

REGULATORY OVERSIGHT: WHAT CAN THE BUDDING CANNABIS INDUSTRY LEARN FROM THE ESTABLISHED ALCOHOL INDUSTRY?

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Stephen Piepgrass:

Hello and welcome to another edition of Regulatory Oversight Podcast. My name is Stephen Piepgrass. I'm one of the hosts of the podcast and a partner here at Troutman Pepper. We feature commentary from business leaders, regulatory experts, current and former government officials and attorneys in our practice group, discussing a range of topics that affect businesses operating in highly regulated industries. Before we get started today, I wanted to remind all of our listeners to visit and subscribe to our blog at regulatoryoversight.com so you can stay up to date on developments and changes in the regulatory landscape. Today we have with us as our guests, Nick Ramos and Christina Sava, two attorneys in our practice group discussing a topic that I think will be of great interest to our listeners. Nick and Christina will be comparing and contrasting regulations in the alcohol industry with those in the cannabis industry.

These are obviously two industries that are highly regulated, but one has been regulated for many, many years and the other is fairly new. I think the lessons that Christina and Nick can draw from alcohol and apply to cannabis should be insightful and interesting to our listeners. So without further ado, Nick and Christina, you both have a deep understanding of the alcohol and cannabis industries and I know most of our listeners will be familiar with both, but they may not know how the two industries are regulated on a day to day basis. I thought we could start this episode with each of you providing maybe a brief overview of the alcohol and cannabis industries from a regulatory perspective.

Nicholas Ramos:

Well, as you said, Stephen, alcohol regulation has been around for a while, post prohibition era, and we have regulations at the federal state and local levels. The 21st amendment obviously ended prohibition back in the 1930s and it's sort of unique because it gives states a good amount of power when it comes to their ability to regulate the alcohol industry within the states. That said, there's a number of federal agencies that regulate alcohol throughout the country. The most prominent of which is the TTB. Then in the states, the agencies go by different names like the ABCs, departments of revenue, police departments are involved in enforcement, little less common names across all the states, every state has kind of different agency names. But I think one important fact about alcohol regulation in the US that's pretty consistent is that it's inconsistent, right?

So when you talk about alcohol regulation, you really got to think about what's the product I'm talking about here. A lot of folks tend to think about alcohol broadly as this monolithic group. And those that consume alcohol know this because of the products that they buy on the shelves, but beer is different from spirits or liquor, different from wine and ciders. And there's different laws that impose different requirements on those types of products at the federal state and local levels, so the first question you're always asking yourself in the US when it comes to how is this product regulated is kind of identifying the category. So I know that alcohol is a little unique, because it's been around for a while. The industry's been regulated for a little while and is kind of matured a little bit. It's very different from what we're

seeing in cannabis, so I'll turn it over to Christina to just kind of give us a little overview of the industry and where it's at.

Stephen Piegrass:

Christina, Nick started out talking about prohibition which strikes me as a great comparison to the cannabis industry and in many ways you all are... those in the cannabis space are coming out of a prohibition era, very similar to the one that those in the alcohol space came out of decades ago. Can you speak to that a little bit and then give us just a little bit of an overview of where things stand in the cannabis space?

Christina Sava:

Sure Stephen. Yeah. And thanks for laying that groundwork, Nick, and that's a very good point. We're actually living the evolution out of prohibition of the cannabis industry right now, so it's a very fascinating time to be watching regulations unfold and we're still very much in an in-between space, because cannabis is still a schedule I substance on the Controlled Substances Act at the federal level, which means it's technically illegal to produce and sell and possess and use cannabis in the eyes of the federal government. So the only regulations we really have are at the state level and as we know, some states allow only medical cannabis, for medical use with appropriate qualifying conditions and a doctor's physician's recommendation. And other states just fully allow adult use and you can walk into a dispensary, show your ID, the same way you would walk into a liquor store and purchase cannabis and we've got about 19 states doing that currently.

And actually within the states, the regulatory model is similar to alcohol. We've got licensing at the production, distribution and retail sales levels. And like Nick said, there's different agencies that will regulate cannabis and some of them combine their alcohol and cannabis regulatory agency while others will regulate cannabis through their department of health, through their board of pharmacy, especially if it's a medical only program and some just set up a new regulatory body altogether, but it has been fascinating to see how the states have handled regulation on a case by case basis. We've really had an excellent laboratories of democracy situation in the cannabis industry.

Stephen Piegrass:

Christina, can you give us maybe some specific examples if you could, of agencies. I know you mentioned just a couple, some that sound like they have maybe even jurisdiction over both alcohol and cannabis and some that seem to be devoted to other areas as well. Which agencies within specific states do you think are best suited to regulating cannabis and dealing with the types of issues that come up in a very complicated regulatory context where you've got schedule I drug at the federal level, but at the state level for permission for use?

Christina Sava:

Yeah, it's a good question. Well, Washington's a primary example of the state that has combined its liquor and cannabis control agencies. It's actually called the Washington Liquor and Cannabis Control Board. And Virginia, contrasting with where we are here in Virginia, where we currently have a medical only marketplace, is regulated under our board of pharmacy. And when we move into adult use, there will be a new agency set up to regulate cannabis. And Nick and I have discussed this a little bit that it

might make sense for alcohol and cannabis regulations to be merged under a similar agency so you don't have too much overlap or inconsistency within a state.

Nicholas Ramos:

And this is an interesting kind of subtopic in our discussion today because ultimately what we're also at the same time talking about is what should be the balance of power when it comes to cannabis regulation throughout the US? Should it reside pretty heavily at the federal level like we see in some industries with states playing a supporting role or like in alcohol where, as I said earlier, TTB is the lead federal agency, and don't get me wrong, it's an important federal agency that has significant power to regulate the industry. But I would say the majority of the day to day stuff happens at the state level and that's obviously an outgrowth of a constitutional amendment. But in cannabis, we're sort of seeing it grow from the local state level up.

And so when you talk about these overarching regulatory schemes in the future of the cannabis industry, you really have to wonder whether, just because of the nature of how the cannabis industry has grown in the country, whether it's necessary to have some sort of strong federal oversight as opposed to kind of a light touch at the federal level and more significant powers at the state level to regulate cannabis. And just to echo kind of what Christina was saying, I think it makes a lot of sense to combine regulatory authorities at the state level between cannabis and alcohol agencies. Looking at alcohol as a model for regulation, if you were to kind of silo agencies with separate authorities to regulate each industry separately, you might run into interpretation issues, so if a cannabis agency is looking to alcohol laws to create and enforce a regulatory scheme just for cannabis, you might run into a situation where you have two state agencies regulating different products based on a very common area of a body of law and regulations, but come to different interpretations.

And I feel like that just creates a mess, so it seems to me like it's more efficient to take the approach that the alcohol and cannabis industries should probably be regulated by the same agency at the state level. Obviously Christina knows better than I do about what's happening and I'd be curious to know your thought on that idea.

Christina Sava:

Yeah. And I think the one big difference with cannabis is that we still do have a large contingent of medical only states and so the use of cannabis is to treat medical conditions. And so as we move towards most states being adult use states, that overlap does make sense. I'm thinking there still will need to be some kind of input or shared authority perhaps with the board of pharmacy or department of health on the medical side. And touching briefly on the federal state balance of power, I totally agree, Nick, that it's an really interesting question and everyone's kind of waiting with bated breath to see what happens. But I think between states and industry alike, they would like to see states retain control the way they have in alcohol, because so much time and effort has been invested in creating these regulatory systems that are really tailored to each state. And so I think alcohol is an excellent model of how there can be a light touch at the federal level without disrupting the regulatory systems that are already in place at the state level.

Stephen Piepgrass:

One other interesting characteristic and somewhat unique, I guess, in the alcohol space and Nick, maybe you could speak to this, is the prohibition on vertical integration. Can you tell us a little bit about how that works in the alcohol industry and maybe the two of you could talk about whether that model is something that may be followed in the cannabis space?

Nicholas Ramos:

Yeah, definitely Stephen, it's definitely unique. I agree with that. The takeaway here is that as a matter of law, federal and state, vertical integration is typically just not allowed in the alcohol industry. I mean, that's a result of this three tier system that we have in which the supplier obtains a license but can also be a wholesaler and a wholesaler can't obtain the license and can't also be a retailer. So you have these three kind of different tiers of licensed authorities and there is some benefits to creating a regulatory system like that. For one, it could in theory, stimulate competition when you have a vertically integrated company that handles alcohol production, its own distribution and sales direct to its consumers. You cut out a ton of opportunities for other businesses to enter the space and innovate, especially if that's a big company. But there's some downsides to the three tier system as well.

And that is just restriction of direct access to these blocks of constituents within the system, retailers for example or consumers. I'm not convinced that the three tier system best addresses the modern realities of how US consumers drink beverages today. I mean, I could go into a lengthy discussion of history, but I think that the key takeaway here is that this was the system that was imposed in the early 20th century. The world has changed a lot since then, we're in 2022, people don't drink at bars like they used to in the sense that bars held more of a social significance in the early 20th century than they do today. Today it is definitely a social fun thing to do, but people tend to consume beverages in their home or in their backyards.

And especially in cities in the early 20th century, I mean, people congregated at bars because it that's where they'd learn more about the news of the day and so it created kind of this opportunity for companies to essentially create local monopolies where they would sell only their types of brands to people. There was over consumption because there wasn't any restrictions on that and so there were lots of reasons for why the three tier system kind of grew by that early 20th century reality. It just doesn't match reality today. So I feel like the system needs to adapt in alcohol and I would even go further and say that we should take that lesson and apply it to cannabis.

Christina Sava:

Yeah. Nick, thanks for describing that and I'm also curious, what is the role of distributors in this restricted three tier model and how does that affect incoming producers? Because I know in cannabis, there's not a widespread restriction on vertical integration. Again, states are experimenting from state to state. Some actually require vertical integration, mostly in medical systems where they want really tight control over the market. But for the most part, vertical integration is not prohibited. And in a state like California, for instance, where I practiced for a while, we still saw, although all licensees had access to distributor licenses, there were a few major distributors that emerged as the most successful. And then they kind of really were gatekeepers between producers and retailers and is that kind of what happens in alcohol as well?

Nicholas Ramos:

Yeah, I think it is, Christina. I think the key takeaway to the discussion of, well, should you allow one company to be vertically integrated and let's say under one license? So if you were to say a manufacturer or a producer can under one license, create a product, liquors, beer, wine and sell it to whoever it wants. Okay, that's sort of a different discussion, but what I think I'm sort of kind of talking about is, you still have different licensing authorities and you could technically be a vertically integrated company subject to the licenses that you're able to get. So you can kind of stack different licenses and each license has different authority. So in alcohol distributors are distributor licenses, wholesaler licenses. For one, they're required to not discriminate against retailers generally, right?

There's different state laws on this, but generally, they have to carry a range of products and they're not necessarily allowed to kind of favor one particular brand over another. There's laws on how the distributor can supply retailers, for example, and there's laws that regulate kind of the shelf space that these products take up and how wholesaler distributors can incentivize retailers to better position brands that they might distribute or sell to the retailers. And then when you switch the producer manufacturer permits, even in states where you can kind of sell direct to a consumer, I mean, the difference is the distributors carry tons of brands to be profitable, that's what they do. And then on the manufacturer producer side, you'd only kind of sell your brand, but if you wanted to have both licenses, you would fall under the authorities and restrictions of each of those licenses. So it's different when you talk about, I need multiple licenses with multiple authorities to operate as one company, as opposed to I'm just going to be one company that operates under one permit or license.

Christina Sava:

That's really interesting. Yeah, I think that's something that cannabis could definitely learn from. As long as you have these conditions tied to the licenses, it may not create that sort of monopoly or cornering the market. And I know states are trying to encourage competition by limiting the number of licenses one owner can have an interest in or perhaps the tiers that they can have an interest in, but it still remains to be seen what will be the dominant model across the country as the industry evolves.

Stephen Piepgrass:

Speaking of evolution, Nick, I found it fascinating, your discussion of sort of the history of alcohol consumption and how it has changed over the years. Obviously, the pandemic has been somewhat revolutionary with the way that we have seen a significant rise in home delivery of alcohol products. And I think I've seen that beginning in the cannabis area and space as well, Christina. Do you think that sort of a trend in both industries is something that's going to continue and what can we learn from how it has occurred in the alcohol space in cannabis?

Christina Sava:

It is a really fascinating area and is a big part of the industry in the states where it is permitted. It's not permitted in all states but certainly in some major markets, it is a way that consumers get their product. And the interesting thing about it is it's kind of like pizza delivery right now, it's very regional. You have to be delivered within a certain distance of your hub because your drivers can't just carry an unlimited amount of product with them. For the most part, it's mostly a cash based system so drivers are also dealing with payment and checking IDs and medical documentation where it applies. Apple, for instance, only recently changed its user terms to allow payment for products through an app which is revolutionary. This was not permitted before due to the federal illegality of cannabis transactions. And

interstate shipments under federal legalization will likely be able... companies will be able to ship their product across state lines which will really change the direct to consumer landscape in cannabis. And I think that we'll be able to learn a lot from the alcohol industry's experience in this space.

And I'm curious what Nick thinks might the best practices that have evolved in direct to consumer in alcohol that could be borrowed by the cannabis industry?

Nicholas Ramos:

This is the interesting thing about shipment and delivery laws in alcohol. It's not as evolved as say the regulatory permitting aspect of the system and that's because consumer demand has changed in more recent years. Technology has changed that, allowed these online sales and delivery services, apps to exist. And so we're kind of evolving at the same time. But I will say that, so in alcohol direct shipment through common carriers across the country is generally okay with the right permit for wineries and producers essentially of wine. It's less so for beer and liquor, that is an evolving area of law. And delivery, so kind of separately from the shipment aspect, delivery is common. There's a lot of states that would allow a retailer, for example, under its standard retail permit to deliver alcohol to a consumer, say from a grocery store, someone that orders through that grocery store and maybe the grocery store wants to allow one of its employees to deliver directly to that consumer's house.

The third party delivery services obviously play a very important role in the industry, growing role. It's not as regulated, we could definitely use more clear oversight and regulatory certainty when it comes to those types of companies. But I think the key here is that alcohol, when it comes to this topic, is evolving. Cannabis is evolving. We have technology that can address the issues, kind of the counter arguments to direct to consumer shipment should be... or delivery should be legally authorized. For example, we have technology and we can impose a system that does its best to ensure that those products only go to adult consumers, right? Someone that's going to break the law is going to break the law. There's online age verification systems, there's companies that you can pay that will do that. There's technology and a handheld device where you can scan an ID at someone's door to make sure it's valid. You can get signatures at the door.

So there's all of these ways to kind of ensure that the product is getting to the right person and I think it's just a matter of us as a society, one, pressuring our legislators, and then the agencies kind of implementing those laws through their regulations to accept the realities of where we're at, socially and technologically. And I think that these two industries can evolve together to kind of address consumer demand.

Stephen Piegrass:

Last topic I wanted to cover in the last couple of minutes. And this is another sort of trend is the question of onsite consumption. I know that breweries, distilleries, wineries serve customers on site when they come and visit and take tours, and I'm sure that helps in many ways, not just that business but with tourism, especially in regions that are known for particular types of alcohol. Is anything similar being contemplated in the cannabis space? Christina, maybe you can speak to that and again, any lessons that can be learned from alcohol?

Christina Sava:

This is a fun discussion between Nick and I kind of realizing the parallels between the brewery model and now cannatourism is the term that's used for the evolution of this space of people traveling to

states where cannabis is legal and wanting to visit the farms where it is grown or of course go to retailers where it is sold, but it's a really big opportunity for states that have legalized cannabis to capitalize on that, not just for their own residents but also for tourists that might travel particularly for that. And one interesting area is that you could go out to California and take a guided tour and actually visit a cannabis farm and see how the cannabis is grown and what their practices are and what the culture is like out there, so counties are experimenting with this. I think we'll see it continue to grow and borrow a lot of systems from the brewery model, which I would love to hear Nick's thoughts on and real quick, I'll just say that the other onsite consumption experiments happening are with onsite consumption lounges, sometimes restaurants or even hotels.

The term is a Bud and Breakfast where you can... In Colorado, I think is opening the first one where there's an onsite consumption lounge like a bed and breakfast type hotel, so we kind of take it for granted that you can consume alcohol in entertainment venues and at bars and at restaurants, but there really aren't that many sanctioned spaces outside the home to use cannabis and share cannabis with your friends and try cannabis. And so I think this is an area that is ripe for evolution and will continue to grow.

Nicholas Ramos:

Yeah, Christina, for sure. And I think these are just neat and fun places to visit. And in alcohol, we have breweries, wineries, distilleries that are located in rural areas, urban areas. They operate under varying permits, depending on state law, to be able to do this. When you start talking about kind of the policy reasons for these laws and regulations, I mean, it makes sense that a state regulator or legislature would want to incentivize tourism in say a rural area off site. I had an interesting conversation with someone in the wine industry a few weeks ago and she basically said, you can make beer anywhere, you can't make wine anywhere, you need room and space, right? So when it comes to wineries, you definitely can incentivize agricultural tourism in rural areas because of the vineyard space that's required.

Breweries, I've seen it both. I've seen them in cities serving their own beer, brewing their own beer and also in agricultural rural areas like... I'm thinking of Virginia, south of Charlottesville and the Blue Ridge mountains, there's a ton of breweries out there. They attract people, not only to their breweries but even to nearby ski resorts. Been to Asheville, North Carolina, another kind of well-known place. And so you start to see these kind of public policy reasons for authorizing producers to operate in this way and then I guess the last point I'll make, and this is just kind of a non-legal, just interesting marketing point to me is that, it seems to me that if you're a brewery or a winery or distillery that makes a product on site and you also serve it on site, people that come and visit, you could establish a certain rapport and relationship with those specific consumers that come and visit you.

It seems like you can promote the brand but also a little bit of loyalty, just because it seems like consumers are more likely to want to drink something when they've seen how it's made and they have sort of a connection to it. So there's all these really interesting and fascinating reasons for allowing this to continue and just regulating it in the right way. And I think that those can be applied to cannabis, certainly.

Stephen Piepgrass:

Christina and Nick, thank you so much for the time you've spent with us today. This was a fascinating conversation and loved to hear the points of comparison and contrast between cannabis and alcohol

and how things have been developing and where you see them continue to develop, so thanks again. I want to thank our audience as well for tuning in today. Please make sure to subscribe to this podcast, either through Apple podcast, Google Play, Stitcher, whatever platform you use. And we look forward to talking to you all next time when you join us for another episode of Regulatory Oversight.

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