New York Law Journal
SERVING THE BENCH AND BAR SINCE 1888
WWW.NYLJ.COM
An ALM Publication
VOLUME 262—NO. 64
MONDAY, SEPTEMBER 30, 2019

Outside Counsel

The Haze and Maze of Cannabis Law: How Will New York Courts Decide Cannabis-Related Business Disputes?



By **Paul D. Sarkozi,** And **Maxwell Palmer** And **Richard Trotter**

Medical marijuana has been legal in New York since 2014, and cannabis possession was decriminalized earlier this year. Will New York join the 11 other states in which recreational cannabis will be legal in 2020? If it does, where will federal courts in New York and New York's Commercial Division turn for guidance as they adjudicate novel issues presented by the commercialization of a formerly illegal substance, and one that remains illegal at the federal level?

Various sources present themselves. First, there is case law from jurisdictions like Colorado and California that are at the forefront of the legalization movement. However, New York has a proud history of developing its own jurisprudence and asserting its own leadership role, particularly in commercial disputes. Moreover, New York commercial law, which places significant weight on the contracts entered into by parties, is well-developed and may be applicable to many of the disputes that will arise. Finally, New York courts may look to equitable considerations to decide cannabis issues of first impression.

Decisions From the Pioneer States

Federal courts sitting in states where recreational cannabis is legal have taken the lead in cannabis-related intellectual property litigation. For example, the Central District of California determined that a cannabis company that owns state-law-protected intellectual property has standing to assert federal trade secret misappropriation claims. See *Siva Enterprises v. Ott*, 2018 WL 6844714, at *5 (C.D. Cal. Nov. 5, 2018).

Federal courts in Colorado and California have likewise made new law in cannabis-related employment disputes. For example, the

> Fasten your seat belts; it's going to be an exciting ride.

District of Colorado recently held that "employers are not excused from complying with federal laws, such as the Fair Labor Standards Act, just because their business practices may violate federal law." *Kenney v. Helix TCS*, 284 F. Supp. 3d 1186, 1190 (D. Colo. 2018). However, not all of the case law favors employees. A federal court in California found that an employer may terminate an employee for use of cannabis outside of the office—even if used to treat a disability—because California's discrimination statutes do not extend to how an

PAUL D. SARKOZI *is co-chair of Tannenbaum Helpern Syracuse & Hirschtritt LLP's litigation and dispute resolution practice.* MAXWELL PALMER *and* RICHARD TROTTER *are associates in the practice.*

employee treats a disability. *Shepherd v. Kohl's Dep't Stores*, 2016 WL 4126705, at *6 (E.D. Cal. Aug. 2, 2016).

By contrast, U.S. District Courts in Connecticut and Arizona have found that the states' respective statutes create implied rights of action for terminated employees to sue under applicable anti-discrimination provisions, and that these claims are not preempted by the Controlled Substances Act or other federal statutes. See *Noffsinger v. SSC Niantic Operating Co.*, 338 F. Supp. 3d 78 (D. Conn. 2018); *Whitmire v. Wal-Mart Stores*, 359 F. Supp. 3d 761 (D. Ariz. 2019).

The decision in *Whitmire* provides an example of how courts from one jurisdiction may rely upon cannabis-related decisions from another, as the federal court in Arizona relied upon "highly persuasive" decisions from the Delaware Superior Court and the District of Connecticut. See *Whitmire*, 359 F. Supp. 3d at 779-80 (citing *Chance v. Kraft Heinz Foods Co.*, No. CV-K18C-01-056 NEP, 2018 WL 6655670, at *6 (Del. Super. Ct. Dec. 17, 2018); *Noffsinger*, 273 F. Supp. at 339-40 (D. Conn. 2017)).

Policy and Equity

Policy and equitable arguments could also factor prominently in New York State and federal courts' adjudication of cannabis-related issues. As Judge Benjamin Cardozo explained almost a century ago, when judges are "called upon to say how far existing rules are to be extended or restricted, they must let the welfare of society fix its path, its direction and its distance." Benjamin N. Cardozo, The Nature of the Judicial Process 51 (1921).

For example, in *Green Earth Wellness Ctr. v. Atain Specialty Ins. Co.*, the District Court for the District of Colorado held that an insurance company that freely agreed to insure marijuana crop could not turn around and disclaim coverage based on the policy being void as against public policy. 163 F. Supp. 3d 821, 835 (D. Colo. 2016). Rather than void the contract on the basis of its federal illegality, the court's decision was driven by considerations of fairness, and the inequities of allowing an insurance company to disclaim coverage based solely on the criminalization of cannabis at the federal level. See id. at 832-33.

Even as bankruptcy courts continue to dismiss bankruptcy petitions filed by entities in the cannabis industry (see *In re Arenas*, 535 B.R. 845 (10th Cir. B.A.P. 2015)), some have been willing to at least entertain policy arguments. For example, in a recent decision by Bankruptcy Court for the District of Nevada, the court noted: "If there are 8,700 residents of Nevada employed by the marijuana industry, then the impact of automatically denying a bankruptcy fresh start to those residents and their dependents would be unconscionable." *In re CWNevada*, 2019 WL 2420032 (Bankr. D. Nev. May 15, 2019).

In fact, the heightened importance of public policy arguments can already be seen in those states where recreational cannabis is still illegal. For example, in *In Appeal of Panaggio*, the New Hampshire Supreme Court held that a worker's compensation insurance carrier was not prohibited from reimbursing the cost of purchasing medical cannabis to a claimant—a decision that appeared to turn on achieving an equitable outcome. 2019 WL 1067945, at *1 (N.H. March 7, 2019).

New York's own equitable doctrines could also be of significant importance to commercial cannabis disputes, and may provide tools for avoiding inequitable outcomes. For example, New York courts will enforce an otherwise valid contract even if it implicates illegal conduct (e.g., cannabis distribution), in order to avoid a windfall to the counter-party, and particularly where the two parties are "equally culpable with respect to the illegal conduct." See *Grape Solutions v. Majestic Wines*, 2015 WL 2207528, at *4 (Sup. Ct. N.Y. County 2015).

The Next Frontier

As millions of dollars have flowed to cannabis and cannabis-related businesses as part of the so-called "green rush," litigants have turned to courts for injunctive relief to

preserve rights in state-issued licenses and to enjoin acquisitions that could squeeze investors out of future gains.

For example, in *Dreger v. Dolan*, 2019 WL 1897116 (Ill. App. Ct. 2019), the plaintiff, a minority partner of a cannabis dispensary, sued the majority partner and moved for a temporary restraining order. The plaintiff asked the court to compel the defendant to make dividend distributions, and alleged that without the distributions, he would not be able to maintain his cannabis license. The trial court denied the temporary restraining order, but the appellate court reversed—directing the defendant to make a distribution of $100,000. The appellate court found that no remedy existed at law because the "unique nature of licensing in [the cannabis] industry" meant that "a money judgment granted to [the plaintiff] at some distant future date could not protect [his] right to maintain his current status as principal officer and owner of a medical cannabis dispensary in Illinois." Id. at *3.

Similarly, a Rhode Island state court recently issued a temporary restraining order enjoining state regulators from signing off on cannabis industry giant Acreage Holdings' proposed acquisition of a Rhode Island-based cannabis dispensary, after a third company claimed that the acquisition would violate its non-competition agreement with Acreage. See *Canwell v. High Street Capital Partners*, No. KM-2019-0948 (RI Superior Ct., Kent County Aug. 22, 2019).

As the cannabis industry continues to mature, these types of corporate and investor disputes are poised to become the next major frontier in cannabis-related litigation. For example, a complaint was recently filed in California Superior Court in which minority investors in several related cannabis businesses alleged that they had been improperly squeezed out, and asserted claims for breach of contract, fraud, breaches of fiduciary duty, turnover of books and records and injunctive relief. *Hillsboro Brown Capital v. Taft*, Case No. 30-2019-01087702 (CA Superior Ct., Orange County Aug. 1, 2019). The complaint contains many of the typical allegations one would expect to see in disputes between insiders and outside investors, such as accusations of preferential payments to entities controlled by insiders, undocumented side-deals, breaches of joint venture covenants and a failure to observe corporate formalities. But it also implicates issues that are unique to the cannabis industry, such as large cash holdings caused by nonexistent commercial banking options, parallel legal and illegal (unlicensed) operations, and the shuffling of resources between the separate legal entities mandated by the state for cannabis growing, manufacturing and retail operations, respectively, in order to disadvantage investors in only one of those entities.

As the cannabis industry continues to mature, these types of corporate and investor disputes are poised to become the next major frontier in cannabis-related litigation.

When these issues find their way to New York, counsel should be ready to draw upon the case law developed in these jurisdictions, New York's substantial body of commercial law in investor and corporate disputes and the equitable principles that courts can use to achieve a fair result. Fasten your seat belts; it's going to be an exciting ride.