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### 1.0 Law & Legal CLE Credit – A/V Approval #1100033

Recording Date - February 20, 2019

Recording Availability – February 22, 2019

Meeting Location	Date	Time	Topic
King County Bar Association 1200 Fifth Avenue - Suite 700 Seattle, WA	<b>Wednesday, February 20, 2019</b>	12:00 PM to 1:15 PM	Marijuana Business Law in Washington State

#### AGENDA

- 12:00 PM** Introduction
- 12:10 PM** Presentation: ‘Marijuana Business Law in Washington State’, by Erik L. Halverson, Halverson Law
  - A basic run down of the dos and don'ts of practicing in this field
- 1:15 PM** Adjourn

#### SPEAKER BIOGRAPHY

**Erik L. Halverson, Halverson Law** - Erik is heavily involved on the front lines of the cannabis industry, having been introduced to the industry during the legalization phase in Colorado and following this up with providing business counsel to the top retailers and producer/processors in Washington State. Through his various work with retailers, producer/processors and ancillary service companies, Erik has grown Halverson Law to occupy a major footprint in the Washington State cannabis 502 industry as a leading 502 cannabis business attorney.

Erik has a long track record of pro-bono public legal service, gaining him recognition in both Colorado and Washington states, including the 2014 Rebekah A. McBride Award as Pro Bono Attorney of the year award for the Northwest Colorado Legal Services Project. Erik has also been a repeat speaker on the cannabis industry, presenting both in 2016, 2017 and 2018 for the National Business Institute continued legal education on Marijuana Law, as well as speaking in December 2018 for the TRENDS real estate conference.

## **HOW DO I EARN CREDIT FOR SELF-STUDY OR AUDIO/VISUAL (A/V) COURSES?**

For pre-recorded A/V (self-study) programs, although the sponsor should apply for accreditation, **lawyers need to report the credits earned for taking the course.**

To add an approved course to your roster, follow the procedures below:

- ❖ Go to the "mywsba" website at [www.mywsba.org/](http://www.mywsba.org/).
- ❖ Log in.
- ❖ Click on the "Access MCLE" link in the "MCLE Info" box on your home profile page.
- ❖ Click on "Add Activity." Search to find the approved course in our system. (See search suggestions on the screen.)

### **Adding a Recorded Course**

Select Recorded Course from the Add New Activity screen.

This will prompt you to search for the activity in case the activity has already been accredited in the MCLE system.

You can search by Activity ID or by specific Activity Details. For the Activity Details search, you can use keywords for the title, sponsor name and date.

After entering your search criteria and selecting Search at the bottom of the screen, a list of possible activities will be provided.

You can select the correct one by clicking the Activity ID. This will take you to the specific activity. Entered the date(s) on which you began and ending viewing this recorded activity.

Then claim the correct credits for which you attended this activity in the Credits Claimed fields and click the Submit button at the bottom of the page.

You will receive a confirmation message at the top of your screen stating, "The activity has been added to your roster."

# RECREATIONAL MARIJUANA BUSINESS LAW IN WASHINGTON

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Erik Halverson  
Halverson Law

# Recently Adopted Rules

- Retail License Forfeiture
  - “Fully Operational”
- Cannabis Packaging and Labeling Requirements
  - New Universal Symbol Introduced
  - Optional Harvest, Best Buy, and Manufactured Dates
  - Loosely packaged products with WSLCB approval
  - Dull color palettes, no fun shapes or bright packaging
  - Leniency on financier issues
  - Potential action for “Safe Harbor” visits



# Powers of State Regulatory Agencies

- Powers are broad.
  - WAC 314-55-087 - Full access to:
    - Records for **FIVE** years demonstrating the financial health of the business
    - Video records – 45 days
    - Purchase invoices, including manifests
    - Accounting and tax records related to the licensed business “and each true party of interest” – arguably granting broad access to the full financial records of each owner.
- Access is broad.
  - 314-55-087(1) grants WSLCB employees mandatory access.
    - Access is not completely unfettered; if completely unrelated, the request can be fought. LCB has to have a rational basis for their request. *Example – unrelated police investigations and “CSI: LCB Enforcement” mentality*
- Violations are broken into 5 Categories (WAC 314-55-520 – 537)
  - (1) Violations against public safety; (2) Regulatory violations; (3) License violations; (4) Nonretail Violations; and (5) Transportation/Freight violations.
- LCB is difficult to work with when seeking to advise clients. Their position on matters changes “on a day to day basis.” The most effective method to assure your client is in compliance is to take a distinctly defensive approach and:
  - work directly with the enforcement officer or their supervisor
  - seek approval through confirmation correspondences outlining the inquiry, the guidance, and the intended course of action.

# Powers continued...

- Some violations directly result in the cancellation of the license with progressively stiffening penalties (sale to a minor); while others don't directly affect the license (minor frequenting.)
- Some actions by the licensee result in multiple administrative violations.
- The penalty rubric codified in the regulations (WAC 314-55-520 to 557) indicates each violation independently results in certain consequences; however, the LCB may take a harsher approach and determine single violations are cumulative.

# Business Types Allowed

- No overt ban on any business type.
- Each owner, member, manager, corporate officer, stockholder, entity/person exercising control over the business, entity/person having a right to gross or net profits is considered a “True Party of Interest.” WAC 314-55-035.
  - Every True Party of Interest (TPI) and their spouses needs to be vetted by the LCB, which can take 2-6 months.
- Different entity forms carry different challenges:
  - Sole proprietorships present tenuous process for sale of the license since it has to first be transferred to an entity.
  - Privately held corporations require all stockholders and their spouses to be vetted as true parties of interest.
  - Greater number of true parties of interest, the more cumbersome the ownership structure is.
- Multilevel ownership structures allowed, but all persons that make up the ownership and control are considered a TPI.

# Marketing/Advertising Restrictions

- See WAC 314-55-155 and LCB FAQs
  - Frequently changing with inconsistent application.
- **GENERAL RULES OF THUMB:**
  - Seek WSLCB Enforcement guidance and approval
  - Be overly conservative
  - When you interface with the public in any medium, include all necessary disclaimers
  - Reliance on third parties is not an excuse for non-compliance (e.g., if you hire an ad agency and the agency fails to include the statutory warning language on the advertising, the licensee will still receive a violation)
  - Observe the buffers for placement of stationary ads.
- Signage is limited to 2 fixed on premises signs, and marijuana leafs are not permitted. Signs must be 1600 sq inches or less, and have 21+ within the verbiage.
- Creative efforts are common in the industry, including separately leasing “ad” space on a neighboring parcel, or even leasing an exterior wall on your premises to have a sign or mural that appears to exceed the statutory maximums. The LCB is clamping down on these efforts, however.



# Zoning Requirements

- Some jurisdictions remain opposed to marijuana and have zoned marijuana out of their land use code.
- Per 314-55-050(10), cannot license a marijuana license within a 1000 feet, as the crow flies, from
  - (a) Elementary or secondary school;
  - (b) Playground;
  - (c) Recreation center or facility;
  - (d) Child care center;
  - (e) Public park;
  - (f) Public transit center;
  - (g) Library; or
  - (h) Any game arcade (where admission is not restricted to persons age twenty-one or older).
- With the exception of elementary/secondary schools and playgrounds, a local jurisdiction can create its own zoning restrictions, including reducing the buffer distance to no less than 100 feet.
- Some points are questionable. Some “Parks” are not really parks. Some “transit centers” are not considered transit centers.
- Resources exist to assist in finding compliance location – [www.cannazoning.com](http://www.cannazoning.com)

# Employment Rules and Restrictions for Cannabis Businesses

- All employees must be 21 years old. 314-55-015
- Employees are the biggest source of administrative violations.
  - ID: Employees tend to forget to look at IDs, or look at IDs but not truly look at the birthdate to verify they are over 21. Employees need to understand they have criminal exposure for sales to minor, and that cases are in fact referred to the prosecutors for prosecution.
    - Use of electronic scanners are essential
    - Use of designated ID checker staff is recommended
  - Traceability: Licensees have challenges with imprinting the importance of maintaining traceability on their employees. Mistakes can happen when lot numbers are combined, when employees ring up products using only the name instead of the lot numbers, etc. Practical methods to hold employees accountable are critical to the license.
  - Firing employees when they cause a violation will not necessarily get you out of a violation.
  - Video should be reviewed around violations so see how business practices can be changed. Cell phone usage on the floor often leads to violations due to the budtenders being distracted.
  - **The responsibility for compliance always falls on the licensee, and arguing that certain duties were left out of the control of the licensee may give rise to another “true party” violation.**

# Negotiating Third Party Agreements with Cultivators, Managers, Etc

- True Party, defined in 314-55-035.
- Disclosure of Licensing and Consulting Agreements
- Significant care has to be used in delegating responsibility to non-true parties to avoid violations.
  - The core business activity that cannot be delegated is the final purchasing decisions. Purchasing agents and managers can be designated to create “pre-orders,” but all orders must be approved by a true party of interest.
- Exclusive contracts are not allowed, including prepayment for pre-orders, which is viewed as a banned loan to another licensee.

# Premises Security Regulation Compliance

- Security is paramount in this industry. WAC 314-55-083.
- It is a cash heavy industry and robberies and employee theft occur. Security is also required to prevent diversion of product to black market and minors.
- Cameras:
  - 24/7 continuous footage, saved for 45 days. Recommend saving 50+ days in case enforcement requests footage from 44 days prior, allowing the client a few days to download the footage.
  - Resolution of video must be 640x470.
  - Cameras must be IP compatible.
  - Time and date must be on the footage.
  - There can't be any dead spots.
  - The camera system is the primary checklist item during final inspection for licensing. Any failures or dead spots in the system's coverage will cause the inspection to fail.
- Other security items:
  - Badges. Employees must wear their badge, including name of the business, the employee's picture and name.
  - Visitor log. Visitors coming into the restricted (what you would consider "employee only" areas) must sign in and out.
  - Producers must have grow operations fenced in.
  - Traceability. Traceability is considered a security measure and is strictly enforced by LCB. The MJ Examiner's unit regularly prepares audits to make sure traceability is maintained by licensees.

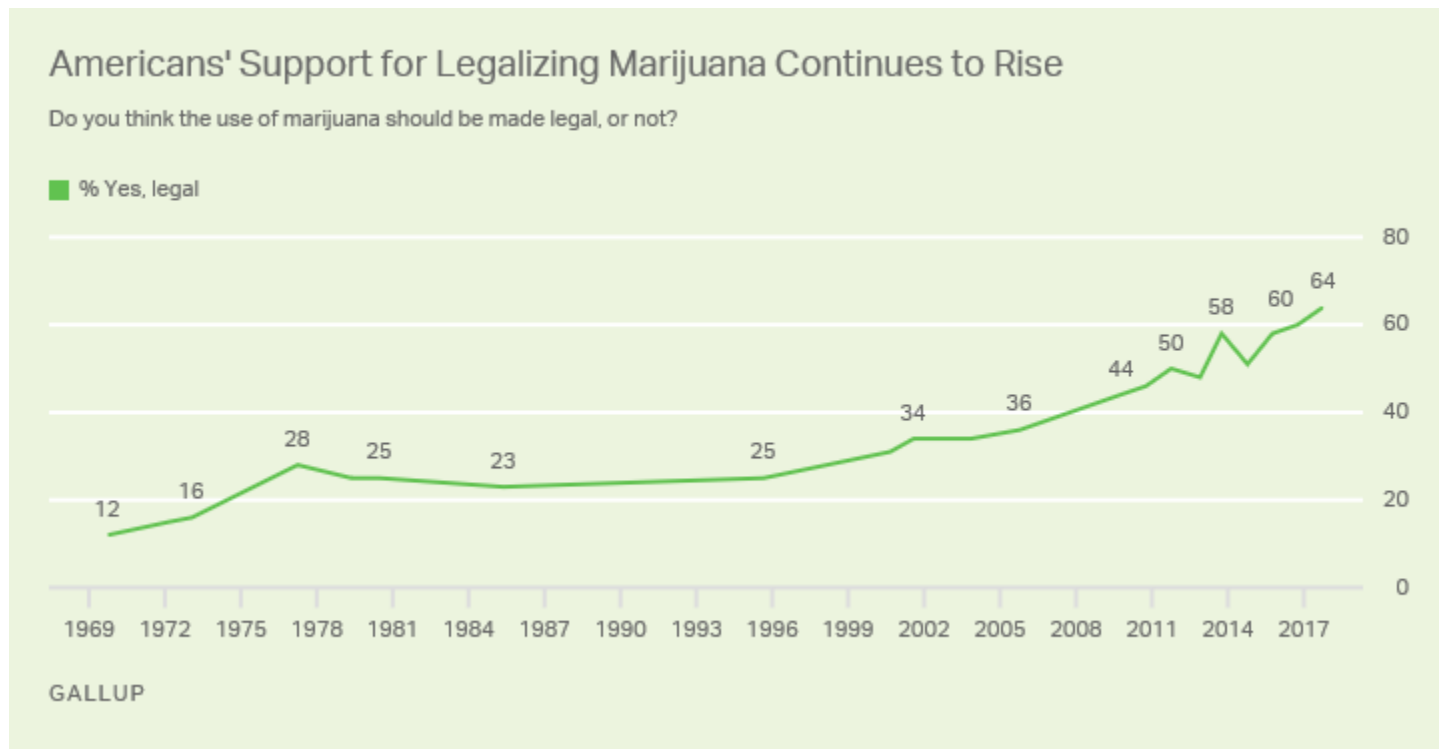
# Preparing for State Regulatory Agency Inspections

- Preparing for inspections is the wrong approach—it is reactive and traceable.
- Clients should be proactive and ensure ongoing compliance.
- Do not let your clients wait for a WSLCB inspection to confirm compliance. It will be an much more difficult to untangle at that point.

# Is a shutdown likely, and how can our clients deal with such an event?

- What would a shut down look like?
  - We've seen this before. In 2011, California co-ops faced a difficult decision: they were presented with a letter from the Federal DA's simply stating: You have 45 days to shut down or face prosecution.
- Is a shut down likely? No.
  - Jeff Sessions, our prior US Attorney General, had strong views in opposition of cannabis legalization, comparing it to opioid addiction. The industry survived. Newly appointed AG Barre is not in favor of cannabis, but has not vocalized any intent to take federal action against compliant recreational and medical states.
  - Gallup polls from October 2017 show 64% approval rating amongst adults for legalization of marijuana. Notable approval even amongst republicans.
  - Trump's circle are not all opposed to cannabis however. Peter Thiel, silicone valley giant and billionaire investor, has been a long supporter of Trump and a part of his transition team. **Peter Thiel is a major investor in Leafly, a marijuana directly and community website widely used in the cannabis industry.**
  - Marijuana excise tax is bringing in almost \$1,000,000 per day for the State of Washington. So far, the industry in Washington has generated well almost a billion dollars in tax revenues.
- Obtain medical endorsement as a backup. If there is a shutdown, it could be a partial shutdown – i.e., preserve the medical operations but gut the recreational.
- Leases – when drafting leases for Cannabis clients, make sure you include a provision providing for reasonable termination of the lease in the event a communication from a public sources, federal, state or local, indicating that legal cannabis sales must cease, that your client may, in their sole discretion, terminate the lease.
- Provide guidance on whether a corporation is the right entity structure, as to limit personal tax burdens in the event of a shut down.

# Growth of Cannabis Approval



# Tips for Landowners

## Beware of the Perils!

- Acceleration clause/calling of notes. If you have a mortgage on your property, it poses a significant risk that renting to a marijuana related business will cause your bank to call the note. This will provide you limited time to obtain a different mortgage, and often at borderline predatory rates. Review your deed of trust and loan documents carefully with an attorney to see whether you are at risk.
- Unlicensed activities and i502 imposters. Bad actors will state they are licensed i502 operators, securing a lease and often paying in cash. They then use the warehouse for **serious drug trafficking crimes**. This can result in the loss of the property through civil forfeiture, or worse, for the unknowing landowner.
- Non-compliant i502 operators. Some operators, even with i502 licenses, are not compliant. This can have negative impacts for Landlords, and even impact the WSLCB's willingness to lease to a landlord. If the WSLCB sees a physical location with numerous troublesome licensees, the WSLCB will begin to associate the location as a troublesome location and no longer consider licenses there.
- "Consultants." Often times, bad actors will label themselves as "consultants," and smooth talk their way into leases, management agreements, etc. This is a major red flag, as they are typically not permitted in the industry due to prior criminal activity. They suffer no consequences for running a non-compliant business, as they are an intermediary at best.
- Seeing Green. Be aware of contractors and other service providers that artificially increase costs because they (wrongfully) assume the marijuana industry is ripe with cash.



# Tips for Landowners, continued..

- Licenses are tied directly to the property.
  - Without a legal right to the property, the license may be cancelled by the WSLCB.
  - The license is the core income generating asset of the business.
  - It takes upwards of 3 to 4 months to relocate a license, during which time the tenant must still have a legal right to your property.
  - This gives you significant leverage for demanding timely rent payments.
- Demand a compliant tenant. Administrative violations are available online at: <https://data.lcb.wa.gov/dataset/Violations-Dataset/dx3i-tzh2/data>
- Stay away from any sort of sneak or goofy hybrid agreements. IE, profit shares, convertible notes for a couple percentage points, etc. They muddy the waters and will lead to licensing issues and disputes.
- Strong Deposits. The failure rate in this industry is very high. Thin margins, difficult staffing, overzealous enforcement by the WSLCB, and high taxes make this an incredibly difficult industry. The most capitalized that your tenant will likely be is when they are starting. Make sure to require a strong initial deposit in case the business fails.
- Strong Default Protections. In case of default, make sure you lease considers:
  - UCC lien on all fixtures – this should become landlord property
  - Right to a general receiver over the business. This preserves the license for a sale. *Make sure to have the right receiver; some only liquidate property and remain the only party to benefit due to high fees.*
- Act quick. Where there is smoke, there is fire. If rent is late or non-existent, their business has likely already failed.
  - New “investors” typically have to go through a 3-month vetting process, so this is typically a pipe dream for failing i502 businesses.

# The main points to take away from this:

- **Be proactive and maintain compliance.**
  - Help your client introduce systems to grow with their business, keep things organized, and keep a keen eye on maintaining traceability and ID checking compliance.
- **Working with the LCB leaves much to be desired.**
  - Paper your file well, and operate in the defensive.
- **Play it safe.**
  - Check with the enforcement officer before any changes to the business, and retain records.
- **Help your client understand the risks.**
  - Marijuana is federally illegal and regulations are rapidly changing. Even the most sophisticated operations make mistakes and the consequences are harsh.

# If you need additional information...



Reach out with questions! We're here to help.

Halverson Law is a four attorney boutique law firm, focusing primarily on the regulatory overlay of the Liquor and Cannabis Board and licensed and ancillary cannabis businesses. We are happy to co-counsel for more specialized issues.

Our attorneys have extensive experience in general business counsel, real estate, intellectual property, trial work, administrative violation defense, contract drafting, and more.

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