

# THE “FREE MARKET” FOR MARIJUANA: A SOBER, CLEAR-EYED ANALYSIS OF MARIJUANA POLICY

by  
H. Justin Pace\*

*Federal law prohibits the possession and sale of marijuana. At the same time, states are not only decriminalizing marijuana but also attempting to provide a regulatory apparatus for its sale. This has created a unique business environment. In some ways, there is a true “free market” for marijuana in states that have legalized it—free, that is, of the legal and financial infrastructure available to fully licit businesses in America.*

*Contracts may not be enforceable because they lack a legal purpose. Relief in bankruptcy court may not be available, either as a debtor or as a creditor. Use of a legal entity to limit liability and take advantage of entity personhood may be impracticable. Federal money laundering and other laws effectively restrict access to the banking system, forcing marijuana businesses to operate as purely cash businesses. The U.S. Patent and Trademark Office refuses to register federal marks related to marijuana. Marijuana businesses face challenges in obtaining competent legal counsel to guide them through a market free on one hand and regulated on the other.*

*The odd legal posture has implications for considering marijuana policy through an economic lens. Any analysis of marijuana externalities should consider the additional externalities created by that odd legal posture. An analysis of policy options for mitigating negative externalities should also factor in the additional costs for marijuana businesses due to this “free market.” The uncertainty, from a policy perspective, counsels in favor of applying heuristics when considering policy options: this Article offers three and applies each.*

*This Article is the first to use this situation to examine the value offered by our legal and financial infrastructure. An inability to use it hurts marijuana businesses in very real ways. But, nonetheless, marijuana businesses are able to operate—to thrive even. That infrastructure is both more and less valuable*

---

\* Assistant Professor of Business Law, Western Carolina University, College of Business. Many thanks for helpful comments by Christopher Bruner, participants at the 2020 Symposium on Legal, Ethical, and Compliance Issues for Emerging Markets: Cannabis in the States hosted by the Center for Legal Studies and Business Ethics at the Spear School of Business, Oklahoma State University, and participants at the 2020 National Business Law Scholars Conference.

*than is appreciated, and in surprising ways. Ultimately, this Article advocates federal action that facilitates a continued incremental, state-by-state approach to marijuana reform.*

I.	Introduction .....	1220
II.	Access to Legal and Financial Infrastructure.....	1226
	A. <i>Contract Law</i> .....	1226
	B. <i>Business Entity Law</i> .....	1230
	C. <i>Access to the Financial System</i> .....	1236
	D. <i>Bankruptcy</i> .....	1240
	E. <i>Trademark Law</i> .....	1242
	F. <i>Obtaining Competent Counsel</i> .....	1244
	G. <i>Other Considerations</i> .....	1249
III.	On the Vanguard of Legalization: Michigan and Illinois.....	1251
	A. <i>Signs of Convergence in State Legalization Efforts</i> .....	1255
	B. <i>Early Evidence of Entity Choice by Michigan and Illinois         Dispensaries</i> .....	1256
IV.	The Economics of the Marijuana Industry.....	1257
	A. <i>Analysis of Externalities Associated with the Marijuana Industry</i> .....	1259
	B. <i>Mitigating Negative Externalities via Policy</i> .....	1268
V.	Approaches to Uncertainty in the Economics.....	1274
	A. <i>Subsidiarity</i> .....	1275
	B. <i>Chesterton's Fence</i> .....	1277
	C. <i>Presumption of Liberty</i> .....	1278
	D. <i>Reconciling Three Approaches in Tension</i> .....	1280
VI.	Conclusion .....	1283

## I. INTRODUCTION

As of the beginning of 2020, fifteen states and the District of Columbia have “legalized” recreational marijuana possession and usage under state law.<sup>1</sup> Twenty-

---

<sup>1</sup> *Marijuana Overview*, NAT'L CONF. ST. LEGISLATURES (Oct. 17, 2019), <http://www.ncsl.org/research/civil-and-criminal-justice/marijuana-overview.aspx>. Four states legalized recreational marijuana in 2020 alone. Lauren Dezenski, *Montana, Arizona, New Jersey and South Dakota Approve Marijuana Ballot Measures*, CNN Projects, CNN (Nov. 5, 2020, 6:20 AM), <https://www.cnn.com/2020/11/04/politics/marijuana-legalization-2020-states/index.html>. The margin of victory in ballot referenda is also increasing. See Kris Krane, *The Future of Marijuana Under Biden and a GOP Senate*, FORBES (Nov. 4, 2020, 5:21 PM), <https://www.forbes.com/sites/kriskrane/2020/11/04/the-future-of-marijuana-under-biden-and-a-gop-senate/?sh=7055d29f2168> (“Before yesterday, the highest vote total we had ever gotten on a legalization initiative was 57% in cannabis-loving California four years ago. This year we won in red Montana with the same 57%, purple Arizona with 60%, and blue New Jersey by a

three more states provide for medical marijuana.<sup>2</sup> California passed the first state medical marijuana statute in 1996,<sup>3</sup> which might suggest that the roughly two-and-a-half-decade-old industry is a growth market. It is,<sup>4</sup> but of an odd and unexpected sort. Marijuana businesses are growing rapidly and are out of the shadows, but marijuana remains prohibited under federal law.<sup>5</sup> This abnormal situation—with marijuana businesses finding active support from state governments and (somewhat) active prohibition from the federal government<sup>6</sup>—effectively bars marijuana businesses from full access to the United States’ basic legal and financial business infrastructure. Marijuana businesses may not be able to take advantage of, in full or in part, business entity law, contract law, or bankruptcy law, or be able to access the financial system in many ways. This affects both businesses directly involved in marijuana, such as dispensaries, growers, and distributors (hereinafter, “plant-touching businesses”), but also ancillary businesses.<sup>7</sup> Despite being heavily regulated at the

---

whopping 67%!”).

<sup>2</sup> See *State Medical Marijuana Laws*, NAT’L CONF. ST. LEGISLATURES (Nov. 4, 2020), <https://www.ncsl.org/research/health/state-medical-marijuana-laws.aspx>. Mississippi voters passed a ballot initiative providing for medical marijuana in 2020. Amber Roberson, *Here’s the List of Mississippi Medical Marijuana Qualifying Conditions*, MISS. CLARION LEDGER (Nov. 4, 2020, 11:55 AM), <https://www.clarionledger.com/story/news/politics/elections/2020/11/04/ms-medical-marijuana-qualifying-conditions-mississippi-initiative-65/6159403002/>. Voters in South Dakota approved both recreational and medical marijuana in the same election, the first state to do so. Dezenski, *supra* note 1.

<sup>3</sup> *State Medical Marijuana Laws*, *supra* note 2; see also Compassionate Use Act of 1996, CAL. HEALTH & SAFETY CODE § 11362.5 (West 1996).

<sup>4</sup> See, e.g., H. Justin Pace, *Rogue Corporations: Unlawful Corporate Conduct and Fiduciary Duty*, 85 MO. L. REV. 1, 44 (2020) [hereinafter Pace, *Rogue Corporations*] (“Marijuana dispensaries outnumber Starbucks in some locales, and a marijuana business might be worth hundreds of millions of dollars.”) (citing Luke Scheuer, *The “Legal” Marijuana Industry’s Challenge for Business Entity Law*, 6 WM. & MARY BUS. L. REV. 511, 521–22 (2015) [hereinafter Scheuer, *Business Entity Law*]).

<sup>5</sup> 21 U.S.C. § 812(c)(c)(10) (2018); see also *Ross v. RagingWire Telecomm., Inc.*, 174 P.3d 200, 204 (Cal. 2008) (citations omitted) (“No state law could completely legalize marijuana for medical purposes because the drug remains illegal under federal law, even for medical users.”).

<sup>6</sup> See *Green Earth Wellness Ctr., LLC v. Atain Specialty Ins. Co.*, 163 F. Supp. 3d 821, 832 (D. Colo. 2016) (noting “conflicting signals” from the federal government “regarding marijuana regulation and enforcement since 2009.”).

<sup>7</sup> See Paul T. Curley, *Guest Post: Marijuana: Big Opportunities and Challenges for Insurers*, D&O DIARY (May 9, 2019), <https://www.dandodiary.com/2019/05/articles/insurance-coverage/guest-post-marijuana-big-opportunities-and-challenges-for-insurers/> (“Generally speaking, companies in the marijuana industry can be separated into two categories: plant-touching and ancillary. Plant-touching companies actually handle marijuana and include cultivators (aka growers), distributors, laboratories, extractors, processors, product manufacturers, and dispensaries (*i.e.*, retail stores). Ancillary companies, which do not handle marijuana, support the plant-touching businesses and provide products and services such as grow equipment, greenhouses, extraction equipment, consumption devices, bottling, packaging, branding,

state level and prohibited at the federal level, the “legal”<sup>8</sup> marijuana industry is a “free” market of sorts—free from a legal infrastructure we think of as fundamental and necessary to modern capitalism.

The National Conference of State Legislatures classifies the marijuana laws of each state as an “Adult & medical use regulated program,” “Adult-use only no medical regulated program,” “Comprehensive medical cannabis program,” “CBD/low THC program,” or “No public cannabis access program.”<sup>9</sup> This Article is largely disinterested in the distinction but will use the terms “adult-use” (also commonly known as “recreational”) and “medical marijuana” as needed. Because this is a matter of state law and there are no applicable uniform laws or model acts, even within those categories, state laws vary widely. Potentially implicated as well are a variety of other state statutes and common law dealing with “illegal” conduct. Delaware, for example, appears to treat corporate directors knowingly allowing the corporation to violate positive law (by, say, operating a marijuana dispensary) as a *per se* violation of their fiduciary duties to the corporation.<sup>10</sup>

Marijuana is not merely illegal at the federal level. It is a Schedule I controlled substance, meaning that it has no acknowledged medical use and is subject to the strictest ancillary rules.<sup>11</sup> Legal penalties extend beyond direct violations under the

---

compliance, consulting, physical security, point-of-sale software, transportation, and media.”). Attorneys and accountants who take marijuana businesses as clients are also ancillary businesses. See Jenn Abelson, *Medical Marijuana Businesses See Opportunity in Mass.*, BOS. GLOBE (Mar. 7, 2013, 1:25 AM), <https://www.bostonglobe.com/business/2013/03/06/medicial-marijuana-businesses-look-massachusetts-for-growthopportunities/zsDvLSuQXM2D3akA94wguN/story.html>. For the most part, I will not differentiate between the two because the same challenges are frequently faced by both plant-touching and ancillary businesses.

<sup>8</sup> See, e.g., *United States v. McIntosh*, 833 F.3d 1163, 1179 n.5 (9th Cir. 2016) (“Nor does any state law ‘legalize’ possession, distribution, or manufacture of marijuana. Under the Supremacy Clause of the Constitution, state laws cannot permit what the federal law prohibits. U.S. CONST. art. VI, cl. 2. Thus, while the CSA remains in effect, states cannot actually authorize the manufacture, distribution, or possession of marijuana. Such activity remains prohibited by federal law.”). As Part II of this Article will make clear, this prevents the marijuana industry from operating like fully legal businesses. The Article will dispense with the scare quotes around “legal” hereinafter.

<sup>9</sup> *State Medical Marijuana Laws*, *supra* note 2.

<sup>10</sup> See Pace, *Rogue Corporations*, *supra* note 4, at 6–9 (explaining that Delaware corporation law provides for a *per se* standard where directors know of or direct unlawful conduct); *id.* at 44–45 (noting the standard’s applicability in the marijuana context).

<sup>11</sup> 21 U.S.C. § 812(b)(1)(B) (2018). This Article is limited to considering the law around cannabis products that contain THC, the “drug” at issue. CBD derived from hemp and its derivatives, federally legalized by the 2018 Farm Bill, is outside the scope of this Article. Kyle Jaeger, *Trump Budget Proposes Ending Medical Marijuana Protections and Blocking DC from Legalizing*, MARIJUANA MOMENT (Feb. 10, 2020), <https://www.marijuanamoment.net/trump-budget-proposes-ending-state-medical-marijuana-protections-and-blocking-dc-from-legalizing/>.

doctrines of conspiracy, aiding and abetting, and accessory after the fact.<sup>12</sup> These doctrines are particularly problematic for ancillary marijuana businesses that might not touch the product itself but nonetheless violate federal law. Various federal laws and regulations make marijuana businesses effectively unbankable.<sup>13</sup>

The federal government continues to send mixed signals about its approach to marijuana in states where it has been legalized at the state level. The Ogden Memorandum, issued during the Obama administration, indicated to U.S. Attorneys that prosecutions of individuals acting in compliance with state medical marijuana laws should not be a federal priority.<sup>14</sup> But the follow-up Cole Memorandum issued just two years later clarified that, despite the Ogden Memorandum, marijuana remains illegal under federal law and federal prosecutors retain their discretion to prosecute violations of federal law.<sup>15</sup> The Cole Memorandum coincided with federal action against dispensaries in California, Montana, and Colorado.<sup>16</sup> Under Attorney General Jeff Sessions, the Trump administration rescinded the enforcement guidance from the Obama administration.<sup>17</sup> Attorney General William Barr, Sessions' successor, was also opposed to marijuana but also indicated that federal marijuana law enforcement was not a priority in states where it is legalized.<sup>18</sup>

---

<sup>12</sup> Julie Andersen Hill, *Banks, Marijuana, and Federalism*, 65 CASE W. RES. L. REV. 597, 607–08 (2015) (citing 18 U.S.C. §§ 2, 3, 371 (2018)). Most states now “require that an accomplice not merely aid the principal to commit the offense, but that he have an actual intent to aid the commission of that offense.” Sam Kamin & Eli Wald, *Marijuana Lawyers: Outlaws or Crusaders?*, 91 OR. L. REV. 869, 887 (2013).

<sup>13</sup> See generally Hill, *supra* note 12.

<sup>14</sup> Erwin Chemerinsky et al., *Cooperative Federalism and Marijuana Regulation*, 62 UCLA L. REV. 74, 86 (2015) (citing DAVID W. OGDEN, OFFICE OF THE DEPUTY ATTORNEY GEN., MEMORANDUM FOR SELECTED UNITED STATES ATTORNEYS: INVESTIGATIONS AND PROSECUTIONS IN STATES AUTHORIZING THE MEDICAL USE OF MARIJUANA 1–2 (Oct. 19, 2009) [hereinafter OGDEN MEMORANDUM]).

<sup>15</sup> Chemerinsky et al., *supra* note 14, at 87–88 (citing JAMES M. COLE, OFFICE OF THE DEPUTY ATTORNEY GEN., MEMORANDUM FOR UNITED STATES ATTORNEYS: GUIDANCE REGARDING THE OGDEN MEMO IN JURISDICTIONS SEEKING TO AUTHORIZE MARIJUANA FOR MEDICAL USE 2 (June 29, 2011) [hereinafter COLE MEMORANDUM]).

<sup>16</sup> Chemerinsky et al., *supra* note 14, at 88 (citing *Feds Warn, Indict California Medical Marijuana Dispensary Operators*, ABC7 (Oct. 7, 2011), <https://abc7.com/archive/8383655/>; Jamie Kelly, *Former Grizzly Pleads Not Guilty to Federal Drug Charges*, MISSOULIAN (Jan. 19, 2012), [https://missoulian.com/news/state-and-regional/former-grizzly-pleads-not-guilty-to-federal-drug-charges/article\\_5166136a-4304-11e1-a886-0019bb2963f4.html](https://missoulian.com/news/state-and-regional/former-grizzly-pleads-not-guilty-to-federal-drug-charges/article_5166136a-4304-11e1-a886-0019bb2963f4.html); *Medical Marijuana: Federal Crackdown, Similar to that in California, Begins in Colorado*, HUFFPOST (Jan. 12, 2012, 4:48 PM), [https://www.huffpost.com/entry/medical-marijuana-federal\\_n\\_1202725](https://www.huffpost.com/entry/medical-marijuana-federal_n_1202725)).

<sup>17</sup> Robert A. Mikos, *The Evolving Federal Response to State Marijuana Reforms*, 26 WIDENER L. REV. 1, 10 (2020) (citing JEFFERSON B. SESSIONS III, OFFICE OF THE ATTORNEY GEN., MEMORANDUM FOR ALL UNITED STATES ATTORNEYS: MARIJUANA ENFORCEMENT (Jan. 4, 2018) [hereinafter SESSIONS MEMORANDUM]).

<sup>18</sup> See Jonathan H. Adler, *Introduction: Our Federalism on Drugs, in MARIJUANA*

On the other hand, Congress has included a rider with its appropriations legislation every year since 2014 that bars the Justice Department from using funds to stop states from implementing *medical* marijuana laws.<sup>19</sup> The Ninth Circuit interpreted this language to prevent criminal prosecution against individuals.<sup>20</sup> But another federal court refused to allow a defendant to use compliance with his state's medical marijuana law as a defense.<sup>21</sup> And, by its own terms, the rider does not apply to adult-use marijuana legalization.<sup>22</sup> The Trump administration has requested Congress remove the rider each of the last three years (the Obama administration also asked for the removal of the rider).<sup>23</sup> The position of the Trump administration is that it is free to ignore the rider.<sup>24</sup>

Economies of scale offer considerable advantages to larger firms. Given this, as an industry matures, it will tend to consolidate. The tobacco, alcohol, and, to a lesser extent, pharmaceutical industries are in some ways similar to what a mature legal marijuana industry might look like; each of those industries is dominated by large players.<sup>25</sup> Market concentration is sensitive to government intervention, though. Government intervention can, and frequently does, lead to a higher market concentration;<sup>26</sup> for example, it raises compliance costs, which are more easily borne by

---

FEDERALISM: UNCLE SAM AND MARY JANE 1, 4 (Jonathan H. Adler ed., 2020) (citing Dominic Holden, *Bill Barr Says He's "Not Going After" Marijuana in States Where It's Legal*, BUZZFEED NEWS (Jan. 15, 2019, 3:30 PM), <https://www.buzzfeednews.com/article/dominicholden/bill-barr-attorney-general-marijuana-legal-enforcement>).

<sup>19</sup> Jaeger, *supra* note 11. *But see* United States v. McIntosh, 833 F.3d 1163, 1179 n.5 (9th Cir. 2016) ("Congress currently restricts the government from spending certain funds to prosecute certain individuals. But Congress could restore funding tomorrow, a year from now, or four years from now, and the government could then prosecute individuals who committed offenses while the government lacked funding.").

<sup>20</sup> *McIntosh*, 833 F.3d at 1176–77.

<sup>21</sup> John Agar, *Michigan Medical Marijuana Seller Gets Prison: 'Federal Law Has Not Changed,' Judge Says*, MLIVE (Jan. 31, 2020), <https://www.mlive.com/news/grand-rapids/2020/01/michigan-medical-marijuana-seller-gets-prison-federal-law-has-not-changed-judge-says.html>.

<sup>22</sup> See Jaeger, *supra* note 11 (quoting language from the rider).

<sup>23</sup> *Id.*

<sup>24</sup> *Id.*

<sup>25</sup> The Hirschman-Herfindahl Index, or HHI, is a common measure of industry concentration. "HHI scores of less than 1,000 indicate low market concentration, those between 1,000 and 1,800 moderate concentration, while scores above 1,800 signify highly concentrated markets." Benjamin Hawkins et al., *Reassessing Policy Paradigms: A Comparison of the Global Tobacco and Alcohol Industries*, 13 GLOBAL PUB. HEALTH 1, 7 (2018). With HHI scores of 3,100 and 2,750, respectively, in the United States, the tobacco and beer industries qualify as "highly concentrated markets." *Id.* at 7, tbl.1.

<sup>26</sup> See, e.g., Eli M. Noam, *Deregulation and Market Concentration: An Analysis of Post-1996 Consolidations*, 58 FED. COMM. L.J. 539, 546 (2006) (showing market concentration in unregulated information industries to be consistently lower than in regulated industries).

larger firms. Government intervention can also lead to lower market concentration.<sup>27</sup> Antitrust law will tend to stymie market concentration at some level.<sup>28</sup> The current legal landscape for marijuana will severely limit market concentration by limiting access to a beneficial legal and financial infrastructure, by scaring off professional investors and managers, and by scaring off large, incumbent firms from other industries that might otherwise enter the market. A state might see this as a feature rather than a bug.

Marijuana is a vice industry, and vice industries tend to produce negative externalities.<sup>29</sup> Marijuana legalization lowers the price and increases access to marijuana: the expectation under classical economic theory is that this will lead to increased consumption. Increased consumption of marijuana may lead to negative externalities for a number of reasons. Inhaling the products of combustion is unhealthy and will lead to an increased strain on our public health system, among other negative externalities.<sup>30</sup> We should expect some of those negative externalities to be *unexpected*, in part because our primary existing experience is with illegal marijuana.

But legalized marijuana may also produce positive externalities.<sup>31</sup> Marijuana may be a substitute good for alcohol and, perhaps more surprisingly, opioids.<sup>32</sup> Given the considerable negative externalities associated with alcohol and opioids, if increased marijuana use decreases alcohol and opioid use, the net externalities may be positive. To the extent marijuana can be used in a way that is medically beneficial, the increased strain on our public health system might be mitigated or even cancelled out. More importantly for the purposes of this Article, an artificially small market concentration may not be the most effective method for mitigating negative externalities.<sup>33</sup>

Part II will survey the various impediments to accessing our legal and financial

<sup>27</sup> *Cf. id.* (showing that market concentration in regulated information industries varies more over time than in unregulated industries).

<sup>28</sup> *Cf.* James W. Brock & Norman P. Obst, *Market Concentration, Economic Welfare, and Antitrust Policy*, 9 J. INDUS. COMPETITION & TRADE 65, 66 (2009) (“Combating economic concentration has long been considered a paramount value of American antitrust policy.”).

<sup>29</sup> *See, e.g.*, LAWRENCE A. GREENFELD, OFFICE OF JUSTICE PROGRAMS, ALCOHOL AND CRIME: AN ANALYSIS OF NATIONAL DATA ON THE PREVALENCE OF ALCOHOL INVOLVEMENT IN CRIME iii (1998) (“[N]early 4 in 10 violent victimizations involve use of alcohol, about 4 in 10 fatal motor vehicle accidents are alcohol-involved; and about 4 in 10 offenders, regardless of whether they are on probation, in local jail, or in State prison, self-report that they were using alcohol at the time of the offense.”).

<sup>30</sup> *See infra* Part IV.A (analyzing the potential externalities associated with legalized marijuana).

<sup>31</sup> *Infra* Part IV.A.

<sup>32</sup> June H. Kim et al., *State Medical Marijuana Laws and the Prevalence of Opioids Detected Among Fatally Injured Drivers*, 106 AM. J. PUB. HEALTH 2032, 2032 (2016).

<sup>33</sup> *See infra* Part IV.B (discussing policy approaches states can take to mitigate negative externalities associated with a vice industry).

infrastructure faced by marijuana businesses. Part III will take a closer look at very early experiences in Michigan and Illinois. Part IV analyzes the economics of the marijuana industry, with an emphasis on externalities. Part V considers how to approach policymaking given substantial uncertainty as to the externalities of marijuana.

## II. ACCESS TO LEGAL AND FINANCIAL INFRASTRUCTURE

Marijuana has been legalized under the laws of several states but remains illegal under the federal Controlled Substances Act (hereinafter, “CSA”).<sup>34</sup> Any plant-touching business at the very least violates the CSA’s prohibitions on manufacturing, possessing, distributing, or dispensing marijuana.<sup>35</sup> Ancillary businesses may, even though they are not plant-touching, nonetheless violate the CSA and other federal laws under theories of conspiracy, aiding and abetting, and accessory after the fact.<sup>36</sup> The CSA expressly prohibits “knowingly renting, managing, or using property ‘for the purpose of manufacturing, distributing, or using any controlled substance.’”<sup>37</sup> It is not just criminal law, as it happens, that takes a dim view of criminal law violations. Several areas of the law include “triggers” that remove their availability to parties that violate the law.

### A. Contract Law

A contract must have a legal purpose and will generally be unenforceable if the “performance, formation, or object of the agreement is against the law.”<sup>38</sup> This is not the last time we will see the legal purpose requirement. Performance is, of course, illegal if it violates a criminal statute.<sup>39</sup> And where the contract violates a criminal

---

<sup>34</sup> 21 U.S.C. § 812(c)(c)(10) (2018).

<sup>35</sup> 21 U.S.C. §§ 802(6), 812, 841(a)(1) (2018).

<sup>36</sup> Hill, *supra* note 12, at 607–08 (citing 18 U.S.C. §§ 2, 3, 371 (2018)).

<sup>37</sup> Clifford J. White III & John Sheahan, *Why Marijuana Assets May Not Be Administered in Bankruptcy*, AM. BANKR. INST. J., Dec. 2017, at 34, 35 (2017) (quoting 21 U.S.C. § 856(a) (2018)).

<sup>38</sup> Snyder v. Snyder, 865 N.E.2d 944, 949 (Ohio Ct. App. 2007); BOURDEAU ET AL., 17A AM. JUR. 2D CONTRACTS § 217 (2020) (citing Zimmerman v. Brown, 306 P.3d 306, 315 (Kan. Ct. App. 2013)); *see also* CAL. CIVIL CODE § 1598 (West 2020) (“Where a contract has but a single object, and such object is unlawful, whether in whole or in part, . . . the entire contract is void.”); 8 SAMUEL WILLISTON, A TREATISE ON THE LAW OF CONTRACTS § 19.11 (Richard A. Lord ed., 4th ed. 2010).

<sup>39</sup> 6A ARTHUR LINTON CORBIN, CORBIN ON CONTRACTS: A COMPREHENSIVE TREATISE ON THE WORKING RULES OF CONTRACT LAW § 1373 (1962) (“A bargain may be illegal because the performance that is bargained for is illegal; and the performance may be illegal because governmental authority has declared it to be a ‘crime’ . . .”).



statute, the presumption is the legislative intent was to make any contracts in violation of that statute void.<sup>40</sup> Even a contract which is not itself unlawful may be void if it is “part of a general scheme to bring about an unlawful result.”<sup>41</sup> This casts a shadow on *all* contracts entered into by and with both plant-touching and ancillary businesses.<sup>42</sup> Because federal marijuana prohibition is a criminal law intended for the benefit of the public, private parties may not waive its application.<sup>43</sup> Even in a state that has legalized marijuana at the state level, courts may treat federal law as effectively being state law.<sup>44</sup> A federal court, at least, will likely look to federal law, not state law, in determining whether a contract is unenforceable for violating the law.<sup>45</sup> Contracts with an illegal purpose are unenforceable as against public policy, and public policy extends beyond strict illegality. Even the sale of a marijuana business legal under state *and* federal law (a manufacturer of drug paraphernalia) was ruled unenforceable as against public policy.<sup>46</sup>

Not all contracts in violation of law are legally unenforceable,<sup>47</sup> especially where the underlying act is criminal only because it is prohibited by statute rather than

---

<sup>40</sup> BOURDEAU ET AL., *supra* note 38, at § 226 (citing *Alleghany Corp. v. James Found. of N.Y. Inc.*, 214 F.2d 446, 450 (2d Cir. 1954)).

<sup>41</sup> Judgment of Dismissal at 4, *Hammer v. Today’s Health Care II*, No. CV2011-051310 (Ariz. Sup. Ct. Apr. 17, 2012) (citing 8 WILLISTON, *supra* note 38, at § 19:11).

<sup>42</sup> See generally Luke Scheuer, *Are “Legal” Marijuana Contracts “Illegal”?*, 16 U.C. DAVIS BUS. L.J. 31 (2015) [hereinafter Scheuer, *Marijuana Contracts*].

<sup>43</sup> *Phoenix Physical Therapy v. Unemployment Ins. Div.*, 943 P.2d 523, 528 (Mont. 1997); BOURDEAU ET AL., *supra* note 38, at § 230 (citing *Lucero v. Van Wie*, 598 N.W.2d 893, 897 (S.D. 1999)).

<sup>44</sup> See, e.g., *Kashani v. Tsann Kuen China Enter. Co.*, 13 Cal. Rptr. 3d 174, 181 (Cal. Ct. App. 2004) (“[A] violation of federal law is a violation of law for purposes of determining whether or not a contract is unenforceable as contrary to the public policy of California” because “California law includes federal law.”); *People v. Sischo*, 144 P.2d 785, 791–92 (Cal. 1943) (holding federal law is “the supreme law of the land (U.S. CONST., art. VI, cl. 2) to the same extent as though expressly written into every state law.”).

<sup>45</sup> *Sola Elec. Co. v. Jefferson Elec. Co.*, 317 U.S. 173, 176–77 (1942); *Ginsburg v. ICC Holdings, LLC*, No. 3:16-CV-2311-D, 2017 WL 5467688, at \*5 (N.D. Tex. Nov. 13, 2017) (citing *Kelly v. Kosuga*, 358 U.S. 516, 519 (1959); *N. Ind. Pub. Serv. Co. v. Carbon Cty. Coal Co.*, 799 F.2d 265, 273 (7th Cir. 1986); *Energy Labs, Inc. v. Edwards Eng’g, Inc.*, No. 14 C 7444, 2015 WL 3504974, at \*3 (N.D. Ill. June 2, 2015)).

<sup>46</sup> *Bovard v. Am. Horse Enters. Inc.*, 247 Cal. Rptr. 340, 343 (Cal. Ct. App. 1988). *Bovard* was decided before California legalized marijuana, but a court could apply the reasoning from *Bovard* even in a state where marijuana is legal under state law, because it remains illegal under federal law.

<sup>47</sup> *DeReggi Constr. Co. v. Mate*, 747 A.2d 743, 747 (Md. Ct. Spec. App. 2000); BOURDEAU ET AL., *supra* note 38, at § 223 (citing *Chapman v. Zakzaska*, 76 N.W.2d 537, 538 (Wis. 1956)); see also *Kashani*, 13 Cal. Rptr. 3d at 541 (“Courts in California have, depending on the facts, carved out exceptions to the statutory and judicial language that illegal contracts are void and unenforceable.”).

being wrong in and of itself.<sup>48</sup> The illegality defense is equitable in nature.<sup>49</sup> A court will consider whether “a causal nexus exists between [the] plaintiff’s illegal conduct and all [of the] plaintiff’s claims.”<sup>50</sup> A court will also consider whether the consequences of ruling the contract unenforceable are “disproportionally harsh considering the nature of the illegality.”<sup>51</sup> A court might enforce an illegal contract “in order to ‘avoid unjust enrichment to a defendant.’”<sup>52</sup> “[R]elative moral culpability”<sup>53</sup> as relevant to the analysis, is necessarily contextual and fact-specific.<sup>54</sup> Even federal courts have adopted a flexible approach to enforcing illegal contracts.<sup>55</sup>

A state court in Arizona ruled that a lease to a company intending to operate a medical marijuana dispensary, legality of the marijuana operation itself aside, was enforceable because it gave a right to sublease that could be exercised without violating any laws.<sup>56</sup> Nor did illegality under federal law render the contract unenforceable. This was because public policy favored enforcement of a contract that complied with state law. The federal law was “in flux,” and enforcing the contract would not *require* the parties to violate federal law.<sup>57</sup> This makes sense because the rule is

---

<sup>48</sup> *Ader v. Guzman*, 23 N.Y.S.3d 292, 295 (N.Y. App. Div. 2016); *BOURDEAU ET AL.*, *supra* note 38, at § 298 (citing *Schlessinger v. Valspar Corp.*, 686 F.3d 81, 85 (2d Cir. 2012)).

<sup>49</sup> *Ginsburg*, 2017 WL 5467688, at \*8 (citing *Carbon Cty.*, 799 F.2d at 273).

<sup>50</sup> *Varela v. Spanski*, 941 N.W.2d 60, 73 (Mich. Ct. App. 2019).

<sup>51</sup> *Kashani*, 13 Cal. Rptr. 3d at 557.

<sup>52</sup> *Asdourian v. Araj*, 696 P.2d 95, 105 (Cal. 1985) (quoting *Southfield v. Barrett*, 91 Cal. Rptr. 514, 516 (Cal. Ct. App. 1970)).

<sup>53</sup> See *Bassidji v. Goe*, 413 F.3d 928, 938 (9th Cir. 2005); *cf. Varela*, 941 N.W.2d at 73 (“[T]he factual allegations do not indicate that defendants were more culpable than [the] plaintiff. . . . When both parties are equally at fault, the wrongful-conduct rule still applies.”).

<sup>54</sup> *South Tahoe Gas Co. v. Hofmann Land Improvement Co.*, 102 Cal. Rptr. 286, 292 (Cal. Ct. App. 1972) (“In each case, the extent of enforceability and the kind of remedy granted depend upon a variety of factors, including the policy of the transgressed law, the kind of illegality and the particular facts.”); *M. Arthur Gensler, Jr., & Assocs., Inc. v. Larry Barrett, Inc.*, 499 P.2d 503, 508 (Cal. 1972) (“In each such case, how the aims of policy can best be achieved depends on *the kind of illegality and the particular facts involved.*”) (citation omitted).

<sup>55</sup> *Ginsburg v. ICC Holdings, LLC*, No. 3:16-CV-2311-D, 2017 WL 5467688, at \*8 (N.D. Tex. Nov. 13, 2017) (citing *Paul Arpin Van Lines, Inc. v. Universal Transp. Servs., Inc.*, 988 F.2d 288, 290 (1st Cir. 1993); *Nagel v. ADM Inv’r Servs., Inc.*, 217 F.3d 436, 440 (7th Cir. 2000)).

<sup>56</sup> *Green Cross Med., Inc. v. Gally*, 395 P.3d 302, 303–05 (Ariz. Ct. App. 2017).

<sup>57</sup> *Id.* at 307–08; see also *Kaiser Steel Corp. v. Mullins*, 455 U.S. 72, 83 (1982) (“It is also well established . . . that a federal court has a duty to determine whether a contract violates federal law before enforcing it.”); *Ginsburg*, 2017 WL 5467688, at \*8 (“Nor would granting relief in this case require that McGraw or ICC violate the CSA. Ginsburg seeks repayment . . . . Obtaining this relief does not require that ICC manufacture, distribute, dispense, or possess marijuana.” (citing *Mann v. Gullickson*, No. 15-cv-03630-MEJ, 2016 WL 6473215, at \*7 (N.D. Cal. Nov. 2, 2016))); *Green Earth Wellness Ctr., LLC v. Atain Specialty Ins. Co.*, 163 F. Supp. 3d 821, 835 (D. Colo. 2016) (enforcing the insurance policy of a medical marijuana business while noting the “continued erosion of any clear and consistent federal public policy in this area . . .”); *Energy Labs,*

less about contracts having a legal purpose than not violating the jurisdiction’s public policy.<sup>58</sup> States that have legalized marijuana and set up regulatory schemes for dispensaries are expressing a public policy quite different from federal policy.

Certain remedies will not be available for a breach of contracts in violation of the law. A court will not order a party to specifically perform on a contract if that performance will violate the law.<sup>59</sup> The same logic applies to rescission. Other equitable remedies are unlikely to be available as well under the unclean hands doctrine.<sup>60</sup> Monetary relief is available in many circumstances because it would not *require* a violation of the law,<sup>61</sup> although in other circumstances it might require, for example, an insurance company to run afoul of money-laundering statutes. The case law is mixed, and as a general matter, it does not offer marijuana businesses the certainty afforded to other businesses.<sup>62</sup> The potential to win on appeal may be too little too late. And even if state courts prove willing to enforce contracts related to marijuana, federal bankruptcy courts are unlikely to be so cooperative.<sup>63</sup>

The contract law issue is perhaps the easiest for states to address. By legalizing marijuana, states are already indicating that marijuana contracts are not against public policy. But they could be more explicit: California and Colorado law provide a specific carve-out.<sup>64</sup> Federal courts may remain reticent, though.

Inc. v. Edwards Eng’g, Inc., No. 14 C 7444, 2015 WL 3504974, at \*4 (N.D. Ill. June 2, 2015).

<sup>58</sup> 2 E. ALLAN FARNSWORTH, FARNSWORTH ON CONTRACTS §5.1 (3d ed. 2004).

<sup>59</sup> *Mann*, 2016 WL 6473215, at \*5 (citing *Bassidji v. Goe*, 413 F.3d 928, 936 (9th Cir. 2005)).

<sup>60</sup> See *Romero v. Allstate Ins. Co.*, 52 F. Supp. 3d 715, 734–36 (E.D. Pa. 2014).

<sup>61</sup> *Mann*, 2016 WL 6473215, at \*7 (“Mandating that payment does not require Gullickson to possess, cultivate, or distribute marijuana, or to in any other way require her to violate the CSA.”); cf. *Bassidji*, 413 F.3d at 939 (“Federal and California law, as explicated above, would bar an American court from ordering [defendant] to pay [plaintiff] pursuant to the illegal guarantees.”).

<sup>62</sup> *Compare Tracy v. USAA Cas. Ins. Co.*, No. 11–00487 LEK–KSC, 2012 WL 928186, at \*13 (D. Haw. Mar. 16, 2012) (ruling that an insurer’s refusal to pay a claim for marijuana plants legal under Hawaii law was not a breach of contract because possession of the plants was illegal under federal law) *with* *Green Cross Med., Inc. v. Gally*, 395 P.3d 302, 304–05 (Ariz. Ct. App. 2017) (ruling that a lease to a company intending to operate a medical marijuana dispensary was enforceable because it gave a right to sublease that could be exercised without violating any laws).

<sup>63</sup> *Infra* Part II.D.

<sup>64</sup> CAL. CIV. CODE § 1550.5(b) (West 2020) (“Notwithstanding any law, including . . . federal law, commercial activity relating to medicinal cannabis or adult-use cannabis conducted in compliance with California law and any applicable local standards, requirements, and regulations shall be deemed to be all of the following: (1) A lawful object of a contract. (2) Not contrary to, an express provision of law, any policy of express law, or good morals. (3) Not against public policy.”); COLO. REV. STAT. § 13-22-601 (2013) (“It is the public policy of the state of Colorado that a contract is not void or voidable as against public policy if it pertains to lawful [marijuana] activities authorized by section 16 of article XVIII of the state constitution and article 43.4 of title 12, C.R.S.”).

Marijuana businesses have an incentive to address these issues through private ordering if the state is slow to address them by statute. However, their ability to do so is limited. Contract law is, of course, the building block of state-facilitated private ordering.<sup>65</sup> How do businesses engage in private ordering when basic contracts may not be enforceable? Marijuana businesses would be wise to avoid any references to marijuana that are not strictly necessary in their contracts.<sup>66</sup> Choice of law provisions should provide for the law of a state that has legalized marijuana. California and Colorado are especially attractive options if reasonable because state law expressly provides that marijuana contracts are not against public policy.<sup>67</sup>

Arbitration offers an attractive alternative to asking a court to enforce a marijuana contract.<sup>68</sup> The strong public policy in favor of enforcing arbitration awards means a court is less likely to set aside an arbitration award than throw out a contract, legal purpose requirement notwithstanding.<sup>69</sup> Both parties want the deal to succeed at its outset and the arbitrator has an incentive to give effect to the parties' agreement, so arbitration is likely to result in enforceable contracts.<sup>70</sup> Arbitration also offers the added benefit of confidentiality—likely to be of particular value to marijuana businesses.<sup>71</sup>

### B. Business Entity Law

Nicholas Murray Butler, president of Columbia University at the time, declared in 1911 that the corporation with limited liability for its shareholders was “the greatest single discovery of modern times,” far more important than steam or

---

<sup>65</sup> Jorge L. Contreras, *From Private Ordering to Public Law: The Legal Framework Governing Standards-Essential Patents*, 30 HARV. J.L. & TECH (SPECIAL SYMPOSIUM) 211, 218–19 (2017); Branislav Hock & Suren Gomtsian, *Private Order Building: The State in the Role of the Civil Society and the Case of FIFA*, 17 INT'L SPORTS L.J. 186, 186 (2018).

<sup>66</sup> See, e.g., Judgment of Dismissal at 4, *Hammer v. Today's Health Care II*, No. CV2011-051310 (Ariz. Sup. Ct. Apr. 17, 2012) (refusing to enforce a contract where “[t]he explicitly stated purpose of these loan agreements was to finance the sale and distribution of marijuana.”).

<sup>67</sup> CAL. CIV. CODE § 1550.5(b); COLO. REV. STAT. § 13-22-601.

<sup>68</sup> Robert McVay, *Cannabis Contracts: Is Arbitration the Key?*, CANNA L. BLOG (May 3, 2016), <https://www.cannalawblog.com/cannabis-contracts-is-arbitration-the-key/>.

<sup>69</sup> See *Epic Sys. Corp. v. Lewis*, 138 S. Ct. 1612, 1621 (2018) (describing the history of the Federal Arbitration Act and the “emphatic directions” it contains in favor of enforcing arbitration (citing *Moses H. Cone Mem'l Hosp. v. Mercury Constr. Corp.*, 460 U.S. 1, 24 (1983); *Am. Express Co. v. Italian Colors Rest.*, 570 U.S. 228, 233 (2013))).

<sup>70</sup> McVay, *supra* note 68 (“Our cannabis business lawyers have met with many arbitrators and at least one arbitration society looking to market their services as arbitrators for cannabis industry disputes. Of course these individuals and associations are not going to toss out all marijuana contracts—they’d be out of business.”).

<sup>71</sup> *Id.*

electricity, which “would be reduced to comparative impotence without it.”<sup>72</sup> Butler’s fellow Ivy League president Charles William Eliot of Harvard agreed, describing limited liability as “the corporation’s most precious characteristic.”<sup>73</sup> Limited liability is even more readily available today than during Butler and Eliot’s time, as the limited liability company (hereinafter, “LLC”) and other alternative business entities combine limited liability with favorable tax treatment.<sup>74</sup>

The ample advantages offered by modern business entity forms are not readily available to marijuana businesses. Management of a business entity brings fiduciary duties to the entity, including the duties of care and loyalty.<sup>75</sup> There is also a duty of good faith subsumed into the duty of loyalty (at least under Delaware corporation law).<sup>76</sup> Actions that would violate that duty include directing the corporation to violate positive law.<sup>77</sup> This logic has been extended to cover where a fiduciary knew of unlawful activity and took no steps to prevent it.<sup>78</sup>

All fiduciaries of marijuana businesses, then, violate their fiduciary duties by allowing the business to violate federal law on an ongoing basis.<sup>79</sup> This is true even if the violation of law will prove profitable.<sup>80</sup> Thus all directors and controlling shareholders face the risk of personal liability for merely being involved in a marijuana business. This is likely a *per se* standard far easier for a plaintiff to meet than is

<sup>72</sup> Roger E. Meiners et al., *Piercing the Veil of Limited Liability*, 4 DEL. J. CORP. L. 351, 351 (1979) (quoting 1 WILLIAM MEADE FLETCHER, *CYCLOPEDIA OF THE LAW OF PRIVATE CORPORATIONS* § 21 (1917)).

<sup>73</sup> *Id.* (quoting Bernard F. Cataldo, *Limited Liability with One-Man Companies and Subsidiary Corporations*, 18 L. & CONTEMP. PROBS. 473, 473 (1953)).

<sup>74</sup> H. Justin Pace, *Contracting Out of Fiduciary Duties in LLCs: Delaware Will Lead, but Will Anyone Follow?*, 16 NEV. L.J. 1085, 1086 (2016) [hereinafter Pace, *Fiduciary Duties*].

<sup>75</sup> Paula J. Dalley, *To Whom It May Concern: Fiduciary Duties and Business Associations*, 26 DEL. J. CORP. L. 515, 519 (2001).

<sup>76</sup> Pace, *Rogue Corporations*, *supra* note 4, at 7 (citing *Stone v. Ritter*, 911 A.2d 362, 370 (Del. 2006)).

<sup>77</sup> *Id.* (citing *In re Walt Disney Co. Derivative Litig.*, 906 A.2d 27, 67 (Del. 2006)); *see also* Leo E. Strine, Jr. et al., *Loyalty’s Core Demand: The Defining Role of Good Faith in Corporation Law*, 98 GEO. L.J. 629, 650 (2010) (“When directors knowingly cause the corporation to do what it may not—engage in unlawful acts or unlawful businesses—they are disloyal to the corporation’s essential nature. By causing the corporation to become a lawless rogue, they make the corporation untrue to itself and to the promise underlying its own societally authorized birth.”).

<sup>78</sup> *In re Abbott Labs. Derivative Shareholders Litig.*, 325 F.3d 795, 808–09 (7th Cir. 2003). The court in *Abbott* looked to Delaware precedent in deciding an issue of Illinois law. *Id.* at 803.

<sup>79</sup> Pace, *Rogue Corporations*, *supra* note 4, at 44; Scheuer, *Business Entity Law*, *supra* note 4, at 537–40.

<sup>80</sup> *See, e.g.*, *Metro Commc’n Corp. BVI v. Advanced Mobilecomm Techs. Inc.*, 854 A.2d 121, 131 (Del. Ch. 2004) (“[A] fiduciary may not choose to manage an entity in an illegal fashion, even if the fiduciary believes that the illegal activity will result in profits for the entity.”).

the case for the vast majority of breach of fiduciary duty suits in the entity context.<sup>81</sup> This is true even if the fiduciaries' actions do not seem to harm the entity because fiduciary duty law defines damages broadly.<sup>82</sup>

Injunctive relief will also be available to plaintiffs. This might not immediately seem relevant, as the owners knowingly invested in a marijuana business, but they may not have known, or understood, the legal nuance. Equity ownership or standing to bring a derivative suit might fall into the hands of another party who does not wish to own a stake in a marijuana business. Dissident shareholders could use the availability of injunctive relief to force ancillary businesses to end the marijuana aspect of their business and to prevent incumbent firms in industries like tobacco from entering the marijuana industry.

Direct liability for breach of fiduciary duty is a concern for all managers and equity holders with fiduciary duties, such as controlling shareholders or members in a member-managed LLC, but even passive investors may not have the protection of limited liability. One ground for piercing the limited liability veil is use of an entity form for an illegal purpose.<sup>83</sup> Courts in some jurisdictions do require "the equity holder exercise control over the business entity" as a predicate to piercing the veil against that equity holder.<sup>84</sup> A court will consider whether the equity holder used that control to engage in the wrongful conduct that justifies piercing the limited liability veil.<sup>85</sup> Investors in an ancillary business might be able to escape liability under the control requirement by showing that they were unaware of the business' involvement in the marijuana industry; equity holders who knowingly invested in a marijuana business would not be successful under this argument. Veil piercing is unheard of for publicly traded corporations,<sup>86</sup> but publicly traded marijuana businesses are unlikely as long as marijuana remains illegal under federal law. On the other hand, the legal purpose requirement is also frequently missing from lists of factors courts will consider before piercing the limited liability veil.<sup>87</sup> Because veil

---

<sup>81</sup> Pace, *Rogue Corporations*, *supra* note 4, at 10–11.

<sup>82</sup> *Id.* at 13–14.

<sup>83</sup> *Assoc. Vendors, Inc. v. Oakland Meat Co.*, 26 Cal. Rptr. 806, 838–40 (Cal. Dist. Ct. App. 1962); Scheuer, *Business Entity Law*, *supra* note 4, at 534 (citing *B & E Gibson Enters. Inc. v. Dargavil Enters. LLC*, No. 6:12-cv-1865-Orl-31GJK, 2013 WL 1969288, at \*3 (M.D. Fla. May 13, 2013)).

<sup>84</sup> Scheuer, *Business Entity Law*, *supra* note 4, at 534–35 n.139 (citing *My Father's House # 1, Inc. v. McCardle*, 986 N.E.2d 1081, 1089 (Ohio Ct. App. 2013)).

<sup>85</sup> See *Ruffin v. Soberg (In re Soberg)*, 349 B.R. 1, 3–4 (Bankr. E.D. Mo. 2006); 18 C.J.S. *Corporations* § 19 (2020) (noting the association between control and fraud for veil piercing) (citing *Sentry Ins. v. Brand Mgmt. Inc.*, 120 F. Supp. 3d 277, 285–86 (E.D.N.Y. 2015)).

<sup>86</sup> Robert B. Thompson, *Piercing the Corporate Veil: An Empirical Study*, 76 CORNELL L. REV. 1036, 1055 tbl. 7 (1991).

<sup>87</sup> See, e.g., *Am. Fuel Corp. v. Utah Energy Dev. Co.*, 122 F.3d 130, 134 (2d Cir. 1997) (listing ten factors, none of which touch on legality) (citing *Wm. Passalacqua Builders, Inc. v.*

piercing is equitable and justice is a factor,<sup>88</sup> the relevance of the illegality of a marijuana business is mitigated by state policy in support of marijuana businesses.

Only three states retain separate courts of equity,<sup>89</sup> but principles of equity remain important to business entity law. Veil piercing “is equitable in nature.”<sup>90</sup> Fiduciary duties are rooted in equity.<sup>91</sup> Equitable principles continue to be applied in the fiduciary duty context, even where the entity itself is a modern, statutory innovation.<sup>92</sup> Equitable doctrines are another impediment to marijuana businesses enjoying real access to our legal infrastructure. The unclean hands doctrine, for example, bars recovery by parties who participated in illegal activities.<sup>93</sup> Recourse is not available for joint participants in a criminal enterprise.<sup>94</sup> Marijuana businesses are, of course, criminal enterprises by definition, and the unclean hands doctrine has been applied in the marijuana business context. A bankruptcy court in *In re Beyries* refused recourse to a marijuana business that alleged its attorney misappropriated funds.<sup>95</sup> Equity holders of marijuana businesses in most circumstances would be knowing (even if passive) participants in a criminal enterprise, and logically the unclean hands doctrine would extend to them. Many creditors of marijuana businesses will also have knowingly extended credit to a criminal enterprise. And this logic would also extend to ancillary businesses that might be violating the CSA under a conspiracy, aiding and abetting, or accessory after the fact theory.

The Ninth Circuit did overturn the bankruptcy court’s ruling relying on the unclean hands doctrine in *In re Beyries*.<sup>96</sup> The court provided two bases for its reversal: the bankruptcy court did not balance the wrongful activity of the marijuana business against the alleged wrongful activity of its attorney,<sup>97</sup> and an attorney misappropriating their “client’s property is a gross violation of general morality.”<sup>98</sup> The

Resnick Developers S., Inc., 933 F.2d 131, 139 (2d Cir. 1991)).

<sup>88</sup> 18 C.J.S. *Corporations*, *supra* note 85, at § 19.

<sup>89</sup> Mohsen Manesh, *Equity in LLC Law?*, 44 FLA. ST. U. L. REV. 93, 98 (2016). The states are Mississippi, Tennessee, and, notably, Delaware. *Id.* at 98 n.26.

<sup>90</sup> 18 C.J.S. *Corporations*, § 18 (2020).

<sup>91</sup> Manesh, *supra* note 89, at 95; H. Justin Pace, *What Equity, the Promise Economy, and Cognition Mean for How Fiduciary Law Should Develop*, 20 U. PA. J. BUS. L. 684, 684–85 (2018).

<sup>92</sup> Manesh, *supra* note 89, at 101 (“[A]nalogizing to other, more established business forms, Delaware courts have readily adapted existing equitable principles to LLCs.”).

<sup>93</sup> Scheuer, *Business Entity Law*, *supra* note 4, at 541 (citing *Northbay Wellness Grp. v. Beyries* (*In re Beyries*), No. 10-13482, 2011 WL 5975445, at \*2 (Bankr. N.D. Cal. Nov. 29, 2011)).

<sup>94</sup> *Id.* (citing *Beyries*, 2011 WL 5975445, at \*2); FRANCIS C. AMENDOLA ET AL., 20A C.J.S. *Equity* § 123 (2020).

<sup>95</sup> *Beyries*, 2011 WL 5975445, at \*2, *rev’d*, 789 F.3d 956 (9th Cir. 2015).

<sup>96</sup> *Northbay Wellness Grp., Inc. v. Beyries*, 789 F.3d 956, 961 (9th Cir. 2015).

<sup>97</sup> *Id.* at 960.

<sup>98</sup> *Id.* at 961 (quoting *Greenbaum v. State Bar*, 544 P.2d 921, 928 (Cal. 1976)).

balancing required is unlikely to help participants in marijuana businesses involved in more run-of-the-mill business disputes (for example, members of an LLC formed to operate a marijuana dispensary seeking judicial dissolution to resolve a deadlock). And the second basis—attorney misappropriation of client funds—only applies in a narrow circumstance.<sup>99</sup> Moreover, the Supreme Court has indicated, in the marijuana context, that “a court sitting in equity cannot ‘ignore the judgment of Congress, deliberately expressed in legislation.’”<sup>100</sup>

The discussion above is necessarily a simplified one. Legalized marijuana in 38 states means 38 distinct sets of entity laws. And within each state different rules apply to different entity forms. Not all businesses, even today, are organized as corporations or LLCs,<sup>101</sup> but even if we limit ourselves to the two most popular formal entity forms, there are 76 different sets of applicable rules. Given the very recent vintage of legal marijuana, businesspeople considering entering the industry cannot rely on any wealth of case law.<sup>102</sup> The LLC form does, though, offer more flexibility in mitigating some of the issues above.<sup>103</sup>

Corporation statutes have evolved into enabling statutes, and the LLC was created as an enabling entity.<sup>104</sup> To the extent there are limits to the enabling, though, they are likely to create issues for marijuana businesses seeking to surmount legal hurdles. Delaware precedents place violations of law at the direction of the board squarely in the good faith realm, and good faith squarely in the duty of loyalty.<sup>105</sup> Section 102(b)(7) exculpation will be unavailable because section 102(b)(7) expressly provides corporations cannot exculpate directors for bad faith or violations of law.<sup>106</sup> If the laws of permissive Delaware are not an option, then the laws of another state are unlikely to be friendlier, absent a specific exception in the marijuana context.

---

<sup>99</sup> Issues marijuana businesses face in retaining competent counsel are covered below. *Infra* Part II.F.

<sup>100</sup> *United States v. Oakland Cannabis Buyers' Coop.*, 532 U.S. 483, 497 (2001) (quoting *Virginian Ry. Co. v. Sys. Fed'n No. 40*, 300 U.S. 515, 551 (1937)).

<sup>101</sup> See *infra* Part III.B (discussing entity forms of initial licensees in Michigan and Illinois).

<sup>102</sup> Courts in many states have not ruled on matters as basic as the enforceability of a fiduciary duty waiver in the LLC context. See *Pace, Fiduciary Duties*, *supra* note 74, at 1112–13 (noting fourteen states that mimic Delaware's approach but that have no case law on point).

<sup>103</sup> Organizing a marijuana business as a Canadian business entity offers risks of its own. Samantha Wu, *Guest Post: Canadian Cannabis Companies' Directors and Officers Face Unique Exposures*, D&O DIARY (Dec. 18, 2019), <https://www.dandodiary.com/2019/12/articles/director-and-officer-liability/guest-post-canadian-cannabis-companies-directors-and-officers-face-unique-exposures/>.

<sup>104</sup> See Elvin R. Latty, *Why Are Business Corporation Laws Largely “Enabling”?*, 50 *Cornell L.Q.* 599, 599 (1965).

<sup>105</sup> *Pace, Rogue Corporations*, *supra* note 4, at 7.

<sup>106</sup> *Id.* at 9.



LLC law offers more hope. The LLC is a product of statute but a creature of contract.<sup>107</sup> Flexibility is a hallmark of the LLC, and LLC statutes generally offer greater ability to contract around fiduciary duties than corporation statutes.<sup>108</sup> The market for LLC law is fractured, but the most popular approaches to waivers of fiduciary duty are divided between the Delaware approach and either the Revised Uniform Limited Liability Act (hereinafter, “RULLCA”) or the Uniform Limited Liability Act (hereinafter, “ULLCA”).<sup>109</sup> Each allows for some waiver of fiduciary duties in the operating agreement. The Delaware LLC Act provides that fiduciary duties may be expanded, restricted, or *eliminated*.<sup>110</sup> The RULLCA provides that the duty of loyalty may be altered by identifying “specific types or categories of activities that do not violate the duty of loyalty” if not manifestly unreasonable.<sup>111</sup> The ULLCA largely mimics the approach taken in the RULLCA.<sup>112</sup> The members of the LLC, though, “may not authorize conduct involving . . . a knowing violation of [the] law.”<sup>113</sup>

The knowing violation of law provision, then, would seem to prevent the use of the LLC form to circumvent fiduciary laws in RULLCA and ULLCA states. Delaware law, on the other hand, allows for even the elimination of fiduciary duties.<sup>114</sup> The Delaware approach is very popular, but most states that follow the Delaware approach do not include the “eliminate” language.<sup>115</sup> Even the elimination of fiduciary duties does not remove the covenant of good faith and fair dealing,<sup>116</sup> but good faith in the LLC context is unrelated to good faith in the corporate context.<sup>117</sup> Delaware courts have repeatedly enforced waivers of fiduciary duty in the LLC context;

---

<sup>107</sup> Pace, *Fiduciary Duties*, *supra* note 74, at 1086.

<sup>108</sup> *Cf. id.* at 1091 (noting that LLC statutes are more amenable to waivers of fiduciary duties than partnership statutes).

<sup>109</sup> *Id.* Introduced in 2006, the RULLCA has now overtaken the ULLCA in popularity. *Limited Liability Company Act (1996)*, UNIFORM L. COMMISSION, <https://www.uniformlaws.org/committees/community-home?CommunityKey=8a1e82f6-8b71-424e-9e12-293e4dbb2063> (last visited Aug. 29, 2020) (listing eight states that have enacted and retain the ULLCA); *Limited Liability Company Act, Revised*, UNIFORM L. COMMISSION, <https://www.uniformlaws.org/committees/community-home?CommunityKey=bbea059c-6853-4f45-b69b-7ca2e49cf740> (last visited Oct. 26, 2020) (listing 20 states that have enacted the RULLCA).

<sup>110</sup> DEL. CODE ANN. tit. 6, § 18-1101(c) (2013).

<sup>111</sup> REVISED UNIF. LTD. LIAB. CO. ACT § 105(d)(3) (UNIF. LAW COMM’N 2013).

<sup>112</sup> UNIF. LTD. LIAB. CO. ACT § 103(b)(2) (UNIF. LAW COMM’N 1996).

<sup>113</sup> *Id.* § 105(d)(3)(C).

<sup>114</sup> DEL. CODE ANN. tit. 6, § 18-1101(c).

<sup>115</sup> See Pace, *Fiduciary Duties*, *supra* note 74, at 1114–21 (surveying waiver provisions in states following the Delaware approach).

<sup>116</sup> *Id.*

<sup>117</sup> See REVISED UNIF. LTD. LIAB. CO. ACT § 409 cmt. (d) (“The contractual obligation of ‘good faith’ has nothing to do with the corporate concept of good faith that for years bedeviled courts and attorneys . . .”).

precedent is scarce in the states that purport to follow the Delaware approach.<sup>118</sup> Uncertainty remains the order of the day in most states.

For states that have legalized marijuana, the issues above are an easy fix. For example, a simple statutory addition can clarify that directors of a corporation in the marijuana business do not act in bad faith by allowing the corporation to remain in the marijuana business in contravention to federal law.

### C. Access to the Financial System

Marijuana businesses also face tremendous difficulty accessing the financial system.<sup>119</sup> By one count, as of 2016 just 220 of 7,600 banks and credit unions in the United States would accept money from marijuana businesses.<sup>120</sup> Federal laws impinging on marijuana businesses' ability to access the financial system go far beyond the CSA.<sup>121</sup> The Money Laundering Control Act,<sup>122</sup> the Bank Secrecy Act,<sup>123</sup> and the PATRIOT Act<sup>124</sup> all make it more difficult for marijuana businesses to obtain banking services, as do the federal deposit and share insurance scheme<sup>125</sup> and Federal Reserve regulations.<sup>126</sup> The Federal Reserve refused access to payment services for

<sup>118</sup> See Pace, *Fiduciary Duties*, *supra* note 74, at 1095–114 (surveying case law in states applying the Delaware approach).

<sup>119</sup> Hill, *supra* note 12, at 600 (citing Sam Kamin, *The Limits of Marijuana Legalization in the States*, 99 IOWA L. REV. BULL. 39, 47 (2014)); see also Mikos, *supra* note 17, at 12 (“Difficulty in obtaining banking services is probably the most notable obstacle federal law continues to impose on state licensed marijuana suppliers.”); Scheuer, *Marijuana Contracts*, *supra* note 42, at 42 (citing Kerri Geiger et al., *Banks Keep Distance from Marijuana Business and Its Unbanked Billions*, INS. J. (May 12, 2015), <https://www.insurancejournal.com/news/national/2015/05/12/367987.htm>); Amelia Templeton, *Lloyd’s Ends Long Relationship with Oregon Cannabis Businesses*, JEFFERSON PUB. RADIO (June 4, 2015, 12:57 PM), <https://www.ijpr.org/post/lloyds-ends-long-relationship-oregon-cannabis-businesses> (noting the banking and insurance industries are largely avoiding servicing marijuana businesses due to concerns about money-laundering laws).

<sup>120</sup> Jeremy Berke, *This Could Be the No. 1 Problem Facing Legal Weed Businesses in America*, BUS. INSIDER (Apr. 20, 2016, 8:59AM), <https://www.businessinsider.com/no-1-problem-facing-legal-weed-businesses-2016-4> (citing Jennifer Kaplan, *Where to Stash Cannabis Cash? Tribal Nations Make Bid to Bank It*, BLOOMBERG (Oct. 11, 2015, 4:00 PM), <https://www.bloomberg.com/news/articles/2015-10-11/where-to-stash-cannabis-cash-tribal-nations-make-bid-to-bank-it>).

<sup>121</sup> See Hill, *supra* note 12, at 610–17.

<sup>122</sup> 18 U.S.C. §§ 1956–57 (2018).

<sup>123</sup> An Act to Amend the Federal Deposit Insurance Act, Pub. L. No. 91-508, 84 Stat. 1114 (1970).

<sup>124</sup> Uniting and Strengthening America by Providing Appropriate Tools Required to Intercept and Obstruct Terrorism (USA PATRIOT Act) Act of 2001, Pub. L. No. 107-56, 115 Stat. 272.

<sup>125</sup> Hill, *supra* note 12, at 617–21.

<sup>126</sup> *Id.* at 625–27.

years to Fourth Corner Credit Union, a credit union set up to provide banking services to the local marijuana industry in Colorado,<sup>127</sup> relenting only after the credit union announced it would serve only advocacy groups, charities, and ancillary businesses, not plant-touching businesses.<sup>128</sup> The National Credit Union Administration also denied Fourth Corner federal share deposit insurance.<sup>129</sup> As of December 2020, Fourth Corner was still not in business.<sup>130</sup>

Guidance issued by the Department of Justice and the federal Financial Crimes Enforcement Network (hereinafter, “FinCEN”) did little to reassure financial institutions.<sup>131</sup> Several months after the FinCEN guidance was released, FinCEN announced financial institutions had filed 502 “Marijuana Limited” reports under the new reporting scheme and 105 financial institutions were serving marijuana businesses.<sup>132</sup> Four years later, there were still only 441 financial institutions serving marijuana businesses.<sup>133</sup> But “[t]here are more than 502 state-licensed marijuana businesses in Colorado alone” and “[t]here are more than 13,000 banks and credit unions.”<sup>134</sup>

Under the U.S. dual banking system, state regulators can assure state-chartered financial institutions that state law and regulations allow them to service marijuana

<sup>127</sup> *Id.* at 629 (citing David Migoya, *Denver Pot Credit Union Awaits Approval*, DENVER POST, Dec. 12, 2014, at 17A; David Migoya, *U.S. Sen. Bennet Urges Fed to Move on State’s Pot Credit Union Case*, DENVER POST (Mar. 9, 2015, 9:38 AM), <https://www.denverpost.com/2015/03/09/u-s-sen-bennet-urges-fed-to-move-on-states-pot-credit-union-case/>).

<sup>128</sup> Omar Sacirbey, *Fourth Corner Credit Union Gets Conditional Approval from Federal Reserve for Marijuana-Related Banking*, MARIJUANA BUS. DAILY (Feb. 6, 2018), <https://mjbizdaily.com/marijuana-focused-credit-union-gets-conditional-approval-federal-reserve/>.

<sup>129</sup> Peter Strozniak, *Pot Credit Union No Closer to Opening Date*, CREDIT UNION TIMES (Oct. 5, 2018, 9:00 AM), <https://www.cutimes.com/2018/10/05/pot-credit-union-no-closer-to-opening-date/?slreturn=20200022210152>.

<sup>130</sup> FOURTH CORNER CREDIT UNION, <https://www.4ccu.org/> (last visited Dec. 28, 2020).

<sup>131</sup> Hill, *supra* note 12, at 632 (citing COLE MEMORANDUM, *supra* note 15; DEP’T OF THE TREASURY, FIN. CRIMES ENF’T NETWORK, FIN-2014-G001: BSA EXPECTATIONS REGARDING MARIJUANA-RELATED BUSINESSES (Feb. 14, 2014), [http://www.fincen.gov/statutes\\_regs/guidance/pdf/FIN-2014-G001.pdf](http://www.fincen.gov/statutes_regs/guidance/pdf/FIN-2014-G001.pdf); JAMES M. COLE, OFFICE OF THE DEPUTY ATT’Y GEN., MEMORANDUM FOR ALL UNITED STATES ATT’YS: GUIDANCE REGARDING MARIJUANA RELATED FINANCIAL CRIMES (Feb. 14, 2014)).

<sup>132</sup> *Id.* (citing Jennifer Shasky Calvery, Dir., Fin. Crimes Enf’t Network, Remarks at the 2014 Mid-Atlantic AML Conf. 5 (Aug. 12, 2014), [http://www.fincen.gov/news\\_room/speech/pdf/20140812.pdf](http://www.fincen.gov/news_room/speech/pdf/20140812.pdf)).

<sup>133</sup> Julie Andersen Hill, *Banks and the Marijuana Industry*, in MARIJUANA FEDERALISM: UNCLE SAM AND MARY JANE 139, 146 (Jonathan H. Adler ed., 2020) (citing FIN. CRIMES ENF’T NETWORK, MARIJUANA BANKING UPDATE (2018)).

<sup>134</sup> Hill, *supra* note 12, at 633 (citing Memorandum from the Colo. Legis. Council Staff to Use of Recreational Marijuana Sales Tax Revenue Comm., Background on Marijuana Policy and Tax Revenue 2 (Aug. 11, 2014); FED. DEPOSIT INS. CORP., ANNUAL REPORT 5 (2013); NAT’L CREDIT UNION ADMIN., ANNUAL REPORT 9 (2013)).

businesses, but state regulators cannot control federal regulators, and even state-chartered financial institutions rely on federal regulators.<sup>135</sup> Banking laws in states such as Colorado commonly require state-chartered financial institutions to “comply with all applicable requirements of federal law.”<sup>136</sup> This is, of course, near impossible for financial institutions serving marijuana businesses.

Lack of access to banking and payment services forces marijuana businesses to operate as cash businesses. This does not just mean that marijuana businesses do not take credit cards; they pay their expenses in cash—everything from payroll to rent.<sup>137</sup> The necessity of dealing in large quantities of cash increases the risk of theft and robbery.<sup>138</sup>

Marijuana businesses’ difficulties extend beyond banking. Because the Federal Reserve has regulatory authority over bank holding companies, its regulations can prevent marijuana businesses from accessing financial services provided by non-bank financial companies owned by bank holding companies.<sup>139</sup> Marijuana businesses may have issues both obtaining insurance and collecting on insurance claims.<sup>140</sup> Few insurers will offer coverage to marijuana businesses, and most major insurers will not.<sup>141</sup> This is a particular problem for marijuana businesses required to carry liability insurance under state marijuana regulations.<sup>142</sup> Even where insurance is available, the necessity of dealing exclusively in cash is likely to drive up insurance prices.<sup>143</sup> Nor can marijuana businesses in all jurisdictions be confident

---

<sup>135</sup> *Id.* at 630, 638.

<sup>136</sup> COLO. REV. STAT. § 11-33-126(1) (2020).

<sup>137</sup> See Berke, *supra* note 120 (“A lot of people hear “cash only” and think that means they can’t accept credit cards,” Taylor West, the director of the National Cannabis Industry Association, told ThinkProgress. “That’s true, but the real complications come on the backend. You’re paying your staff in cash, your utility bills, your mortgages, and your taxes. Not being able to handle these transactions electronically is just incredibly difficult.”).

<sup>138</sup> *Id.* (“Jaime Lewis, the owner of Denver-based marijuana company Mountain Medicine, told ThinkProgress that because her business is all cash, she has to factor the threat of robbery into every business decision.” (relying on Alan Pyke, *Colorado’s Pot Industry Shut Out of Banks, Forced to Operate Entirely with Cash*, THINKPROGRESS (Aug. 11, 2015, 12:00 PM), <https://thinkprogress.org/colorados-pot-industry-shut-out-of-banks-forced-to-operate-entirely-with-cash-aba15e70cc89/>)).

<sup>139</sup> Hill, *supra* note 12, at 627.

<sup>140</sup> See generally Francis J. Mootz III & Jason Horst, *Cannabis and Insurance*, 23 LEWIS & CLARK L. REV. 893 (2019) (covering a wide range of insurance issues in regard to marijuana).

<sup>141</sup> See Curley, *supra* note 7 (“While approximately 25 insurers (mostly nonadmitted) offer coverage to industry participants, most major insurers have opted out, with federal illegality being the main stumbling block.”); Templeton, *supra* note 119 (noting the difficulties created by Lloyd’s of London cutting ties with the marijuana industry in the United States).

<sup>142</sup> Mootz III & Horst, *supra* note 140, at 896 (citing CAL. CODE REGS. tit. 16, § 5308 (2020)).

<sup>143</sup> *Cf.* Green Earth Wellness Ctr., LLC v. Atain Specialty Ins. Co., 163 F. Supp. 3d 821,

their insurer’s obligations under their policy will be enforced.<sup>144</sup> There is a policy concern with allowing parties to insure against losses from illegal conduct.<sup>145</sup> “[C]ourts have tended to read coverage for losses arising out of the use of illegal drugs somewhat narrowly . . . .”<sup>146</sup>

One court, in *Tracy v. USAA Casualty Insurance Co.*, refused to enforce terms of an insurance policy that would hold an insurer liable for failure to pay a claim for damage or loss to marijuana plants because it “would be contrary to federal law and public policy.”<sup>147</sup> Pointing to a “nuanced (and perhaps even erratic) expression of federal Policy,” another court, in *Green Earth Wellness Center, LLC v. Atain Specialty Insurance Co.*, declined to follow *Tracy* and ruled that a “contraband” exclusion was ambiguous as to whether it covered a marijuana business’s plants and that the insurance policy was not unenforceable on public policy grounds.<sup>148</sup> Notably, *Tracy* involved a homeowner’s insurance policy, while *Green Earth* involved an insurer that consciously chose to insure a marijuana business.<sup>149</sup> The Sixth Circuit suggested that compliance with state law would prevent the application of a criminal/dishonest acts exclusion (the court held no reasonable jury could find that the business in question complied with Michigan marijuana law).<sup>150</sup> Limited and conflicting case law hardly offers solace to businesspeople wondering whether they will actually be able to collect on an insurance claim.<sup>151</sup>

There is some desire to alleviate the problems covered above and to facilitate access to legal and financial infrastructure for marijuana businesses. Interest is particularly high in the banking space in recognition of the downsides of forcing businesses to operate entirely on a cash basis. Colorado, for example, is experimenting

---

831 (D. Colo. 2016) (noting the insurance application for a marijuana business included a number of questions related to security).

<sup>144</sup> Cf. Mootz III & Horst, *supra* note 140, at 895 (noting that insurers have “a motive to deny coverage and exploit the policyholder’s vulnerability following a loss or claim.”).

<sup>145</sup> See *id.* at 896 (“[T]here is a fundamental public policy against insuring illegal conduct, because protecting against fortuitous losses arising out of the illegal conduct would tend to encourage the illegal behavior.” (citing Francis J. Mootz III, *E/Insuring the Marijuana Industry*, 49 U. PAC. L. REV. 43, 57–63 (2017))).

<sup>146</sup> *Id.* at 898.

<sup>147</sup> *Tracy v. USAA Cas. Ins. Co.*, No. 11–00487 LEK–KSC, 2012 WL 928186, at \*13 (D. Haw. Mar. 16, 2012); see also Mootz III & Horst, *supra* note 140, at 895 (noting that the “fundamental touchstones for insurance law are deeply rooted in considerations of public policy that trump the freedom of parties to contract for insurance”).

<sup>148</sup> *Green Earth*, 163 F. Supp. 3d at 832–35.

<sup>149</sup> *Id.* at 834; *Tracy*, 2012 WL 928186, at \*1.

<sup>150</sup> *K.V.G. Props., Inc. v. Westfield Ins. Co.*, 900 F.3d 818, 821–22 (6th Cir. 2018).

<sup>151</sup> Cf. Curley, *supra* note 7 (“It seems fair to say that this limited and conflicting case law offers little guidance to both insurers and insureds.”).

with cannabis co-ops.<sup>152</sup> That effort, though, has not been met with immediate success. Desires of the states notwithstanding, a dual federal and state regulatory scheme for banking severely limits states' ability to circumvent federal banking restrictions.<sup>153</sup> Federal action is necessary. The Secure and Fair Enforcement (SAFE) Banking Act would facilitate access to the financial system by marijuana businesses, but it remains pending before Congress.<sup>154</sup> Marijuana businesses also engage in their own workarounds, including through the use of cryptocurrencies, but such workarounds are imperfect.<sup>155</sup>

#### D. Bankruptcy

Most new businesses fail.<sup>156</sup> The “fresh start” offered by the federal bankruptcy system serves both to facilitate future entrepreneurial activity by the founders of failed firms and to provide for an orderly process to make creditors as whole as possible.<sup>157</sup> Reorganizations under Chapter 11 also allow firms that are worth more as an ongoing concern than their break-up value to continue as viable, ongoing businesses despite insolvency.<sup>158</sup> Plant-touching businesses may not be able to take advantage of this system. Worse, ancillary businesses and even simple creditors of marijuana businesses may not be able to take advantage of the bankruptcy system.

---

<sup>152</sup> Hill, *supra* note 12, at 638–43.

<sup>153</sup> *See id.* at 630–43.

<sup>154</sup> Tiney Ricciardi, *Marijuana Banking Bill Gets Pushback from Colorado's Buck, Lamborn*, DENVER POST (Feb. 17, 2020, 3:25 PM), <https://www.denverpost.com/2020/02/17/marijuana-safe-banking-act/>.

<sup>155</sup> *See* Hill *supra* note 133, at 148 (noting that such workarounds probably violate anti-money laundering statutes and will result in account closure if discovered by a financial institution) (citing Charles Alvisetti, *Pipe Dreams: Bitcoin Won't Solve Pot Industry's Banking Problem*, COINDESK (Nov. 11, 2017, 14:00 UTC), [www.coindesk.com/pipe-dreams-bitcoin-wont-solve-pot-industrys-banking-problem/](http://www.coindesk.com/pipe-dreams-bitcoin-wont-solve-pot-industrys-banking-problem/); David Migoya, *Bank Pulls ATMs' Plugs*, DENVER POST, Oct. 23, 2014, at 1A); *see also* David Migoya, *Hundreds of ATMs Unplugged in Legal Pot Shops in Colorado, Washington*, DENVER POST (last updated Oct. 2, 2016, 3:33 PM), <https://www.denverpost.com/2014/10/23/hundreds-of-atms-unplugged-in-legal-pot-shops-in-colorado-washington-2/>.

<sup>156</sup> PAUL A. GOMPERS & JOSH LERNER, *THE MONEY OF INVENTION: HOW VENTURE CAPITAL CREATES NEW WEALTH* 28 (2001) (“For newly launched enterprises without venture capital backing, failure is almost assured: nearly 90 percent fail within three years.”).

<sup>157</sup> *See* DAVID A. SKEEL, JR., *DEBT'S DOMINION: A HISTORY OF BANKRUPTCY LAW IN AMERICA* 6 (2001) (discussing the central role discharge plays in the U.S. bankruptcy system and explaining the role of the trustee's avoidance power in preventing unfair transfers to favored creditors).

<sup>158</sup> *See id.* at 9–10 (briefly describing reorganizations under Chapter 11).

The United States has an entirely federal bankruptcy system,<sup>159</sup> although it relies in many ways on state law.<sup>160</sup> State courts might be free to ignore federal law under the anti-commandeering doctrine; federal courts are not.<sup>161</sup> Debtors have been denied bankruptcy relief under the unclean hands doctrine.<sup>162</sup> Federal courts have proven unwilling to direct a Chapter 7 trustee to violate the CSA by taking control of or selling marijuana plants.<sup>163</sup> Nor will bankruptcy courts allow the bankruptcy system to protect a debtor whose business constitutes an ongoing federal crime.<sup>164</sup> This is true even where the business is limited to leasing space to a plant-touching business.<sup>165</sup> It makes no difference if marijuana cultivation and sale is not “intrinsically evil conduct.”<sup>166</sup> The policy of the United States Trustee Program is to seek dismissal of bankruptcy cases involving marijuana businesses.<sup>167</sup>

Participation in the marijuana industry is not necessarily “a *per se* bar to relief under the Bankruptcy Code.”<sup>168</sup> Pre-petition violations of the CSA may not prevent access to the bankruptcy system.<sup>169</sup> And ancillary businesses do not necessarily violate the CSA.<sup>170</sup> Equity might require the bankruptcy system give relief to a party, such as when a debtor attorney misappropriated funds from a creditor marijuana business.<sup>171</sup>

Bankruptcy law offers some uncertainty to marijuana businesses. A growing body of cases offer guidance, albeit much of it within the Ninth Circuit.<sup>172</sup>

---

<sup>159</sup> See *In re Way to Grow, Inc.*, 597 B.R. 111, 117 (Bankr. D. Colo. 2018) (“Of course, bankruptcy laws and bankruptcy courts are purely creatures of federal law.”).

<sup>160</sup> See generally Thomas E. Plank, *Bankruptcy and Federalism*, 71 *FORDHAM L. REV.* 1063, 1064 (2002) (discussing the interplay between federal bankruptcy law and state law).

<sup>161</sup> Cf. *Fourth Corner Credit Union v. Fed. Reserve Bank of Kan. City*, 154 F. Supp. 3d 1185, 1189 (D. Colo. 2016), *vacated*, 861 F.3d 1052 (10th Cir. 2017) (“In short, these guidance documents simply suggest that prosecutors and bank regulators might ‘look the other way’ if financial institutions don’t mind violating the law. A federal court cannot look the other way.”).

<sup>162</sup> *In re Rent-Rite Super Kegs W. Ltd.*, 484 B.R. 799, 807 (Bankr. D. Colo. 2012).

<sup>163</sup> *In re Arenas*, 535 B.R. 845, 853 (B.A.P. 10th Cir. 2015); see also White III & Sheahan, *supra* note 37, at 34 (“[B]ankruptcy trustees and other estate fiduciaries should not be required to administer assets if doing so would cause them to violate federal criminal law.”).

<sup>164</sup> *In re Rent-Rite*, 484 B.R. at 805.

<sup>165</sup> *Id.* at 809.

<sup>166</sup> *In re Arenas*, 535 B.R. at 849–50.

<sup>167</sup> White III & Sheahan, *supra* note 37, at 34.

<sup>168</sup> Order at 11, *In re B Fischer Indus., LLC*, No. 16-20863 MER (Bankr. D. Colo. Sept. 27, 2017), ECF No. 147.

<sup>169</sup> *In re Way to Grow, Inc.*, 597 B.R. 111, 119–20 (Bankr. D. Colo. 2018).

<sup>170</sup> *Id.* at 119 (noting that the court in *B Fischer* “could not find the debtor’s sales of butane to a pass-through non-debtor affiliate necessarily violated the CSA,” despite its alleged “use in manufacturing marijuana concentrates”) (citing Order, *supra* note 168).

<sup>171</sup> *Northbay Wellness Grp., Inc. v. Beyries*, 789 F.3d 956, 961 (9th Cir. 2015).

<sup>172</sup> See, e.g., *id.* at 959–61; *In re Medpoint Mgmt., LLC*, No. AZ-15-1130-KuJaJu, 2016

A relatively stable body of rules has emerged.<sup>173</sup> That body of rules offers little solace to parties to marijuana businesses, however. As federal courts are bound to follow federal law, bankruptcy courts will not countenance the use of the bankruptcy system to facilitate the ongoing violation of the CSA; nor will they force a trustee to violate the CSA.<sup>174</sup> Exceptions are limited, and even ancillary businesses will struggle to take advantage of the bankruptcy system.

Many business law issues, even under state law, wind up litigated in bankruptcy court. And bankruptcy courts are unlikely to prove amenable to even statutory fixes of state law. The fact remains that marijuana is illegal under federal law and bankruptcy courts are creatures of federal law and the federal government. Limited access to the bankruptcy system does not, however, necessarily prevent marijuana businesses from negotiating with creditors outside of the bankruptcy system.<sup>175</sup> And states can still facilitate marijuana businesses participating in state law alternatives to bankruptcy such as foreclosure, bulk sales, and assignments for the benefit of creditors.<sup>176</sup> Even under state law, though, marijuana businesses may run into some of the same issues.

#### E. Trademark Law

Marijuana businesses also face barriers to using trademark laws to protect their

---

WL 3251581, at \*1 (B.A.P. 9th Cir. June 3, 2016); *In re Arenas*, 535 B.R. 845, 845 (B.A.P. 10th Cir. 2015); *In re Way to Grow*, 597 B.R. at 111; Order, *supra* note 168, at 1; *In re Rent-Rite Super Kegs W. Ltd.*, 484 B.R. 799, 807 (Bankr. D. Colo. 2012); *In re McGinnis*, 453 B.R. 770, 770 (Bankr. D. Or. 2011).

<sup>173</sup> *In re Way to Grow*, 597 B.R. at 120 (“Taken together, the decisions in *Rent-Rite*, *Arenas* and *B. Fischer* elucidate three basic propositions. First, a party cannot seek equitable bankruptcy relief from a federal court while in continuing violation of federal law. Second, a bankruptcy case cannot proceed where the court, the trustee or the debtor-in-possession will necessarily be required to possess and administer assets which are either illegal under the CSA or constitute proceeds of activity criminalized by the CSA. And third, the focus of this inquiry should be on debtor’s marijuana-related activities during the bankruptcy case, not necessarily before the bankruptcy case is filed.”).

<sup>174</sup> *Id.*

<sup>175</sup> See generally Edward R. Morrison, *Bargaining Around Bankruptcy: Small Business Workouts and State Law*, 38 J. LEGAL STUD. 255, 256 (2009) (noting that no more than 20% of small businesses that cease operations file for bankruptcy). Marijuana businesses will remain relatively small as long as their access to legal and financial infrastructure is limited.

<sup>176</sup> See *id.* at 265 (discussing those three state law alternatives to federal bankruptcy and their popularity with small businesses).



growing brands.<sup>177</sup> The United States has a dual trademark system: federal law provides trademark protection under the Lanham Act<sup>178</sup> and state governments provide trademark protection under both state statutes and common law.<sup>179</sup> Taking full advantage of federal trademark law requires successful registration of a trademark.<sup>180</sup> Federal trademark law requires the mark be used in *legal* commerce.<sup>181</sup> The United States Patent and Trademark Office (USPTO) has denied marks that it deems associated with marijuana.<sup>182</sup> Federal courts have also refused to give priority to a senior user of a mark on the basis that it had used the mark in association with marijuana.<sup>183</sup>

The United States has a dual system for trademark law, but, unlike its dual system for banking regulation,<sup>184</sup> state trademark law is able to exist outside of federal trademark law. Even if the USPTO refuses to register marijuana-related marks, states can still provide protection for the trademarks of marijuana businesses under state law. State trademark protection only extends, however, to the borders of the state itself<sup>185</sup> and “may be limited to areas of actual use and natural expansion.”<sup>186</sup> But marijuana businesses may run into issues even in states that have legalized marijuana. Efforts failed in California to clarify that marks can be protected if they are associated with the sale of marijuana in compliance with state law.<sup>187</sup> California has nonetheless allowed the state-level registration of marijuana marks.<sup>188</sup> State courts

<sup>177</sup> Mike Schuster & Robert Bird, *Legal Strategy During Legal Uncertainty: The Case of Cannabis Regulation*, 26 STAN. J.L. BUS. & FIN. (forthcoming 2021) (manuscript at 13) (on file with author).

<sup>178</sup> 15 U.S.C. § 1051 et seq. (2018).

<sup>179</sup> Schuster & Bird, *supra* note 177, at 14 (citing Steven J. Eisen & Anne J. Cheatham, *Trademark and Marketing Issues for Financial Institutions*, 60 CONSUMER FIN. L.Q. REP. 194, 198–99 (2006)).

<sup>180</sup> ROGER E. SCHECHTER & JOHN R. THOMAS, *INTELLECTUAL PROPERTY: THE LAW OF COPYRIGHTS, PATENTS, AND TRADEMARKS* § 26.2 (2003).

<sup>181</sup> Schuster & Bird, *supra* note 177, at 15 (citing *Clorox Co. v. Armour-Dial Inc.*, 214 U.S.P.Q. (BNA) 850, 851 (T.T.A.B. 1982); *Dessert Beauty, Inc. v. Fox*, 617 F. Supp. 2d 185, 189 (S.D.N.Y. 2007), *aff'd*, 329 F. App'x 333 (2d Cir. 2009)).

<sup>182</sup> *Id.*

<sup>183</sup> *Kiva Health Brands LLC v. Kiva Brands Inc.*, 402 F. Supp. 3d 877, 886 (N.D. Cal. 2019).

<sup>184</sup> *See supra* Part II.C (discussing the issues the dual system creates for state attempts to provide for marijuana banking).

<sup>185</sup> *Allard Enters., Inc. v. Advanced Programming Res., Inc.*, 249 F.3d 564, 572 (6th Cir. 2001).

<sup>186</sup> Schuster & Bird, *supra* note 177, at 14 (relying on *Popular Bank of Fla. v. Banco Popular de P.R.*, 9 F. Supp. 2d 1347, 1354–55 (S.D. Fla. 1998); *Stat Ltd. v. Beard Head, Inc.*, 60 F. Supp. 3d 634, 638–39 (E.D. Va. 2014)).

<sup>187</sup> *Id.* at 20 (citing Assemb. B. 64, 2017 Leg., Reg. Sess. (Cal. 2016)).

<sup>188</sup> *Id.* (citing Press Release, Alex Padilla, Cal. Sec'y of St., Secretary of State Alex Padilla

have been willing to enforce state-registered marijuana marks against junior users.<sup>189</sup>

There are steps available to marijuana businesses to mitigate limited access to federal trademark registration. Marijuana businesses can register a mark used with a marijuana good for another type of legal use, such as on clothing.<sup>190</sup> This may chill future use of the mark by a would-be junior user.<sup>191</sup>

#### *F. Obtaining Competent Counsel*

Businesspeople rely on legal counsel in structuring and operating their businesses. The U.S. legal system, for all its advantages, is not well suited for amateurs. Businesspeople in particular rely on legal counsel where their industry is highly regulated, or the relevant law is in flux. Both are true for marijuana businesses. Despite their increased need for competent legal counsel,<sup>192</sup> marijuana businesses face specific challenges in obtaining it.

At the crux of the matter is the obligation by lawyers to not knowingly assist criminal conduct.<sup>193</sup> Effective counsel requires knowledge of a client's business.<sup>194</sup> This creates a problem for advising ongoing marijuana businesses that inherently violate federal law by operating. State legalization regimes and opaque federal policy notwithstanding, a lawyer for a plant-touching business cannot honestly argue that they did not know their client's conduct violated criminal law.<sup>195</sup> Model Rule 1.2(d) of the American Bar Association Rules of Professional Conduct prohibits lawyers

---

Launches Cannabizfile Online Cannabis Business Portal, Releases PSA Featuring Actor Cheech Marin (Dec. 11, 2017), <https://www.sos.ca.gov/administration/news-releases-and-advisories/2017-news-releases-and-advisories/secretary-state-alex-padilla-launches-cannabizfile-online-cannabis-business-portal-releases-psa-featuring-actor-cheech-marin/>).

<sup>189</sup> *Headspace Int'l LLC v. Podworks Corp.*, 428 P.3d 1260, 1265–66 (Wash. Ct. App. 2018), *cert. denied*, 435 P.3d 269 (2019). It may be notable that both the senior and junior users were marijuana businesses.

<sup>190</sup> Schuster & Bird, *supra* note 177, at 16.

<sup>191</sup> *Id.* at 17.

<sup>192</sup> *Cf.* Kamin & Wald, *supra* note 12, at 871 (“[W]here a state has chosen to regulate marijuana as medicine or to tax and regulate it like alcohol, lawyers are a necessary part of the implementation of these policy decisions.”).

<sup>193</sup> *Id.* at 871–72 (citing MODEL RULES OF PROF'L CONDUCT r. 1.2(d) (AM. BAR ASS'N 2020)).

<sup>194</sup> *Id.* at 896.

<sup>195</sup> *But see id.* at 900–01 (“Consequently, there is an argument to be made that the validity and application of the federal law in question is in doubt, at least until such time as it is clarified by the courts, or by enforcement efforts by the federal government. Indeed, one could even argue that until the interplay between federal and state law is clarified, no lawyer *knows* her client's conduct to be criminal.”). But *Gonzales v. Raich*, 545 U.S. 1, 29 (2005), reconfirmed the Supremacy Clause, and marijuana remains illegal under the CSA, even were the federal government to disclaim enforcement altogether. It should be noted that Kamin and Wald themselves raise this argument but ultimately reject it. Kamin & Wald, *supra* note 12, at 900–02.

from assisting or counseling a client to pursue criminal activity.<sup>196</sup> It does not distinguish between state and federal criminal law.<sup>197</sup> Legal advice that assists criminal activity can and sometimes does result in criminal charges,<sup>198</sup> including in the marijuana context.<sup>199</sup> Lawyers serving marijuana business clients face not just the risk of criminal prosecution but the (perhaps more likely) risk of facing professional discipline.<sup>200</sup> The risk of negative consequences for representing marijuana businesses, then, can lead to a chilling effect on lawyers’ decisions to accept marijuana businesses as clients.<sup>201</sup>

Perhaps due to the odd legal posture of marijuana, several lawyers and firms focus heavily on advising marijuana businesses.<sup>202</sup> Specialization among lawyers, of course, makes ample economic sense. It makes particular sense given the unique regulatory and legal environment faced by marijuana businesses. This could, however, make lawyer culpability more likely.<sup>203</sup> But marijuana businesses face particularly acute legal issues. Competent counsel is needed not just to mitigate the effects of limited access to legal infrastructure but to navigate a thicket of rules in a new,

<sup>196</sup> *Id.* at 901.

<sup>197</sup> *Id.* at 928.

<sup>198</sup> *Id.* at 892 (citing Jens David Ohlin, *The Torture Lawyers*, 51 HARV. INT’L L.J. 193, 209 (2010); Fred Zacharias, *Lawyers as Gatekeepers*, 41 SAN DIEGO L. REV. 1387, 1389 (2004)); see also *People v. Morley*, 725 P.2d 510, 518–19 (Colo. 1986) (upholding the disbarment of a lawyer who assisted his client with a prostitution scheme).

<sup>199</sup> Jonah Valdez, *San Diego DA’s Prosecution of Pot Attorney Has Sent Chills Through the Legal Community*, VOICE SAN DIEGO (Aug. 9, 2017), <https://www.voiceofsandiego.org/topics/news/san-diego-das-prosecution-of-pot-attorney-has-sent-chills-through-the-legal-community/>. Admittedly, this case seems exceptional. See also Dennis A. Rendleman, *Ethical Issues in Representing Clients in the Cannabis Business: “One toke over the line?”*, AM. BAR ASS’N (July 2, 2019), [https://www.americanbar.org/groups/professional\\_responsibility/publications/professional\\_lawyer/26/1/ethical-issues-representing-clients-the-cannabis-business-one-toke-over-line/](https://www.americanbar.org/groups/professional_responsibility/publications/professional_lawyer/26/1/ethical-issues-representing-clients-the-cannabis-business-one-toke-over-line/).

<sup>200</sup> Ian Wagemaker, *Professional Ethics—The High Risk of Going Green: Problems Facing Transactional Attorneys and the Growth of the State-Level Legal Marijuana Industries*, 37 W. NEW ENG. L. REV. 371, 391 (2015) (suggesting that an attorney disciplinary proceeding is more likely to be seen as the proper venue for punishment rather than a criminal prosecution).

<sup>201</sup> See Kamin & Wald, *supra* note 12, at 895–96 (“If lawyers fear that the representation of disfavored groups will open them up to investigation and possible prosecution, they are likely to be over-deterred—shying away from lawful, ethical conduct in order to remain above suspicion.” (citing Bruce A. Green, *The Criminal Regulation of Lawyers*, 67 FORDHAM L. REV. 327, 354 (1998)).

<sup>202</sup> The International Cannabis Bar Association maintains an extensive directory. *Attorney Member Directory*, INT’L CANNABIS BAR ASS’N, <https://www.canbar.org/member-directory#/directory/ord=lnm> (last visited Dec. 21, 2020).

<sup>203</sup> See Kamin & Wald, *supra* note 12, at 897 (“[F]inding that an attorney manifests a true intent to violate the CSA simply because she represents a marijuana client seems farfetched unless . . . the lawyer . . . has an unusually high volume of business . . . with marijuana clients generally.”).

highly regulated industry.<sup>204</sup> State rules create demand for legal counsel by providing for a regulatory regime with one hand and bar counsel from meeting that demand with another.<sup>205</sup> State rules provide a safe harbor for marijuana businesses that comply with state marijuana regulation with one hand and stymie attempts to seek guidance in complying with those regulations with another.<sup>206</sup>

While Rule 1.2(d) prohibits a lawyer from assisting or counseling a client to violate criminal law, it does permit lawyers to discuss the legal consequences of violating the law.<sup>207</sup> But the traditional reading of Rule 1.2(d) defines “assist” and “discuss” to prohibit providing any legal services for a client the lawyer knows is violating the law.<sup>208</sup> The lawyer may only discuss consequences.<sup>209</sup> Even a very aggressive interpretation of Rule 1.2(d) would prohibit providing certain types of legal services for marijuana businesses, such as acting as an intermediary between two marijuana businesses.<sup>210</sup> Rule 8.4(b) also likely bars lawyers from investing in marijuana businesses,<sup>211</sup> depriving the industry of a source of both funds and expertise—expertise that is particularly valuable for a highly regulated industry.

Rule 1.2(d) is an effective bar on transactional lawyering for adult-use marijuana businesses.<sup>212</sup> Representation of medical marijuana businesses is arguably permissible under Rule 1.2(d) because of the congressional rider some courts have interpreted as barring spending federal funds to prosecute persons in compliance with state medical marijuana laws.<sup>213</sup> Compliance with state medical marijuana laws can

<sup>204</sup> See Wagemaker, *supra* note 200, at 372 (“[M]any legislatures are quickly adopting the approach that the [marijuana] industries must be tightly regulated, taxed, and controlled . . . . As a consequence of the implementation of strict regulatory structures and guidelines, ‘tax and business-transaction lawyers will become more and more in demand as state-level medical and recreation marijuana reforms create new needs for new businesses to sort through new tax laws and business-planning challenges posed by operating a state-permitted marijuana business.’” (quoting Douglas A. Berman, *Great Jobs for Green Lawyers in the New Green Ganja Legal World(?)*, PRAWFSBLAWG (Nov. 8, 2013), <https://prawfsblawg.blogs.com/prawfsblawg/2013/11/great-jobs-for-green-lawyers-in-the-new-green-ganja-legal-world.html>).

<sup>205</sup> Cf. Kamin & Wald, *supra* note 12, at 907 (“We believe that when a state chooses to regulate particular conduct—in this case marijuana cultivation and sale—access to law and lawyers becomes a necessary aspect of implementing this policy decision.”).

<sup>206</sup> Cf. *Varela v. Spanski*, 941 N.W.2d 60, 68 (Mich. Ct. App. 2019) (noting that Michigan’s medical marijuana scheme provides a safe harbor for “those who properly register and adhere to its requirements . . .”).

<sup>207</sup> Kamin & Wald, *supra* note 12, at 901–02.

<sup>208</sup> *Id.* at 902.

<sup>209</sup> *Id.*

<sup>210</sup> See *id.* at 921–22 (giving this as an example of a service that would be prohibited even under their very aggressive proposed reading of Rule 1.2(d)).

<sup>211</sup> *Id.* at 916–17.

<sup>212</sup> Wagemaker, *supra* note 200, at 390.

<sup>213</sup> Rendleman, *supra* note 199.

be argued as a defense in those jurisdictions, making competent legal counsel particularly valuable.<sup>214</sup> This would not, however, protect a lawyer advising an adult-use marijuana business.

These concerns are largely speculative. Evidence of professional discipline for representing marijuana businesses remains elusive. The same policy concern relevant above remains relevant here: states that choose to legalize and regulate marijuana necessarily change public policy in the state, federal law notwithstanding. Both state bars and courts, then, may prove reticent in pursuing lawyers who represent marijuana businesses, especially in light of the Preamble and Scope to the Model Rules, which states that the rules “are rules of reason” that “should be interpreted with reference to the purposes of legal representation and of the law itself.”<sup>215</sup>

Regulation of lawyers remains largely state-based,<sup>216</sup> so states that legalize marijuana have the power to tailor their rules of professional responsibility to allow lawyers to counsel marijuana businesses that seek to comply with state law. But a state would need to actively exercise that power.<sup>217</sup> Many states have now done just that.<sup>218</sup> At least one state’s professional ethics commission described advising a

---

<sup>214</sup> *Id.*

<sup>215</sup> MODEL RULES OF PROF’L CONDUCT pmb. para. 14 (AM. BAR ASS’N 2020).

<sup>216</sup> Notably, one federal court in Colorado refused to follow the Colorado Rules of Professional Conduct in okaying the representation of marijuana businesses. Rendleman, *supra* note 199.

<sup>217</sup> Kamin & Wald, *supra* note 12, at 929 (arguing that states should be estopped from attempts to discipline lawyers guiding clients through the state’s regulatory apparatus).

<sup>218</sup> See Brannah Hamilton, *The High Risk of Going Green: The Ethical Dilemmas Attorneys Face Representing the Marijuana Industry*, KY. J. EQUINE, AGRIC., & NATURAL RES. L. BLOG (Aug. 8, 2016), <https://perma.cc/3MAJ-WY2M> (“Washington added a new rule addendum to the state ethics rules and in Colorado, the State Supreme Court changed the state ethics rules itself to make clear that attorneys could practice in the cannabis field and still uphold their ethical obligations.” (citing Robert McVay, *Representing Cannabis Clients: The Legal Ethics*, CANNA L. BLOG (Apr. 13, 2015), <http://www.cannalawblog.com/representing-cannabis-clients-the-legal-ethics>)); Rendleman, *supra* note 199 (citing RULES OF PROF’L CONDUCT 1.2.1, 1.2.1 cmt. 6 (CAL. BAR ASS’N 2018) (“Paragraph (b) permits a lawyer to advise a client regarding the validity, scope, and meaning of California laws that might conflict with federal or tribal law, and, despite such a conflict, to assist a client in conduct that the lawyer reasonably believes is permitted by California statutes, regulations, orders, and other state or local provisions implementing those laws. If California law conflicts with federal or tribal law, the lawyer should also advise the client regarding related federal or tribal law and policy.”); ILL. RULES OF PROF’L CONDUCT 1.2(d) (2016) (“[A] lawyer may . . . counsel or assist a client in conduct expressly permitted by Illinois law that may violate or conflict with federal or other law, as long as the lawyer advises the client about that federal or other law and its potential consequences.”); OHIO RULES OF PROF’L CONDUCT 1.2(d)(2) (2020) (“A lawyer may counsel or assist a client regarding conduct expressly permitted under Sub. H.B. 523 of the 131st General Assembly authorizing the use of marijuana for medical purposes and any state statutes, rules, orders, or other provisions implementing the act. In these circumstances, the lawyer shall advise the client regarding related federal law.”)); *see also* Cassandra

medical marijuana business as risky and ethically fraught.<sup>219</sup> At least one state has given guidance interpreting Rule 1.2(d) literally.<sup>220</sup> Three other state bars, though (including the state bar that described the advice as ethically fraught), have indicated that it is permissible to represent marijuana businesses so long as they are reminded they violate the CSA.<sup>221</sup> Three states have adopted non-disciplinary approaches.<sup>222</sup>

To the extent it is ethically acceptable for lawyers to represent marijuana businesses because of a federal policy of quasi-non-enforcement, lawyers risk the standards changing with federal policy.<sup>223</sup> Federal courts may balk at accepting permissive

Burke Robertson, *Legal Advice for Marijuana Business Entities*, in MARIJUANA FEDERALISM: UNCLE SAM AND MARY JANE, 160, 160 (Jonathan H. Adler ed., 2020) (“In other states, including Alaska, Illinois, Nevada, Hawaii, Oregon, and Washington, the state supreme court adopted rule changes specifically permitting attorneys to assist in-state marijuana businesses. One state acted through the legislative branch rather than the judicial branch: Minnesota adopted a statutory provision barring attorney discipline for attorneys’ advice to state-authorized marijuana entities.”) (citing ALASKA RULES OF PROF’L CONDUCT 1.2(f) (2015); ILL. RULES OF PROF’L CONDUCT 1.2(d)(3) (2010); NEV. RULES OF PROF’L CONDUCT 1.2, cmt. 1 (2019); HAW. RULES OF PROF’L CONDUCT 1.2(d) (2014); OR. RULES OF PROF’L CONDUCT 1.2(d) (2020); WASH. RULES OF PROF’L CONDUCT 1.2, cmt. 18 (2011); MINN. STAT. ANN. § 152.32(2)(a) (2019)).

<sup>219</sup> Kamin & Wald, *supra* note 12, at 903 (citing Me. Prof’l Ethics Comm’n., Op. 199 (2010), [http://maine.gov/tools/whatsnew/index.php?topic=mebar\\_oversers\\_ethics\\_opinions&id=110134&v](http://maine.gov/tools/whatsnew/index.php?topic=mebar_oversers_ethics_opinions&id=110134&v)).

<sup>220</sup> Pa. Bar Ass’n Legal Ethics & Prof’l Responsibility Comm. & Phila. Bar Ass’n Prof’l Guidance Comm., Joint Formal Op. 2015-100 (2015); *see also* Burke Robertson, *supra* note 218, at 160–61 (“[A]s of 2019, New Mexico still maintains the position that lawyers may not assist clients with marijuana-related activity.” (citing State Bar of N.M.’s Ethics Advisory Comm., Formal Op. 2016-1, at 8 (2015))).

<sup>221</sup> Rendleman, *supra* note 199; State Bar of Ariz., Formal Op. 11-01 (2011), <http://www.azbar.org/Ethics/EthicsOpinions/ViewEthicsOpinion?id=710> (“[W]e decline to interpret and apply ER 1.2(d) in a manner that would prevent a lawyer who concludes that the client’s proposed conduct is in ‘clear and unambiguous compliance’ with state law from assisting the client in connection with activities expressly authorized under state law, thereby depriving clients of the very legal advice and assistance that is needed to engage in the conduct that the state law expressly permits.”); Conn. Bar. Ass’n, Prof’l Ethics Comm., Informal Op. 2013-02 (2013); Me. Prof’l Ethics Comm’n, Op. 214 (2016), *vacated*, Op. 215 (2017); *see also* Burke Robertson, *supra* note 218, at 160 (“A New York ethics committee, for example, concluded that New York lawyers may give legal assistance ‘that goes beyond a mere discussion of the legality of the client’s proposed course of conduct.’” (citing N.Y. Comm. on Prof’l Ethics, Op. 1024 (2014))). *But see* Conn. Bar. Ass’n, Prof’l Ethics Comm., Informal Op. 2013-02 (2013) (“Lawyers may not assist clients in conduct that [violates] federal criminal law.”).

<sup>222</sup> Rendleman, *supra* note 199 (categorizing Florida, Massachusetts, and Minnesota as taking this approach); *see also* Burke Robertson, *supra* note 218, at 160 (“Two other states, Florida and Massachusetts, issued opinions stating that lawyers would not be subject to discipline for assisting marijuana entities.”).

<sup>223</sup> *Cf.* Rendleman, *supra* note 199 (questioning the continued validity of the Arizona ethics opinion in light of changed federal policy).

state rules.<sup>224</sup> Legal malpractice insurers may balk at paying out claims related to the representation of a marijuana business.<sup>225</sup> Uncertainties remain. Those uncertainties may cause competent lawyers to choose to refuse to represent marijuana businesses. Worse, those uncertainties may cause marijuana businesses to not seek legal counsel.

### G. Other Considerations

The unclean hands doctrine stymies marijuana businesses' ability to take advantage of business entity law and bankruptcy law.<sup>226</sup> A court will not order a party to violate federal law, so specific performance and other forms of injunctive relief will frequently be unavailable.<sup>227</sup> The unclean hands doctrine extends beyond the business entity and bankruptcy context.<sup>228</sup> Equity in general will be of limited help to marijuana businesses. This will be particularly true in federal court. In some circumstances, e.g., bankruptcy, federal court will be unavoidable, and parties will frequently be able to strategically seek to litigate in federal court.

Theft is a serious concern for marijuana businesses.<sup>229</sup> Assistance from local law enforcement might prove grudging.<sup>230</sup> Limited access to banking services means that

---

<sup>224</sup> See Burke Robertson, *supra* note 218, at 161 (noting that the federal district court in Colorado pointedly amended its rules to omit the comment to the Colorado Rules of Professional Conduct that indicated attorneys could assist marijuana businesses (citing Anna El-Zein, *Caught in a Haze: Ethical Issues for Attorneys Advising on Marijuana*, 82 MO. L. REV. 1171, 1181 (2017); Peter A. Joy & Kevin C. McMunigal, *Lawyers, Marijuana, and Ethics*, 32 CRIM. JUST. 29, 30–31 (2017); *Attorney Local Rules*, II(b)(2), U.S. DIST. CT. FOR DIST. COLO. LOC. R. PRAC. (2017)).

<sup>225</sup> See Burke Robertson, *supra* note 218, at 162 (noting illegal acts exclusions and the strong incentives insurers have to deny coverage).

<sup>226</sup> *Supra* Part II.A, II.D. Individual states have complementary common law rules of their own. See, e.g., *Varela v. Spanski*, 941 N.W.2d 60, 73 (Mich. Ct. App. 2019) (“The wrongful-conduct rule is well established in Michigan common law. This rule, which bars a claim if a plaintiff must rely on his or her own illegal conduct for recovery, stems from the sound public policy that ‘courts should not lend their aid to a plaintiff who founded his cause of action on his own illegal conduct.’” (quoting *Orzel v. Scott Drug Co.*, 537 N.W.2d 208, 220 (Mich. 1995))).

<sup>227</sup> *Supra* Part II.B, II.D.

<sup>228</sup> See generally T. Leigh Anenson, *Limiting Legal Remedies: An Analysis of Unclean Hands*, 99 KY. L.J. 63, 63 (2010) (“Unclean hands is perhaps the most powerful and least containable defense that came from ancient courts of equity.”).

<sup>229</sup> See, e.g., *Varela*, 941 N.W.2d at 65 (discussing a grow operation that had its first harvest stolen by a street gang after its commercial landlord failed to install a security system); *Green Earth Wellness Ctr., LLC v. Atain Specialty Ins. Co.*, 163 F. Supp. 3d 821, 824 (D. Colo. 2016) (discussing a grow operation that suffered damage to its ventilation system after thieves entered through the roof and stole marijuana plants); Tiney Ricciardi, *Denver Dispensary Burglaries Hit 3-Year High as 2019 Ended with Rash of Armed Robberies*, DENVER POST (Jan. 20, 2020, 6:00 AM), <https://www.denverpost.com/2020/01/20/denver-marijuana-burglaries-increase/> (noting that burglaries and robberies of dispensaries are up but still only account for a tiny fraction of reported crime in Denver).

<sup>230</sup> See *infra* note 238 and accompanying text.

marijuana businesses must operate as cash businesses—and not just in dealing with customers.<sup>231</sup> Moving and storing large quantities of cash leads to an increased risk of theft and violence.<sup>232</sup> It will be difficult to insure against theft.<sup>233</sup>

Loss of property from marijuana businesses is not limited to criminal theft. States can legalize marijuana under state law and refuse to cooperate with federal law enforcement, but they cannot prevent federal law enforcement from raiding marijuana businesses.<sup>234</sup> Those raids can result in civil and criminal forfeiture—and not just of marijuana plants themselves.<sup>235</sup> Nor is forfeiture something that only happens at the end of a legal proceeding.<sup>236</sup> Marijuana businesses cannot insure against this risk. This is a risk for ancillary businesses, not just plant-touching businesses.<sup>237</sup> A commercial landlord might suffer property damage from raids, diminution in the value of their property, and the loss of revenue from the rent stream of the marijuana business raided.<sup>238</sup> Property confiscated in a raid will no longer be available to a creditor to seize in satisfaction of secured debt. And the mere specter of civil forfeiture is enough to spook marijuana businesses.<sup>239</sup>

<sup>231</sup> Hill, *supra* note 12, at 600–02.

<sup>232</sup> See, e.g., Alex Altman, *Pot's Money Problem*, TIME, Jan. 27, 2014, at 34 (“In October 2012 the industry was shaken by the grisly tale of three people who allegedly kidnapped the owner of a lucrative dispensary in Orange County. According to court documents, the assailants zip-tied the victim, tortured him and drove him to a patch of desert where they believed he had buried large sums of money. When the kidnappers couldn’t find it, they allegedly burned him with a blowtorch, cut off his penis and doused him with bleach before dumping him along the side of a road. (He survived.)”).

<sup>233</sup> *Supra* Part II.C.

<sup>234</sup> Brian M. Blumenfeld, *State Legalization of Marijuana and Our American System of Federalism: A Historio-Constitutional Primer*, 24 VA. J. SOC. POL’Y & L. 77, 88–93 (2017) (discussing the anti-commandeering doctrine in the context of marijuana policy); *id.* at 91–93 (discussing the Supremacy Clause in the marijuana context). Federal law enforcement’s ability to enforce federal law against medical marijuana businesses is limited. See Jaeger, *supra* note 11.

<sup>235</sup> TODD GARVEY & BRIAN T. YEH, CONG. RESEARCH SERV., R43034, STATE LEGALIZATION OF RECREATIONAL MARIJUANA: SELECTED LEGAL ISSUES 27 (2014) (“Property subject to the CSA’s civil forfeiture provision includes any controlled substance that has been manufactured, distributed, dispensed, acquired, or possessed in violation of federal law, as well as any equipment, firearm, money, mode of transportation, or real property *used or intended to be used to facilitate a violation of the CSA.*” (citing 21 U.S.C. § 881(a))).

<sup>236</sup> *Id.* at 26 (explaining that criminal forfeiture is only possible after the conviction of the owner, but that civil forfeiture requires no showing of guilt by the property owner).

<sup>237</sup> *Id.* at 26–27. The combination of a broad range of objects of forfeiture, aiding and abetting, and conspiracy doctrine, and the framing of civil forfeiture as against property not property owners means the assets of ancillary businesses are very much at risk.

<sup>238</sup> Michael N. Widener, *Medical Cannabis Entrepreneurs as Commercial Tenants: Assessment and Treatment*, 46 REAL PROP. TR. & EST. L.J. 377, 391 (2011).

<sup>239</sup> Kamin & Wald, *supra* note 12, at 883 (citing *Feds Warn, Indict California Medical Marijuana Dispensary Operators*, ABC7 (Oct. 7, 2011), <https://abc7.com/archive/838365/>).



Not all of the above is cut and dry. The legalization of adult-use marijuana dates back only to 2012,<sup>240</sup> so case law is understandably limited. There is mixed case law in many areas. There are good reasons for courts to not apply some of the principles above in the marijuana context, given clear policy guidance from the state, and decidedly mixed policy guidance from the federal government. States are beginning efforts to mitigate some of these issues and limited workarounds are available to private parties.<sup>241</sup> But businesses thrive on legal certainty.<sup>242</sup> Marijuana businesses cannot be *certain* they are covered legally for any of the above. Each must be considered a significant legal risk, and that creates real risks for the business. Real risks are effective costs.

### III. ON THE VANGUARD OF LEGALIZATION: MICHIGAN AND ILLINOIS

Much of the above case law comes from states like California and Colorado which were early adopters of marijuana legalization.<sup>243</sup> It is instructive, though, to consider the frontier of legalization efforts as well. Accordingly, then, this Part focuses on Michigan and Illinois. Michigan and Illinois are large, economically important states.<sup>244</sup> They have legalized marijuana for adult-use (recreational) instead of just for medical use.<sup>245</sup> They are relatively new entrants to the market.<sup>246</sup> Legalization has been most predominant in the western and northeastern United States;

---

There remains some risk of being raided by local law enforcement, state law notwithstanding. *See* United States v. \$186,416.00 in U.S. Currency, 590 F.3d 942, 948 (9th Cir. 2010) (ruling violation of federal law did not provide probable cause for a raid of state-law-compliant dispensary by local law enforcement).

<sup>240</sup> Kamin & Wald, *supra* note 12, at 879 (noting voters passed the first adult-use legalization initiatives in Washington and Colorado in 2012).

<sup>241</sup> *Supra* Part II.

<sup>242</sup> *Cf.* Pace, *Fiduciary Duties*, *supra* note 74, at 1119 (noting that an amorphous legal standard “seriously erodes the certainty on which businesses thrive”).

<sup>243</sup> *See, e.g.*, Northbay Wellness Grp., Inc. v. Beyries, 789 F.3d 956 (9th Cir. 2015); *In re* Arenas, 535 B.R. 845 (B.A.P. 10th Cir. 2015); *In re* Way to Grow, Inc., 597 B.R. 111 (Bankr. D. Colo. 2018); Order, *supra* note 168; Green Earth Wellness Ctr., LLC v. Atain Specialty Ins. Co., 163 F. Supp. 3d 821 (D. Colo. 2016); Mann v. Gullickson, No. 15-cv-03630-MEJ, 2016 WL 6473215 (N.D. Cal. Nov. 2, 2016); *In re* Rent-Rite Super Kegs W. Ltd., 484 B.R. 799 (Bankr. D. Colo. 2012); Northbay Wellness Grp. v. Beyries (*In re* Beyries), No. 10–13482, 2011 WL 5975445 (Bankr. N.D. Cal. Nov. 29, 2011).

<sup>244</sup> Illinois and Michigan are the 5th and 14th largest states in the U.S. by GDP, respectively. *Gross Domestic Product by State, Third Quarter 2019*, BUREAU OF ECON. ANALYSIS (Jan. 10, 2020), [https://www.bea.gov/system/files/2020-01/qgdpsstate0120\\_2.pdf](https://www.bea.gov/system/files/2020-01/qgdpsstate0120_2.pdf).

<sup>245</sup> *See State Medical Marijuana Laws*, *supra* note 2 (listing Michigan and Illinois as adult-use states).

<sup>246</sup> Adult-use sales began on December 1, 2019, in Michigan and January 1, 2020, in Illinois. *Adult-Use Stores Continue to Open; Expungement Bill Awaits Senate Action*, MARIJUANA POL’Y

Michigan and Illinois bring legalization to the Midwest.<sup>247</sup>

Both Michigan<sup>248</sup> and Illinois<sup>249</sup> provided for medical marijuana prior to extending legalization to adult-use. Michigan voters approved medical marijuana by a 63–37 margin in a 2008 referendum and approved adult-use marijuana by a 56–44 margin in a 2018 referendum.<sup>250</sup> The 2018 referendum immediately decriminalized marijuana but only provided for the commercial sale of marijuana after the state implemented a state licensing system.<sup>251</sup> The referendum also allowed municipalities to opt-out by banning marijuana businesses.<sup>252</sup> Roughly 80% initially did so, including Detroit.<sup>253</sup> Many of those municipalities are adopting a “wait-and-see” approach,<sup>254</sup> and the number of municipalities opting out may decline in the future.<sup>255</sup> The regulatory scheme encourages that approach since marijuana businesses that

PROJECT (Jan. 13, 2020), <https://www.mpp.org/states/michigan/>; Robert McCoppin, *It's Now Only Days Away: Jan. 1 to Usher in the Era of Legalized Recreational Weed in Illinois. 'It Changes Everything.'*, CHI. TRIB. (Dec. 27, 2019, 3:08 PM), <https://www.chicagotribune.com/marijuana/illinois/ct-illinois-marijuana-legalization-on-jan-1-20191227-aa52o6wmrnegvfgb55uedlgcq-story.html>.

<sup>247</sup> Nine of the fifteen states that have legalized adult-use marijuana are in the West—Alaska, Arizona, California, Colorado, Montana, Nevada, Oregon, South Dakota, and Washington. *Marijuana Overview*, *supra* note 1.

<sup>248</sup> See *Varela v. Spanski*, 941 N.W.2d 60, 67–73 (Mich. Ct. App. 2019) (discussing a breach of contract claim for a marijuana business in light of certain safe harbor provisions in Michigan’s existing medical marijuana scheme).

<sup>249</sup> 410 ILL. COMP. STAT. 130/1 (2019).

<sup>250</sup> Kathleen Gray, *Legal Marijuana in Michigan: What You Need to Know*, DETROIT FREE PRESS (Nov. 7, 2018, 5:54 AM), <https://www.freep.com/story/news/marijuana/2018/11/07/michigan-marijuana-results-election-legalization/1835297002/>.

<sup>251</sup> *Id.*

<sup>252</sup> *Id.*

<sup>253</sup> Steve Carmody, *4 out of 5 Michigan Communities Opt out of Recreational Marijuana Retail Market*, MICH. RADIO NPR (Nov. 15, 2019), <https://www.michiganradio.org/post/4-out-5-michigan-communities-opt-out-recreational-marijuana-retail-market>.

<sup>254</sup> Steve Neavling, *Detroit's Ban on Recreational Marijuana Sales May be Too Late to Stop Some Dispensaries from Opening*, DETROIT METRO TIMES (Nov. 15, 2019), <https://www.metrotimes.com/detroit/detroits-ban-on-recreational-marijuana-sales-may-be-too-late-to-stop-some-dispensaries-from-opening/Content?oid=23126819>.

<sup>255</sup> Portage, Michigan, for example, passed an ordinance allowing for adult-use dispensaries in May 2020. Lindsay Moore, *Portage Passes Recreational Marijuana Business Regulations*, MLIVE (May 27, 2020), <https://www.mlive.com/news/kalamazoo/2020/05/portage-passes-recreational-marijuana-business.html>. Detroit City Council members proposed an ordinance doing the same in October 2020. Jason Davis, *Proposed Ordinance Lays out Rules for Recreational Marijuana Businesses in Detroit*, CRAIN’S DETROIT BUS. (Oct. 26, 2020 6:42 AM), <https://www.crainsdetroit.com/marijuana/proposed-ordinance-lays-out-rules-recreational-marijuana-businesses-detroit>.

apply for a license before the opt-out will still be able to operate.<sup>256</sup> The newly created Marijuana Regulation Agency within the Michigan Department of Licensing and Regulatory Affairs issues regulations governing the marijuana industry in Michigan.<sup>257</sup> Adult-use sales in Michigan will be subject to both a 10% excise tax and a 6% sales tax.<sup>258</sup> Sales began on December 1, 2019.<sup>259</sup>

Adult-use sales in Illinois began just one month later on January 1, 2020.<sup>260</sup> Only 35 stores were authorized to sell adult-use marijuana as of the first day sales were legal.<sup>261</sup> In issuing initial adult-use dispensary licenses, Illinois provided for 75 licenses for new applicants, in addition to any licenses for the existing 55 medical dispensary operators.<sup>262</sup> Rather than a lottery, the state used a points-based scoring system that includes social metrics to evaluate applicants.<sup>263</sup> Existing medical marijuana businesses were given license priority.<sup>264</sup> Illinois also allows municipalities to opt-out, with many suburbs choosing to do so.<sup>265</sup> Illinois did not originally expand grow licenses, limiting the supply to existing medical growers.<sup>266</sup> Illinois marijuana regulations include testing requirements designed both to detect contaminants like mold and pesticides and to ensure marijuana is as potent as advertised.<sup>267</sup> Growers

---

<sup>256</sup> Neavling, *supra* note 254 (noting that marijuana businesses that applied for a license during the five-day window between the application period opening and Detroit deciding to opt out will still be able to operate).

<sup>257</sup> *Adult-Use Stores Continue to Open*, *supra* note 246.

<sup>258</sup> Gray, *supra* note 250.

<sup>259</sup> *Id.*

<sup>260</sup> McCoppin, *supra* note 246.

<sup>261</sup> *Id.*

<sup>262</sup> Jonah Meadows, *Illinois Marijuana Dispensary License Applications Unveiled*, PATCH (Oct. 2, 2019, 11:37 AM), <https://patch.com/illinois/springfield-il/marijuana-dispensary-license-applications-unveiled-regulators>.

<sup>263</sup> *Id.* (“Applicants will be evaluated on a 250-point scale consisting of 10 factors—labor, diversity and environmental plans, security, business plans, experience, employee training, the owners’ status as a veteran, an Illinois resident or a social equity applicant. . . . In case of a tie, the applicant with the best community engagement plan will get the license.”).

<sup>264</sup> McCoppin, *supra* note 246. Giving priority to existing medical marijuana businesses prevents them from organizing as a powerful interest group in *opposition* to adult-use. See PHILIP WALLACH & JONATHAN RAUCH, CTR. FOR EFFECTIVE PUB. MGMT. AT BROOKINGS, *BOOTLEGGERS, BAPTISTS, BUREAUCRATS, AND BONGS: HOW SPECIAL INTERESTS WILL SHAPE MARIJUANA LEGALIZATION 7* (2016) (categorizing medical marijuana businesses as “semi-legal bootleggers,” discussing their opposition to adult-use in Washington, and discussing their support for adult-use in Colorado, where they were given priority in the new scheme).

<sup>265</sup> McCoppin, *supra* note 246.

<sup>266</sup> *Id.*

<sup>267</sup> *Id.*

will pay a 7% gross receipts tax.<sup>268</sup> Retail taxes range from 10–25%.<sup>269</sup> Illinois has the second-highest taxes on adult-use marijuana sales; Michigan has the third lowest.<sup>270</sup> Notably, the Illinois law also provides for automatic expungement of marijuana convictions, with an estimated 740,000 cases eligible.<sup>271</sup>

Michigan is also notable for being a relatively large state that unexpectedly voted for Donald Trump in the 2016 election, but that flipped back to the Democratic Party candidate in 2020.<sup>272</sup> A solid majority—56%—of Michigan residents voted for adult-use marijuana.<sup>273</sup> Legalization by popular vote in a swing state on the eve of a presidential election may be the final nail in the coffin of federal efforts to stem the tide of state-level marijuana legalization. Illinois is particularly notable for two reasons. One, Illinois has the fifth-largest GDP in the nation.<sup>274</sup> One set of investment materials projected the Illinois medical marijuana market alone at more than \$1 billion.<sup>275</sup> Two, Illinois is the first state to provide for legalization and regulation of adult-use marijuana sales legislatively.<sup>276</sup>

Opening the Midwest to adult-use marijuana is a significant step in its continued state-by-state adoption. In the space of a month, six states now neighbor a state that allows adult-use sales (two neighboring states, for Wisconsin and Indiana). Lost potential tax revenue from residents crossing the border to purchase marijuana can

---

<sup>268</sup> Christian Britschgi, *Illinois Becomes 11th State to Legalize Weed*, REASON (June 25, 2019, 5:25 PM), <https://reason.com/2019/06/25/illinois-becomes-11th-state-to-legalize-weed/>.

<sup>269</sup> McCoppin, *supra* note 246 (“Taxes will add another 10% for products with up to 35% THC—the component of pot that gets users high—while cannabis-infused products such as edibles will be taxed at 20%, and products with more than 35% THC will be taxed at 25%.”).

<sup>270</sup> Austin Berg, *Illinois Cannabis Taxes Among Nation’s Highest, Could Keep Black Market Thriving*, ILL. POL’Y (Jan. 9, 2020), <https://www.illinoispolicy.org/illinois-cannabis-taxes-among-nations-highest-could-keep-black-market-thriving/>.

<sup>271</sup> *Adult-Use Legalization Program Launches*, MARIJUANA POL’Y PROJECT (Jan. 21, 2020), <https://www.mpp.org/states/illinois/>.

<sup>272</sup> Shane Goldmacher et al., *It’s Such a Relief: Biden Voters Rebuild a Wall That Trump Smashed*, N.Y. TIMES (Nov. 9, 2020), <https://www.nytimes.com/2020/11/08/us/politics/joe-biden-voters.html>.

<sup>273</sup> Gray, *supra* note 250.

<sup>274</sup> *Gross Domestic Product by State*, *supra* note 244, tbl. 3.

<sup>275</sup> *Ginsburg v. ICC Holdings, LLC*, No. 3:16-CV-2311-D, 2017 WL 5467688, at \*1 (N.D. Tex. Nov. 13, 2017); *see also id.* at \*12 (noting the market size projection was calculated using “a conservative national average of 7.7 patients per 1000 residents in states where medical cannabis is legal”).

<sup>276</sup> Vermont’s legislature decriminalized possession of marijuana but did not provide for legal sale. Adult-use marijuana sales were legalized in the other nine states by popular referenda. Britschgi, *supra* note 268.

be a powerful motivating factor for policymakers.<sup>277</sup> The two centrally located Midwestern states also make marijuana tourism easier for much of the country.<sup>278</sup>

### A. *Signs of Convergence in State Legalization Efforts*

Marijuana legalization is no longer novel. Reformers and opponents now have experience with successful campaigns for medical marijuana, unsuccessful campaigns for medical marijuana, successful campaigns for adult-use marijuana, and unsuccessful campaigns for adult-use marijuana. Patterns have begun to emerge in successful legalization efforts.<sup>279</sup> These patterns likely don't reflect a sober, clear-eyed judgment of the best policy approach to marijuana legalization but, instead, reformers have increasing knowledge of how to play interest group politics and to successfully market legalization efforts.<sup>280</sup>

Experience in Michigan and Illinois reflects what may be a new normal. Unlike somewhat chaotic spurts of simultaneous new regulation leading to a highly fragmented regulatory environment, as we saw in the United States with alcohol regulation after the end of Prohibition, and as we may be seeing with province-level regulation of marijuana in Canada,<sup>281</sup> the iterative, incremental nature of marijuana legalization in the United States may lead to a more uniform state-level regulation end-state. Voters are more comfortable with a regulated, legalized marijuana industry than with simple decriminalization.<sup>282</sup> Reformers can blunt a potentially powerful opposition interest group by giving existing medical marijuana licensees priority access to adult-use licenses.<sup>283</sup> Both Michigan and Illinois did so.<sup>284</sup> Opposition from

<sup>277</sup> Cf. WALLACH & RAUCH, *supra* note 264, at 12 (noting the role legalization in Washington played in speeding legalization in neighboring Oregon).

<sup>278</sup> Cf. Nick Kovacevich, *The Next Big Thing in Cannabis: Tourism*, FORBES (Aug. 16, 2018, 6:32 PM), <https://www.forbes.com/sites/nickkovacevich/2018/08/16/the-next-big-thing-in-cannabis-tourism/> (reporting that 6.5 million marijuana tourists visited Colorado in 2016).

<sup>279</sup> Cf. John Hudak & Christine Stenglein, *Public Opinion and America's Experimentation with Cannabis Reform*, in MARIJUANA FEDERALISM: UNCLE SAM AND MARY JANE 15, 20 (Jonathan H. Adler ed., 2020) (“Although differences exist among state systems, many state-based cannabis reform ballot initiatives build on others, and there is a degree of policy learning from the experiences of other states.”).

<sup>280</sup> See generally WALLACH & RAUCH, *supra* note 264 (detailing the evolution of successful legalization efforts).

<sup>281</sup> See generally John F. McArdle & Alice de Koning, *Regulatory Hurdles for New Venture Entrants in the Cannabis Industry: Pitfalls and Lessons from the Canadian Experience* (Feb. 19, 2020) (unpublished manuscript) (on file with author).

<sup>282</sup> See WALLACH & RAUCH, *supra* note 264, at 14 (noting that a 2014 Oregon campaign that “emphasiz[ed] the importance of regulation” resulted in “a 9-point swing in favor of legalization” over a campaign two years earlier with a “more libertarian feel”).

<sup>283</sup> See *id.* at 8 (discussing how reformers were able to coopt medical marijuana licensees in Colorado and California by giving them a privileged position in the new regulatory environment).

<sup>284</sup> Meadows, *supra* note 262 (noting that existing medical marijuana licenses can access

more conservative locales can also be blunted by allowing them to opt-out of allowing dispensaries, as both Michigan and Illinois did.<sup>285</sup> More generally, reformers have succeeded by shifting the debate to “the harms of criminalizing marijuana,” comparing marijuana to alcohol, and drawing parallels with alcohol prohibition, widely seen as “a severe social blunder.”<sup>286</sup>

*B. Early Evidence of Entity Choice by Michigan and Illinois Dispensaries*

Entity choices by Michigan and Illinois adult-use dispensary licensees indicate licensees are choosing rationally. Almost three times as many Michigan licensees are organized as LLCs than are incorporated.<sup>287</sup> In Illinois LLCs outnumber corporations by ten to one, but the number of licensees remains very small.<sup>288</sup> Beyond the usual advantages for small businesses, LLCs are better suited to workarounds for the issues covered above.<sup>289</sup> Despite the cloud over the ability of marijuana businesses to take advantage of business entity law,<sup>290</sup> very few licensees have chosen to forego a formal entity form.<sup>291</sup> Despite not requiring any particular business structure,<sup>292</sup> only one licensee in Illinois is not organized as an LLC or corporation.<sup>293</sup> This likely reflects both a judgment that the risks described in Part II.B are relatively low and the modest cost of using a legal entity. The risk of no protection from a legal entity is better than a certainty of no protection with no legal entity.

---

adult-use licenses that do not count against the 75-license cap for adult-use licenses).

<sup>285</sup> Gray, *supra* note 250 (Michigan); McCoppin, *supra* note 246 (Illinois).

<sup>286</sup> WALLACH & RAUCH, *supra* note 264, at 11.

<sup>287</sup> *Infra* Table 1.

<sup>288</sup> *Id.* At the time information was pulled to compile Table 1, only 37 licensees were listed.

<sup>289</sup> *Supra* Part II.B. The relative popularity of corporations in Michigan is likely a remnant of state tax policy that only very recently began offering more attractive tax treatment to LLCs over corporations.

<sup>290</sup> *Supra* Part II.B.

<sup>291</sup> Table 1.

<sup>292</sup> *Adult Use Cannabis Program License Application*, ILL. DEP’T FIN. & PROF. REG. 32 (Nov. 1, 2019), <https://www.idfpr.com/Forms/AUC/Conditional%20Adult%20Use%20Dispensing%20Organization%20License%20Application%20QA%20Round%201.pdf>.

<sup>293</sup> See *infra* Table 1. Table 1 was compiled using lists of licensees made available by Michigan and Illinois. The Michigan data did not distinguish adult-use licensees from medical licensees and frequently did not indicate entity type. It was cleaned up using outside lists of open and operating adult-use dispensaries and with entity searches on the Michigan Department of Licensing and Regulatory Affairs website.

**Table 1: Entity Choice for Michigan and Illinois Adult-Use Marijuana Dispensary Licensees<sup>294</sup>**

	Michigan	Illinois
Corporation	13	3
LLC	30	33
No entity or No identifiable entity	4	1

#### IV. THE ECONOMICS OF THE MARIJUANA INDUSTRY

Conventional economic theory holds that a primary function of government is to provide a legal infrastructure for business.<sup>295</sup> Facilitating the financial system and access to it is held to be of great importance as well.<sup>296</sup> With a longstanding, robust legal infrastructure for business and easy access to the financial system in the United States, there has been little reason or opportunity to examine the conventional story. The decidedly unconventional story of marijuana legalization thus far suggests we reevaluate the conventional story. Moreover, it provides us with an example of rapid industry growth despite limited access to legal and financial infrastructure.

Cannabis is rapidly becoming big business despite a lack of access to legal and financial infrastructure. The marijuana industry is growing faster than any other industry in the United States.<sup>297</sup> From 2013 to 2014 the marijuana industry saw a 74% increase in revenue, with sales jumping from \$1.5 billion to \$2.7 billion.<sup>298</sup> Every state that legalizes marijuana opens up a largely untapped market. California

---

<sup>294</sup> Compiled using lists of licensees made available by Michigan and Illinois.

<sup>295</sup> See generally Tamar Frankel, *The Legal Infrastructure of Markets: The Role of Contract and Property Law*, 73 B.U. L. REV. 389 (1993).

<sup>296</sup> See generally Thorsten Beck et al., *Law and Firms' Access to Finance*, 7 AM. L. & ECON. REV. 211, 229 (2005) (finding that firms in common law countries have an easier time getting external financing than firms in countries with legal systems originating in France).

<sup>297</sup> Matt Ferner, *Legal Marijuana is the Fastest-Growing Industry in the U.S.: Report*, HUFFPOST (Jan. 26, 2015, 12:00 AM), [https://www.huffpost.com/entry/marijuana-industry-fastest-growing\\_n\\_6540166](https://www.huffpost.com/entry/marijuana-industry-fastest-growing_n_6540166); Scheuer, *Marijuana Contracts*, *supra* note 42, at 41 (citing Bob Knudsen, *Colorado Marijuana Prices See Huge Drop, Drug Cartels Reeling*, EXAMINER (June 23, 2015, 1:34 PM), <http://www.examiner.com/article/colorado-marijuana-prices-see-huge-drop-drug-cartels-reeling>; George Budwell, *Is 1 Drug Really Outselling Legalized Marijuana?*, MOTLEY FOOL (Jan. 19, 2015, 1:03 PM), <http://www.fool.com/investing/general/2015/01/19>).

<sup>298</sup> Scheuer, *Marijuana Contracts*, *supra* note 42, at 42.

alone contributed \$1.3 billion in marijuana sales in 2014.<sup>299</sup> California contributes 14.5% of U.S. gross domestic product.<sup>300</sup> Extrapolating out California's sales to the entire nation results in annual sales of \$8.96 billion. That number is still dwarfed by \$253.8 billion in alcohol sales in 2018,<sup>301</sup> but marijuana is far from a mature industry. California did not even provide for adult-use marijuana sales until January 2018.<sup>302</sup>

Explosive sales growth has created an enormous demand for labor.<sup>303</sup> The industry added 64,389 jobs in 2018 alone, 44% more than it added in 2017.<sup>304</sup> Total jobs in the industry now exceed 200,000.<sup>305</sup> Marijuana is not just the fastest-growing industry in the United States, it is "the fastest-growing labor market in the U.S."<sup>306</sup> Despite the immaturity of the industry and the ample legal uncertainty,<sup>307</sup> there have been marijuana businesses with assets in the tens and hundreds of millions of dollars for years now.<sup>308</sup> The marijuana industry is also beginning to attract deep-pocketed investors and sophisticated financial intermediaries.<sup>309</sup>

<sup>299</sup> Ferner, *supra* note 297.

<sup>300</sup> *Gross Domestic Product by State*, *supra* note 244, tbl. 3.

<sup>301</sup> Seren Morris, *US Alcohol Sales Increased by 5.1% in 2018*, DRINKS BUS. (Jan. 17, 2019), <https://www.thedrinksbusiness.com/2019/01/us-alcohol-sales-increased-by-5-1-in-2018/>.

<sup>302</sup> CAL. HEALTH & SAFETY CODE § 11018 (West 2017).

<sup>303</sup> See Scheuer, *Marijuana Contracts*, *supra* note 42, at 42 ("[The marijuana industry] is also a booming area of job growth." (citing Jonah Bennet, *Job Growth in the Cannabis Industry Continues, 200,000 Positions Expected*, DAILY CALLER (Jan. 16, 2015, 4:25 PM), <https://dailycaller.com/2015/01/16/job-growth-in-the-cannabis-industry-continues-200000-positions-expected/>)).

<sup>304</sup> Jeff Cox, *The Marijuana Industry Looks Like the Fastest-Growing Job Market in the Country*, CNBC (Mar. 14, 2019, 1:48 PM), <https://www.cnbc.com/2019/03/14/the-marijuana-industry-looks-like-the-fastest-growing-job-market-in-the-country.html>.

<sup>305</sup> *Id.*

<sup>306</sup> *Id.* (quoting Nick Colas, founder of DataTrek Research).

<sup>307</sup> *Supra* Part II.

<sup>308</sup> Scheuer, *Marijuana Contracts*, *supra* note 42, at 42 (citing Alex Akesson, *Small Cap Hedge Funds Show Interest in Edible Marijuana Products from Latteno*, HEDGE.CO.NET (May 15, 2013), <http://www.hedgeco.net/news/05/2013/marijuana-hedge-fund-launches-edibles.html> [<http://perma.cc/9LGF-64LG>]; Jonathan Kaminsky, *Ex-Microsoft Manager Plans to Create First U.S. Marijuana Brand*, REUTERS (May 30, 2013, 3:14 PM), <http://www.reuters.com/article/2013/05/30/usa-marijuanaidUSL2NOEBOYA20130530> [<http://perma.cc/3UH4-W5CR>]; Dan Ritter, *Who Will Get High Off the Marijuana Gold Rush?*, WALL STREET CHEAT SHEET (July 1, 2013), <http://wallstcheatsheet.com/stocks/who-will-get-high-off-the-marijuana-gold-rush.html?a-viewall> [<http://perma.cc/S9RV-N376>]; Eric Russell, *Medical Marijuana Group Submits Financing Plan to State*, BANGOR DAILY NEWS (Aug. 15, 2011), <http://bangordailynews.com/2011/08/15/business/medical-marijuana-group-submits-financing-plan-to-state/> [<http://perma.cc/T9P5-SJ56>]).

<sup>309</sup> See, e.g., Roger Parloff, *Yes We Cannabis*, FORTUNE (Mar. 21, 2013, 8:28 AM), <https://fortune.com/2013/03/21/yes-we-cannabis/> (quoting the founder of an investor network



*A. Analysis of Externalities Associated with the Marijuana Industry*

The marijuana industry may be growing rapidly, but we should expect the lack of access to legal and financial infrastructure to stymie that growth, if only relative to what it could have been. Externalities from the legal marijuana industry are relevant to judging the consequences of reform. Slowing the growth of the marijuana industry might be beneficial, after all, if the industry brings substantial negative externalities.

There is evidence of negative externalities linked to marijuana use, and the industry more broadly. Marijuana use in the United States, of course, predates legalization efforts. Keeping in mind factors like stigma,<sup>310</sup> safety, and risk of criminal prosecution,<sup>311</sup> legalization lowers the price of purchasing and consuming marijuana. Basic economic theory teaches that lowering the price of an activity will lead to an increase in the frequency of the activity. Early experience bears that out.<sup>312</sup>

Because much of the cost for healthcare is borne by the public rather than individuals, negative health effects create externalities.<sup>313</sup> As a general rule, inhaling the products of combustion is bad for a person’s health.<sup>314</sup> Worse, cigarettes may be a complementary good to marijuana, with marijuana legalization leading both to increased marijuana smoking and tobacco smoking.<sup>315</sup> Tobacco causes far more

---

that “aims to bridge the gap between would-be financiers of this new industry—investors who sometimes know little about marijuana—and would-be entrepreneurs in it, who sometimes know little about finance or business.”)

<sup>310</sup> See Shereen Khatapoush & Denise Hallfors, “*Sending the Wrong Message*”: *Did Medical Marijuana Legalization in California Change Attitudes About and Use of Marijuana*, J. DRUG ISSUES 751, 751 (2004) (finding change in attitudes toward marijuana between 1995 and 1999).

<sup>311</sup> Cf. WALLACH & RAUCH, *supra* note 264, at 5 (“[M]oralists and public-health advocates can argue with justification that criminalization reduces use of marijuana . . .”).

<sup>312</sup> See, e.g., Robin M. Murray et al., *Traditional Marijuana, High-Potency Cannabis and Synthetic Cannabinoids: Increasing Risk for Psychosis*, 15 WORLD PSYCHIATRY 195, 195 (2016) (“Given [legalization], it seems likely that consumption of cannabis will increase rather than decrease.”). *But see* Khatapoush & Hallfors, *supra* note 310 at 759–60 (finding use did not increase in California between 1995 and 1999).

<sup>313</sup> Ian W.H. Parry, *Should Alcohol Taxes Be Raised?*, REGULATION, Fall 2009, at 10, 10 (noting externalities from alcohol because “the burden of medical treatment [is] largely borne by third parties (the government and insurance companies), for liver cirrhosis and other alcohol-induced illnesses.”).

<sup>314</sup> See, e.g., Robert McCoppin, *Thinking of Buying Pot in Illinois on Jan. 1? Here’s How Experts Say It Could Affect Your Health—for Better and for Worse*, CHI. TRIB. (Dec. 24, 2019), <https://www.chicagotribune.com/marijuana/illinois/ct-marijuana-illinois-health-effects-20191224-j2qafgizjbe5vibxrajw7c6kq-story.html> (“Long-term use [of marijuana] can lead to chronic coughing and bronchitis. . . . [S]econdhand smoke . . . could adversely affect children and people with asthma.”). *See generally* TIM SMEDLEY, *CLEARING THE AIR: THE BEGINNING AND THE END OF AIR POLLUTION* (2019).

<sup>315</sup> See Julie B. Wang et al., *Medical Marijuana Legalization and Cigarette and Marijuana Co-*

deaths each year in the United States than marijuana does.<sup>316</sup> Marijuana use brings a higher risk of psychosis<sup>317</sup> and increases the susceptibility to false memories.<sup>318</sup> Maternal marijuana smoking leads to lower birth weight.<sup>319</sup> Marijuana use “carries cardiovascular risks.”<sup>320</sup> Chronic use brings greater risks. It may lead to a higher risk of depression.<sup>321</sup> The number of drivers in fatal automotive crashes who were marijuana-positive has gone up in Colorado after the legalization of medical marijuana.<sup>322</sup> Calls to poison control after accidental ingestion of marijuana edibles by children also went up in Colorado.<sup>323</sup>

Any negative externalities, though, must be weighed against positive externalities. Health effects create externalities due to increased public funding of healthcare costs; this is true for positive as well as negative externalities. To the extent that marijuana is used effectively to treat various ailments (including as a substitute for expensive, subsidized pharmaceutical drugs),<sup>324</sup> it creates positive externalities. Ma-

*Use In Adolescents and Adults*, 166 DRUG & ALCOHOL DEPENDENCE 32, 32 (2016) (finding a correlation between the legalization of medical marijuana and cigarette and marijuana co-use).

<sup>316</sup> Luke Scheuer, *The Worst of Both Worlds: The Wild West of the “Legal” Marijuana Industry*, 35 N. ILL. U. L. REV. 557, 569 (2015) [hereinafter, Scheuer, *Wild West*].

<sup>317</sup> Murray et al., *supra* note 312, at 195.

<sup>318</sup> Lilian Kloft et al., *Cannabis Increases Susceptibility to False Memory*, 117 PROC. NAT’L ACAD. SCI. 4585, 4588 (Feb. 10, 2020), <https://doi.org/10.1073/pnas.1920162117>.

<sup>319</sup> Aubree L. Walton et al., *The Potential Health Risks and Legal Implications of Cannabis 12–13* (unpublished manuscript) (on file with author) (“There is substantial evidence of a statistical association between maternal cannabis smoking and lower birth weight of the offspring.” (citing NAT’L ACADS. SCI. ENGINEERING & MED., *THE HEALTH EFFECTS OF CANNABIS AND CANNABINOIDS: THE CURRENT STATE OF EVIDENCE AND RECOMMENDATIONS FOR RESEARCH 253* (2017) [hereinafter NASEM])).

<sup>320</sup> *Id.* at 13 (citing Christopher Franz & William Frishman, *Marijuana Use and Cardiovascular Disease*, 24 CARDIOLOGY REV. 158–62 (2016); P. Korantzopoulos et al., *Atrial Fibrillation and Marijuana Smoking*, 62 INT’L J. CLINICAL PRAC. 308, 308–13 (2008)).

<sup>321</sup> *Id.* at 18 (citing S. Lev-Ran et al., *The Association Between Cannabis Use and Depression: A Systematic Review and Meta-Analysis of Longitudinal Studies*, 44 PSYCHOL. MED. 797, 797 (2014)).

<sup>322</sup> Stacy Salomonsen-Sautel et al., *Trends in Fatal Motor Vehicle Crashes Before and After Marijuana Commercialization in Colorado*, 140 DRUG & ALCOHOL DEPENDENCE 137, 140 (2014); *see also* Walton et al., *supra* note 319, at 21–22 (noting marijuana use leads to increased risk of being involved in a motor vehicle accident (citing NASEM, *supra* note 319, at 230)).

<sup>323</sup> Walton et al., *supra* note 319, at 13 (citing Isabelle Claudet et al., *Unintentional Cannabis Intoxication in Toddlers*, 140 PEDIATRICS 1, 1–15 (2018)).

<sup>324</sup> *See* McCoppin, *supra* note 314 (“[T]he National Academy of Sciences, Engineering and Medicine published a comprehensive review of research in 2017. Among its primary findings, the academy concluded there was conclusive or substantial evidence that cannabis is effective to treat chronic pain in adults, chemotherapy-induced nausea and vomiting, and muscle contractions from multiple sclerosis. There was moderate evidence that cannabis can treat sleep problems and

rijuana is a promising treatment option for patients with multiple sclerosis, for example.<sup>325</sup> The evidence is substantial that marijuana “is an effective treatment for chronic pain.”<sup>326</sup> Synthetic cannabis drugs have been approved by the Federal Drug Administration to treat “nausea and vomit induced by cancer chemotherapy” and seizure disorders.<sup>327</sup>

The most promising positive externalities, though, may come because legal marijuana is a substitute for other products with significant negative externalities. There is evidence that marijuana is considerably safer than alcohol, tobacco, cocaine, and heroin.<sup>328</sup> One of the primary arguments for legalization is to mitigate the negative effects of the illegal marijuana trade. Harm from drug use comes as much or more from the environment *around* the drug use as opposed to the drug use itself.<sup>329</sup> The Detroit police chief recently ascribed 60% of recent shootings and homicides in the city to illicit marijuana transactions.<sup>330</sup> Marijuana legalization may rob violent drug cartels of a prime funding source. The cost of the War on Drugs is substantial,

---

fibromyalgia, and limited evidence that marijuana decreases anxiety and improves post-traumatic stress disorder.”).

<sup>325</sup> Barbara S. Koppel et al., *Systematic Review: Efficacy and Safety of Medical Marijuana in Selected Neurological Disorders*, 82 *NEUROLOGY* 1556, 1556 (2014); *Position Statement: Use of Medical Cannabis for Neurological Disorders*, *AM. ACAD. NEUROLOGY* (2014), [https://www.aan.com/siteassets/home-page/policy-and-guidelines/policy/position-statements/medical-marijuana/17medicalmarijuana\\_pg.pdf](https://www.aan.com/siteassets/home-page/policy-and-guidelines/policy/position-statements/medical-marijuana/17medicalmarijuana_pg.pdf).

<sup>326</sup> NASEM, *supra* note 319, at 90.

<sup>327</sup> Walton et al., *supra* note 319 at 9–10 (citing Nanette Porter, *Three Different Cannabinoid-Based Medicines Approved by the FDA*, *MED. JANE* (May 1, 2017), <https://www.medicaljane.com/2017/05/01/the-3-cannabis-based-medicines-approved-by-the-fda/>; Valentina Franco & Emilio Perucca, *Pharmacological and Therapeutic Properties of Cannabidiol for Epilepsy*, 79 *DRUGS* 1435 (2019)).

<sup>328</sup> Dirk W. Lachenmeier & Jürgen Rehm, *Comparative Risk Assessment of Alcohol, Tobacco, Cannabis and Other Illicit Drugs Using the Margin of Exposure Approach*, 5 *SCI. REP.* 1, 2–3 (2015) (finding that alcohol and heroin have the lowest margins of exposure (MOE), tobacco and cocaine have an intermediary MOE, and marijuana has a high MOE (“the lower the MOE, the larger the risk for humans”)).

<sup>329</sup> *Id.* at 5 (citing B. Fischer et al., *Charting WHO—Goals for Licit and Illicit Drugs for the Year 2000: Are We ‘On Track?’*, 111 *PUB. HEALTH* 271, 271 (1997)) (“Much of the harm from drug use is not inherently related to consumption, but is heavily influenced by the environmental conditions of the drug use.”); *see also* Parry, *supra*, note 313, at 14 (noting that drug prohibition “is almost certainly worse than doing nothing, even if drug use generates significant externalities”).

<sup>330</sup> George Hunter, *Detroit Police Target Violence from Illegal Marijuana Sales*, *DETROIT NEWS* (Jan. 21, 2020 5:41 PM), <https://www.detroitnews.com/story/news/local/detroit-city/2020/01/21/detroit-police-fight-spike-violence-illegal-marijuana-sales/4532735002/>. The Detroit police chief went so far as to describe “an attitude of immunity because the law has changed,” which suggests the limited benefits of decriminalization relative to legalization.

and almost all costs of the War on Drugs are externalities, including those less subject to utilitarian analysis, like racial disparity in enforcement of marijuana laws.<sup>331</sup> Sellers of heavily taxed and regulated legal marijuana may find it difficult to compete with illegal marijuana on price.<sup>332</sup> But continuing legalization and the maturation of the industry should lead to prices dropping as supply chains develop, potentially undercutting the black market (which has additional costs of its own).<sup>333</sup> Legal marijuana may lead to increased illicit marijuana growing,<sup>334</sup> but in an environment where states have decriminalized marijuana and made it available legally, illicit marijuana growing may not bring the negative externalities it does under full prohibition.

The United States is experiencing a sharp and country-specific increase in mortality among white, non-Hispanic, middle-aged men and women.<sup>335</sup> This is driven

<sup>331</sup> See Kamin & Wald, *supra* note 12, at 876.

<sup>332</sup> *But see* Angela Dills et al., *The Effect of State Marijuana Legalization, in* MARIJUANA FEDERALISM: UNCLE SAM AND MARY JANE 35, 45–46 (Jonathan H. Adler ed., 2020) (noting that it appears there was little change in marijuana prices in Colorado and Washington after legalization); *cf.* Yu-Wei Luke Chu, *The Effects of Medical Marijuana Laws on Illegal Marijuana Use*, 38 J. HEALTH ECON. 43 (2014) (finding medical marijuana laws led to a 15% to 20% increase in marijuana arrests among adult males).

<sup>333</sup> Ben Rooney, *This Colorado Pot Shop Made \$3.6 Million Last Year*, CNN: BUS. (Jan. 6, 2015, 4:57 ET), <https://money.cnn.com/2015/01/06/smallbusiness/colorado-marijuana-best-year/> (noting that a Colorado dispensary originally set prices at the going black market rate but was able to cut prices in half as more supply came on the market); *see also* Eric Gorski & John Ingold, *More Colorado Pot is Flowing to Neighboring States, Officials Say*, DENVER POST (Sept. 3, 2013, 11:45 AM), <https://www.denverpost.com/2013/09/03/more-colorado-pot-is-flowing-to-neighboring-states-officials-say/> (noting that marijuana purchased in Colorado can double in value across state lines); Pyke, *supra* note 138 (noting that in Colorado “[t]he state’s black market is withering”). *But see* Berg, *supra* note 270 (arguing high marijuana taxes in Illinois could lead to a black market that continues to thrive and noting that 80% of marijuana sold in California is black market marijuana); Matthew Ormseth & Stephanie Lai, *Seven Bodies, Nothing Stolen: Were Killings at Riverside Marijuana Grow ‘A Message?’*, L.A. TIMES (Oct. 28, 2020, 5:00 AM), <https://www.latimes.com/california/story/2020-10-28/aguanga-riverside-marijuana-grow-murders-laotian> (“Violence haunts California’s illegal marijuana market, which, law enforcement authorities concede, dwarfs its fledgling, legal counterpart . . .”).

<sup>334</sup> Gorski & Ingold, *supra* note 333; *see also* Anita Chabria, *California Fire Threatens Cannabis Farms Worth Millions*, L.A. TIMES (Sept. 24, 2020, 4:20 PM), <https://www.latimes.com/california/story/2020-09-24/californias-biggest-blaze-august-complex-fire-cannabis> (“Trinity Pines alone is home to up to 40 legal farms, with more than 10 times that number of illegal grows hidden off its dirt roads, according to people familiar with this part of the Trinity Alps, inland from Humboldt.”). *But see* CROSS CANADIAN RAGWEED, *Boys From Oklahoma, on LIVE AND LOUD AT BILLY BOB’S TEXAS* (Smith Music Group 2002) (“Yeah, them boys from Colorado’d just as soon pan for gold, the nights are too long, the growing season’s too cold.”).

<sup>335</sup> Anne Case & Angus Deaton, *Rising Morbidity and Mortality in Midlife Among White Non-Hispanic Americans in the 21st Century*, 112 PROC. NAT’L ACAD. SCI. U.S. 15078, 15078

by drug overdoses, alcohol-related liver diseases, and suicides among non-college graduates.<sup>336</sup> There is some evidence of a link between medical marijuana legalization and fewer suicides.<sup>337</sup> Opioid abuse is closely tied to this epidemic.<sup>338</sup> Marijuana shows promise as a treatment for opioid use disorder.<sup>339</sup> Medical marijuana laws have led to a decrease in the portion of drivers in fatal accidents who test positive for opioids.<sup>340</sup> Medical marijuana laws are associated with lower opioid overdose mortality rates.<sup>341</sup> Opioid overdoses are sensitive to marijuana regulation; the effect on opioid overdose mortality rates decreases as state marijuana dispensary regulations become stricter.<sup>342</sup> Provisions for home cultivation increase the effect.<sup>343</sup>

---

(2015) [hereinafter Case & Deaton, *Rising Morbidity*]. *But see* Brianna Ehley & Dan Goldberg, *U.S. Life Expectancy Increases for First Time in 4 Years*, POLITICO (Jan. 30, 2020, 12:01AM), <https://www.politico.com/news/2020/01/30/us-life-expectancy-increases-for-first-time-in-4-years-109397> (“Life expectancy in the United States increased in 2018 for the first time in four years.”). *See generally* ANNE CASE & ANGUS DEATON, *DEATHS OF DESPAIR AND THE FUTURE OF CAPITALISM* 3–9 (2020) [hereinafter CASE & DEATON, *CAPITALISM*] (describing Case and Deaton’s findings at length).

<sup>336</sup> Case & Deaton, *Rising Morbidity*, *supra* note 335, at 15079; *see also* CASE & DEATON, *CAPITALISM*, *supra* note 335, at 31 (noting that the “decline in midlife black mortality also came to an end [around 2015], likely linked to opioids”); Lachenmeier & Rehm, *supra* note 328, at 5 (“[F]or the society as a whole, the several ten-thousands of alcohol-related deaths considerably outnumber drug overdose deaths.”); *cf.* Ehley, *supra* note 335 (“More than 67,000 people died of an overdose in 2018, the second-highest number ever recorded, but that represents a 4 percent decline from 2017.”). Slowing progress in reducing cancer and heart disease deaths is another major factor. CASE & DEATON, *CAPITALISM*, *supra* note 335, at 40–45.

<sup>337</sup> *See* Dills et al., *supra* note 332, at 46 (“Previous studies have suggested a link between medicalization of marijuana and a lower overall suicide rate, particularly among demographics most likely to use marijuana in general (males age twenty to thirty-nine).” (citing D. Mark Anderson et al., *Medical Marijuana Laws and Suicides by Gender and Age*, 104 AM. J. PUB. HEALTH 2369, 2369–76 (2014))).

<sup>338</sup> Case & Deaton, *Rising Morbidity*, *supra* note 335, at 15081.

<sup>339</sup> Hudak & Stenglein, *supra* note 279, at 24 (citing Beth Wiese & Adrienne R. Wilson-Poe, *Emerging Evidence for Cannabis’ Role in Opioid Use Disorder*, 3 CANNABIS & CANNABINOID RES. 179, 185 (2018)).

<sup>340</sup> Kim et al., *supra* note 32.

<sup>341</sup> Marcus A. Bachhuber et al., *Medical Cannabis Laws and Opioid Analgesic Overdose Mortality in the United States, 1999-2010*, 174 JAMA INTERNAL MED. 1668, 1668 (2014).

<sup>342</sup> David Powell et al., *Do Medical Marijuana Laws Reduce Addictions and Deaths Related to Pain Killers?*, 58 J. HEALTH ECON. 29, 29 (2018).

<sup>343</sup> Pelin Özlük, *The Effects of Medical Marijuana Laws on Utilization of Prescribed Opioids and Other Prescription Drugs* 1, 3 (Oct. 21, 2017) (unpublished manuscript), [https://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=3056791](https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3056791). Illinois extended its medical marijuana scheme to cover sufferers of chronic pain in recognition of marijuana’s promise as an opioid substitute. Eddie Damstra, *General Assembly Passes Bill Expanding Medical Marijuana Access as Opioid Alternative*, ILL. POL’Y (June 7, 2018), <https://www.illinoispolicy.org/general-assembly-passes-bill-expanding-medical-marijuana-access-as-opioid-alternative/>; *see also* 30 ILL. COMP.

Heroin is a type of opioid.<sup>344</sup> Not only is heroin particularly harmful, efforts to restrict prescription opioid use led to users substituting heroin.<sup>345</sup> Medical marijuana laws have led to a decrease in heroin possession arrests and admissions for heroin-related treatment.<sup>346</sup> The potential implications are substantial. It is remarkable for a wealthy, developed country to see mortality rise, not drop. Marijuana might mitigate this growing problem. This alone would probably be dispositive in favor of legalization, but the effect may not persist.

Alcohol, like opioids, plays a significant role in the rise in American mortality.<sup>347</sup> But while there is mounting evidence that marijuana is a substitute good for opioids,<sup>348</sup> marijuana may be a complementary good for alcohol.<sup>349</sup> Legalization has not led to any drop in alcohol-related automotive crashes.<sup>350</sup> Alcohol interests, who might be expected to fight legalization if alcohol and marijuana are substitute goods, have been largely absent from the legalization debate.<sup>351</sup> The potential for increased use is particularly troubling because alcohol is more dangerous than marijuana<sup>352</sup> and carries a much higher addiction risk.<sup>353</sup> Marijuana use is associated with higher

STAT. 500/1-10 (2018).

<sup>344</sup> *Heroin DrugFacts: What is Heroin?*, NAT'L INST. ON DRUG ABUSE (Nov. 2019), <https://www.drugabuse.gov/publications/drugfacts/heroin>.

<sup>345</sup> Case & Deaton, *Rising Morbidity*, *supra* note 335, at 15081. The synthetic opioid fentanyl is another problem. See Ehley, *supra* note 335 (noting the death rate from fentanyl has increased by 10% since 2017).

<sup>346</sup> Yu-Wei Luke Chu, *Do Medical Marijuana Laws Increase Hard-Drug Use?*, 58 J.L. & ECON. 481, 496, 511 (2015).

<sup>347</sup> Case & Angus, *Rising Morbidity*, *supra* note 335, at 15079.

<sup>348</sup> Painkiller drug companies are voting with their pocketbooks. Journalist Lee Fang showed that several anti-marijuana researchers and anti-marijuana advocacy groups received financial backing from drug companies. Lee Fang, *Leading Anti-Marijuana Academics Are Paid by Painkiller Drug Companies*, VICE NEWS (Sept. 7, 2014, 9:19 AM), [https://www.vice.com/en\\_us/article/xwppyk/leading-anti-marijuana-academics-are-paid-by-painkiller-drug-companies](https://www.vice.com/en_us/article/xwppyk/leading-anti-marijuana-academics-are-paid-by-painkiller-drug-companies).

<sup>349</sup> See WALLACH & RAUCH, *supra* note 264, at 8 (“Marijuana researchers are split on the . . . question of whether marijuana and alcohol are complements or substitutes.”). *But see* Dills et al., *supra* note 332, at 44 (“Alcohol use shows a pattern similar to marijuana: a gradual upward trend but no obvious evidence of a response to marijuana policy.”).

<sup>350</sup> Salomonsen-Sautel et al., *supra* note 322, at 140.

<sup>351</sup> WALLACH & RAUCH, *supra* note 264, at 8.

<sup>352</sup> Lachenmeier & Rehm, *supra* note 328, at 2. Public opinion polls show that Americans think that marijuana is less dangerous than alcohol, tobacco, and sugar. See Hudak & Stenglein, *supra* note 279, at 16 (discussing polling asking Americans to compare marijuana to alternatives) (citing HART RES. ASSOCIATES, STUDY #18033: NBC NEWS/WALL STREET JOURNAL SURVEY 21 (2018); *Support for Legal Marijuana Remains High*, CBS NEWS (Apr. 20, 2018, 7:00 AM), [www.cbsnews.com/news/support-for-legal-marijuana-use-remains-high-cbs-news-poll/](http://www.cbsnews.com/news/support-for-legal-marijuana-use-remains-high-cbs-news-poll/)).

<sup>353</sup> Walton et al., *supra* note 319, at 19 (citing Catalina Lopez-Quintero et al., *Probability and Predictors of Transition from First Use to Dependence on Nicotine, Alcohol, Cannabis, and Cocaine: Results of the National Epidemiologic Survey on Alcohol and Related Conditions (NESARC)*,

rates of substance abuse, including alcohol abuse.<sup>354</sup> This undercuts the case for marijuana legalization, although alcohol regulation is likely a better avenue than marijuana policy to mitigate the harms from alcohol use.

There are also more esoteric sources of potential externalities. The marijuana industry might be a rich source of jobs for workers without college degrees.<sup>355</sup> Legal marijuana may even be good for bee populations.<sup>356</sup> In other areas, effects are unclear or too early to tell. Evidence as to whether marijuana impairs cognition is mixed.<sup>357</sup> Evidence on the effect of legalization on use by teenagers is mixed as well.<sup>358</sup>

Limiting access to legal and financial infrastructure will also shape the marijuana industry in particular ways. The industry is likely to have positive and negative externalities of its own not tied directly to the nature of marijuana itself. Trade in marijuana *might* inevitably lead to crime. But forcing marijuana businesses to operate as cash businesses surely will, because forcing *any* business to operate on a cash basis will lead to increased crime.<sup>359</sup> Crime inherently creates negative externalities

115 DRUG & ALCOHOL DEPENDENCE 120, 122 (2011)).

<sup>354</sup> *Id.* at 20 (citing C. Blanco et al., *Cannabis Use and Risk of Psychiatric Disorders: Prospective Evidence from a U.S. National Longitudinal Study*, 73 JAMA PSYCHIATRY 388, 392 (2016)).

<sup>355</sup> Cox, *supra* note 304.

<sup>356</sup> Nathaniel Ryan Flicker et al., *The Bee Community of Cannabis Sativa and Corresponding Effects of Landscape Composition*, 49 ENVTL. ENTOMOLOGY 197, 201 (2020); Paul Seaburn, *Bees Love Cannabis and are Buzzing About the Buds*, MYSTERIOUS UNIVERSE (Jan. 22, 2020), <https://mysteriousuniverse.org/2020/01/bees-love-cannabis-and-are-buzzing-about-the-buds/>.

<sup>357</sup> J. Megan Ross et al., *Investigating the Causal Effect of Cannabis Use on Cognitive Function with a Quasi-Experimental Co-Twin Design*, 206 DRUG & ALCOHOL DEPENDENCE 1, 2 (2020); see also Jue Wang et al., *Do Firms Get High? The Impact of Marijuana Legalization on Firm Performance, Corporate Innovation, and Entrepreneurial Activity*, [https://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=3511872](https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3511872) (finding a positive association between legalization and increases in various measures of innovation). *But see* Walton et al., *supra* note 319, at 21 (citing Samantha J. Broyd et al., *Acute and Chronic Effects of Cannabinoids on Human Cognition—A Systematic Review*, 79 BIOL. PSYCHIATRY 557, 557 (2016)) (noting studies finding that marijuana users perform worse on memory tests even when not intoxicated and finding that teenage marijuana use leads to decreased intelligence in middle age); Madeline H. Meier et al., *Persistent Cannabis Users Show Neuropsychological Decline from Childhood to Midlife*, 109 PROC. NAT'L ACAD. SCI. U.S. 15980, 15980 (2012).

<sup>358</sup> Julie C. Rusby et al., *Legalization of Recreational Marijuana and Community Sales Policy in Oregon: Impact on Adolescent Willingness and Intent to Use, Parent Use, and Adolescent Use*, 32 PSYCHOL. ADDICTIVE BEHAV. 84, 84 (2018) (finding that legalization did not increase how many adolescents used marijuana but did increase the intensity of use by adolescents who already used marijuana); Magdalena Cerdá et al., *Association of State Recreational Marijuana Laws With Adolescent Marijuana Use*, 171 JAMA PEDIATRICS 142, 142 (2017) (finding adolescent marijuana use increased in Washington after legalization but did not change in Colorado).

<sup>359</sup> *Cf.* Richard Wright et al., *Less Cash, Less Crime: Evidence from the Electronic Benefit Transfer Program*, 60 J.L. & ECON. 361, 361 (2017) (showing that moving welfare benefits to electronic reduces the overall crime rate in the area).

because much of the cost of law enforcement and the court system is borne by the public. And any increase in crime is likely to also be felt by people uninvolved in the marijuana trade.

The marijuana industry is dominated by small businesses,<sup>360</sup> but that is to be expected of any nascent industry. Industries tend to consolidate as they mature.<sup>361</sup> Regulation also incentivizes consolidation,<sup>362</sup> and the marijuana industry is heavily regulated. The problems posed above, though, should be expected to heavily slow this consolidation. Wealthy investors are unlikely to be attracted to the industry if they cannot trust the limited liability shield.<sup>363</sup> Savvy investors are unlikely to be willing to serve on the board of a marijuana business if simply allowing the business to remain in the industry is a breach of their fiduciary duties.<sup>364</sup> Sophisticated, successful managers are likely to shy away from the industry if they think it brings a greatly increased likelihood of personal liability.<sup>365</sup> It is not feasible to run a large business without the use of a legal entity. The involvement of sophisticated players is hugely important to building a successful venture.<sup>366</sup>

If marijuana businesses will remain small until the various legal hurdles described in Part II are resolved, what externalities will result? Without economies of scale, the marijuana industry will struggle to take full advantage of the division of labor, limiting output.<sup>367</sup> Negative externalities could be a valid basis for a policy approach that limited marijuana industry output, but it is neither clear that this is the best approach to mitigating those externalities nor that the externalities are net negative rather than net positive.<sup>368</sup> Less efficient processes might spur employment within the industry, but this alone is not a valid basis for policy.<sup>369</sup>

---

<sup>360</sup> Scheuer, *Business Entity Law*, *supra* note 4, at 522.

<sup>361</sup> *See supra* Part I (discussing the far greater industry consolidation in the tobacco, alcohol, and pharmaceutical industries relative to the marijuana industry).

<sup>362</sup> *See, e.g.*, Noam, *supra* note 26, at 546 (graph 4 showing market concentration in unregulated information industries to be consistently lower than in regulated industries).

<sup>363</sup> *See supra* Part II.B (discussing why limited liability may not be available for investors in entities that serve as the legal vehicle for marijuana businesses).

<sup>364</sup> *See id.* (discussing why allowing an entity to stay in the marijuana business is likely a *per se* breach of fiduciary duties).

<sup>365</sup> *See id.*

<sup>366</sup> *See, e.g.*, GOMPERS & LERNER, *supra* note 156, at 28 (noting that nearly one-third of venture-capital-backed companies fail as businesses but that 90% of non-venture backed companies do).

<sup>367</sup> *Cf.* 1 ADAM SMITH, AN INQUIRY INTO THE NATURE AND CAUSES OF THE WEALTH OF NATIONS (R.H. Campbell & A.S. Skinner eds., Liberty Classics ed. 1981) (1776) (describing how the division of labor in the manufacture of pins allowed for greatly increased production).

<sup>368</sup> *See infra* Part IV.B (considering policy approaches to mitigating negative externalities).

<sup>369</sup> *Cf.* Frédéric Bastiat, *A Petition: From the Manufacturers of Candles, Tapers, Lanterns, Sticks, Street Lamps, Snuffers, and Extinguishers, and from Producers of Tallow, Oil, Resin, Alcohol, and Generally of Everything Connected with Lighting*, BASTIAT, <http://bastiat.org/en/petition.html>



Are small businesses better for civil society? There is some evidence policymakers are acting on this assumption. The Illinois dispensary licensing regulations include a bias toward community engagement in the scoring system used to allocate licenses.<sup>370</sup> The marijuana industry in Colorado was able to win the support of Republican politicians who wanted to promote small business ownership.<sup>371</sup> Colorado initially limited licenses to Colorado residents.<sup>372</sup> Legitimate small businesses certainly seem preferable to black market operations.<sup>373</sup> Marijuana is one of the few industries that show particular promise for small businesses.<sup>374</sup> As small marijuana businesses become more established and their owners build wealth, their owners will naturally become more concerned about protecting that wealth and thus become more conservative about engaging in “regulatory entrepreneurship.”<sup>375</sup> Keeping the industry diffused among many small businesses may blunt arguments against continued legalization rooted in “corporate predation.”<sup>376</sup> Keeping the industry diffused might also stymie regulatory capture that could lead to regulation that is ineffective at mitigating negative externalities.<sup>377</sup> But the influx of marijuana businesses may also hurt other small businesses by, for example, driving up rents on commercial real

---

(last visited Oct. 26, 2020) (satirically noting that but for the sun, the employment of candlestick makers would be higher).

<sup>370</sup> Meadows, *supra* note 262 (“Applicants will be evaluated on a 250-point scale consisting of 10 factors . . . . In case of a tie, the applicant with the best community engagement plan will get the license.”).

<sup>371</sup> Scheuer, *Marijuana Contracts*, *supra* note 42, at 42 n.68.

<sup>372</sup> Scheuer, *Wild West*, *supra* note 316, at 567 (citing *How to Start a Marijuana Dispensary in Colorado*, BUSINESSNAMEUSA.COM, <http://www.businessnameusa.com/view/How%20to%20Start%20A%20Marijuana%20Dispensary%20in%20Colorado.aspx> (last visited Feb. 17, 2020)).

<sup>373</sup> Wagemaker, *supra* note 200, at 383 (noting the shift from the black market to local and licit businesses as a motivator for states considering legalization).

<sup>374</sup> *Id.* at 384.

<sup>375</sup> Elizabeth Pollman & Jordan M. Barry, *Regulatory Entrepreneurship*, 90 S. CAL. L. REV. 383, 396 (2017) (discussing the concept of “regulatory entrepreneurship,” including in the marijuana context); *cf.* Scheuer, *Wild West*, *supra* note 316, at 570–71 (arguing professional stakeholders will be more cautious than other marijuana entrepreneurs because they have more wealth at stake).

<sup>376</sup> WALLACH & RAUCH, *supra* note 264, at 2 (suggesting that opponents of legal marijuana may counter proponents shifting the conversation “from harms of marijuana *use* to harms of marijuana *criminalization*” by changing the subject “from harms of *criminalization* to harms of *corporate predation*.”).

<sup>377</sup> *Cf.* GORDON TULLOCK ET AL., GOVERNMENT FAILURE: A PRIMER IN PUBLIC CHOICE 37–38 (2002) (noting that small groups that will see concentrated benefits or costs tend to win out politically over large groups that will see only small, diffuse costs or benefits (relying on MANCUR OLSON, THE LOGIC OF COLLECTIVE ACTION: PUBLIC GOODS AND THE THEORY OF GROUPS 1, 53 (1971))).

estate.<sup>378</sup> Professional managers and investors do not necessarily lead to more legally compliant or socially responsible businesses than small businesspeople.<sup>379</sup> It is also not clear that big business contributes less to local communities than small business; however, local sole proprietors embedded within the community are more likely to contribute to the community than absentee, dispersed owners of public corporations.<sup>380</sup>

### *B. Mitigating Negative Externalities via Policy*

The next question is how to best mitigate the negative externalities associated with marijuana. Or, more precisely, how to shift the overall mix of externalities as far in a positive direction as possible. For example, if adult-use marijuana adds both positive and negative externalities relative to marijuana prohibition, but the positive externalities outweigh the negative externalities, then moving back to prohibition would mitigate negative externalities but still be the inferior policy approach.<sup>381</sup> A proper analysis of addressing externalities from marijuana legalization requires returning to the question of the importance of access to legal infrastructure.

The basic legal infrastructure for business includes property rights, the ability to enforce contracts, legal entities that offer personhood and limited liability, an orderly process for dealing with insolvent firms through the bankruptcy system, and redress for injury through tort and criminal law.<sup>382</sup> Access to this infrastructure is limited by the strange legal posture of marijuana—legalized in and even encouraged by many states but still prohibited under federal law.<sup>383</sup> Marijuana businesses are also effectively unbankable and otherwise face difficulties utilizing the financial system.<sup>384</sup> These problems are compounded by obstacles to retaining competent counsel.<sup>385</sup>

If the primary focus of marijuana policy ought to be mitigating externalities,

<sup>378</sup> See Mary Emily O'Hara, *Denver's Marijuana Gold Rush is Forcing Out Locals*, VICE NEWS (Aug. 13, 2014, 6:50 AM), [https://www.vice.com/en\\_us/article/vbnj98/denvers-marijuana-gold-rush-is-forcing-out-locals](https://www.vice.com/en_us/article/vbnj98/denvers-marijuana-gold-rush-is-forcing-out-locals) (describing difficulties small businesses are having finding affordable commercial real estate in Denver due to the additional demand created by marijuana businesses).

<sup>379</sup> See Scheuer, *Wild West*, *supra* note 316, at 570 ("The jury is still out on whether professional stakeholders make businesses more legally compliant or socially responsible.") (citing Tom Baker & Sean J. Griffith, *Predicting Corporate Governance Risk: Evidence from the Directors' & Officers' Liability Insurance Market*, 74 U. CHI. L. REV. 487, 542–43 (2007)).

<sup>380</sup> Pace, *Rogue Corporations*, *supra* note 4, at 33–34.

<sup>381</sup> This is a simplification, to be sure. For one, reversing a policy does not simply reverse the policy outcomes.

<sup>382</sup> Cf. Frankel, *supra* note 295, at 390 ("[T]he institution of markets requires a contract regime and a property regime.").

<sup>383</sup> *Supra* Part II.

<sup>384</sup> *Supra* Part II.C.

<sup>385</sup> *Supra* Part II.E.

the next question is the best approach to mitigating those externalities. States can attempt to mitigate externalities several ways. We will look at five. They are, in rough order of descending effectiveness, Pigouvian vice taxes, regulation, license caps, a direct role for the state in the distribution system, and limiting access to legal and financial infrastructure.

Pigouvian taxes mitigate externalities from a given activity by taxing it, thus shifting cost to the actor “internalizing” it.<sup>386</sup> Otherwise, costs are externalized, and negative externalities result in too much of a given activity. Raising taxes raises the cost of engaging in the activity, thus reducing the activity.<sup>387</sup> Pigouvian taxes affect markets without short-circuiting them; policymakers need not attempt to estimate the appropriate number of licenses and more efficient firms will continue to win out over less efficient firms.<sup>388</sup> Additional taxes are a standard aspect of legalization, and both Michigan and Illinois provide for them, with Illinois’ marijuana taxes being particularly high.<sup>389</sup>

Pigouvian taxes are not without their downsides. Pigouvian taxes on a particular activity are a poor tool for mitigating negative externalities that are heterogeneous within that activity, if, for example, a substantial portion of the negative effects of marijuana use are from a subset of users, such as heavy users or people who consume marijuana and drive.<sup>390</sup> Taxes distort economic activity, but this concern is mitigated in the context of Pigouvian taxes for a vice good for which less consumption is desirable.<sup>391</sup> The resulting tax revenue could be used to offset distortive taxes elsewhere, remedy the harms of marijuana prohibition and marijuana use, or more generally for the public benefit, but there is considerable risk the revenues will instead be wasted.<sup>392</sup> Pigouvian taxes are also difficult to calibrate to an efficient level, especially

<sup>386</sup> Pa Black, *Alcohol Taxes vs. Preventative Measures: A Theoretical Note*, 76 S. AFR. J. ECON. 607, 607 (2008) (citing A. C. PIGOU, *THE ECONOMICS OF WELFARE* (1920)).

<sup>387</sup> Cf. Benjamin Hansen et al., *The Taxation of Recreational Marijuana: Evidence from Washington State* 1, 26 (Nat’l Bureau of Econ. Research, Working Paper No. 23632) (finding consumer demand for marijuana is price elastic in the long run and thus responsive to changes in marijuana taxes).

<sup>388</sup> See Danna Thomas, *License Quotas and the Inefficient Regulation of Sin Goods: Evidence from the Washington Recreational Marijuana Market* 2 (Nov. 2019) (unpublished manuscript), <https://ssrn.com/abstract=3312960> (“[F]irms will continue to enter until the jurisdiction’s marginal benefit of a firm equals the marginal cost, and the most efficient firms will enter.”).

<sup>389</sup> See *supra* Part III.

<sup>390</sup> See Parry, *supra* note 313, at 14 (noting that “some people use alcohol in ways that unquestionably generate externalities—driving under the influence—but many others consume alcohol on a regular basis without causing significant externalities).

<sup>391</sup> See *id.* at 12 (suggesting that alcohol taxes are an exception to the conventional wisdom).

<sup>392</sup> See *id.* (“If instead those revenues are wasted on pork-barrel spending projects, the fiscal argument for alcohol taxes is undermined . . .”).

given the considerable uncertainty around marijuana externalities.<sup>393</sup> One particular danger in the marijuana context is that if taxes on legal sales are set too high, then the already robust black market for marijuana is likely to persist, stymying the goal of reformers to mitigate the negative externalities from black market sales. All of which might suggest that Pigouvian taxes are the worst way to mitigate negative externalities, except for all the others.

In addition to advancing a number of other public policy goals, regulation of marijuana will, because it increases cost, tend to reduce consumption and thus also mitigate negative externalities.<sup>394</sup> The current trend in legalization is to both regulate and decriminalize marijuana, not to just decriminalize.<sup>395</sup> Common regulatory approaches include requiring seed-to-sale tracking<sup>396</sup> and testing of marijuana.<sup>397</sup> Because regulation in these terms attempts to serve two goals simultaneously, misalignment between the two leads to inefficient advancement of at least one goal. Interest group politics and regulatory capture reduce the likelihood of effective regulation.<sup>398</sup>

---

<sup>393</sup> See Black, *supra* note 386, at 607 (“It is, however, generally recognised that an excise tax on alcohol is a blunt instrument that fails to differentiate between moderate and heavy drinkers; it is at best an ‘approximate Pigouvian’ tax . . . .” (quoting Stephen Smith, *Taxation and the Environment*, in *THE ECONOMICS OF TAX POLICY* 215, 217 (Michael P. Devereux ed., 1996))); see also Parry, *supra* note 313, at 13 (noting the difficulty in calibrating alcohol taxes “until more empirical consensus is achieved on productivity effects, the possibility of uninternalized addiction risks, and the appropriate balance between alcohol taxes and broader taxes in financing the government’s budget.”).

<sup>394</sup> See Black, *supra* note 386, at 607 (“Perhaps because of the relatively modest impact of excise taxes, most governments also rely on a host of regulatory measures to control alcohol consumption.”).

<sup>395</sup> See Keegan Peterson, *Want Your Cannabis Company to be Acquired? Do This First*, GREEN ENTREPRENEUR (Feb. 21, 2020), <https://www.greenentrepreneur.com/article/345067> (“The cannabis industry is one of the most highly regulated industries in the world.”); see also *supra* Part III.A.

<sup>396</sup> See, e.g., Kendra Majors, *Medical Marijuana Bill Introduced*, ANDALUSIA STAR-NEWS (Feb. 17, 2020, 5:44 PM), <https://www.andalusianstarnews.com/2020/02/17/medical-marijuana-bill-introduced/> (reporting on a medical marijuana bill in Alabama that includes a seed-to-sale tracking requirement); Peterson, *supra* note 395 (noting that California, Colorado, Oregon, Alaska, Maryland, Maine, Michigan, Ohio, Massachusetts, Missouri, Montana, Nevada, Louisiana, and Washington, D.C all use the same seed-to-sale tracking system).

<sup>397</sup> See, e.g., Vanessa Caceres, *Are Marijuana Edibles Safe?*, U.S. NEWS & WORLD REP. (Sept. 27, 2019), <https://health.usnews.com/health-care/patient-advice/articles/are-marijuana-edibles-safe> (“If you buy an edible product from a registered dispensary, the product sold there must undergo various safety tests . . . .”); McCoppin, *supra* note 246 (“The Chicago Democrats said the change will . . . increase public safety by requiring testing of products for pesticides and contaminants like mold, and to ensure they contain the potency claimed.”).

<sup>398</sup> Jean-Jacques Laffont & Jean Tirole, *The Politics of Government Decision-Making: A Theory of Regulatory Capture*, 106 Q.J. ECON. 1089, 1117–18 (1991).

Access to legal and financial infrastructure is uncertain; regulation, on the other hand, is not. States are failing to do all in their power to provide access to infrastructure for businesses they are otherwise giving their stamp of approval. States are instead providing a robust regulatory framework.<sup>399</sup> That framework is unlikely to garner the same positive results infrastructure would offer. Regulation invites interest group politics and gives priority to bureaucratic interests.<sup>400</sup> Regulators may have a free hand today to attempt to engineer the industry, but interest groups old and new will increasingly interject themselves successfully into the regulatory process.<sup>401</sup> Indeed, labor interests in Michigan have already succeeding in inserting language in proposed marijuana regulations that would require a labor peace agreement be in place with a union before the state will grant a marijuana license.<sup>402</sup>

License caps are another option in the policymaker’s toolkit.<sup>403</sup> Rather than grant a license to all qualified applicants who pay the associated fees, a state artificially caps the number of licenses it will grant. License caps “limit competition, increasing firms’ markups and, hence, reducing consumption.”<sup>404</sup> Washington and Illinois, for example, implemented license caps.<sup>405</sup> Washington “distributed licenses via a lottery;” Illinois used a complicated scoring system.<sup>406</sup> License caps create “allocative costs” by short-circuiting markets’ ability to reallocate capital to the most

---

<sup>399</sup> See WALLACH & RAUCH, *supra* note 264, at 11 (discussing the success of legalization advocates shifting to “the message that marijuana should be regulated like alcohol rather than forced into dangerous black markets”); see also *supra* Part III (discussing the new regulatory schemes in Michigan and Illinois in detail). Regulation has helped make marijuana legalization more politically popular.

<sup>400</sup> See WALLACH & RAUCH, *supra* note 264, at 1 (“Where there are markets, regulations, and money, special interests and self-serving behavior will not be far away. However desirable technocratic regulation might (or might not) seem in principle, interest-group politics and bureaucratic priorities will shape the way marijuana is legalized and regulated—probably increasingly over time.”).

<sup>401</sup> *Id.* at 2.

<sup>402</sup> *Michigan Marijuana Agency Hears Mixed Reactions to Labor Peace Agreements*, CRAIN’S DETROIT BUS. (Feb. 13, 2020, 7:59 AM), <https://www.crainsdetroit.com/marijuana/michigan-marijuana-agency-hears-mixed-reactions-labor-peace-agreements>.

<sup>403</sup> Thomas, *supra* note 388, at 40 (comparing the effectiveness of Pigouvian taxes versus license quotas).

<sup>404</sup> *Id.* at 1.

<sup>405</sup> *Id.* at 8 (noting that Washington caps licenses by jurisdiction and that license applications in some jurisdictions exceeded the cap); *supra* Part III (noting that the Illinois scheme caps available licenses).

<sup>406</sup> Thomas *supra* note 388, at 8; Meadows, *supra* note 262 (“Applicants will be evaluated on a 250-point scale consisting of 10 factors—labor, diversity and environmental plans, security, business plans, experience, employee training, the owners’ status as a veteran, an Illinois resident or a social equity applicant. . . . In case of a tie, the applicant with the best community engagement plan will get the license.”).

profitable jurisdictions and firms.<sup>407</sup>

The state can also directly participate in one or more stages in the distribution chain. The government has heavy direct involvement under the legalization regime in Canada.<sup>408</sup> State governments in places such as North Carolina still directly operate the only stores allowed to sell hard liquor.<sup>409</sup> The government monopoly effectively creates implicit taxes.<sup>410</sup> The government, though, is much more poorly suited to participate in markets than private businesses. The province-owned corporation granted a monopoly over wholesale and online marijuana sales in Ontario, for example, lost \$42 million for the fiscal year ended March 31, 2019.<sup>411</sup>

Denying businesses access to legal and financial infrastructure is effectively another way to regulate because it increases the real cost to run a marijuana business. The economics of a marijuana business are relatively less attractive due to the extra security required because of the cash nature of the business, the inability to attract outside capital, and the inability to attract professional investors and managers, to name just a few.<sup>412</sup> It is basic economics that increased costs shift the supply curve to the left and decrease quantity sold. If policymakers are concerned about net negative externalities, this may be a feature rather than a bug. But it will also limit tax revenues, and it is an inferior approach to mitigating negative externalities relative to the above options.

Limited access to the legal and financial infrastructure might also raise costs *too* much, limiting its effectiveness at mitigating negative externalities. Legal marijuana businesses already bear a number of costs such as taxes, licenses and fees, testing, and overhead, that sellers of illicit marijuana do not. A legal regime for marijuana that comes with too many costs, then, could not only fail to mitigate the net negative externalities of legal marijuana but also fail to mitigate the negative externalities of

---

<sup>407</sup> Thomas, *supra* note 388 at 4 (“[A]llocative costs comprise over 70% of the efficiency loss due to Washington’s license quota policy.”); *see also id.* at 1.

<sup>408</sup> *See* McArdle & Koning, *supra* note 281, at 12, tbl. 2 (listing the government as the sole wholesaler of marijuana in 12 provinces, the sole brick and mortar retailer in 5 provinces, and the sole online retailer in 10 provinces).

<sup>409</sup> *See* Yaël Ossowski, *End North Carolina’s Archaic Monopoly on Liquor Sales*, CHARLOTTE OBSERVER (Feb. 27, 2019, 11:41 AM), <https://www.charlotteobserver.com/opinion/oped/article226861699.html> (“Though ours is among 17 states with an alcohol control system, where the state retains monopoly control of part of the alcohol trade, it stands out as one of the most restrictive. Private liquor stores are banned, prices are fixed, and a Prohibition-era mentality still pervades the plethora of alcohol regulations overseen by the state Alcoholic Beverage Control Commission.”).

<sup>410</sup> Bruce L. Benson et al., *Implicit Taxes Collected by State Liquor Monopolies*, 115 PUB. CHOICE 313, 318 (2003).

<sup>411</sup> *The Ontario Government Lost \$42M Selling Cannabis in the Last Year*, CBC (Sept. 13, 2019, 2:55 PM), <https://www.cbc.ca/news/canada/toronto/ontario-cannabis-loss-1.5282994>.

<sup>412</sup> *See* Pyke, *supra* note 138 (“All of that marketplace friction undermines the industry’s growth . . .”).

illicit marijuana.<sup>413</sup>

One justification offered by policymakers for heavy regulation of marijuana businesses is the need to separate the licit industry from the illicit industry.<sup>414</sup> But the same goal could be better accomplished, and at lower cost, by facilitating access to legal and financial infrastructure. The “tight chain of control from seed to sale” in Colorado<sup>415</sup> could be tracked more easily and cheaply if marijuana businesses were not forced to operate on a cash basis. Money laundering statutes that make marijuana businesses unbankable may facilitate money laundering, tax evasion, and other malfeasance by forcing marijuana businesses to operate on a cash basis.<sup>416</sup> Lack of access to legal and financial infrastructure frightens off the professional managers and investors who would help the marijuana industry self-police and introduce greater caution in dealing with legal limitations on the industry.<sup>417</sup> Impeding legal recourse removes an important deterrent to dishonest business practices. Regulation cannot replace litigation in this respect because regulators lack the motivation and information of injured parties. States, despite a stated desire to make the marijuana industry a heavily regulated one, are leaving a regulation option—a form of self-regulation by private parties—on the shelf.

The marijuana industry’s tremendous growth notwithstanding, the inability of marijuana businesses to access legal and financial infrastructure does not mean that infrastructure is not valuable to business. A potentially massive market has just been opened to legitimate business for the first time—massive growth was inevitable. That growth does show that access to legal and financial infrastructure is not *necessary* to business. Businesses can and—in the marijuana industry—are muddling through without it. Legal infrastructure facilitates long-term planning, relationship building, and stability among businesses.<sup>418</sup> The marijuana industry will have difficulty transitioning from a nascent, growth industry to a mature industry without access to it.

---

<sup>413</sup> See Berg, *supra* note 270 (arguing high marijuana taxes in Illinois could lead to a black market that continues to thrive and noting that 80% of marijuana sold in California is black market marijuana).

<sup>414</sup> Rob Reuteman, *Medical Marijuana: New Age Entrepreneurs and a Hungry Market*, CNBC NEWS (Apr. 20, 2010), <http://www.cnbc.com/id/36179402>.

<sup>415</sup> Caroline Cournoyer, *Medical Marijuana: Do States Know How to Regulate It?*, GOVERNING (Aug. 2012), <https://www.governing.com/topics/public-justice-safety/gov-medical-marijuana-becoming-mainstream.html> (quoting Colorado State Senator Pat Steadman).

<sup>416</sup> *Supra* Part II.C.

<sup>417</sup> See *supra* Part II.B (discussing why issues around business entity law may scare off professional managers and investors).

<sup>418</sup> See, Scheuer, *Marijuana Contracts*, *supra* note 42, at 44 (“The ability to form contracts is integral to long term planning and relationship building for businesses and helps promote their stability.”).

## V. APPROACHES TO UNCERTAINTY IN THE ECONOMICS

Several words of caution are in order. This is not and is not intended to be a complete or rigorous review of applicable externalities. And it is only actual externalities that are relevant. Health impacts necessarily result in externalities in a nation that provides substantial subsidies of various sorts to healthcare, but much of the costs (or benefits) will be borne directly by the individuals who choose to use marijuana. Findings from studies using results from medical marijuana and decriminalization reforms may not hold for adult-use. Truly legal adult-use may bring additional changes as marijuana businesses begin to take advantage of the full legal and financial infrastructure. States have provided for medical marijuana for less than 25 years and adult-use for a much shorter period of time;<sup>419</sup> early results may be very different from long-term results.

We can take another look at marijuana policy in light of this. The status quo is undesirable from a utilitarian standpoint. There might be substantial negative externalities from marijuana, but states can use other methods to mitigate those externalities more effectively, including through taxation. Taxation offers the added benefit of providing the state with an additional stream of revenue. More concentrated industries are more efficient and can provide customers with the same level of service while paying more in taxes.<sup>420</sup> The additional uncertainty and risk of the current marijuana business environment also mitigates the *positive* externalities from marijuana. Given evidence that legal marijuana may be a substitute good for opioids,<sup>421</sup> easing access to marijuana could bring substantial benefits. Lack of infrastructure will help keep marijuana businesses small, though, and the positive externalities of small businesses are underappreciated. But those positive externalities will be blunted by the churn associated with a new industry and by the barrier quasi-legality creates between marijuana businesses and civil society.

There is more than one way to approach this uncertainty. We could apply a purely utilitarian analysis with no thumb on the scale. But empirical data remains very limited. The externalities remain uncertain (and a fertile ground for future empirical work). We can rely on models, but the explanatory and predictive power of the models is uncertain. A purely utilitarian analysis is much less attractive in a situation of considerable uncertainty. Heuristics give us a tool for dealing with that uncertainty. We turn, then, to three promising heuristics for judging marijuana reform.

---

<sup>419</sup> *Supra* Part I.

<sup>420</sup> See Frank H. Easterbrook, *Workable Antitrust Policy*, 84 MICH. L. REV. 1696, 1704 (1974).

<sup>421</sup> *Supra* Part IV; see, Kim et al., *supra* note 32, at 2032; see also Fang, *supra* note 348.



### A. Subsidiarity

One approach is to apply the doctrine of subsidiarity. Under the doctrine of subsidiarity, policy should be made and implemented at the lowest possible level of organization.<sup>422</sup> Subsidiarity is implicit in the design of the U.S. government; powers not expressly given to the federal government are left to the states.<sup>423</sup> The country benefits from the states serving as “laboratories of democracy.”<sup>424</sup> State and local governments are closer to the people.<sup>425</sup> The United States has a fragmented, decentralized system of government suited to its diverse, pluralistic society. It is not without its downsides. Decentralization frequently slows coordination and initial reaction but eventually leads to very vigorous response, as demonstrated during the COVID-19 crisis.<sup>426</sup>

At first blush, subsidiarity counsels in favor of allowing states to experiment

<sup>422</sup> See Pace, *Rogue Corporations*, *supra* note 4, at 36 (citing *Quadragesimo Anno: Encyclical of Pope Pius XI*, VATICAN ¶ 79–80 (1931), [http://www.vatican.va/content/pius-xi/en/encyclicals/documents/hf\\_p-xi\\_enc\\_19310515\\_quadragesimo-anno.html](http://www.vatican.va/content/pius-xi/en/encyclicals/documents/hf_p-xi_enc_19310515_quadragesimo-anno.html) (“Subsidiarity is the idea that the lowest level of organization possible to address an issue should be the one to do so.”)).

<sup>423</sup> *Id.* (citing George A. Bermann, *Taking Subsidiarity Seriously: Federalism in the European Community and the United States*, 94 COLUM. L. REV. 331, 337 (1994); Steven G. Calabresi & Lucy D. Bickford, *Federalism and Subsidiarity: Perspectives from U.S. Constitutional Law*, in FEDERALISM AND SUBSIDIARITY 8 (James E. Fleming & Jacob T. Levy eds., 2014)).

<sup>424</sup> *Evenwel v. Abbott*, 136 S. Ct. 1120, 1141 (2016) (Thomas, J., concurring) (citing *Ariz. State Legis. v. Ariz. Indep. Redistricting Comm’n*, 135 S. Ct. 2652, 2673 (2015)); *see also* Stephen Davies, *Good Riddance to the Roman Empire*, REASON (Mar. 2020), [https://reason.com/2020/02/24/good-riddance-to-the-roman-empire/?fbclid=IwAR30eIRE\\_e9UWyx1Ehe0mk9kHQ83VwXrSxYp0fAT7CkhPpau3AUEnAxpXw4](https://reason.com/2020/02/24/good-riddance-to-the-roman-empire/?fbclid=IwAR30eIRE_e9UWyx1Ehe0mk9kHQ83VwXrSxYp0fAT7CkhPpau3AUEnAxpXw4) (noting that Scheidel argues that innovation is encouraged by polycentrism (relying on WALTER SCHEIDEL, *ESCAPE FROM ROME: THE FAILURE OF EMPIRE AND THE ROAD TO PROSPERITY* (2019))).

<sup>425</sup> See MARIST POLL tbl. TRSTCV1AR (Mar. 17, 2020), [http://maristpoll.marist.edu/wp-content/uploads/2020/03/NPR\\_PBS-NewsHour\\_Marist-Poll\\_USA-NOS-and-Tables\\_2003151338.pdf](http://maristpoll.marist.edu/wp-content/uploads/2020/03/NPR_PBS-NewsHour_Marist-Poll_USA-NOS-and-Tables_2003151338.pdf) (reporting that only 46% of U.S. adults think the federal government is doing enough to address the COVID-19 crisis but 65% of U.S. adults think their state government is doing enough to address the COVID-19 crisis, and that only 37% of U.S. adults trust the federal government but 72% of U.S. adults trust information from their state and local governments regarding the COVID-19 crisis).

<sup>426</sup> See Tyler Cowen, *Don’t Worry. America’s Response to the Coronavirus Will Improve*, BLOOMBERG (Mar. 9, 2020, 3:00 AM), [https://www.bloomberg.com/opinion/articles/2020-03-09/america-s-coronavirus-response-has-started-slow-but-will-improve?utm\\_content=view&utm\\_medium=social&utm\\_campaign=socialflow-organic&utm\\_source=twitter&cmpid%3D=socialflow-twitter-view](https://www.bloomberg.com/opinion/articles/2020-03-09/america-s-coronavirus-response-has-started-slow-but-will-improve?utm_content=view&utm_medium=social&utm_campaign=socialflow-organic&utm_source=twitter&cmpid%3D=socialflow-twitter-view) (“It is no accident that America is slow out of the starting gate. The federal government is large and complex . . . Federalism means American politics has many moving parts, and the government tends to work closely with the private sector, heightening coordination problems and slowing response times. . . . As time passes, the number of discrete decision points in the U.S. system goes from being a drawback to a strength. . . . America also has one of the strongest traditions of civil society and volunteerism, and those resources too will be mobilized to help fight the coronavirus as appropriate.”).

with their own marijuana policy. But the subsidiarity scheme implicit in the U.S. Constitution provides a federal government of only enumerated powers, with remaining powers reserved for the states and tiebreaker that goes to the federal government in the form of the Supremacy Clause.<sup>427</sup> And the Supreme Court reaffirmed in the medical marijuana context that the subsidiarity scheme embedded in the Constitution—but not the tiebreaker—has largely been rejected in deciding *Gonzales v. Raich*.<sup>428</sup> Nor is it clear when state-level policy is ineffective and federal policy is preferable. But, regardless, subsidiarity does give us a workable bias: toward state-level marijuana policy.

Federal decriminalization of marijuana would not legalize marijuana so much as allow states self-determination.<sup>429</sup> State self-determination is preferable to a uniform federal policy as long as and to the extent states can effectively make marijuana policy. The state-level marijuana experiment is still young, but early results suggest that state-level marijuana regulation is feasible. Effects are not limited to those states, though. Free movement across states lines means that states will inevitably be affected by the marijuana policies of their neighbors.<sup>430</sup> Marijuana from Colorado has made its way to New York and Florida, let alone Kansas and Oklahoma.<sup>431</sup> A federal policy toward transporting marijuana across national borders is still necessary. Financial services will remain heavily regulated at the federal level, so federal financial services regulations will need to address marijuana.<sup>432</sup> But subsidiarity counsels in favor of shifting marijuana regulation to the states. States cannot effect that shift alone; Congress can and should facilitate state experimentation. The current situation is at odds with subsidiarity because federal policy, while not effective at banning marijuana, interferes with states' ability to set their own marijuana policies. Members of Congress and federal bureaucrats have self-interested reasons for refusing to relinquish power in favor of state-level policymakers.<sup>433</sup> Congress has made one concession to subsidiarity, though, in prohibiting the Department of Justice from

---

<sup>427</sup> U.S. CONST. art. VI, cl. 2.

<sup>428</sup> *Gonzales v. Raich*, 545 U.S. 1, 29 (2005).

<sup>429</sup> See, e.g., Hill, *supra* note 12, at 644 (“Congress could broadly decriminalize marijuana instead allowing states freedom to determine marijuana policies.”).

<sup>430</sup> See, e.g., Scheuer, *Marijuana Contracts*, *supra* note 42, at 37–38 (citing Jon Gettman, *Arresting Developments: Marijuana Arrests on the Rise in 17 States*, HUFFPOST (Sept. 26, 2014, 5:35 PM) [https://www.huffpost.com/entry/arresting-developments-ma\\_b\\_5890824](https://www.huffpost.com/entry/arresting-developments-ma_b_5890824); Gorski & Ingold, *supra* note 333) (noting “that marijuana arrests are up in states that have not legalized marijuana, especially states bordering Colorado”).

<sup>431</sup> Gorski & Ingold, *supra* note 333.

<sup>432</sup> See Hill, *supra* note 12, at 647 (concluding that congressional action is necessary to allow marijuana businesses access to the financial system).

<sup>433</sup> Cf. WALLACH & RAUCH, *supra* note 264, at 8 (discussing federal bureaucrats' role in a “Baptists and bootleggers” coalition against marijuana legalization).

spending federal funds to prevent the implementation of state-level medical marijuana schemes.<sup>434</sup> The Obama administration made another in exercising its prosecutorial discretion to deprioritize prosecutions of legal marijuana businesses.<sup>435</sup>

If policymaking should be devolved to states, then the states must take advantage of that power. “[R]espect for state sovereignty and principles of federalism” might “compel a reading of Rule 1.2(d) that enhances client access to law and lawyers,”<sup>436</sup> but states could compel that reading simply by changing the rule. Another way that states can and have embraced subsidiarity is by further devolving discretion to local government, setting up an opt-out system for marijuana businesses or certain types of marijuana businesses.<sup>437</sup>

### B. *Chesterton’s Fence*

Another approach is to apply a version of Chesterton’s fence.<sup>438</sup> As the prominent English writer and thinker G.K. Chesterton put it, a “modern type of reformer” is the sort who will go up to “a fence or gate erected across a road” and immediately say “‘I don’t see the use of this; let us clear it away.’”<sup>439</sup> In Chesterton’s telling, the response of “the more intelligent type of reformer” is “[i]f you don’t see the use of it, I certainly won’t let you clear it away.”<sup>440</sup> Effectively, this means to apply a bias against reform. The burden is on the reformer to establish the case for reform and in particular to identify the benefits and costs of the current approach and compare them to the benefits and costs of the proposed approach. Indeed, the United States is effectively taking an approach much like this by approaching legalization state-by-state rather than moving to legalize marijuana at a national level, as Canada did.<sup>441</sup> Legislatures in states that have not yet legalized marijuana can observe results

---

<sup>434</sup> Jaeger, *supra* note 11.

<sup>435</sup> See *supra* Part I (summarizing the memoranda laying out the Obama administration approach to state-level legalization efforts).

<sup>436</sup> Kamin & Wald, *supra* note 12, at 907.

<sup>437</sup> See, e.g., *supra* Part III (describing the opt-out schemes in Michigan and Illinois).

<sup>438</sup> GILBERT K. CHESTERTON, *THE THING: WHY I AM A CATHOLIC* (1929) (“In the matter of reforming things, as distinct from deforming them, there is one plain and simple principle; a principle which will probably be called a paradox. There exists in such a case a certain institution or law; let us say, for the sake of simplicity, a fence or gate erected across a road. The more modern type of reformer goes gaily up to it and says, ‘I don’t see the use of this; let us clear it away.’ To which the more intelligent type of reformer will do well to answer: ‘If you don’t see the use of it, I certainly won’t let you clear it away. Go away and think. Then, when you can come back and tell me that you do see the use of it, I may allow you to destroy it.’”); cf. G.K. CHESTERTON, *TWELVE MODERN APOSTLES AND THEIR CREEDS* (Ayer Co. Pub. 1926) (“Nine out of ten of what we call new ideas are simply old mistakes.”).

<sup>439</sup> CHESTERTON, *THE THING*, *supra* note 438.

<sup>440</sup> *Id.*

<sup>441</sup> Randy E. Barnett, *The Presumption of Liberty and the Public Interest: Medical Marijuana*

in states that have and calibrate their responses accordingly. Medical marijuana can be seen not as an end-reform itself but as an incremental reform that allows legislatures to better decide whether and how to provide for adult-use. But this is an organic process rather than a conscious application of Chesterton's fence. And reasonable minds can differ on how fast is too fast.<sup>442</sup> If public sentiments again shift towards further liberalization of marijuana policy,<sup>443</sup> states can put the brakes on reform.

Chesterton's fence counsels in favor of a cautious approach. More narrowly tailored, incremental reforms are preferable to quick, large reform. Congress could choose only to, for example, provide a waiver allowing banks to serve the marijuana industry, other federal laws notwithstanding.<sup>444</sup> Restricting access to legal and financial infrastructure should slow the growth of the marijuana industry.<sup>445</sup> But if the potential endpoint of reform is a fully legal, regulated marijuana industry, then the wisdom to be gleaned from early state experiments with legal marijuana are limited. A marijuana industry that cannot access legal and financial infrastructure provides only an imperfect preview of a marijuana industry that can.

### C. *Presumption of Liberty*

A final approach is to apply a presumption in favor of liberty, i.e., personal choice.<sup>446</sup> Restricting a person's choices necessarily harms them, although that harm

---

*and Fundamental Rights*, 22 WASH. U. J.L. & POL'Y 29, 38 (2006) ("Federalism enables states to perform as 'laboratories of experimentation.' But perhaps a better word today would be 'diversity.' That is its principal virtue. You can have up to fifty ways to try to figure out how to solve a social problem rather than a one-size-fits-all solution."); see also Dan Bilefsky, *Legalizing Recreational Marijuana, Canada Begins a National Experiment*, N.Y. TIMES (Oct. 17, 2018), <https://www.nytimes.com/2018/10/17/world/canada/marijuana-pot-cannabis-legalization.html>.

<sup>442</sup> See, e.g., Jonathan Caulkins, *Against a Weed Industry*, NAT'L REV. (Mar. 15, 2018, 12:06 PM), <https://www.nationalreview.com/magazine/2018/04/02/legal-marijuana-industry-leap-unknown/> ("I suggest we pause for a decade and restrict legal supply to nonprofit organizations. . . . Maybe ten years' experience will show that legalization does not increase problem use enough to fuss over. If so, a for-profit industry could enter the market then.").

<sup>443</sup> This might be happening. Support for legalization is at a record high, but it has recently dropped with Generation X and the Baby Boomers. Natalie Fertig, *The Great American Cannabis Experiment*, POLITICO (Oct. 14, 2019, 8:01 AM), <https://www.politico.com/agenda/story/2019/10/14/cannabis-legal-states-001031>.

<sup>444</sup> Hill, *supra* note 12, at 644 (citing David Blake & Jack Finlaw, *Marijuana Legalization in Colorado: Learned Lessons*, 8 HARV. L. & POL'Y REV. 359, 370–71 (2014)).

<sup>445</sup> The marijuana industry is of course still growing very quickly—much more quickly than other industries. But it would be likely to grow faster yet but for limited access to legal and financial infrastructure.

<sup>446</sup> Of course, these three approaches are not the only available. Both John Rawls and Catholic Social Thought would consider potential policy change in light of its expected effect on the poorest. JOHN RAWLS, *A THEORY OF JUSTICE* (Belknap Press rev. ed. 1999) ("[T]he higher

may be outweighed by benefits to them or reduction in harm to others. Liberty and choice are intrinsic to human dignity and flourishing, though, so we start with the assumption that the less restrictive policy is preferable and only change that assumption based on a firmly persuasive argument in favor of the more restrictive policy.<sup>447</sup> Under this approach, the case against marijuana legalization has not been established, and liberalization of marijuana law should continue until such a case is proven because marijuana prohibition is the more restrictive policy. The presumption of liberty and Chesterton’s fence are not always at odds: they both counsel against e-cigarette bans, for example. But here, because marijuana prohibition is well established, the two presumptions are in conflict.

Chesterton’s fence counsels in favor of a cautious approach.<sup>448</sup> A bias toward liberty, on the other hand, counsels in favor of immediately extending access to legal and financial infrastructure to marijuana businesses. It does raise an interesting question, though: to what extent does “liberty” require access to state-enforced law? Economic freedom is freedom; a bias toward liberty should not only apply in the non-commercial context. Property rights are fundamental to liberty. Closely related is the freedom to bargain with those rights. State-enforced property rights and contract law involve state action, but in a way that complements liberty and only to the narrowest degree possible in support of that. Business entity and contract law in the United States are enabling—it is private parties, not the state, that are the primary determinants in what exactly the entities and contracts that result look like. There is no good reason for a state to allow the commercial sale of marijuana with one hand and restrict access to business entities and contract law with the other. Nor is it justifiable from a liberty perspective to regulate an industry but prevent the self-regulation that occurs when businesses access legal and financial infrastructure.

---

expectations of those better situated are just if and only if they work as part of a scheme which improves the expectations of the least advantaged members of society.”); U.S. CATHOLIC BISHOPS, ECONOMIC JUSTICE FOR ALL: PASTORAL LETTER ON CATHOLIC SOCIAL TEACHING AND THE U.S. ECONOMY ¶ 24 (1986) (“The fundamental moral criterion for all economic decisions, policies, and institutions is this: They must be at the service of *all people, especially the poor.*”). While many of the negative externalities from legal marijuana will fall heavily on the poor, the negative externalities for substitute goods to legal marijuana also fall particularly heavily on the poor. Another approach would be to consider marijuana policy from a fairness perspective, taking into account racial disparities in enforcement of prohibition and harms from marijuana use relative to alcohol use. *Cf.* Lachenmeier & Rehm, *supra* note 328, at 5 (“[F]or the society as a whole, the several ten-thousands of alcohol-related deaths considerably outnumber drug overdose deaths.”).

<sup>447</sup> See Barnett, *supra* note 441, at 43 (“In short, while all liberty may be reasonably regulated, the burden is on the government to show why the regulation of any particular liberty is truly necessary and proper.”).

<sup>448</sup> *Supra* Part V.B.

*D. Reconciling Three Approaches in Tension*

Uncertainty is the theme running through all attempts by marijuana businesses to leverage the legal and financial infrastructure. Many of the impediments covered above are by no means certain. State legislatures and the marijuana industry should continue their efforts to facilitate access to legal infrastructure. But efforts by states to address the problem by statute have been and will be incomplete, ineffective, or both.<sup>449</sup> Private ordering offers only partial solutions.<sup>450</sup> The *degree* of uncertainty may shift, but the marijuana industry will continue to operate in an arena of deep uncertainty until Congress acts.<sup>451</sup>

The uncertainty extends to policy approaches. Policymakers lack full or even robust information. But, at the same time, the status quo is untenable and pressure from the electorate is substantial. The three heuristics discussed above offer a way to deal with uncertainty, but there is tension among the three approaches. To the extent current federal law slows change in state-level marijuana laws, this is a feature through the prism of Chesterton's fence and a bug through the prism of subsidiarity. Because marijuana prohibition restricts personal freedom, it is a bug through the prism of a presumption of liberty, but liberalization of marijuana laws is a bug through the prism of Chesterton's fence. State-by-state legalization is a feature through the prism of subsidiarity, and maybe Chesterton's fence, but it is a bug through the prism of the presumption of liberty, under which federal legalization would be preferable. In spite of that, we can chart a way forward that at least attempts to reconcile the three heuristics. Taking each into account is preferable because each offers advantages, but each is flawed; integrating all three incorporates the strengths and mitigates the weaknesses of each.<sup>452</sup>

The best way to do so is by facilitating continuing state experimentation and, in states where marijuana has been legalized, by facilitating access to legal and financial infrastructure. There is much that individual states can do. Every state that has legalized or does legalize marijuana should enact statutory fixes that ensure marijuana businesses can enter into enforceable contracts,<sup>453</sup> take full advantage of legal

---

<sup>449</sup> *Supra* Part II.

<sup>450</sup> *Supra* Part II.

<sup>451</sup> *Cf.* Hill, *supra* note 12, at 643 ("These failed attempts show that for banking services to become widely available to the marijuana industry, Congress must act.").

<sup>452</sup> *See* Pace, *Rogue Corporations*, *supra* note 4, at 15 (discussing why five political theory models are applied to a particular problem).

<sup>453</sup> *Supra* Part II.A.

entity forms,<sup>454</sup> seek protection under state trademark law,<sup>455</sup> and obtain legal counsel.<sup>456</sup> Under the anti-commandeering doctrine,<sup>457</sup> the federal government cannot force state employees—even judges—to enforce federal law, but, under the Supremacy Clause,<sup>458</sup> states cannot prevent the federal government from itself enforcing federal law. States cannot change federal law, but they can facilitate access to insurance, prepare for a banking system amenable to marijuana businesses,<sup>459</sup> and provide workarounds under state law to bankruptcy.<sup>460</sup>

Real experimentation with legalization cannot happen under the current federal scheme of marijuana prohibition. Marijuana should be removed from Schedule I—classifying marijuana as lacking any medical use is at odds with existing research.<sup>461</sup> Removing marijuana from Schedule I can probably be done without offending or changing U.S. obligations under various treaties.<sup>462</sup> The SAFE Banking Act would lower now insurmountable hurdles to marijuana banking.<sup>463</sup> Marijuana banking will also require changes to existing federal financial regulation;<sup>464</sup> any congressional action should direct that change. A federal non-prosecution policy toward medical marijuana businesses legal under state law is insufficient.<sup>465</sup> Nor is a congressional rider barring federal funds from being spent on enforcement efforts

---

<sup>454</sup> *Supra* Part II.B.

<sup>455</sup> *Supra* Part II.E.

<sup>456</sup> *Supra* Part II.F.

<sup>457</sup> Blumenfeld, *supra* note 234, at 88–93 (discussing the anti-commandeering doctrine in the context of marijuana policy). The most important anti-commandeering doctrine case is *Printz v. United States*, 521 U.S. 898 (1997).

<sup>458</sup> Blumenfeld, *supra* note 234, at 91–93 (discussing the Supremacy Clause in the marijuana context); *see also* *Gonzales v. Raich*, 545 U.S. 1, 29 (2005) (“[L]imiting the activity to marijuana possession and cultivation ‘in accordance with state law’ cannot serve to place respondents’ activities beyond congressional reach. The Supremacy Clause unambiguously provides that if there is any conflict between federal and state law, federal law shall prevail.”). The state law in question in *Raich* was California’s medical marijuana law.

<sup>459</sup> *Supra* Part II.A.

<sup>460</sup> *Supra* Part II.B.

<sup>461</sup> *Supra* Part IV.A (providing a partial summary of studies showing medical uses for marijuana and marijuana-based drugs).

<sup>462</sup> John Hudak & Grace Wallack, *How to Reschedule Marijuana, and Why It’s Unlikely Anytime Soon*, BROOKINGS (Feb. 13, 2015), <https://www.brookings.edu/blog/fixgov/2015/02/13/how-to-reschedule-marijuana-and-why-its-unlikely-anytime-soon/>.

<sup>463</sup> *See* Hill, *supra* note 12, at 643–46 (discussing potential congressional approaches to facilitating access to the financial system); Ricciardi, *supra* note 152; *see also* Part I (discussing the SAFE Banking Act).

<sup>464</sup> *See* Hill, *supra* note 12, at 646–47 (noting that congressional action would leave in place regulations that could make banking difficult for marijuana businesses).

<sup>465</sup> *See* Part I (discussing enforcement guidance from the Obama and Trump administrations).

against medical marijuana businesses legal under state law sufficient.<sup>466</sup> Both by their own terms apply only to medical marijuana, not adult-use. Enforcement guidance is non-binding and subject to change.<sup>467</sup> Prosecutions could proceed if the rider was removed (even based on acts prior to removal), and not all courts have ruled the rider is a bar to prosecution.<sup>468</sup> Congress should pass legislation making non-enforcement binding policy for acts in compliance with state law (whether related to medical or adult-use marijuana).<sup>469</sup> The STATES Act would do just that, carving out an exception to the CSA for “any person acting in compliance with State law relating to the manufacture, production, possession, distribution, dispensation, administration, or delivery of marihuana.”<sup>470</sup> Federal law problems are not limited to the financial system; Congress should also act to facilitate access to the bankruptcy system and the federal trademark system.<sup>471</sup> What Congress should not do, at least not yet, is legalize marijuana nationally.<sup>472</sup>

Despite the tension among our three heuristics, this approach best respects each. Federal legalization, with medical marijuana only permitted by three-fifths of states and adult-use marijuana only permitted by one-fifth of states, would be premature. It would fit poorly with subsidiarity and Chesterton’s fence and ignore legitimate concerns both over marijuana and the limited data on the effects of legalization. Federal action that facilitates state experimentation, on the other hand, respects all three heuristics. It empowers states, keeps reform incremental, and increases individual freedom. Federal action removing impediments to access to legal infrastructure and the financial system gives states more flexibility to engage in marijuana reform. Federal and state action facilitating that access provides information by allowing legalization that more closely resembles a fully legal national end-state and increases individual freedom by increasing economic freedom, not just the freedom to consume marijuana products.

---

<sup>466</sup> See Part I (summarizing the congressional rider).

<sup>467</sup> See, e.g., OGDEN MEMORANDUM, *supra* note 14; COLE MEMORANDUM, *supra* note 15; SESSIONS MEMORANDUM, *supra* note 17.

<sup>468</sup> See, e.g., Agar, *supra* note 21 (discussing a prosecution in Michigan where the federal court refused to allow the defendant to introduce evidence of his compliance with state law).

<sup>469</sup> This would, admittedly, be problematic under U.S. treaty obligations, but not as problematic as outright legalization at the federal level.

<sup>470</sup> H.R. 2093, 116th Cong. (1st Sess. 2019); see Krane, *supra* note 1 (characterizing the “federalist approach” of the STATES Act, pushed by the marijuana industry, as “the most likely vehicle for comprehensive reform”).

<sup>471</sup> See *supra* Part II (detailing limitations on access to federal bankruptcy and trademark systems).

<sup>472</sup> The MORE Act, for example, would “decriminalize and deschedule cannabis.” S. 2227, 116th Cong. (1st Sess. 2019). Notably, Vice President-elect Kamala Harris was the primary sponsor of the MORE Act. *Id.* However, it “is likely a political non-starter in a Mitch McConnell controlled Senate.” Krane, *supra* note 1.



## VI. CONCLUSION

Continued federal intransigence notwithstanding, the march is in the direction of legalized marijuana. It is highly doubtful at this point that there is anything the federal government can feasibly do to reverse that march. Even if there were, the will to do so is decidedly lacking. But neither is there much will to change federal marijuana law. Until that happens, marijuana businesses will continue to operate in a quasi-legal form. It is similarly clear at this point that quasi-legality is not enough to stop tremendous growth in the marijuana industry.<sup>473</sup> Supply will meet demand, with legal and financial infrastructure or without it. But barring effective, full access to that infrastructure has real costs and consequences. A federal policy to facilitate access to legal and financial infrastructure and incremental state-level reform is both more feasible and better policy.

---

<sup>473</sup> *Supra* Part IV.A.