3, 2020. Given the uncertainties in the state due to the coronavirus, the slow and cautious move toward reopening, and questions regarding a potential return of the virus in the fall, how robust will voting be? The state is taking measures to ensure that every New Jersey voter will have the opportunity to exercise his or her right to vote in November, whether that vote will be cast in person or by mail.

A. Background

In May 2017, State Senator Nicholas Scutari introduced a measure to legalize adult use marijuana, including limits on personal possession of cannabis products, a ban on home cultivation, and a progressive state sales tax with annual increases up to 25%. Then Republican Governor Chris Christie opposed the legalization efforts, but after the election of Democrat Governor Phil Murphy in 2018, legalization was back on the table, with multiple competing proposals. The New Jersey Marijuana Legalization Act, introduced on June 7, 2018, would have, in its final form, allowed adults over 21 to possess up to one ounce of marijuana, and imposed a \$42 per ounce excise tax and local transfer or user tax to be determined. State lawmakers tried for more than a year to pass the bill, but fell short of votes in the Senate. It appears that there was momentum in favor among the Democratic majority, but the devil was in the details. There was debate over issues of expungement of criminal records, how to tax the sales, proper awarding of licenses for new business, and potential negative impact on communities. Certain legislators had consistently opposed legalization because of fear of impaired drivers, increased crime, and a general concern over public health issues.

B. Legalization Put to a Vote

On Dec. 19, 2019, both the Assembly and the Senate voted in favor placing the legalization question on the ballot on Nov. 3, 2020, as follows (requiring a “yes” or “no” vote):
Do you approve amending the Constitution to legalize a controlled form of marijuana called “cannabis”? Only adults at least 21 years of age could use cannabis. The State commission created to oversee the State’s medical cannabis program would also oversee the new, personal use cannabis market. Cannabis products would be subject to the State sales tax. If authorized by

political subdivision, but also businesses that provide financial services to those organizations. A final bill is expected to include explicit protections for insurance companies.

the Legislature, a municipality may pass a local ordinance to charge a local tax on cannabis products.

- *Will New Jersey Avoid the Mistakes of Other Adult Use States?*

Concerns have been raised that the brevity of the ballot question fails to capture the many nuances presented by adult use cannabis. The proposed amendment leaves open-ended all issues related to licensing, distribution, tax rates, social justice and equity, combating the illicit market, insurance requirements and more, instead mandating the state legislature to work out these critical issues after the vote. Several of these issues were implicated in the failure of the 2019 adult use bill in the first place. But if the ballot initiative passes, the will of the people will be clear and the state legislators will be forced to work together to hammer out a plan to make marijuana available to all adults over 21 in New Jersey.

Early states that legalized adult use cannabis through a ballot initiative followed by voter-mandated legislation made costly errors that can be avoided in New Jersey. Until federal legalization allows for some level of interstate commerce, every legalized state is a self-contained market with a unique supply-and-demand environment formed by the state licensing structure, regulatory oversight, tax rates and engagement by city and county governments. Limitations imposed by localities on the number and location of licenses, on “vertical” licenses that allow commercial activity from cultivation through sale to consumers, and through social equity priorities, have a profound impact on the barriers to entry and the success of any state’s model. How well a state market functions in turn drives the capital markets within those states, which allow cannabis operators to raise money outside traditional lending and financing through banks and other regulated financial institutions. Successful state cannabis models have sought to strike a balance between limited licenses and social equity priorities without imposing unreasonable barriers to entry and growth that freeze fundraising. The New Jersey Legislature and the proposed commission should be mindful of striking this balance.

- *Will New Jersey Turn Out to Vote?*

According to the Nov. 18, 2019, press release from Senator Scutari and Senate President Steve Sweeny, the November 2020 ballot date was specifically targeted, as “voter turnout will be maximized for the national election.” A looming concern now is whether New Jersey will turn out to vote given social distancing restrictions and a potential second wave of COVID-19 in the fall. In the 2018 election, 88% of votes were cast in person, according to the federal Election Assistance Commission.

Unlike most other states, however, any registered voter may vote by mail in New Jersey with no special requirements or limitations. The ballot for voting in person and by mail is identical. Although the voter typically must apply via a Vote-by-Mail application by a first deadline, and must mail in the completed ballot by a second deadline, these requirements could be suspended or altered for the November 2020 election.

The state currently is scheduled for a dry run in the form of the primary election, which has been postponed until July 7. On May 17, Governor Murphy announced via Executive Order 144 that the primary will be conducted principally by mail, with most voters registered as Democrat or Republican automatically receiving a ballot by mail. All other registered voters will receive a ballot application. All of these will have prepaid postage, a significant expense to the state, but the traditional sample ballot will not be sent for this primary election. The Executive Order does

not require voting by mail, but allows the voter the option to vote in person. Each county is directed to establish at least five secure ballot drop boxes, and to open at least one polling place in each municipality for a minimum goal of 50% of all polling places for in-person voters on July 7. Those polling places are directed to follow certain safety guidelines.

C. Projection for the Vote and the Outcome

In these times, vote-by-mail may result in higher overall turnout. Wisconsin's governor tried and failed to stop in-person voting in that state's April 7, 2020, primary. According to reports, voters waited as long as two and a half hours in Milwaukee, which could open only five polling places due to a lack of workers instead of the 180 it normally offers. In Milwaukee, more than 56,489 absentee ballots were cast compared with 18,803 ballots that were cast in person. Approximately 1.3 million voters had requested an absentee ballot throughout the state, but with that large volume and the short time frame, some were not sent to or received by voters in time for the primary.

No announcement regarding vote-by-mail for the November 2020 election has yet been made, and the decision could turn on what happens with the July 7 primary and status of the pandemic in New Jersey leading up to November 3. However, there is no reason to believe that New Jersey voters will not be motivated to vote by whatever means are available.

• *Polling Results Bode Well for Legalization*

An April 2020 Monmouth University Poll of registered New Jersey voters showed that 61% would vote in favor of cannabis legalization in November, and 34% would vote against. Per the poll, support comes from 74% of Democrats, 64% of Independents and 40% of Republicans. In fact, according to the same Monmouth Poll, legalization is more popular in New Jersey than either presidential candidate, Democrat Joe Biden (54%) or Republican Donald Trump (38%). The April 2020 Monmouth Poll was conducted by telephone between April 16 and April 19, 2020, shortly after the New Jersey shutdown began. When asked how likely voters would be to vote in November, 81% said that they were certain to vote, 15% said they were likely to vote, 4% said they were not sure and 1% said they were unlikely to vote. The question made no distinction between in-person voting and vote by mail. No questions from the survey addressed vote-by-mail.

Turnout in November will be driven primarily by the presidential election, as recognized by Senators Scutari and Sweeny when placing the legalization question on the ballot for Nov. 3, 2020. It appears that New Jersey is prepared to be flexible in facilitating the ability of all registered voters to vote, and is working toward promoting maximum turnout in November by spending the money necessary to facilitate vote-by-mail and planning for ease and safety at the polls.

D. Conclusion

The April 2020 poll results demonstrate that support for adult use legalization is strong in New Jersey, and that the support does cross party lines to some extent. Whatever the turnout in November, the results on the legalization question likely will not differ from the April 2020 poll results, which would result in the measure passing. But that leads to a more important question

—what comes next? It will be up to the Legislature to answer that question and to hopefully employ lessons learned from other adult use states.