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presents

IP Cannabis Law Conference

Kiss, Marry, Kill: IP Licensing, Franchising, and DIY Agreements in Cannabis

Wednesday, April 19, 2023
1:15 p.m. – 2:30 p.m.

MCLE: 1.25

Speakers:

Dawn Newton

Brian Ross

Conference Reference Materials

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The Intellectual Property Law Section presents

THE CANNABIS IP LAW CONFERENCE

KISS, MARRY, KILL: IP Licensing, Franchising, and DIY Agreements in Cannabis

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Dawn Newton, Donahue Fitzgerald LLP

April 19, 2023



Trademark Licensing

The cannabis industry is perhaps the only industry that is state legal, while federally illegal

This conflict has created siloed state markets, legal uncertainties, financial distortions and general confusion

The cannabis industry has distinctive legal needs (and so does hemp)

Due Diligence

Licensors: Confirm Licensee's cannabis licensure

- Scope of permitted cannabis activities
- Who actually holds the cannabis license?
- Medical and/or recreational?

Licensee: Confirm Licensor's TM rights

- What does the TM registration actually cover?
 - No federal registrations for cannabis
 - State registrations require lawful use

Cannabis regulatory compliance

- Control or financial interest can trigger disclosure
- Vetting/background checks may be required
- State residency requirements may apply

Consider business sophistication of the parties

Other/standard diligence



Key Terms – Trademark Licensing in Cannabis

Scope of TM license

- Permitted uses depend on Licensee's right to operate
- Representations and warranties
- Contingent on maintaining cannabis licensure

Compensation

- Cannabis laws and regulations vary by state, and may require a novel fee structure
- Royalty based on profit or revenue share may subject Licensor to disclosure and regulator scrutiny
- Accounting/reporting of production and sales

Key Terms – Trademark Licensing in Cannabis

- **Compliance is key**
 - Legal compliance across entire supply chain
 - Sourcing, manufacturing, testing, distribution, sales
 - Quality control
 - Laws, regs, SOPs, GMPs, TM style guides
 - Too much Licensor control may lead to cannabis regulatory scrutiny
 - Too little Licensor control may result in naked license
 - Insurance
 - Product recalls
- **Anticipating changes of law**
 - Cannabis laws and regulations evolve
 - Responsibility for costs
 - Medical vs. recreational
 - Interstate commerce



Key Terms – Trademark Licensing in Cannabis

Risk Disclosures

- Federal illegality
- Market realities
- Cannabis regulatory requirements

Audits/Inspections

Indemnification, Limitation of Liability

- IP infringement
- Product liability

Morality

Marketing and Advertising

Key Terms – Trademark Licensing in Cannabis

Termination Rights

- Compliance violations
- Diverting product into illicit markets
- Loss of cannabis license/right to operate
- Insolvency
- Effect of termination - sell through, etc.

Choice of Law

- Probably state of cannabis licensure
- But consider enforceability of cannabis contracts

Choice of Forum

- State court or ADR, not federal court!

Waiver of Illegality Defense



Relevant Law – Cannabis (“Marihuana”)



21 U.S.C. Sec. 812 (CONTROLLED SUBSTANCES ACT)

“(c) Initial schedules of controlled substances

Schedules I, II, III, IV, and V shall, unless and until amended pursuant to section 811 of this title, consist of the following drugs or other substances,¹ by whatever official name, common or usual name, chemical name, or brand name designated:

Schedule I

c) Unless specifically excepted or unless listed in another schedule, any material, compound, mixture, or preparation, which contains any quantity of the following hallucinogenic substances, or which contains any of their salts, isomers, and salts of isomers whenever the existence of such salts, isomers, and salts of isomers is possible within the specific chemical designation:

. . . (10) Marihuana”

Relevant Law – Tax

26 U.S. Code (“Internal Revenue Code”) § 280E

“No deduction or credit shall be allowed for any amount paid or incurred during the taxable year in carrying on any trade or business if such trade or business (or the activities which comprise such trade or business) consists of trafficking in controlled substances (within the meaning of schedule I and II of the Controlled Substances Act) which is prohibited by Federal law or the law of any State in which such trade or business is conducted.”



Relevant Law - Hemp

Agriculture Improvement Act of 2018 ("2018 Farm Bill"), § 297A Definitions

"In this subtitle: "(1) HEMP.—The term 'hemp' means the plant *Cannabis sativa* L. and any part of that plant, including the seeds thereof and all derivatives, extracts, cannabinoids, isomers, acids, salts, and salts of isomers, whether growing or not, with a delta-9 tetrahydrocannabinol concentration of not more than 0.3 percent on a dry weight basis."

2018 Farm Bill, § 12619

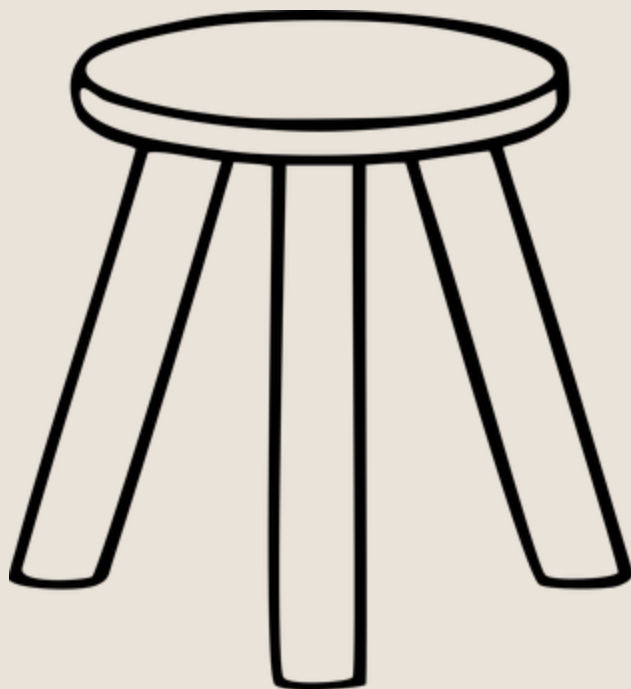
(a) IN GENERAL.—Section 102(16) of the Controlled Substances Act (21 U.S.C. 802(16)) is amended— (1) by striking "(16) The" and inserting "(16)(A) Subject to subparagraph (B), the"; and (2) by striking "Such term does not include the" and inserting the following: "(B) **The term 'marihuana' does not include— "(i) hemp, as defined in section 297A of the Agricultural Marketing Act of 1946; or** "(ii) the". (b) TETRAHYDROCANNABINOL.— Schedule I, as set forth in section 202(c) of the Controlled Substances Act (21 U.S.C. 812(c)), is amended in subsection (c)(17) by inserting after "Tetrahydrocannabinols" the following: ", **except for tetrahydrocannabinols in hemp (as defined under section 297A of the Agricultural Marketing Act of 1946)**".

Franchising

- Business replication
- Highly regulated
- Consumer protection oriented



When is it a Franchise Agreement?



- The licensor grants a right to do business with...
 - The licensor's trademark
 - Any fee paid to the licensor (other than the bona fide wholesale price of resaleable goods)
 - The licensor has the right to exert significant control or assistance and/or the business is connected to a marketing plan or system directed by the licensor

See Cal. Corp. Code § 31005; 16 C.F.R. § 436.1(h)
www.dfpi.ca.gov/commissioners-release-3-f

Federal Trade Commission, Statement of Basis & Purpose (1978)

- Type and degree of control
- Licensor
 - Quality of final product
 - Passive control: inspection & testing
- Franchisor
 - Methods of operation
 - Active control: location, hours, management, etc.



Significance of Control (FTC)

FTC Informal Staff Advisory Opinion 05-2 (March 2, 2005)

- Nature of the industry
- Sophistication of investors
- Importance of assistance/control
- Conclusion – No Significant Control
 - License of sales-boosting methods to existing staffing companies, with 1-day training and periodic “advice and encouragement”
 - No change to operations

Significance of Control (FTC)

FTC Informal Staff Advisory Opinion 98-4 (June 8, 1998)

- Degree of reliance by franchisees
- Conclusion – Potentially Significant Control
 - License of technology to experienced environmental consultants could be significant and may require training
 - Exclusive sales territories pertain to the licensee's operational methods

Marketing Plan or System (California)

Dept of Corporations Opinion 01-1F (Sept. 7, 2001)

- “Appearance of centralized management”
- Conclusion – Marketing Plan or System exists
 - Restaurant licensee had to use trademark, follow prescribed menus, use a distinctive color scheme, prohibited from changing locations without permission, protected territory, etc.
- Compare Opinion 93-1F – business operated under a different trademark, no trade dress/color scheme, no restrictions re locations, advertising or promotion.

Why is Franchising so disliked?

Significant compliance obligations, such as...

- Annual franchisor audit requirement
- Robust & detailed disclosures
 - How much will the franchisee spend to get the business up & running?
 - Litigation & bankruptcy disclosures
 - Contact information for ex-franchisees
- Significant restriction on sharing potential earnings
- Strict franchisor liability for ongoing accuracy of information
- Regulatory oversight

Avoid Franchising



- Avoid business replication
- License products/services to experienced business owners for sale alongside other products
- High tech platforms may allow the reversal of payments
- NOT waivable!

Embrace Franchising?

ONE Cannabis Presents Cannabis Franchising Business Model at CWCBE expo and IFE

By: Unity Rd. Franchise Opportunity – Cannabis Dispensary | 1 Shares 581 Reads

Unique Opportunity for Colorado Cannabis Franchisor to Address its Key Industry Audiences- Cannabis & Franchising- This Week at the Jacob K. Javits Convention Center

May 29, 2019 // [Franchising.com](https://www.franchising.com) // NEW YORK CITY - Denver-based ONE Cannabis is building a major growth vehicle that will be taking the industry mainstream: cannabis franchising.

Embrace Franchising *Where?*

- Pre-offer and pre-sale registration & disclosure laws:
 - California, Hawaii, Illinois, Indiana, Maryland, Minnesota, New York, North Dakota, Rhode Island, South Dakota, Virginia, Washington, Wisconsin
- Pre-offer and pre-sale notice filings or other compliance:
 - Florida, Kentucky, Michigan, Nebraska, Oregon, Texas, Utah
- Additional hurdles without trademark registration:
 - Connecticut, Georgia, Louisiana, North Carolina, South Carolina (state TM okay)



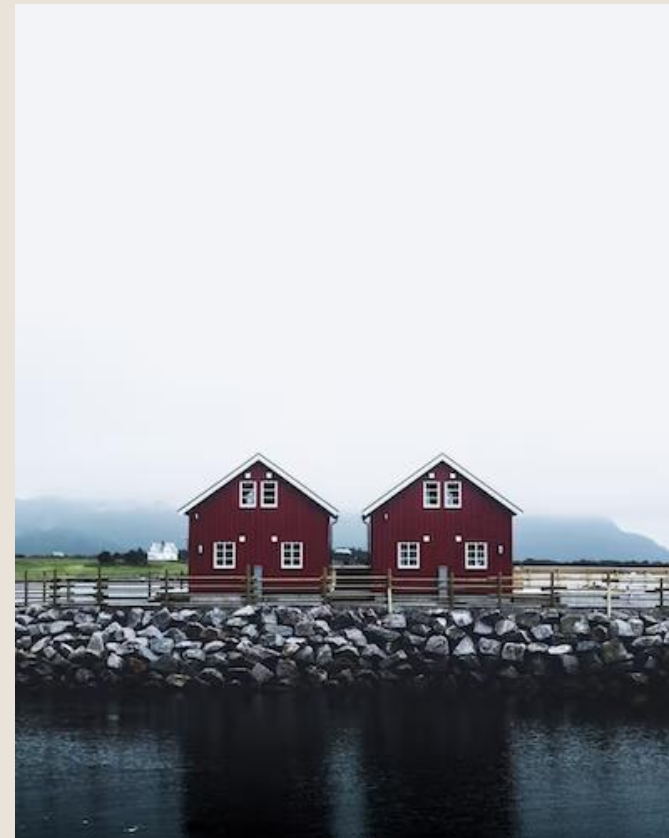
“

The DFPI would continue to have concerns about the federal illegality and consequently closely scrutinize any application, but also would recognize the status of the law in California in evaluating an application for registration.

-- California Department of Financial Protection & Innovation informal policy guidance regarding a cannabis franchise in California

Embrace Franchising?

- Financial strength of franchisor
- Sophistication of prospective buyers
- Minimization of risks



Exemptions



- Basis for avoiding registration requirements
- Often requires filing something to memorialize
- Very limited grounds
- Non-uniform between states or with federal bases for exemption

Cal. Corp. Code §§ 31100 *et seq.*; 16 C.F.R. § 436.8

“It needs to be short.”

Non-lawyers often disfavor thorough licensing agreements.

Use of plain English in the contract and explaining consequences via hypotheticals may help.

Questions?



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