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# New York's Rollout of Its Adult-Use Cannabis Program Hits Another Snag

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By Alex Malyshev. Published in the *New York Law Journal*.

As we previously covered in these pages, the story of New York's adult-use cannabis legalization is a long and tortured one. After numerous false starts, the Marihuana Regulation & Taxation Act (MRTA) was signed into law on March 31, 2021. Yet, almost two years later, there are still no legal sales of adult-use cannabis in New York. This, in turn, has led to a proliferation of unlicensed cannabis retail shops—euphemistically referred to as the "grey market"—even though §136 of the MRTA refers to such untaxed cannabis as "illicit cannabis." Recently, reports have circulated that a crackdown has begun in some parts of New York City on both trucks and "smoke shops" selling such illicit cannabis (leading to at least two arrest). The proposed adult-use regulations, published on Nov. 21, 2022, warn that the sale of such illicit cannabis may preclude the award or renewal of licenses. See Proposed Rule §120.12(a)(9) (License Denials).

A delay was to be expected since the MRTA required the establishment of an entirely new bureaucracy—the Office of Cannabis Management (OCM)—and the promulgation of rules and regulations for the various tiers of the industry (cultivation, manufacture, distribution and retail). But at least some of the delay is attributable to New York's decision to prioritize its social equity through its *Seeding Opportunity* initiative, which was designed to give "justice involved" social equity applicants a first mover advantage through the Conditional Adult-Use Retail Dispensary (CAURD) program. In essence, this meant that, by design, retail licenses in 2022 would only be awarded to New Yorkers who have been impacted by the war on drugs (generally through a conviction for marijuana related offenses), while cultivation licenses were awarded to existing participants in the hemp cultivation program in order to create supply for these dispensaries. As noted, the proposed rules for the wider program were published on Nov. 21, 2022, and as a result will not become final until January 2023 (after the 60-day comment period ends). A timeline for opening the application window for that program has not yet been announced.

In the meantime, the CAURD program ran into its first major hurdle on Nov. 10, 2022, when a federal judge in the Northern District of New York found that it ran afoul of the dormant commerce clause of the U.S. Constitution because it discriminates against out of state residents. As a result, Judge Sharpe issued an injunction, covering five out of the 14 regions established by OCM, preventing the issuance of any CAURD retail licenses in the Finger Lakes, Central New York, Western New York, Mid-Hudson and Brooklyn (the five regions selected by the unsuccessful applicant). The lawsuit, *Variscite NY One v. State of New York*, 22-cv-1013 (N.D.N.Y. 2022) was filed on Sept. 26, 2022, by a Michigan resident who was the majority owner of Variscite, an entity he established in New York (which would be able to compete for a retail license under the MRTA because, presumably, Variscite has its corporate headquarters in New York), but which could not get a license as part of the CAURD program due to the requirement that it be majority owned by someone convicted of a marijuana offense in New York, and who has a "significant presence" in New York.

At the heart of the challenge is the same constitutional principle that, earlier this year, snarled Maine's cannabis licensing scheme. The test under the dormant commerce clause is whether the law or regulation clearly discriminates against interstate commerce in favor of intrastate commerce. *Town of Southold v. Town of East Hampton*, 477 F.3d 38, 47 (2d Cir. 2007). "[I]f a state law discriminates against out-of-state goods or nonresident economic actors, the law can be sustained only on a showing that it is narrowly tailored to advanc[e] a legitimate local

purpose." *Tenn. Wine & Spirits Retailers Ass'n v. Thomas*, 139 S. Ct. 2449, 2471 (2019). The U.S. Court of Appeals for the First Circuit, in a split decision in *Northeast Patients Group, et al. v. United Cannabis Patients and Caregivers of Maine et al.*, 45 F.4th 542 (1st Cir. 2022), struck down the state's residency requirement (which banned non-residents from owning or operating a state-licensed medical cannabis dispensary) on this basis. In upholding the district court's prior ruling, the First Circuit rejected the state's claim that the dormant commerce clause does not apply to state cannabis regulatory frameworks on the basis that Congress has suspended the doctrine, or because the dormant commerce clause does not apply to a market that remains illegal under federal law.

In arriving at his conclusion that the CAURD program violated the dormant commerce clause, Judge Sharpe relied on *Northeast Patients*, in addition to district court decisions from Missouri, Michigan, and Illinois, striking down similar schemes. Judge Sharpe determined that heightened scrutiny—under which the state would have to show that the law was narrowly tailored to advance a legitimate local purpose—would apply because the CAURD licensing scheme would have a discriminatory effect on out-of-state residents seeking a CAURD license (indeed, they are mostly precluded from doing so). As the court recognized, under this heightened standard the law is virtually invalid per se. The court went on to note that when "questioned … as to whether the challenged laws and regulations could survive the heightened level of scrutiny during [argument], [the state] offered no cogent response." With respect to injunctive relief, the court found that it is well-settled in Second Circuit that an alleged constitutional violation constitutes irreparable harm.

The *Variscite* injunction—which was limited to the five regions in which the plaintiff applied—was granted less than two weeks before OCM began issuing CAURD licenses in the regions unaffected by the injunction. But as the decision made clear, OCM was unable to provide a rationale for the requirement which would pass muster, and it is not out of the question that additional lawsuits will be brought challenging the program, and the award of licenses. If the decision stands, this bodes ill for OCM and the state in trying to defend the program in other lawsuits, and in seeking to head off additional injunctions. Indeed, the state's best argument will likely lie in balancing the hardships, as it has now begun issuing licenses (the only element of injunctive relief where the court felt there was a close call, on the basis of the fact that no licenses were yet issued, and only five of the regions were being enjoined).

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