

# The Cannabis Industry: Harvesting the Benefits of a Counter-Narrative Model to

## Arbitration

### I. Introduction

In recent years, the cannabis industry has begun to emerge from the shadows of the black market to provide patients and recreational users a safe and legal way to purchase cannabis.<sup>1</sup> The industry has already seen resounding success with an estimated 6.7 billion dollars in sales in 2016 while it continues to grow.<sup>2</sup> The industry, however, is still plagued by federal illegality.<sup>3</sup> The consequences of this federal illegality affect all aspects of a legal cannabis business.<sup>4</sup> One aspect that is affected is the ability of the cannabis industry to create and enforce legal contracts.<sup>5</sup>

One response to the problem of contract illegality has been to pursue contractual disputes through arbitration.<sup>6</sup> Arbitration is a method of private dispute resolution that allows parties to resolve their disputes outside of the traditional legal system.<sup>7</sup> The speed and cost-effectiveness of arbitration, as opposed to traditional litigation, are traditionally cited as the reasons parties choose arbitration.<sup>8</sup> The narrative of why parties choose arbitration, however, is richer than simply speed and cost.<sup>9</sup> Various trade groups, religious groups, and cultural minorities select arbitration for its ability to allow them to pursue shared values that are either underrepresented or misunderstood by the traditional legal system.<sup>10</sup>

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<sup>1</sup> See Part II.

<sup>2</sup> See Debra Borchardt, *Marijuana Sales Totaled \$6.7 Billion in 2016*, FORBES, (Jan. 3, 2017, (9:00 AM)), <https://www.forbes.com/sites/debraborchardt/2017/01/03/marijuana-sales-totaled-6-7-billion-in-2016/#229abd6475e3>.

<sup>3</sup> See Part III.

<sup>4</sup> See Generally Johnathan S. Robbins, Joshua R. Mandell, Herman Enayati, Mark Y. Liu, and Rachel C. Schumacher, *Practice Update*, AKERMAN, (Nov. 9, 2016), <https://www.akerman.com/documents/res.asp?id=2738>.

<sup>5</sup> See Part III.

<sup>6</sup> See Part IV.

<sup>7</sup> See Part IV.

<sup>8</sup> See Part IV.

<sup>9</sup> See Part IV.

<sup>10</sup> See Part IV.

Arbitration’s ability to provide cannabis businesses a forum to hear and decide disputes free from the threat of contract illegality is widely advocated.<sup>11</sup> So far due to the confidential nature of arbitration and the general immaturity of the cannabis industry, it has been unclear if the cannabis industry has adopted this strategy. As part of this paper, I conducted a survey to see if the cannabis industry has adopted arbitration as a method of dispute resolution, the extent arbitration has been adopted, who has been arbitrating these disputes, what types of disputes have emerged, and why arbitration was chosen.<sup>12</sup> The overwhelming response from the survey respondents is that although actual arbitrations are beginning to emerge most lawyers have yet to have direct experience with an arbitration focused on cannabis businesses and their intra-business disputes or business-to-business contracts.<sup>13</sup> Despite the lack of arbitrations, the survey revealed that the industry has been quick to adopt the use of pre-dispute arbitration clauses with over 67% of respondents including a binding pre-dispute arbitration clause in over 50% of their contracts.<sup>14</sup> The high prevalence of arbitration clauses is unique for an industry where a lot of the contracts drafted are “material contracts.”<sup>15</sup> Lawyers tend to prefer to take the disputes that emerge out of these contracts to litigation.<sup>16</sup> Also in response to the problem of federal illegality, arbitration societies have been developed and are being developed to serve the cannabis industry.<sup>17</sup>

When asked what factors influenced their decision to include a pre-dispute arbitration clause, respondents indicated the speed and cost of arbitration as positively influencing their

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<sup>11</sup> See Part V.

<sup>12</sup> See Part V.

<sup>13</sup> See Part V.

<sup>14</sup> See Part V.

<sup>15</sup> See Part V.

<sup>16</sup> See Part V.

<sup>17</sup> See Part V.

decision.<sup>18</sup> These reasons match the typical reasons parties choose arbitration.<sup>19</sup> Where the cannabis industry differs from the traditional narrative of arbitration is that 70% of respondents stated that fear of an illegality defense encouraged or strongly encouraged their decision to include an arbitration clause.<sup>20</sup> The respondents also selected other factors like the importance of maintaining client reputation within the industry, the ability to control the choice of state law, and the ability to pick the arbitrator as crucial factors in their decision to include a pre-dispute arbitration clause.<sup>21</sup> All of these factors indicate not only the importance of shared values within the cannabis industry but also that the industry views arbitration as a method to pursue these shared values.

Therefore, based on my survey and other research, although many of the reasons the cannabis industry is using pre-dispute arbitration clauses are like other reasons parties pursue arbitration, a counter-narrative model to arbitration is necessary to understand that the main reason the cannabis industry is pursuing arbitration is for the shared interest of reducing the risks of federal illegality. Further, by adopting a counter-narrative model, the cannabis industry can develop systems of arbitration that can enhance the values shared within the industry while helping to resolve some of the other unique challenges the industry faces.

## **II. Legal Background of Cannabis**

The primary impediment to the growth of the cannabis industry is the current illegality of cannabis under federal law. Under federal law, cannabis is governed by the Controlled Substance Act (“CSA”), 21 U.S.C. § 841(a), which makes it illegal to manufacture, distribute, or possess

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<sup>18</sup> See Part V.

<sup>19</sup> See Part V.

<sup>20</sup> See Part V.

<sup>21</sup> See Part V.

with intent to manufacture, distribute, or dispense cannabis.<sup>22</sup> Under the CSA, cannabis along with heroin is a Schedule I drug.<sup>23</sup> As a Schedule I drug, cannabis has been determined to have a high potential for abuse, no accepted medical use in treatment, and a lack of accepted safety use under medical supervision.<sup>24</sup>

In recent years, state governments have tried to work around the CSA by enacting measures to decriminalize and legalize cannabis production, sale, and consumption within their respective states. Currently, twenty-nine states and the District of Columbia have laws legalizing cannabis for either medical or recreational use.<sup>25</sup> Despite the recent state efforts, the federal government still retains the power to regulate and enforce the CSA.<sup>26</sup> The 10<sup>th</sup> Amendment's Anti-Commandeering Doctrine limits the federal government's enforcement capability.<sup>27</sup> The 10<sup>th</sup> Amendment prevents the federal government from forcing the states to enact specific laws or from utilizing state officials to assist in the enforcement of federal laws.<sup>28</sup>

Even if the federal government cannot force the states to enact anti-cannabis laws, if there is a positive conflict between state laws legalizing cannabis and the CSA, those state laws could be preempted by federal law.<sup>29</sup> A positive conflict would emerge if a court found that compliance with both the federal and the state law would be a physical impossibility or if the state law stands

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<sup>22</sup> See 21 U.S.C. § 841(a) (2010).

<sup>23</sup> See 21 U.S.C.A. § 812 (West 2012); *The Controlled Substances Act (CSA): Overview*, THOMSON REUTERS, (2017), <http://criminal.findlaw.com/criminal-charges/controlled-substances-act-csa-overview.html> (The CSA created five classifications of drugs based on the potential for abuse, status in international law, and any medical benefits they provided).

<sup>24</sup> See 21 U.S.C.A. § 812 (West 2012).

<sup>25</sup> See *29 Legal Medical Marijuana States and DC*, PROCON.ORG, <http://medicalmarijuana.procon.org/view.resource.php?resourceID=000881> (Last updated on Apr. 20, 2017, (10:48 AM)).

<sup>26</sup> See *Gonzales v. Raich*, 545 U.S. 1, 26-29 (2005).

<sup>27</sup> See Erwin Chemerinsky, Jolene Forman, Allen Hopper, and Sam Kamin, *Cooperative Federalism and Marijuana Regulation*, 62 UCLA L. Rev. 74, 101 (January 2015).

<sup>28</sup> See *id.* at 102-103.

<sup>29</sup> See *id.* at 104.

as a barrier to the fulfillment of the federal law.<sup>30</sup> Various scholars like Erwin Chemerinsky and state courts have taken the position that state decriminalization and legalization efforts do not create a positive conflict with federal law that would subject them to preemption.<sup>31</sup> However, a federal court has yet to rule on whether state legalization efforts do not create a positive conflict with the CSA and are therefore free from fear of preemption.<sup>32</sup>

The current federal enforcement policy of the CSA is built around the Cole memo and the Rohrabacher-Farr Amendment. Issued in 2013 by Deputy Attorney General James Cole, the Cole memorandum outlines the Justice Department's enforcement priorities in response to state legalization efforts.<sup>33</sup> The memo lists eight enforcement priorities for the justice department in deciding whether to pursue enforcement of the CSA.<sup>34</sup> Missing from the list of enforcement priorities is the enforcement of the CSA against cannabis businesses operating in compliance with state law.<sup>35</sup> The memo makes clear that the current policy of non-enforcement has no effect on nor prevents federal enforcement of the CSA.<sup>36</sup> The Rohrabacher-Farr Amendment passed in 2014 serves as a limitation on the Department of Justice's use of federally apportioned funds.<sup>37</sup> It

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<sup>30</sup> *See id.*

<sup>31</sup> *See id.* at 101; *Beek v. City of Wyo*, 846 N.W.2d 531 (Mich. 2014) (State cannabis law not preempted by federal law).

<sup>32</sup> *See Chemerinsky, supra* note 27, at 101.

<sup>33</sup> *See* U.S. Dep't of Justice, Office of the Deputy Attorney General, Memorandum for All United States Attorneys: Guidance Regarding Marijuana Enforcement 1-2 (2013), available at <https://www.justice.gov/iso/opa/resources/3052013829132756857467.pdf> ("This memorandum does not alter in any way the Department's authority to enforce federal law, including federal laws relating to marijuana, regardless of state law").

<sup>34</sup> *See id.* (The enforcement priorities are 1) preventing distribution to minors, 2) preventing revenue from the sale of marijuana from states to criminal enterprises, 3) preventing the interstate movement of cannabis, 4) preventing legal cannabis businesses from being used as fronts for illegal activity, 5) preventing violence and the use of firearms in the cannabis industry, 6) preventing public health consequences associated with cannabis use like driving under the influence, 7) preventing the growth of cannabis on federal lands, and 8) preventing possession or use on federal lands).

<sup>35</sup> *See* Luke Scheuer, *Are "Legal" Marijuana Contracts "Illegal"?*, 16 U.C. Davis Bus. L.J. 31, 37 (Fall 2015).

<sup>36</sup> *See id.* ("This memorandum does not alter in any way the Department's authority to enforce federal law, including federal laws relating to marijuana, regardless of state law").

<sup>37</sup> *See* MARIJUANA BUSINESS DAILY, TRUMP & THE \$5 BILLION MARIJUANA INDUSTRY: EXECUTIVE REPORT 16 (Chris Walsh et al. eds., Marijuana Business Daily, a division of Anne Holland Ventures, Inc., 2017).

prevents the use of funds by the DOJ to prevent the implementation of state approved medical cannabis regimes in states that in 2014 had currently legalized medical marijuana.<sup>38</sup>

The Cole memo and the Rohrabacher-Farr Amendment continue to show the federal government's willingness to allow the legal cannabis industry to continue and develop. However, the memo is not law and is simply a list of enforcement priorities which the Justice Department is free to revise at any time, and the Rohrabacher-Farr Amendment must be renewed in September 2017.<sup>39</sup> Until there is further federal action, an ever-shifting assortment of memos and amendments determines all states, cannabis businesses, and persons associated with the cannabis industry compliance with the CSA.

### **III. Contract Illegality in the Cannabis Industry**

Due to the existence of the CSA, one of the major challenges that the cannabis industry deals with is the threat of contract illegality.<sup>40</sup> This threat emerges from the classic contract defense whereby a contract can be found void when it is against public policy.<sup>41</sup> A contract is not automatically void if it is found to be against public policy; rather a judge uses her discretion to conduct a balancing test of those interests for enforcement and those interests against enforcement to determine whether or not to enforce the contract.<sup>42</sup> The possibility of an opposing party raising the defense and its reliance on judicial discretion haunts every contract in the

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<sup>38</sup> See Consolidated and Further Continuing Appropriations Act, 2015, Pub. L. No. 113-235, 128 Stat 2130, 2217 SEC. 538 (December 16, 2014).

<sup>39</sup> See MARIJUANA BUSINESS DAILY, *supra* note 35, at 31 (Discussing how the Trump administration could simply throw out the Cole memo); Sara Brittany Stone, *Federal Medical Marijuana Protections Extended Through September 2017*, HIGH TIMES, (May 01, 2017), <http://hightimes.com/news/federal-medical-marijuana-protections-extended-through-september-2017/>.

<sup>40</sup> See Luke Scheuer, *supra* note 35, at 44-45.

<sup>41</sup> See ROBERT A. MIKOS, MARIJUANA LAW, POLICY, AND AUTHORITY 650 (Aspen 2017).

<sup>42</sup> See Restatement (Second) of Contracts § 178 (1981) (A court balances two sets of interests: those for enforcement (the justified expectations of the parties, any forfeiture that would result if enforcement was denied, and any special public interest in the term of enforcement) and those against enforcement (the strength of the public policy as manifested by law, the likelihood that a refusal to enforce the term will further the policy, the seriousness of any misconduct involved, and the directness of the connection between the misconduct and the term).

cannabis industry.

The most famous example of a court holding a cannabis contract illegal is *Hammer v. Today's Health Care II*, CV2011-051350 (Ariz. Sup. Ct. Apr. 17, 2012). The case arose in 2012, when Hammer, an Arizona resident, loaned Today's Health Care, a Nevada corporation, \$250,000 to start a dispensary in Colorado.<sup>43</sup> After THC had defaulted on its loan agreement, Hammer sued in Arizona to collect the outstanding debt.<sup>44</sup> An Arizona Superior Court found that the contract “was in clear violation of the laws of the United States” and therefore was “void and unenforceable.”<sup>45</sup> The court refused to enforce the loan agreement and dismissed the case.<sup>46</sup> Comparable results have been reached in other courts.<sup>47</sup>

In recent years, the existence of the Cole memo and the growing legalization movement have begun to reverse this trend. *Northbay Wellness Grp., Inc. v. Beyries*, 789 F.3d 956, 958 (9th Cir. 2015) is one of the first examples of a federal judge holding a cannabis contract enforceable. In *Northbay*, Northbay, a dispensary in Oakland, entrusted Beyries, its attorney, with a \$25,000 legal trust fund, created from its dispensary's sale revenue.<sup>48</sup> Subsequently, Beyries absconded with the \$25,000 legal trust fund.<sup>49</sup> Northbay sued Beyries in California Superior Court for breach of contract and conversion of a legal trust fund and won a judgment against him.<sup>50</sup> Beyries then filed for Chapter 7 bankruptcy in which Northbay commenced an action against

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<sup>43</sup> See *Hammer v. Today's Health Care II*, CV2011-051350, at \*1 (Ariz. Sup. Ct. Apr. 17, 2012).

<sup>44</sup> See *id.*

<sup>45</sup> See *id.* at \*2.

<sup>46</sup> See *id.*

<sup>47</sup> See *Tracy v. USAA Cas. Ins. Co.*, No. 11-00487LEK-KSC, 2012 WL 928186, at \*13 (D. Haw. Mar. 16, 2012) (“The Court therefore CONCLUDES that, as a matter of law, Defendant's refusal to pay for Plaintiff's claim for the loss of her medical marijuana plants did not constitute a breach the parties' insurance contract”); *Haerberle v. Lowden*, No. 2011CV709, 2012 WL 7149098, at \*5 (Colo. Dist. Ct. Aug. 8, 2012) (“Consequently, contracts for the sale of marijuana are void as they are against public policy”).

<sup>48</sup> See *Northbay Wellness Grp., Inc. v. Beyries*, 789 F.3d 956, 958 (9th Cir. 2015).

<sup>49</sup> See *id.*

<sup>50</sup> See *id.*

Beyries in the Northern District of California alleging that the state-court award was non-dischargeable.<sup>51</sup> The district court found that the debt would normally be dischargeable, but the unclean hand's doctrine precluded Northbay from recovery “because Northbay created the fund using the proceeds from illegal marijuana sales.”<sup>52</sup> In the subsequent appeal before the 9<sup>th</sup> circuit, the court employed the balancing test to determine that Beyries wrongdoing outweighed Northbay’s wrongdoing.<sup>53</sup> The court still found that Northbay’s activity was wrongful but found that “allowing Beyries to avoid through bankruptcy his responsibility for misappropriating his client's money would undermine the public interest in holding attorneys to high ethical standards.”<sup>54</sup>

Another example is *Green Earth Wellness Ctr., LLC v. Atain Specialty Ins. Co.*, 163 F. Supp. 3d 821, 823 (D. Colo. 2016). In *Green Earth*, Green Earth, a dispensary, had a Commercial Property and General Liability Insurance Policy with Atain.<sup>55</sup> A fire in the local area occurred, and the ash and debris from the fire overwhelmed Green Earth’s ventilation system for its growing operation and caused damage to its cannabis plants.<sup>56</sup> Subsequently, thieves broke in through the ventilation system and stole cannabis plants.<sup>57</sup> Green Earth filed claims under its policy with Atain for both incidents, but Atain denied both the claims.<sup>58</sup> Green Earth filed an action in Federal District Court for breach of contract, bad faith, and unreasonable delay in payment.<sup>59</sup> Atain filed a Motion for Determination of Question of Law as to whether it was legal for it to pay for damages to the plants and whether the court could order it to pay for

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<sup>51</sup> *See id.* at 958-59.

<sup>52</sup> *See id.* at 959.

<sup>53</sup> *See id.* at 961.

<sup>54</sup> *See id.*

<sup>55</sup> *See Green Earth Wellness Ctr., LLC v. Atain Specialty Ins. Co.*, 163 F. Supp. 3d 821, 823 (D. Colo. 2016).

<sup>56</sup> *See id.*

<sup>57</sup> *See id.* at 824.

<sup>58</sup> *See id.*

<sup>59</sup> *See id.*

those plants.<sup>60</sup> The court refused to decide what the current federal policy in regards to cannabis was.<sup>61</sup> Instead, it found that Atain, “having entered into the Policy of its own will, knowingly, and intelligently” had to honor its obligations under it.<sup>62</sup>

The positive judgments in *Northbay* and *Green Earth* show that judges may become more accepting of cannabis contracts. However, both courts reached decisions with reluctance and with limited findings. Therefore, even though there is a noticeable change in the way courts view and enforce contracts that involve the cannabis industry at best these contracts and other determinations continue to rely on individual judge’s opinions of the legality of cannabis.

#### **IV. Solutions to Contract Illegality**

The threat of contract illegality has been well recognized within the cannabis industry.<sup>63</sup> One of the solutions that have been advocated to deal with this risk is the use of arbitration.<sup>64</sup> Arbitration is traditionally defined as a method of private dispute resolution that allows parties to forgo the procedural rigor and appellate review of the courts to realize the benefits of lower costs, greater efficiency and speed, and the ability to choose expert adjudicators.<sup>65</sup> Parties routinely seek arbitration for its ability to resolve disputes quicker and cheaper than traditional litigation.<sup>66</sup> In recent years, the Supreme Court has given broad protection to parties’ ability to

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<sup>60</sup> See *id.*

<sup>61</sup> See *id.* at 833.

<sup>62</sup> See *id.* at 835.

<sup>63</sup> See Generally Luke Scheuer, *supra* note 35; Stephen Mare, *She Who Comes into Court Must Not Come with Green Hands: The Marijuana Industry’s Ongoing Struggle with the Illegality and Unclean Hands Doctrines*, 44 Hofstra L. Rev. 1351 (Summer 2016).

<sup>64</sup> See TODD A. WELLS, MICHAEL REILLY, & TAYLOR MINSHALL, ARTICLE ON THE ENFORCEMENT OF CANNABIS-RELATED CONTRACTS & ARBITRATION (Continuing Legal Education in Colorado, Inc., 2016).

<sup>65</sup> See *Stolt-Nielsen S.A. v. AnimalFeeds Int’l Corp.*, 559 U.S. 662, 685 (2010).

<sup>66</sup> See See Thomas J. Stipanowich and J. Ryan Lamare, *Living with ADR: Evolving Perceptions and Use of Mediation, Arbitration, and Conflict Management in Fortune 1000 Corporations*, 19 Harv. Negotiation L. Rev. 1, 37 (Spring, 2014) [Hereinafter *Living with ADR*] (68.5% of respondents sought arbitration to save time, 68.6% sought arbitration to save money).

enter into arbitration agreements impacting the way arbitration is traditionally viewed and used.<sup>67</sup> One of the ways the court has done this is through the Doctrine of Severability.<sup>68</sup> Under the Doctrine of Severability, an arbitration agreement effectively divides a contract into two pieces: the arbitration agreement and the underlying contract.<sup>69</sup> Matters that deal with the underlying contract such as contract illegality are decided by the arbitrator and are not subject to review by a court.<sup>70</sup> The doctrine has the effect that even if the underlying contract is illegal, the parties can't avoid arbitration.<sup>71</sup> The court has also protected arbitration agreements by narrowing the grounds for vacating arbitration awards to exclude the common law vacatur standards.<sup>72</sup>

The Supreme Court decisions upholding the validity of arbitration along with the ability of arbitration agreements to control who arbitrates a case, the scope of that arbitrator's authority, the location of the arbitration, and the choice of law offers parties the ability to craft private systems of law to address issues that may be important to the parties but are not addressed by the current dispute resolution process. Professor Helfand has argued that parties who seek arbitration as means of developing their shared values outside of the traditional reasons of speed and cost efficiency operate under a counter-narrative model to arbitration.<sup>73</sup> By utilizing this counter-narrative model of arbitration groups like religious organizations, cultural minorities, and trade groups can be understood as pursuing arbitration not for its ability to resolve disputes quicker and cheaper but for its ability to provide parties a venue to pursue and develop their shared

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<sup>67</sup> See Michael A. Helfand, *Arbitration, Transparency, and Privatization: Arbitration's Counter-Narrative: The Religious Arbitration Paradigm*, 124 Yale L.J. 2994, 3000-3010 (2015) (Discussing how recent Supreme Court decisions have impacted the narrative of arbitration).

<sup>68</sup> See *Prima Paint v Conklin*, 388 U.S. 395 (1967)

<sup>69</sup> See *id* at 403-404 ("Federal court may consider only issues relating to the making and performance of the agreement to arbitrate").

<sup>70</sup> See *id*.

<sup>71</sup> See *Buckeye Check Cashing, Inc. v. Cardegna*, 546 U.S.440 (2006) (Parties to a contract cannot avoid arbitration just because the underlying agreement is void for possible illegal activity).

<sup>72</sup> See *Hall St. Assocs., LLC, v. Mattel. Inc.*, 552 U.S. 576 (2009).

<sup>73</sup> See Helfand, *supra* note 67, at 3010-3011.

values through dispute resolution.<sup>74</sup> Recognizing the importance of these shared values as the reason groups seek arbitration is critical to developing arbitration procedures that understand and develop these shared values as opposed to designing systems of arbitration that merely respond to problems traditionally associated with litigation.<sup>75</sup>

One way arbitration helps communities pursue shared value is by allowing them an alternative to the legal system which can embody cultural biases against them which can prevent them from obtaining a fair result. Professor Gary Spitko has argued that the example of a testator who chooses to leave his estate to someone or something besides his legal spouse or blood relations is one example that demonstrates how arbitration can help cultural minorities.<sup>76</sup> Majoritarian values that favor blood relatives can negatively influence the probate proceeding for these abhorrent testators.<sup>77</sup> Arbitration allows these individuals to structure adjudication so that they can ensure these majoritarian norms do not influence adjudicators.<sup>78</sup> Specifically, arbitration agreements can allow arbitrators to ignore legal rules that embody unfair prejudice and prevent the just resolution of substantive claims.<sup>79</sup> Most importantly, arbitration allows these groups an ability to limit outsiders pre-understanding of the group which can be based on assumptions and can influence the adjudicatory process.<sup>80</sup>

Many trade groups have adopted arbitration because of the economic benefits arbitrations can provide parties through expert arbitrators. Arbitrators with industry knowledge can offer unique

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<sup>74</sup> *See id.*

<sup>75</sup> *See id.* at 3022.

<sup>76</sup> E. Gary Spitko, *Gone But Not Conforming: Protecting the Abhorrent Testator from Majoritarian Cultural Norms Through Minority-Culture Arbitration*, 49 Case W. Res. 275, at 294-295 (Winter 1999) [hereinafter *Gone But Not Conforming*].

<sup>77</sup> *See id.* at 278-286.

<sup>78</sup> *See id.* at 294-297.

<sup>79</sup> *See* E. Gary Spitko, *Judge Not: In Defense of Minority - Culture Arbitration*, 77 Wash. U. L. Q. 1065, at 1077 (1999) [hereinafter *Judge Not*].

<sup>80</sup> *See Gone But Not Conforming*, *supra* note 74, at 297.

advantages to parties in not only evaluating relevant standards within a field that govern a dispute but also evaluating expert testimony on an issue and assessing damages.<sup>81</sup> Another advantage arbitrators provide is the ability to make factual determinations with greater accuracy and less expensively.<sup>82</sup> Arbitrators also have the ability to design judgments that respond to unique problems that may prevent resolution and that a normal court may lack the ability to make.<sup>83</sup> These abilities can make parties feel more comfortable expanding the potential contractible elements of a contract and entering into more complete contracts which address more possible contingencies.<sup>84</sup> The ability to expand the realm of contractible elements helps lowers the potential for dispute and reduces the extent of a dispute if one emerges.<sup>85</sup>

Another economic advantage arbitration can afford trade groups is by helping members maintain and utilize their commercial reputations for greater economic advantage.<sup>86</sup> Lisa Bernstein has argued that in certain commercial industries, a variety of factors within the industry can increase the importance of a commercial reputation like the limited size of the industry, the subjective nature of the goods sold, or the high frequency of repeat transactions.<sup>87</sup> The systems of sustained multilateral cooperation that can emerge from the ability to trust other

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<sup>81</sup> Thomas J. Stipanowich, *Managing Construction Conflict: Unfinished Revolution*, Continuing Evolution, 34 Constr. Law 13, 21-22 (2014) (Discussing the role expert can play as arbitrators in the construction industry).

<sup>82</sup> See Lisa Bernstein, *Private Commercial Law in the Cotton Industry: Creating Cooperation Through Rues, Norms, and Institutions*, 99 Mich. L. Rev. 1724, 1740 (June 2001) [hereinafter *Cotton Industry*] (Discussion of private arbitration within the cotton industry).

<sup>83</sup> See Thomas J. Stipanowich, *Reflections on the State and Future of Commercial Arbitration: Challenges, Opportunities, Proposals*, 25 Am. Rev. Int'l Arb. 297, 331 (2014) (Discussing the abilities of arbitrators in reference to *David Co. v. Jim Miller Constructions, Inc.* Specifically how the award was crafted from a business perspective by experts within the field)

<sup>84</sup> See *Cotton Industry*, *supra* note 82, at 1740.

<sup>85</sup> See *id.*

<sup>86</sup> See Generally Lisa Bernstein, *How Community Institutions Create Economic Advantage: Jewish Diamond Merchants in New York*, 31 Law & Soc. Inquiry 383 (Spring 2006) [hereinafter *Diamond Industry*] (Discussion of private arbitration within the diamond industry).

<sup>87</sup> See Generally *id.* (Discussion of how the community of Jewish diamond merchants in New York is the result of the unique pressures associated with the diamond trade which necessitates a multilateral system of cooperation based on commercial reputation); *Cotton Industry*, *supra* note 82 (For a discussion of how similar variables mandated multilateral cooperation based on commercial reputation within the cotton industry)

players within the industry offer unique economic advantages.<sup>88</sup> Some of these economic advantages include the ability to reduce the costs of transactions by reducing the number of breach of contract disputes and by the ability to enter into extralegal understandings which may be performed across a range of market conditions.<sup>89</sup> To truly unlock the commercial benefits of a system of sustained multilateral cooperation arbitration must not just resolve disputes but must empower organizations within the industry by collecting and distributing accurate information regarding disputes which may be valuable to future transactions.<sup>90</sup> By publishing the information regarding these disputes, arbitrators can work to affirmatively correct misinformation and ensure “cheating” is seen throughout the industry as less attractive than cooperating in the future.<sup>91</sup>

## V. Survey Results and Analysis

In order to determine the relation between the cannabis industry and arbitration, I created an online survey of 21 questions to determine if the cannabis industry has adopted arbitration as a method of dispute resolution, the extent arbitration has been adopted, who has been arbitrating these disputes, what types of disputes have emerged, and why arbitration was chosen. To further flesh out the results of the survey and to try and correct for any ambiguities in the questions, I conducted follow-up telephone interviews with willing participants. I conducted the survey by emailing the survey to over 253 cannabis lawyers. To compile the list of potential lawyers, I relied on the Cannabis Bar Association’s directory of lawyers, Google searches for lawyers marketing themselves as having expertise in cannabis law, and recommendations. Eighteen lawyers provided responses to the online survey request, and four of those eighteen performed follow-up phone interviews and an additional four lawyers performed phone interviews without

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<sup>88</sup> See *Cotton Industry*, *supra* note 82, at 1754-1761.

<sup>89</sup> See *id.*

<sup>90</sup> See *Diamond Industry*, *supra* note 86, at 400-403.

<sup>91</sup> See *id.*

providing a survey response. It is not possible to determine the response rate to the survey because I was unable to determine if the lawyers had received the survey. Further, given the small sample size, the results from this exploratory study cannot be generalized.

### A. General Characteristics of the Participants

The following section goes over the amount of the experience the respondents to the survey had as attorneys, working with cannabis industry clients, the number of contracts they draft each year for the cannabis industry, and their participation and influence of cannabis related groups.

The first two questions of the survey asked how many years of experience the respondent had as an attorney and how many years of experience they had worked with cannabis industry clients. (See Figure 1). The responses indicate that the general legal experience of most of the respondents is over 5-10 years. The results are flipped regarding experience with cannabis industry clients, with most attorneys having 5-10 years of experience or less.

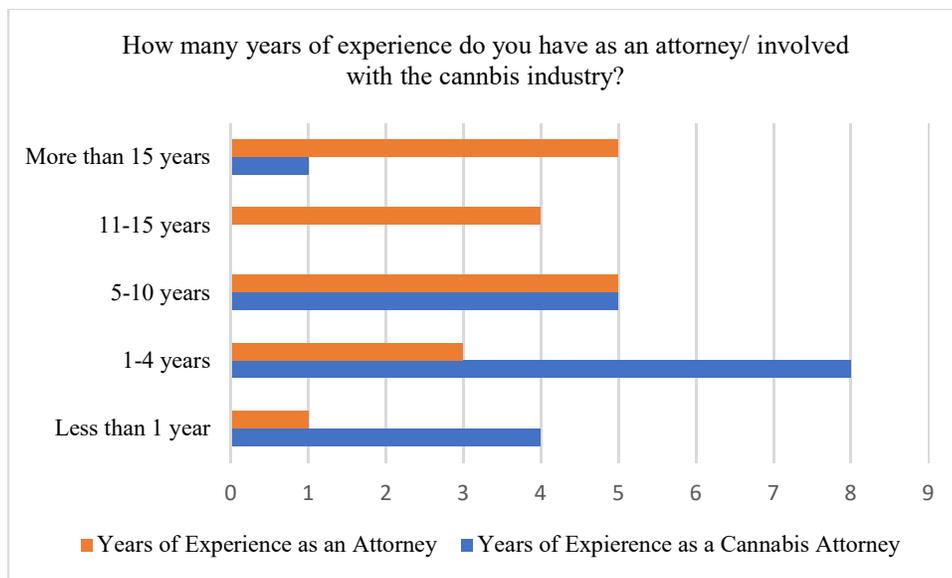


Figure 1

The respondents were asked how many business-to-business contracts they draft each year that involve the cannabis industry. (See Figure 2). 39% of the respondents draft or review 26 or

more business-to-business contracts a year with 22% drafting over 100 contracts a year. A plurality of the respondents, however, draft around 11 to 25 business-to-business contracts a year.

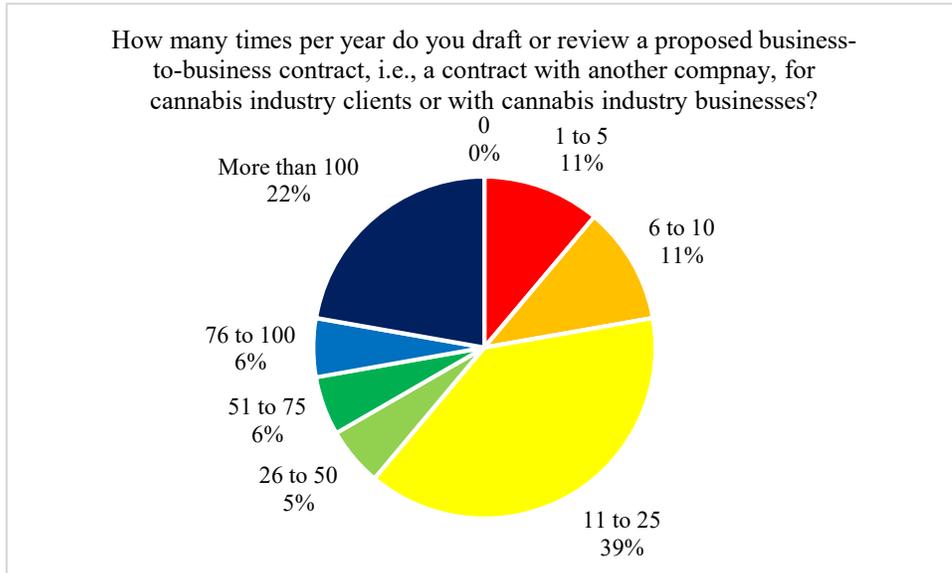


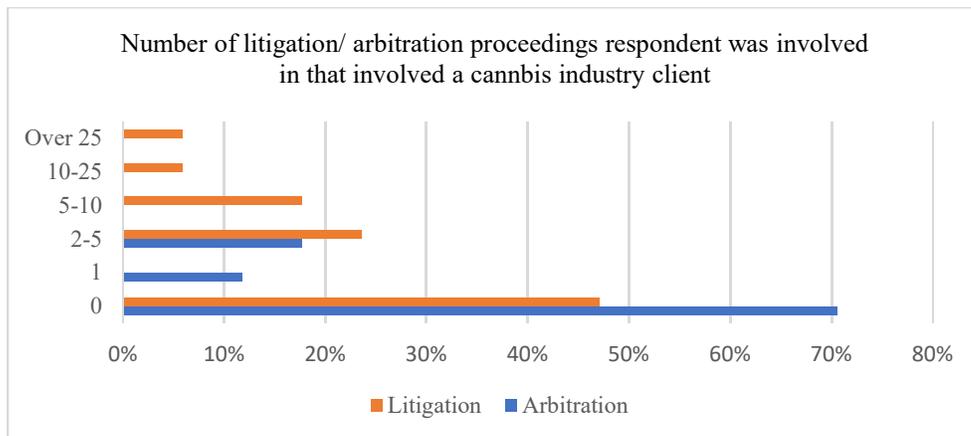
Figure 2

Respondents were also asked if they belonged to a cannabis related business or legal organization and how influential they saw that organization in shaping policy within the cannabis industry. All respondents belonged to at least one legal or business-related cannabis organization.<sup>92</sup> Over 80% of the respondents felt these associations were at least somewhat influential or very influential in shaping their understanding of the cannabis industry and relevant law. The remaining respondents felt neutral about the influence of the organizations in shaping their understanding.

<sup>92</sup> The organizations listed range from associations dedicated to the legalization of cannabis like: NORML, Marijuana Policy Project, Americans for Safe Access, Drug Policy Alliance, and the Ad Hoc Coalition for Drug Policy Reforms; national industry and legal associations like: The National Cannabis Industry Association, Marijuana Business Conference, The Cannabis Alliance, Association of Cannabis Professionals, Women Grow, and the National Cannabis Bar Associations; to state industry and legal associations like the Colorado Cannabis Chamber of Commerce, Colorado Bar Association Cannabis Law Committee, and the California Cannabis Industry Association.

## B. The Spread of Arbitration within the Cannabis Industry

To determine the extent of arbitration in the cannabis industry and the influence of arbitration as opposed to litigation, I asked respondents how many times they had been involved in arbitration or litigation related proceedings that involved a cannabis industry client. (See Figure 3). Most respondents have had some involvement with litigation involving cannabis related clients, but most have yet to be involved in a cannabis related arbitration proceeding. These results match with phone interviews with respondents that indicate that cannabis related disputes have yet to emerge. Although as one survey response put it, many expect dispute resolution “will be booming soon.”<sup>93</sup>



*Figure 3*

Even though the industry is young, one of the ways arbitration emerges is by pre-dispute arbitration clauses. Respondents were asked in what percentage of their business-to-business contracts do they include arbitration clauses. (See Figure 4). Only 11% of respondents indicated that they did not include arbitration clauses in any contract they draft. Over 67% of respondents indicated that they include binding arbitration clauses in over 50% of the contracts that they draft

<sup>93</sup> Response was given to the survey question “What else would you like to tell us about business-to-business arbitration in the cannabis industry?”

or review. These numbers may even be low. One survey response added that he includes a mandatory arbitration clause in every cannabis related contract he drafts.<sup>94</sup> In a telephone interview, one lawyer indicated that, outside of special circumstance, he includes arbitration clauses in every cannabis related contract he drafts.<sup>95</sup> The high prevalence of arbitration clauses within the cannabis industry shows that even though the industry has yet to experience a lot of arbitration proceedings, arbitration is still considered when drafting contracts.

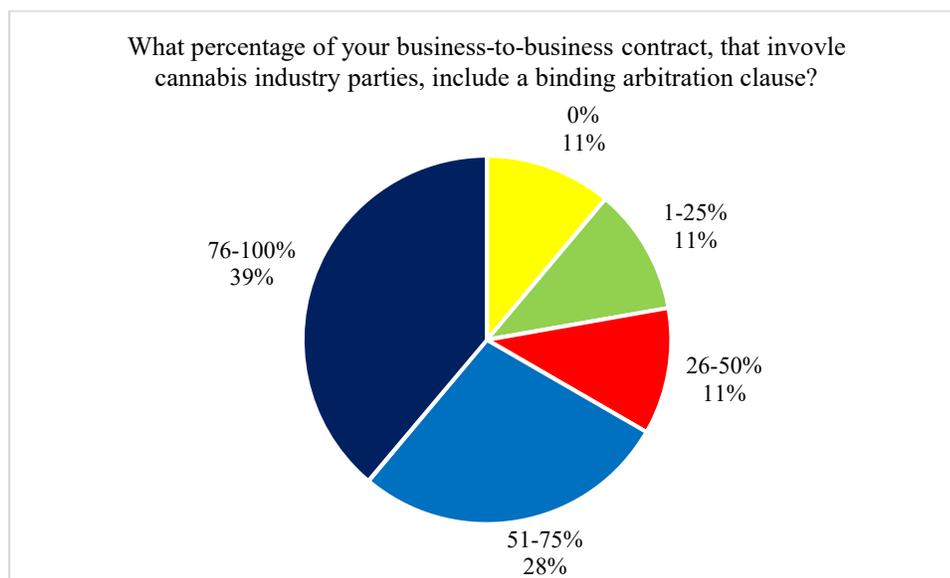


Figure 4

### C. The Choice of Arbitrator and the Emergence of Cannabis Arbitration

#### Associations

I asked respondents in the event of arbitration, how do they select an arbitrator? (See Figure 5). It is important to note that only 11 respondents answered this question and 2 respondents selected two organizations. Most respondents indicate that they rely on either the American Arbitration Association (AAA) or JAMS when they select a set of rules for their

<sup>94</sup> Response was given to the survey question “What else would you like to tell us about business-to-business arbitration in the cannabis industry?”. Respondent also marked 75-100% of contracts for response

<sup>95</sup> Telephone interview with survey respondent (Mar. 29, 2017 at 10:10 AM)

arbitration clause or as a designated arbitrator for their arbitration clause. Three respondents broke from the norm. One indicated that they prefer a retired jurist that is familiar with the cannabis industry. Another respondent indicated that they have begun to rely on the Cannabis Dispute Resolution Institute (CDRI) for their designated rules and as their designated arbitrator. When asked in phone interviews why parties chose an arbitration society, many indicated that they rely on the AAA and JAMS based on familiarity with past legal matters unrelated to cannabis.

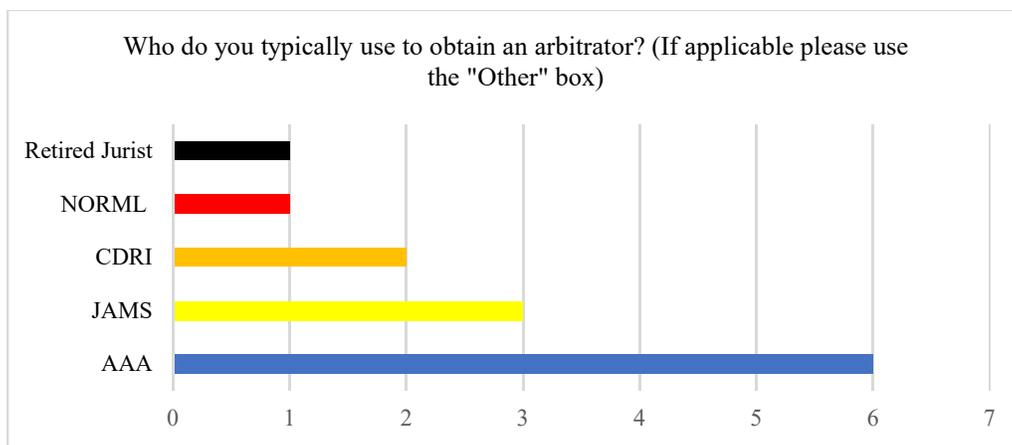


Figure 5

The above results match with other research on the emergence of cannabis related arbitrations. Traditional arbitration services like the AAA and JAMS have seen an emergence of cannabis industry clients in recent years. In 2016, the AAA’s Denver office had seen over 15 arbitrations across 10 states.<sup>96</sup> The Director of ADR services for the AAA’s Denver office even appeared at a cannabis arbitration related CLE event to educate attorneys on how to use the AAA online clause builder.<sup>97</sup> The Director mentioned that attorneys utilizing the AAA sought

<sup>96</sup> *Weed in the Garden: The Cannabis Industry, Private Law and Conflict Resolution*, STATE BAR OF ARIZONA CONTINUING LEGAL EDUCATION, (September 9, 2016) <https://azbar.inreachce.com/Details?groupId=B8B6A8B1-DFCB-456A-A994-BBA6F84936CD>

<sup>97</sup> *See id.*

arbitrators with cannabis experience and arbitrators who were not against cannabis legalization.<sup>98</sup>

In response to the potential to provide a method of dispute resolution for cannabis clients a few cannabis specific arbitration associations have emerged: the Cannabis Dispute Resolution Institute and NORML Woman’s Alliance.<sup>99</sup> The Cannabis Dispute Resolution (CDRI) formed in 2015 and based in Denver, specifically offers its services as “the solution to conflict between Federal Controlled Substances regulations, State law, and the Federal Arbitration Act.”<sup>100</sup> It sees its services as reducing the risk and providing an outlet outside of courts that may declare a contract void “whenever it suits them.”<sup>101</sup> The CDRI even provides a model arbitration clause.<sup>102</sup> The model arbitration clause calls for an arbitrator to use the CDRI arbitration rules, to have the dispute governed by the state laws of Colorado, and expressly limits the scope of the arbitrator in voiding the contract based solely “on the cannabis-related nature of the contract.”<sup>103</sup> The success or failure of the CDRI is unclear however as indicated in the survey at least two attorneys have relied on their rules and services.

#### **D. Type of Disputes within the Cannabis Industry**

The survey tried to determine what type of disputes were emerging in the cannabis industry by asking respondents to choose from a list all the dispute types they had seen emerge. (See Figure 6). For this question, only ten respondents answered. The most common type of disputes were disputes about the performance of contract and ownership/partnership disputes.

The phone interviews confirm that the most common disputes that currently exist in the

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<sup>98</sup> See *id.*

<sup>99</sup> See Kyndra Miller, *NORML Women’s Alliance Launches Alternative Dispute Resolution Services for the Cannabis Industry*, CANNABUSINESS LAW, (Apr. 5, 2016) <http://cannabusinesslaw.com/2016/04/norml-womens-alliance-launches-alternative-dispute-resolution-services-for-the-cannabis-industry/> (NORML’s program has yet to officially launch); *Cannabis Dispute Resolution Institute*, CDRI, <http://www.candri.org/> (Last visited May 31, 2017).

<sup>100</sup> See *About CDRI*, CDRI, <http://www.candri.org/about-cdri/> (Last visited May 31, 2017).

<sup>101</sup> See *Why Arbitration*, CDRI, <http://www.candri.org/why-arbitration/> (Last visited May 31, 2017).

<sup>102</sup> See *Resources*, CDRI, <http://www.candri.org/resources/> (Last visited May 31, 2017).

<sup>103</sup> See *id.*

cannabis industry, in general, are partnership/ ownership disputes and breach of contract disputes. Use of arbitration clauses is fairly common in goods oriented businesses where a breach of contract and product quality issues are common.<sup>104</sup> Where the cannabis industry differs from other industries is the prevalence of arbitration clauses despite the number of ownership or partnership disputes that emerge from so-called “material contracts.”<sup>105</sup> Arbitration clauses are not included in these “material contracts” that involve these “bet the company” type issues.<sup>106</sup> The reason arbitration clauses are not included in these type of contracts is that in such high-risk situations parties prefer the procedural safeguards and appellate review of traditional litigation.<sup>107</sup> The general conclusion that can be drawn from the prevalence of arbitration clauses despite a large number of material contracts is that to some lawyers the risk of federal illegality outweighs the risk of needing the ability to appeal an adverse decision. In a phone interview, one lawyer confirmed that a lot of breach of contract and ownership disputes are going to arbitration to avoid the threat of a residual bias against the cannabis industry and because of the contentious nature of these type of disputes.<sup>108</sup> Evidence of actual arbitration over material contracts can be seen in the *Bhang vs. Mentor Capital* arbitration, where an investment firm sued a cannabis business over the business’s failure to deliver shares of the company in which the investment firm had provided capital.<sup>109</sup>

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<sup>104</sup> Christopher R. Drahozal & Stephen J. Ware, *Why Do Businesses Use (or Not Use) Arbitration Clauses?*, 25 Ohio St. J. on Disp. Resol. 433, 463 (2010).

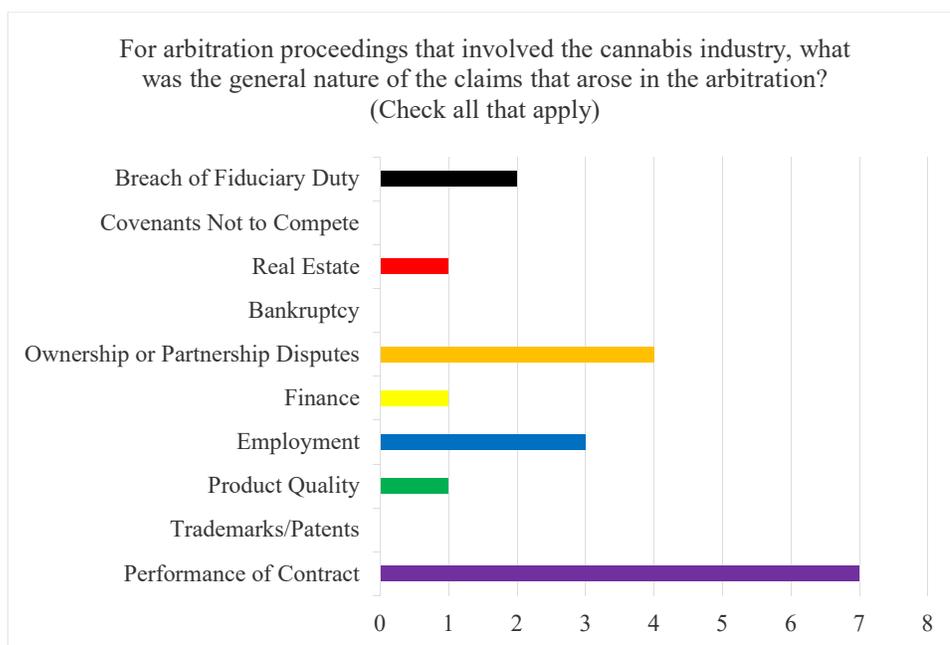
<sup>105</sup> *See id.* at 459 (Material contracts are “contracts made out of the ordinary course and material to the business” as opposed to contracts that don’t concern the very existence of the business and involve the regular transactions of the business).

<sup>106</sup> *See id.* at 454.

<sup>107</sup> *See id.*

<sup>108</sup> Telephone interview with survey respondent (Mar. 29, 2017 at 10:10 AM)

<sup>109</sup> *See Major infused products co. Bhang Loses Arbitration Battle*, MARIJUANA BUSINESS DAILY, (July 19, 2016) <https://mjbizdaily.com/major-infused-products-co-bhang-loses-arbitration-battle/>.



*Figure 6*

### **E. The Factors Behind the Decision to Include Arbitration Clauses**

The survey included a list of factors that attorneys could mark as strongly encouraging, somewhat encouraging, neutral, somewhat discouraging, strongly discouraging, or non-applicable to indicate the role a factor played in their decision whether to include an arbitration clause. (See Figure 7). Figure 7 includes factors where over 51% of the respondents indicated the factor somewhat or strongly encouraged their use of arbitration clauses. The factors chosen mirror common factors associated with including arbitration clauses in business-to-business contracts.<sup>110</sup> Concerns over the speed and cost of litigation like in other industries dominate lawyers' decision of whether to include an arbitration clause.<sup>111</sup>

<sup>110</sup> See *Living with ADR*, *supra* note 66, at 65.

<sup>111</sup> See *Id.*

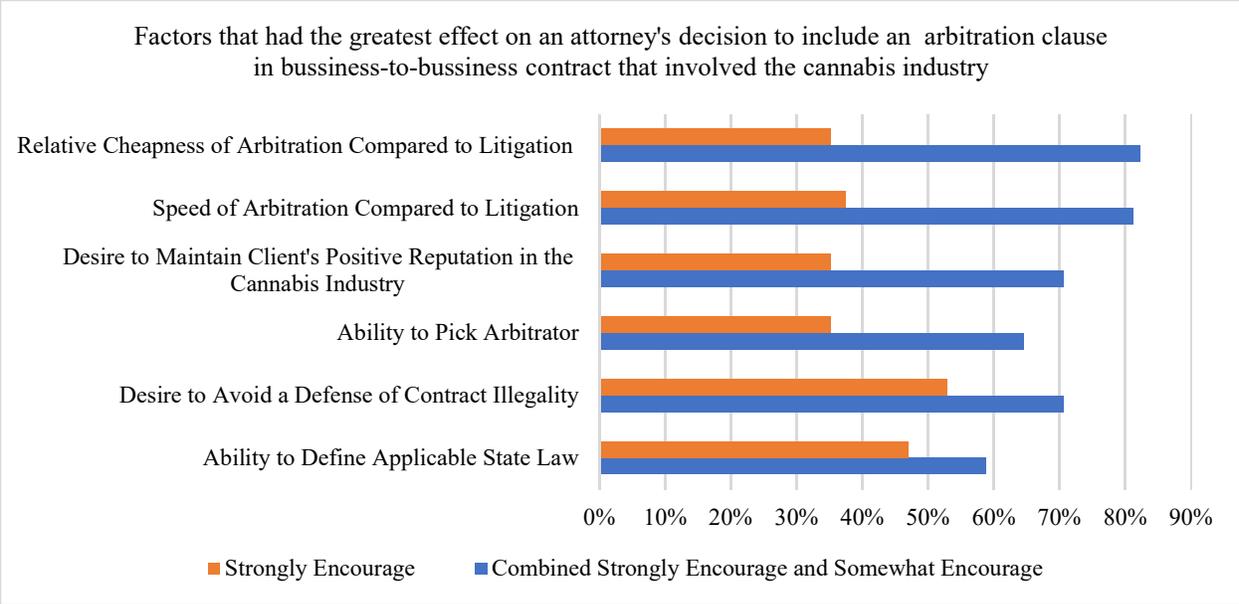


Figure 7

Even though speed and cost were the most popular factors, factors that indicate the use of arbitration that fit within a counter-narrative model were also important. Seventy percent of the respondents stated fear of federal illegality defense encouraged or strongly encouraged their decision to include an arbitration clause. This response was the highest pick for strongly encourage. Respondents also found the ability to define the applicable state law and ability to pick an arbitrator as desirable. These responses indicate that arbitration is being adopted for its ability to protect the shared values of the cannabis industry, specifically the belief that the CSA should not serve as an impediment to the development of contractual relations made in accordance with state law.

The ability to pick an arbitrator was also seen as useful not just for the ability to prevent biases towards a cannabis related company but also for the expertise she may bring to a dispute. Multiple telephone interviews mentioned that outside of federal illegality the only other thing that truly distinguishes cannabis from other industries focused on goods is the complex system of regulations that govern it. The complexity of the regulations governing transactions within the

cannabis industry leads one lawyer to comment that an average contract lawyer examining these contracts would see them as a foreign language.<sup>112</sup>

The laws governing hemp are an example of the complexity of the laws governing the cannabis industry.<sup>113</sup> The intersection of the CSA, separate federal laws, state laws, and international laws create an incongruent system of laws where a hemp plant's legality can rest on what stage of development the plant is in, what part of the plant you are using, what state you reside in, what product you are making, and how you are making that product.<sup>114</sup> These complexities require a knowledge of the federal law governing hemp and a knowledge of the plant itself.<sup>115</sup> Complexities and incongruences like these will continue to grow and multiply as more state regulations emerge, and the federal government remains largely absent from the substantive policy discussion.

The desire to maintain client reputation is another factor that shows why a counter-narrative perspective may be helpful. 70% of the respondents stated that a desire to maintain client's positive reputation in the cannabis industry community. In phone interviews, multiple respondents confirm that they feel that their clients have a reputation in the industry and maintenance of that reputation is an important consideration. One of the reasons cited in phone interviews for the importance is the small size of cannabis markets that are restricted to individual states due to state laws restricting the size of the industry and outside investment. One lawyer commented that due to its small size and the desire for repeat business, many in the cannabis industry fear the spread of salacious information about themselves or their products.<sup>116</sup>

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<sup>112</sup> Telephone interview with survey respondent (Apr. 12, 2017)

<sup>113</sup> See Generally Rod Klight, *Is CBD legal? A Lawyer's Perspective*, KLIGHTONCANNABIS DEFINITIVE WORD ON WEED, (Oct 10, 2015) <http://kightoncannabis.com/is-cbd-legal-a-lawyers-perspective/>

<sup>114</sup> See *id.*

<sup>115</sup> See *id.*

<sup>116</sup> Telephone interview with survey respondent (Mar. 29, 2017 at 3:09 PM)

These concerns may only grow as more disputes emerge around product quality and as competition within the industry grows.<sup>117</sup>

## **VI. Conclusion**

There has been widespread adoption of the use of pre-dispute arbitration clauses within the cannabis industry. The use of these pre-dispute resolution clauses has occurred even though a lot of the contracts currently being formulated within the cannabis industry are material contracts. Further, although the traditional reasons a business elects to choose arbitration have been strong factors in the adoption of these clauses, the primary reason cannabis businesses have adopted these clauses is the ability to pursue their shared interest in reducing the risks of federal illegality. All of this demonstrates lawyers within the industry recognize the value of arbitration as a forum for dispute resolution that can be structured to reduce or eliminate lingering biases against cannabis contracts. In this regard, a counter-narrative model of arbitration is necessary to help recognize and structure arbitration for cannabis businesses to help them pursue that interest.

As the threat of federal illegality begins to dissipate lawyers may move away from arbitration for a lot of the reasons lawyers are currently moving away from arbitration: inability to appeal a judgment, lack of traditional legal rules, compromised outcomes.<sup>118</sup> There is also a growing number of lawyers who have begun to view arbitration as increasingly costly and inefficient.<sup>119</sup> One phone interviewee feels that the risk that a federal illegality defense will be raised in a state court proceeding has already diminished.<sup>120</sup> Another phone interviewee agrees and states that the ability to use contract provisions to define applicable state law is enough

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<sup>117</sup> See e.g. John Schroyer, *Does Vape Lawsuit Foreshadow Litigious Future for Cannabis Industry*, MARIJUANA BUSINESS DAILY (Apr. 12, 2017) <https://mjbizdaily.com/vape-lawsuit-foreshadow-litigious-future-cannabis-industry/> (Discussing lawsuit between two companies over false advertising and the potential for more defamation claims as the industry matures)

<sup>118</sup> See *Living with ADR*, *supra* note 110, at 53

<sup>119</sup> See *id.*

<sup>120</sup> Telephone interview with phone interviewee (Apr. 05, 2017)

protection against a defense of contractual illegality.<sup>121</sup> Both attorneys see the growing expense of arbitration and the inability to appeal judgments as reasons to pursue traditional litigation over arbitration.<sup>122</sup>

Although some lawyers may move away from arbitration as the threat of federal illegality diminishes, a lot of the shared values within the cannabis industry that spur the current use of arbitration will remain. A continued focus on a counter-narrative model of arbitration may be able to help recognize and develop these shared values. As mentioned above, arbitration societies specifically geared towards arbitration are already beginning to emerge. These societies along with traditional arbitration societies and cannabis industry groups can look to other counter-narrative models cited in this paper to develop techniques to help the cannabis industry pursue shared values. For example, they can work to help develop and provide expert adjudicators to navigate the incongruent systems of laws governing cannabis disputes. These societies and groups can build on the current importance of commercial reputation within the industry and develop methods to enhance current networks of information potentially reducing the rise of defamation litigation within the industry. These and other techniques developed from counter-narrative models can help the cannabis industry not just resolve its current problem with federal illegality but promote and achieve other shared interests and values within the industry.

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<sup>121</sup> Telephone interview with non-survey respondent (Apr. 18, 2017)

<sup>122</sup> Telephone interview with non-survey respondent (Apr. 05, 2017); Telephone interview with non-survey respondent (Apr. 18, 2017).