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# The Changing U.S. Cannabis Legal Landscape: Challenges and Opportunities for Israeli Companies and Investors

*For investors, operators and ancillary businesses seeking to enter the legal U.S. cannabis market, different sets of laws must be navigated.*

One clear winner in the 2020 U.S. election has been the continuing state-level legalization of both medical and recreational cannabis. Four additional states – New Jersey, Arizona, Montana and South Dakota – voted to allow recreational use, and Mississippi voters authorized a medical marijuana program. As it stands, 36 states have legalized medical marijuana, and 15 of those states will allow recreational (or “adult use”) marijuana.

However, “marijuana” remains fully illegal under U.S. federal law, which applies to all individuals and companies in the United States in tandem to state laws. Federal law is particularly pronounced in the areas of banking, securities, intellectual property, bankruptcy, immigration and import and export. The United States, unlike many countries, distinguishes between very low-THC cannabis (called “hemp”) and its derivatives including hemp-derived CBD, and all other forms of intoxicating cannabis (called “marijuana”). In the hemp and CBD space, state-level regulators are beginning to step in where federal regulators are moving more slowly.

As a result, different sets of laws must be considered by investors, operators, and ancillary businesses, trying to enter the market. We will try to cover some of the major areas to consider in this note.

## LANDMINES TO WATCH OUT FOR

The very first piece of advice prospective investors will receive from their U.S. based attorney is that, as far as the official stance of the federal government goes, cultivating marijuana is no different than producing any other Schedule I drug (like heroin, LSD, GHB or MDMA). The second piece of advice they will receive from that attorney is that the attorney cannot, ethically or legally, advise them on how to try and avoid those federal laws. In accordance with various ethics opinions an attorney can, however, advise them about what those laws are, and also about how to comply with state laws in effect.

As far as U.S. federal law is concerned, because it is a Schedule I drug, marijuana is a dangerous drug. Some of the reasoning behind such classification: (a) it has a high potential for abuse, (b) it has no currently accepted medical use in treatment in the United States, and (c) it lacks safety in use under medical supervision. Perhaps surprisingly, cocaine is actually listed as a Schedule II drug because it has accepted medical uses.<sup>1</sup> There have been lawsuits seeking to force the U.S. Drug Enforcement Administration to act on recommendations to re-schedule marijuana from Schedule I to Schedule II,<sup>2</sup> and considering increasing acceptance of cannabis

as “mainstream” in the political landscape, it may well happen in the next few years. But as of the date of this article, that is simply not the law. This current classification has several implications we will outline below.

### The Legal Consequences of Federal Prohibition

Because federal criminal law forbids the possession, distribution, sale or use of marijuana – and provides no exception for medical uses – there are risks of potential liability under federal law for: (i) conspiring to manufacture and distribute marijuana, (ii) aiding and abetting the manufacture and distribution of marijuana, and (iii) acting as an accessory after the fact for the manufacture and distribution of marijuana.<sup>3</sup> The government may also choose to target the source of the funds using criminal and civil forfeiture laws which allow federal officials to seize marijuana-related property, including bank accounts.<sup>4</sup> Finally, non-US citizens who invest (or participate) in the cannabis industry may be permanently barred from entry into the United States by the U.S. Customs and Border Protection Agency.<sup>5</sup> The federal landscape means that cannabis activities carry even greater risk for non-US citizens, such as Israelis that wish to be involved in the emerging US industry. Investing in, or working for, a cannabis company can be seen as aiding and abetting an illegal enterprise, and even attending a cannabis convention in the US can be seen by US border authorities as supporting an illegal enterprise.

While in practice certain protections exist for U.S. based operators who comply with state laws and adhere to certain guidelines (including making sure that marijuana does not cross state lines), they are largely a matter of enforcement priorities for the federal government (both of individual prosecutorial discretion, and annual mandates of Congress as to how resources must be spent).<sup>6</sup> Actual change will only come from comprehensive legislation by Congress.

### The Business Consequences of Federal Prohibition

Due to federal prohibition marijuana related businesses – both plant touching businesses and ancillary businesses that derive their income from state-legal marijuana activities – face headwinds



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that other industries do not. Some of the most common are:

*Payment Processing and Banking.* Although there are limited number of credit unions and smaller banks providing basic banking services to state-legal marijuana related businesses, access is constrained. This is because banks could face potential exposure to anti-money laundering laws by assisting such businesses. The limited banking that does exist is due to the guidance issued by the Department of the Treasury’s Financial Crimes Enforcement Network (FinCEN) in February of 2014.<sup>7</sup> It tracks the non-enforcement priorities outlined (and then rescinded) by the U.S. Department of Justice in the “Cole Memo.” The banking services provided to marijuana related businesses, which are broken up into “tiers” based on how close they are to the plant, are fairly basic the closer you get to it and the monitoring fees charged by the banks (to offset the costs of compliance) are quite high (several thousand dollars a month for “leaf-touching” businesses). Congress has attempted to remedy the situation somewhat by creating safe-harbors for banks serving the cannabis industry in the proposed Secure And Fair Enforcement (SAFE) Banking Act of 2019,<sup>8</sup> but despite considerable momentum the bill did not become law in 2020.

While limited banking is available to marijuana businesses, true credit card processing remains out of reach. Major credit card networks, including Visa and MasterCard, do not permit cannabis-related transactions in the United States (though Mastercard does in Canada). Cash, debit cards, and

Automated Clearing House (“ACH”) withdrawals remain the norm for most dispensaries. While some “solutions” have popped up, caution is warranted as many of these high-risk processors are not FDIC insured, and the industry is rife with potential for fraud and abuse. Any “solution” that seek to mask the name of the business or the type of transaction or purchase made, may be potentially violating anti-money laundering laws.

*Limited Federal Rights.* Three commercial areas of law where federal law is especially pronounced are intellectual property (both trademark and patent law), tax, and bankruptcy. True marijuana related businesses are severely constrained in these areas.

## Although hemp has many uses, the current “gold rush” focuses on CBD extracted from hemp which continues to be imported into the U.S.

When it comes to intellectual property, consumer products often rely on trademarks to differentiate their brand. Unfortunately, for many cannabis businesses, that is not an option. The U.S. Patent and Trademark Office (“USPTO”) does not allow registration of trademarks for illegal drugs (like marijuana).<sup>9</sup> Thus, so long as cannabis remains a Schedule I controlled substance (or unless the USPTO changes its rules), primary trademark protection is not available at the federal level for marks relating to the production, sale, or distribution of cannabis. Registration may, however, be available for ancillary goods and services. The news is better on the patent front. The USPTO has been willing to issue cannabis-related patents since at least 1942. Thousands of such patent applications have been filed because patents are a unique form of property that secure only a negative right to exclude others from an invention. It remains to be seen, however, if federal

courts are going to actually be willing to enforce those rights.<sup>10</sup> Under a line of “highwayman” cases (named for bank robbers of the 1920’s), there may be an argument that federal courts should not enforce illegal rights.

When it comes to tax, most federal deductions for business expenses are not available to marijuana related business (whether or not they are “leaf-touching”) under Section 280E of the Internal Revenue Code of 1986. That section disallows the deductions of expenses incurred during a taxable year “in carrying on any trade or business if such trade or business (or the activities which comprise such trade or business) consists of trafficking in controlled substances (within the meaning of Schedule I and II of the CSA) which is prohibited by federal law or the law of any state in which such trade or business is conducted.” Some states have parallel provisions for state-tax law purposes. Nor are the protections of the bankruptcy code available to marijuana related businesses,<sup>11</sup> requiring distressed businesses to rely on much less potent state-law procedures.

### A Mixed Bag for Hemp and CBD

Since passage of the 2018 Farm Bill, cannabis with very low levels of THC (less than 0.3% on a dry weight basis) has been named “hemp” and removed from Schedule I of the CSA (so long as it is grown in accordance with an approved cultivation plan and adheres to certain testing requirements that are in the process of being finalized). Although hemp has many uses, the current “gold rush” focuses on CBD extracted from hemp. Hemp and hemp derived products, in their various forms, continue to be imported into the United States.

The U.S. Food and Drug Administration (“FDA”) has asserted jurisdiction over certain hemp derived products containing CBD under the Federal Food, Drug, and Cosmetic Act and section 351 of the Public Health Service Act because CBD is an active ingredient in an FDA approved drug (Epidiolex). While the rulemaking is ongoing, there is a great deal of uncertainty as to where the lines will be ultimately drawn: will the FDA limit itself to prohibiting or regulating the addition of CBD to food and beverages, and false claims of medical benefits, or will the restrictions be broader?<sup>12</sup> In the meantime, state level regulators (including

most recently New York) have introduced their own regulatory regimes for hemp derived CBD products. There is a great emphasis on consumer protection and testing in these regulations.

### **THERE ARE OPPORTUNITIES FOR INVESTORS AND INNOVATORS**

Notwithstanding some of the headwinds faced by the legal and regulatory uncertainty surrounding the cannabis industry, it is expected to reach a size of \$35 billion by 2025 according to some estimates. With the right approach, opportunities are available for Israeli investors and innovators who want to take part.

For investors it is a matter of risk appetite. The national U.S. exchanges, NYSE and NASDAQ, do not permit the listing of companies operating in violation of federal law. Generally, the only U.S. “cannabis” companies that trade on the national exchanges operate in a gray area by not “touching the leaf,” which means their business is ancillary to any cannabis operations. Publicly traded tobacco companies are also testing the boundaries of national exchanges with products and brands in or near to the cannabis industry.

Canadian companies listed on U.S. national exchanges and operating in the cannabis industry outside the United States present another channel to cannabis investing. Both U.S. public companies that do not “touch the leaf” and Canadian companies that do not operate in violation of U.S. federal law represent relatively conservative investments compared to companies directly involved in the production or sale of marijuana in the United States. Although historically “leaf-touching” (or more closely adjacent) companies relied on private placements, more recently they have been looking to the over-the-counter (OTC) market. Carter Ledyard has extensive experience with such listings generally, and more recently has been helping companies in the field assess the feasibility of such listings.

Moreover, while mergers and acquisitions in the cannabis industry may require a complicated structure involving the sale of related businesses and affiliated entities and a changing of the board, Carter Ledyard has the expertise for that as well. By way of example, Carter Ledyard acted as U.S. counsel to a Canadian Securities Exchange-listed British Columbia corporation headquartered in

Colorado, in a reverse takeover transaction, as well as in the acquisition of brands, dispensaries, and other operators in the cannabis industry. Carter Ledyard also acted as counsel to a public company listed on the Canadian Securities Exchange and the OTCQX which invests in the medical recreational cannabis space, in its acquisition of a Nevada-based group of companies licensed for cannabis cultivation.

Opportunities also exist for innovators who want to solve the logistical challenges plaguing this cannabis industry: inventory tracking requirements (known as “seed-to-sale”), application and compliance management for operators (especially multi-state operators who must interact with dozen of regulators in some instances), AML compliant payment processing, and a myriad of other services that an industry of that size will face. Israel’s reputation as a technological innovation powerhouse

## **The cannabis industry is expected to reach a size of \$35 billion by 2025 according to some estimates, providing opportunities for Israeli investors and innovators**

gives it a clear advantage in this field, and Carter Ledyard has extensive experience working with technology companies in bringing their products to market and protecting their brand.

Innovation in the fields of cultivation and extraction, as well as the various applications of extracts (whether CBD, THC, or some of the other less well known compounds), will be important in the years to come. These kinds of technologies, if properly protected, can be licensed in the United States without the need to establish operations in the country. This is, again, an area in which Carter Ledyard’s intellectual property team can help.

Israeli companies have been continuously

innovating in cannabis as the Israeli cannabis laws change. An exciting often mentioned company is Cannasure Therapeutics (trading on the Tel Aviv Stock Exchange). Israel also recently approved a law that may allow export of medical cannabis. It is estimated that nearly 350 startups founded by Israeli entrepreneurs are currently operating in New York, with the majority of them concentrated in Manhattan, so as more Israeli cannabis companies emerge, we should expect to see them here next to our Offices. ■

#### ABOUT THE AUTHORS:

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#### NOTES

1 Controlled Substances Act (“CSA”) of 1970, 21 U.S.C.A. § 812(b)(1).

2 See *Washington v Barr*, 925 F.3d 109, 122 (2d Cir. 2019) (dismissing appeal because plaintiff failed to exhaust administrative remedies, but “in light of the unusual circumstances of [the] case” holding the case in abeyance and retaining jurisdiction should the “administrative process fail to operate with adequate dispatch.”).

3 See 18 U.S.C. § 2 (“Whoever... aids, abets, counsels, commands, induces or procures” a federal crime, or “causes” a federal criminal act to be done, “is punishable as a principal.”); 18 U.S.C. § 3 (“Whoever, knowing that an offense against the United States has been committed, receives, relieves, comforts or assists the offender in order to hinder or prevent his apprehension, trial or punishment, is an accessory after the fact.”); 18 U.S.C. § 371 (“If two or more persons conspire either to commit any offense against the United States ... and one or more of such persons do any act to effect the object of the conspiracy, each shall be fined under this title or imprisoned not more than five years, or both.”)

4 See 21 U.S.C. §§ 853, 881(a)(6).

5 <https://www.cbp.gov/newsroom/speeches-and-statements/cbp-statement-canadas-legalization-marijuana-and-crossing-border>

6 For more information about the “Cole Memo” and the “Rohrabacher Amendment” see, generally, “Despite the Trend Towards Legalization, Challenges Remain for Investors Considering Investment in State-Legal Cannabis Industries,” (March 26, 2019), at Section II (Protections from Federal Law are Limited, and Sometimes Overstated) available at <https://www.clm.com/publication.cfm?ID=5647&Att=172>.

7 See U.S. Treas. FinCEN, *BSA Expectations Regarding Marijuana-Related Businesses* (Feb. 14, 2014), available at <https://www.fincen.gov/resources/statutes-regulations/guidance/bsa-expectations-regarding-marijuana-related-businesses>.

8 Secure and Fair Enforcement Banking Act of 2019, H.R. 1595, 116th Cong. (2019), available at <https://www.congress.gov/bill/116th-congress/house-bill/1595/text>.

9 Specifically, TMEP Section 907 provides that the use of a mark in commerce must be lawful to be the basis of a Federal mark. Available at <https://tmep.uspto.gov/RDMS/TMEP/current#/current/TMEP-900d1e1.html>.

10 For more background, please see “Protecting Cannabis and Hemp-Related Intellectual Property,” (May 9, 2019) available at <https://www.clm.com/publication.cfm?ID=5654&Att=172>.

11 See “Bogart That Joint, But Don’t Bankrupt It: Cannabis Businesses in Bankruptcy” (September 23, 2019) available at <https://www.clm.com/publication.cfm?ID=5666>.

12 For further background, please see “Things to Consider If You Decide to Invest in the Hemp and CBD Industries,” available at <https://www.clm.com/publication.cfm?ID=5651>.

With a long history of providing legal services to Israeli-based companies coupled with the expertise to steer clients through the rapidly changing legal landscape of the cannabis industry, we work with clients who are keenly focused on the future and offer sophisticated advice within a culture that provides innovative problem solving.

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