

February Finale: Hemp Law

February 28, 2020

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February Finale: Hemp Law

PROGRAM DETAILS

CLE CREDIT | 3.0 Hours

PLANNED BY | NCBA CLE Department

AGENDA

FRIDAY, FEBRUARY 28, 2020 | 1:00 p.m. – 4:40 p.m.

1:00-1:25	Registration
1:25-1:30	Welcome and Introductions
1:30-2:15	An Introduction to the Hemp Industry; Federal and State Legislative History <i>Russell and Trask</i>
2:15-2:20	Break
2:20-3:05	The Current and Future Regulatory Landscape <i>Russell and Trask</i>
3:05-3:10	Break
3:10-4:40	Legal Issues Facing the Industry <i>Russell and Trask</i>
4:40	Adjourn

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SPEAKERS

Tyler J. Russell is a practicing attorney with Ward and Smith, PA. He co-chairs the firm's Hemp Law practice group. He regularly works with clients involved in all levels of hemp and CBD industries and guides the firm's practice in those efforts.

Tyler is passionate about the hemp and cannabidiol ("CBD") industries, their products, and their people. He co-chairs the firm's Hemp Law practice group, and he represents clients in all aspects of the hemp and CBD industries – both in North Carolina and beyond. His clients include farmers and growers, processors, extractors, product manufacturers, wholesalers, distributors, and retailers. He also assists clients who are involved in the industry but do not directly "touch the plant" – including brokers, consultants, marketing agencies, lenders and financial institutions, and other suppliers and vendors.

[Click here](#) for more information about Tyler.

Allen N. Trask, III is a practicing attorney with Ward and Smith, PA. He began his career as a litigator focused on business and real estate disputes, and he continues to focus his practice on representing those who own, develop, manage, and work the land. Although litigation and dispute resolution remain core parts of Allen's practice, he also enjoys advising clients on a broad range of general legal and regulatory matters. He leads the Firm's Agribusiness Practice Group, and he co-leads its Hemp Law and Community Associations Practice Groups. Allen also serves as the co-Geographic Team Leader for the Firm's Wilmington Office.

Allen works with clients from all sectors of the hemp and CBD markets, both in North Carolina and beyond, and he helps guide the Firm's practice in those efforts. Allen regularly partners with hemp farmers, processors, extractors, product manufacturers, wholesalers, distributors, and retailers to address their unique legal needs. He also assists indirect industry participants, including brokers, consultants, marketing agencies, lenders and financial institutions, and other suppliers and vendors.

[Click here](#) for more information about Allen.

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Tyler J. Russell – Raleigh

Allen N. Trask, III – Wilmington

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CHAPTER I

Hemp Law

I. Overview

These materials, and our presentation on February 28, 2020, are not comprehensive. Instead, they seek to provide a generalized understanding of the hemp industry, which is rapidly growing and changing, and considerations that may impact your clients' operations, investments, transactions, and legal and regulatory compliance. We welcome any and all questions, calls, and comments at or after our presentation. The hemp industry is incredibly dynamic and the rules, regulations, and statutes governing industry participants are still developing and changing – both nationally and in North Carolina.

As used in these materials and in our discussion, the term "hemp" refers to both: "Industrial Hemp", as defined under Section 7606 of the Agricultural Act of 2014 (the "2014 Farm Bill")¹; and "Hemp", as defined under the Agriculture Improvement Act of 2018 (the "2018 Farm Bill")². As used herein, the term "THC" refers specifically to delta-9 tetrahydrocannabinol and the term "CBD" refers specifically to cannabidiol.

II. Hemp's Commercial and Legal Journey

Hemp, like marijuana, is a variety of the plant species *Cannabis sativa L.* (the "Plant"). Hemp can be mistaken for marijuana based on its visual appearance and smell. But unlike marijuana, hemp contains only trace amounts of THC, the cannabinoid primarily responsible for the Plant's intoxicating or psychoactive effects. Simply put, hemp doesn't give users the "high" associated with smoking or ingesting marijuana.

Hemp, as an agricultural commodity, is used in the production of a wide range of products, including foods, beverages, cosmetics, personal care products, nutritional supplements, fabrics, textiles, fibers, paper, construction materials, and many other manufactured goods. It can be grown for its fiber, seed, and flower.

a. Hemp's Commercial Life Cycle

The stream of commerce for all agricultural commodities begins with cultivation. Hemp varieties can roughly be sorted into those varieties grown for fiber and seed, and those varieties grown for flower. Fiber and seed

¹ 7 U.S.C. § 5940.

² PL 115-334, December 20, 2018, 132 Stat 4490

varieties resemble bamboo and typically are grown outdoors in large-scale row crop type applications. Harvest of the fiber involves cutting the plants with large combines, allowing the plants to decompose in the field, and then collecting the plants and delivering them to processors. Harvest of seed and food item varieties resembles the large-scale harvest of other small grains, with standard farm combines and draper heads as fixtures. Floral varieties are cultivated both outdoors, in more traditional agricultural fields, and indoors in a variety of ways ranging from informal "hoop house" type greenhouses to more industrial hydroponic applications. In contrast to the more mechanical harvest of fiber and seed hemp varieties, the majority of the harvest of floral varieties today is done by hand.

Harvested hemp is then processed into mid-stage products. For fiber, this means undertaking a process called decortication, whereby the usable fiber is extracted from the core of the hemp stalk. For seeds, this means cleaning, sorting, and possibly shelling. The primary goal of the processing of floral varieties is the extraction of the Plant's cannabinoids, most prominently CBD. At scale, this process is highly industrial and utilizes specialized equipment that exposes the hemp material to either ethanol, pressurized carbon dioxide, or similar solvents. The resulting crude oil may be further refined into other intermediate products.

The final phases involve taking these mid-stage products and manufacturing end-stage products, such as clothing fiber, packaged seed and seed-based flour, or oil-based tinctures, and bringing those products to market, for which there is meaningful consumer demand. The Congressional Research Service has reported that U.S. hemp product sales were estimated to have grown from \$688 million in 2016³ to \$818 million in 2017.⁴

Clearly, despite significant legal challenges and risks in the industry (which are addressed in more detail below), hemp is big business. And that business is growing, especially here in North Carolina. To better understand where hemp is today and where it is going in the future, it makes sense to start at the beginning.

b. 2014 Farm Bill

Since passage of the Marihuana Tax Act in 1937, all forms of cannabis (including hemp) have been effectively prohibited at the federal level. Over the last 5 decades, hemp has been regulated by the Drug Enforcement Administration ("DEA") as a Schedule I controlled substance pursuant to the Controlled Substances Act of 1970 (the "CSA")⁵. Its cultivation, possession,

³ <https://fas.org/sgp/crs/misc/RL32725.pdf>

⁴ <https://crsreports.congress.gov/product/pdf/IF/IF10391>

⁵ 21 U.S.C. Ch. 13, § 801 *et seq.*

and use in commerce has been, effectively, illegal under the CSA's blanket prohibition. But, the 2014 Farm Bill loosened those restrictions by allowing cultivation under authorized state research programs pursuant to certain specified conditions. The 2014 Farm Bill defines "Industrial Hemp" as "the plant *Cannabis sativa L.*, and any part of such plant, whether growing or not, with a delta-9 THC concentration of not more than 0.3% on a dry weight basis."⁶

The 2014 Farm Bill did not amend the CSA to remove Industrial Hemp from its list of Schedule I controlled substances. However, the 2014 Farm Bill did explicitly state that the cultivation of Industrial Hemp in compliance with the 2014 Farm Bill is permitted "notwithstanding the CSA or any other federal law," and the United States Court of Appeals for the Ninth Circuit has concluded that the 2014 Farm Bill therefore "preempts" the CSA.⁷ Further, as stated above, the 2018 Farm Bill has since become law and it does expressly remove Hemp (which includes Industrial Hemp) from the CSA.

The 2014 Farm Bill permits the cultivation of Industrial Hemp under limited circumstances only where authorized by state law. The cultivation must be conducted by either "an institution of higher education (as defined in section 101 of the Higher Education Act of 1965 (20 U.S.C. § 1001))" or "a State department of agriculture."⁸ And, institutions of higher education or state departments of agriculture must satisfy the following conditions: (a) the Industrial Hemp must be cultivated for research purposes, conducted under an agricultural pilot program or other agricultural or academic research; and (b) the cultivation of Industrial Hemp must be allowed under applicable law.⁹

The 2014 Farm Bill defines "agricultural pilot program" as a "pilot program to study the growth, cultivation, or marketing of [I]ndustrial [H]emp," in a state that permits such cultivation, provided that: (1) "only institutions of higher education and State departments of agriculture are used to cultivate Industrial Hemp"; and (2) the site used for cultivation is "certified by, and registered with, the State department of agriculture."¹⁰ The 2014 Farm Bill also authorizes the applicable State department of agriculture to "promulgate regulations to carry out the pilot program in the State in accordance with the purposes of [the 2014 Farm Bill]."¹¹ Generally speaking, the 2014 Farm Bill does not specify the regulations that a State department of agriculture may promulgate and does not establish any federal regulatory framework for

⁶ 7 U.S.C. § 5940(b)(2).

⁷ See *Hemp Indus. Ass'n v. U.S. Drug Enf't Admin.*, 720 F. App'x 886, 887 (9th Cir. 2018).

⁸ 7 U.S.C. § 5940(a).

⁹ *Id.*

¹⁰ 7 U.S.C. § 5940(b)(1).

¹¹ *Id.*

hemp cultivation. Instead, states were afforded the authority to determine the appropriate regulatory regimes for their respective jurisdictions and, as such, states have taken varying approaches in their pilot programs. Since the passage of the 2014 Farm Bill, some states have promulgated regulations governing (and issued registrations permitting) not only the cultivation of Industrial Hemp, but also the processing and handling of Industrial Hemp. North Carolina only licenses hemp cultivation under its research pilot program (discussed more below).

In addition to permitting the cultivation of Industrial Hemp for research purposes, the 2014 Farm Bill also permits agricultural pilot programs to study the "marketing of industrial hemp," a phrase that is not defined in the 2014 Farm Bill. In August 2016, the Federal Food and Drug Administration ("FDA"), U.S. Department of Agriculture ("USDA"), and DEA issued a Statement of Principles attempting to define the scope of market research activities permitted under the 2014 Farm Bill. In relevant part, the Statement of Principles provides that "[f]or purposes of marketing research...but not for the purposes of general commercial activity, industrial hemp products may be sold in a State with an agricultural pilot program or among States with agricultural pilot programs but may not be sold in States where such sale is prohibited."¹² Thus, at a minimum, the 2014 Farm Bill allows commercial activity in conjunction with market research, and permits Industrial Hemp-derived products to be transferred amongst states with agricultural pilot programs authorizing such activity. It is worth noting, however, that the Statement of Principles is not legally binding and is disputed by many, including members of Congress who drafted the 2014 Farm Bill, as contravening the intent of the 2014 Farm Bill and exceeding the FDA's, USDA's, and DEA's authority.¹³ However, as recently as February 27, 2019, the USDA referenced the Statement of Principles as "additional guidance" that remains applicable to the 2014 Farm Bill.¹⁴

In summary, the 2014 Farm Bill permits the limited cultivation and marketing of Industrial Hemp (which, by definition, cannot contain more than 0.3% THC), if (i) the Industrial Hemp is grown for research purposes; (ii) by an institution of higher education or pursuant to an agricultural pilot program, and (iii) in a state that permits its cultivation. In addition, if the cultivation is conducted pursuant to an agricultural pilot program, the cultivator must register with the State's department of agriculture and comply with all regulations promulgated by same. Although the 2018 Farm

¹² Office of the Secretary, USDA; DEA, DOJ; FDA, HHS, "Statement of Principles on Industrial Hemp," 81 Fed. Reg. 53395-01 (August 12, 2016), <http://federalregister.gov/a/2016-19146>.

¹³ See, e.g. Amicus Brief of Members of United States Congress in *Hemp Indus. Ass'n v. U.S. Drug Enf't Admin.*, Case No. 17-70162, Jan. 11, 2018, Dkt. 47 (available at https://files.iowamedicalmarijuana.org/imm/federal/usca9_17_70162_047.pdf)

¹⁴ See <https://www.ams.usda.gov/content/hemp-production-program>.

Bill supersedes the 2014 Farm Bill in some ways, as discussed in more detail below, the 2014 Farm Bill is still relevant and applicable as the full regulatory scheme under the 2018 Farm Bill has not yet come to bear.

c. NC Industrial Hemp Research Pilot Program

The North Carolina General Assembly responded to the passage of the 2014 Farm Bill by, in turn, adopting and enacting its own industrial hemp authorization laws¹⁵ and regulations¹⁶ in 2015. Among other things, that legislative action created the North Carolina Industrial Hemp Commission (the "Hemp Commission") – our state's licensing body for hemp cultivators – and decriminalized the production and use of industrial hemp if certain rules are followed. The Hemp Commission, in partnership with the North Carolina Department of Agriculture, presently licenses and oversees the production of industrial hemp in North Carolina through the administration of a highly regulated pilot program.

d. 2018 Farm Bill and its Changes

The passage of the 2018 Farm Bill and its execution by President Donald Trump on December 20, 2018, materially altered the legal landscape governing the production of hemp in the United States. The 2018 Farm Bill, in effect, decriminalized hemp and hemp-derived cannabinoids, extracts, and isomers by: (a) expressly excluding hemp (as defined under the 2018 Farm Bill) from the definition of "marijuana"; and, (b) expressly excluding any THC that exists in hemp (as defined under the 2018 Farm Bill) from the Schedule I controlled substances list. Under the 2018 Farm Bill, hemp is now regulated as an agricultural crop by the USDA in coordination with state departments of agriculture and tribal authorities (as explained below).

The 2018 Farm Bill defines hemp as "the plant *Cannabis sativa L.* and any part of that plant, including the seeds thereof and all derivatives, extracts, cannabinoids, isomers, acids, salts, and salts of isomers, whether growing or not, with a delta-9 tetrahydrocannabinol concentration of not more than 0.3 percent on a dry weight basis."¹⁷ This definition is a notable expansion from the limited definition of "Industrial Hemp" contained in the 2014 Farm Bill, which did not explicitly include cannabinoids and extracts, and thus left room for debate amongst agencies. Most significantly, the 2018 Farm Bill amends the CSA to explicitly exclude hemp – inclusive of all of its derivatives, extracts, and cannabinoids containing not more than 0.3% THC – from the

¹⁵ See NC General Statutes Chapter 106, Article 50E.

¹⁶ See NCAC, Title 2, Chapter 62.

¹⁷ PL 115-334, December 20, 2018, 132 Stat 4490, Section 10113, Sec. 297A.

federal definition of "marihuana" and also creates a specific exemption for THC found in hemp.¹⁸

Unlike the 2014 Farm Bill, the 2018 Farm Bill establishes a federal regulatory framework for hemp production in the United States. The 2018 Farm Bill appoints the USDA (as opposed to the DEA) as the primary federal regulatory agency overseeing hemp production in the United States. However, any states, U.S. territories, and Indian tribes desiring to obtain (or retain) primary regulatory authority over hemp activities within their border are allowed to do so after submitting a plan for regulating hemp production to the USDA and receiving approval from the USDA for that plan.¹⁹ State plans must be submitted through the state's department of agriculture in consultation with the Governor and chief law enforcement officer of the state (or the tribal government, as applicable).²⁰ The USDA is required to approve or disapprove any state or tribal plan within sixty (60) days of receiving it.²¹

States or tribal authorities that choose to submit and subsequently receive USDA-approval for their own plans will be responsible for issuing licenses through their respective departments of agriculture. Hemp production in jurisdictions that do not submit their own plans (and that do not otherwise prohibit hemp production) will be governed by USDA regulation,²² and individuals seeking to cultivate hemp in such jurisdictions will be able to apply to the USDA for licensure.²³ Once USDA regulations are implemented, (1) in jurisdictions without USDA-approved plans, it will be unlawful to cultivate hemp in the state (or territory or Indian tribe, as applicable) without a license issued by the USDA;²⁴ and (2) in jurisdictions with USDA-approved plans, it will be unlawful to cultivate hemp in the state (or territory or Indian tribe, as applicable) without a license issued by that state's department of agriculture (or tribal government, as applicable).²⁵

e. U.S. Domestic Hemp Production Program

The USDA established the U.S. Domestic Hemp Production Program through an Interim Final Rule ("IFR") published on October 31, 2019.²⁶ It is codified at 7 CFR Part 990. The IFR will remain in place for up to 2 years – through November 21, 2021 – unless it is extended by notification in the Federal

¹⁸ *Id.* Section 12619

¹⁹ *Id.* Section 10113, Sec. 297B(a)(1).

²⁰ *Id.*

²¹ PL 115-334, December 20, 2018, 132 Stat 4490, Section 10113, Sec. 297B(b)(1).

²² *Id.* Sec. 297C(a).

²³ *Id.* Sec. 297C(b).

²⁴ *Id.* Sec. 297C(c)(1).

²⁵ *Id.* Sec. 297B(e)(2)(A)(ii).

²⁶ <https://www.federalregister.gov/documents/2019/10/31/2019-23749/establishment-of-a-domestic-hemp-production-program>

Register. A "final rule" is expected to be drafted and published on or before November 21, 2021. The final rule may be different from the IFR, based on the public comments received by USDA and its ongoing consideration. Public comment was taken through January 31, 2020. The specifics of the IFR are discussed in more detail below.

The 2018 Farm Bill includes a provision continuing the operation and applicability of the 2014 Farm Bill until one year after the United States Secretary of Agriculture publishes regulations governing commercial production of hemp in jurisdictions without USDA-approved programs.²⁷ That publication occurred on October 31, 2019, when the IFR was released. Accordingly, the 2014 Farm Bill and existing state-level research pilot programs will phase out of applicability on October 30, 2020. Until then, states may continue to allow licensed hemp cultivation under the 2014 Farm Bill and their existing research pilot programs unless (1) the state submits a permanent hemp production plan to the USDA under the IFR and that plan is approved by USDA before October 30, 2020, or (2) the state terminates its research pilot program prior to October 30, 2020.

III. Federal and State Regulatory Considerations

Federal decriminalization of hemp and hemp-derived products through the 2018 Farm Bill was a watershed moment for the hemp industry. But, by decriminalizing hemp, the 2018 Farm Bill also ushered in a new era of regulatory scrutiny and control within the hemp (and, particularly, CBD) industry. Under the 2014 Farm Bill and state pilot program structure, only cultivation was directly regulated. That structure persists for now at the federal level, but hemp cultivation will soon be regulated under the U.S. Domestic Hemp Production Program (or state programs approved by the USDA thereunder). While cultivation has a somewhat clearer road to regulation, the regulation of cannabinoid-related retail products has been very uncertain.

a. Regulation of Hemp Cultivation

In North Carolina, as mentioned above, the Hemp Commission approves and issues hemp cultivation licenses. To obtain a license, applicants must meet all of the threshold criteria for licensure described in the applicable program rules – including, qualification of the applicant as a bona fide farmer. The Hemp Commission does not approve or issue licenses for other participants in the hemp industry – including extractors, product formulators, manufacturers, distributors, and retailers. The Hemp Commission does, however, require "processors" (a term that is not defined by the law) to

²⁷ PL 115-334, December 20, 2018, 132 Stat 4490, Section 7605.

register with the state and to provide certain annual reports on their operations.

No North Carolina hemp is yet being cultivated under the IFR but its provisions warrant proactive attention as they are markedly different from the current regulatory structure. These differences include, but are not limited to, the following: (i) the USDA Farm Service Agency will manage, as it does with other crops, farm information such as location, acreage, and the like; (ii) hemp crops must be sampled for THC testing fifteen (15) days *prior* to the anticipated harvest; (iii) all THC testing must be complete by DEA-registered third party laboratories; and (iv) all hemp exceeding acceptable levels of THC must be disposed of in accordance with the applicable provisions of the Controlled Substances Act and DEA regulations. All state plans must meet the regulatory floor set by the IFR. State plans can be more restrictive than the IFR – but they cannot be less restrictive.

b. Regulation of CBD Retail Products

On the same day that the 2018 Farm Bill was signed into law, the FDA released a statement which forecast its clear intention to take an active role in regulation and enforcement for hemp and CBD products going forward.²⁸ Since then, the FDA has reaffirmed this statement on multiple occasions and it has been actively involved in the industry from an enforcement standpoint.

Under its own interpretation of the Federal Food Drug & Cosmetic Act ("FD&C Act"), the FDA has concluded that it is illegal to market or sell food, beverage, and dietary supplement products containing CBD in interstate commerce. The North Carolina Department of Agriculture has adopted this position for intrastate commerce activities as well, and it has warned CBD companies and consumers of its position in advisory letters. The FDA has publicly affirmed its desire to establish a regulatory "pathway forward" for hemp-derived CBD and CBD products, but there is no certain timeline for the agency's efforts on that topic. Congress is pressuring the FDA to take action sooner than later, including the passage of a recent appropriations provision that requires the FDA to provide a full report on the status of its efforts, but no action has yet been taken which would require the FDA to accomplish this process by a date certain.

The Federal Trade Commission ("FTC") has also begun to show increased regulatory scrutiny and concern in the hemp and CBD industries. The FTC joined with the FDA in warning letters issued to CBD product companies in the Spring of 2019 involving claims made in those companies' marketing materials that were false, misleading, unsubstantiated by competent

²⁸ <https://www.fda.gov/news-events/press-announcements/statement-fda-commissioner-scott-gottlieb-md-signing-agriculture-improvement-act-and-agencys>

evidence, and that otherwise violated the FTC Act and the FD&C Act. The FDA followed this with additional warning letters in November of 2019,²⁹ and it took a hard line in stating that it could not conclude that CBD was "generally recognized as safe"³⁰ such that it would not require FDA approval to be added to food and beverages.

Companies can expect the interest and influence of regulatory agencies like the FDA and FTC to continue to grow and develop as the commercial hemp and CBD industries mature.

IV. Doing Business with the Hemp Industry

The following briefly summarizes key considerations for any clients that are involved (or considering involvement) in the hemp industry, regardless of whether or not they actually "touch the plant."

a. Landlords, know your tenants

Whether your client owns farm land or commercial properties, if they are considering a lease to a hemp-related operation, it is imperative that they understand who the tenants are, and what they plan to do in business. Landlords should be comfortable that their tenants are fully licensed or authorized (as applicable) by the state to conduct their business operations, and that those operations are being conducted in compliance with all applicable hemp laws and regulations. Landlords should protect themselves with written lease agreements that contain appropriate representations, warranties, covenants, and indemnification. Written leases should also give landlords an appropriate "out" in the event a company loses its licensure or governmental authorization to operate, operates in violation of the law, etc.

Landlords may also want to address what will happen to the tenant's possessions at the property if a default and/or eviction occurs. For example, if plant material (flower or biomass) is left at the premises following default, what can (and should) the landlord do to dispose of it? Landlords may also want to scrutinize the tenants' financials (or, the financials of the tenants' principals) to mitigate risk of default issues. There are many undercapitalized startups in this industry.

b. Insurance

Will typical, general liability policies be sufficient to protect your client and its business from a risk-related event? For example, extraction facilities

²⁹ <https://www.fda.gov/news-events/press-announcements/fda-warns-15-companies-illegally-selling-various-products-containing-cannabidiol-agency-details>

³⁰ <https://www.fda.gov/food/food-ingredients-packaging/generally-recognized-safe-gras>

involve highly dangerous chemicals and industrial processes. Your clients should be fully assessing all available insurance products for their business and comparing the costs of same against the real risks and liabilities they may face in their hemp-related operations.

Governmental crop insurance is not yet fully available for all hemp cultivators. But, whole farm revenue coverage is available this year for certain farmers who may qualify. Also, the USDA has announced a limited pilot insurance program through Multi-Peril Crop Insurance, and also some coverage through the Noninsured Crop Disaster Assistance Program.³¹ Private crop insurance options may also be available in some instances.

Product liability insurance is important for any company that is making, selling, or re-selling any consumer products intended for consumption or ingestion (or, any ingredients utilized in those ultimate end-use products). Product liability lawsuits have not yet begun to hit the industry in waves – but, it is only a matter of time before those claims are made in the court system. Consumer class action lawsuit are currently on the rise.

c. Banking concerns

Whether your client's business "touches the plant" or not, there are real banking considerations and concerns for anyone involved in the industry. Your clients should communicate with their lenders before diving into hemp-related activities. Although it is legal for banks and lenders to do business with lawful, compliant hemp-related businesses, many traditional financial institutions and credit unions are nonetheless choosing to mitigate their compliance risks by refraining to do business with hemp-related companies. In some instances, those banks and credit unions are also terminating their relationships with vendors, landlords, and other companies that do not directly cultivate, produce, or sell hemp or hemp products. It is important to know and understand the risk appetite of their existing lenders before your client begins any hemp-related operations. Some lenders may be willing to continue to do business with your clients, but others may close out accounts, call debt obligations, and otherwise seek to terminate their deposit and/or lending relationships.

d. Investments; Availability of Capital

As indicated above, banking relationships for hemp businesses can be difficult to obtain. There are real access to capital concerns for hemp businesses today. Loans and credit lines are not easy to obtain within the

³¹ <https://www.usda.gov/media/press-releases/2020/02/06/usda-announces-details-risk-management-programs-hemp-producers>

industry. Even deposit accounts can be difficult to obtain for hemp-related businesses.

Merchant services are often denied to the industry due to its "high risk" status. Few providers are willing to offer credit card services for brick-and-mortar and online sellers. Those companies that do offer merchant services to the industry usually require burdensome capital reserves and charge fees much higher than those charged to other industry groups. Your clients should be cognizant of these access to capital issues before they embark on their business operations.

Often, today, hemp-related businesses are funded through private investment (capital raises from accredited investors, private equity groups, and other sources) and/or self-financing of operations by the owners/operators of the companies.

e. Bankruptcy issues

Rarely considered, but important if a business venture does not ultimately succeed, are bankruptcy concerns for the industry. Hemp-related operations that are fully and properly licensed and operating in compliance with applicable state and federal laws should be afforded bankruptcy protection under the United States Bankruptcy Code.

However, before seeking bankruptcy protections, it is imperative that your clients confirm that their hemp-related operations are fully legal and operating in compliance with the law. Federal bankruptcy courts have rejected marijuana-related businesses from seeking protection due to illegality of that industry at the Federal level, even if the businesses were compliant with the state laws of their operational jurisdiction. If a hemp-related business is not operating in compliance with Federal laws and regulations, bankruptcy courts may reject those hemp-businesses as well in the event of a filing.

The same analysis must also apply if your company does not "touch the plant" but, instead, offers services or goods to a hemp-related business. If your client's plan to reorganize its debts hinges on an ongoing relationship with a business that is not operating in full compliance with Federal laws and regulations, it may create issues. Even a commercial landlord that leases space to a non-filing cannabis-related business may be prevented from reorganizing its debts in some instances.

V. Ethical Considerations

Given the (relatively speaking) recent decriminalization of hemp and CBD, and the still evolving state of applicable laws and regulations, every interaction with a

hemp and CBD client must – to some degree – involve an ethical analysis on the part of the lawyer. This is necessitated, in large part, by the lightning speed with which the commercial markets for hemp and CBD are growing (and the slowness with which our regulators and lawmakers are acting to develop laws, policies, and programs to oversee those commercialized efforts).

This is especially true given that Rule 0.1 of the Rules of Professional Conduct (each a "Rule" and collectively the "Rules") requires lawyers to be competent, prompt and diligent, and their conduct to conform to the requirements of the law.

Who is Your Client?

Who is your client? Are you representing an individual person? Or, are you representing an organization? Do you also represent the owners or operators of that organization in their individual capacity? If an organization, who is authorized to act as an agent of the organization and to give you instructions as the entity's attorney?

What is the nature of your client's business? Do they "touch the plant" or not? Do they have all required licenses, approvals, and authorities to lawfully conduct their business in each jurisdiction where they operate?

These questions (and their answers) matter. If you do not know who your client is, or what they do, then you cannot effectively counsel your client, and you cannot be sure that you are satisfying your professional and ethical obligations in that representation.

Rule 1.2

Rule 1.2 prohibits a lawyer from counseling a client to engage, or assisting a client, in conduct that the lawyer knows is criminal. A lawyer may discuss the legal consequences of any proposed course of conduct with a client and may counsel or assist a client to make a good faith effort to determine the validity, scope, meaning or application of the law. Rule 1.2 also allows an attorney to limit the scope of the representation if such limitation is reasonable under the circumstances.

Example: Prospective client calls your office to discuss their business venture. They would like your help setting up an LLC for a new operating entity. They would also like your advice and assistance as it relates to their development of an edible CBD product that they intend to market and sell in interstate commerce. They believe that their product formulation has healing properties and treats or heals diagnosed medical conditions (but they have not obtained FDA approval for those claims), and they intend to indicate same on their labels and in the product's marketing materials. How do you respond? And will you take them on as a client?

Rule 1.13

Rule 1.13 allows a lawyer employed or retained by an organization to act through that organization's duly authorized representatives. If a lawyer for an organization knows that an officer, employee, or other person associated with the organization is engaged in action, intends to act or refuses to act in a matter related to the representation that is a violation of a legal obligation to the organization, or a violation of law which reasonably might be imputed to the organization, and is likely to result in substantial injury to the organization, then the lawyer shall proceed as is reasonably necessary in the best interest of the organization. Unless the lawyer reasonably believes that it is not necessary in the best interest of the organization to do so, the lawyer shall refer the matter to higher authority in the organization, including, if warranted by the circumstances, to the highest authority that can act on behalf of the organization as determined by applicable law. If, despite the lawyer's efforts, the highest authority that can act on behalf of the organization insists upon action, or a refusal to act, that is clearly a violation of law and is likely to result in substantial injury to the organization, the lawyer may reveal that information outside the organization (if permitted by Rule 1.6) and may resign in accordance with Rule 1.16.

Example: You represent a hemp-related business entity. Part of its business involves the processing of hemp biomass and the resulting production of CBD-rich oils and products. Your client contact (the plant facility manager) discloses to you that the organization has recently received a shipment of hemp biomass from a farmer that tested "hot" (greater than 0.3% THC by dry weight). The contact also discloses that he intends to retain the biomass anyways and to process that material notwithstanding its illegal status. What do you do?

Example 2: Your client contact (the plant facility manager) discloses to you that they intend to use legally compliant hemp biomass to produce highly-concentrated products that contain more than 0.3% THC by dry weight. You inform the client contact that this violates state and federal law, but he indicates that he intends to ignore your advice. What do you do? Do you tell his superiors at the organization you represent and counsel them against this course of conduct? What should you do if those superiors also ignore your advice?

VI. Cross-Border Representation Issues.

The hemp and CBD industry regularly touches on interstate commerce. Rarely are operations wholly intrastate in nature. As such, there are always cross-border representation issues to consider.

Rule 5.5.

Rule 5.5 prohibits a lawyer from practicing law in a jurisdiction where doing so violates the regulation of the legal profession in that jurisdiction. And, it prohibits

a lawyer from assisting another person in the unauthorized practice of law. However, a lawyer is not prohibited from providing services limited to federal law.

Example: A prospective client calls your office. The client's operations are located in Arizona. The client is licensed to cultivate and produce hemp by the Arizona Department of Agriculture. The client would like your assistance with state and federal regulatory compliance and advisory matters. You are not licensed to practice law in Arizona. May you advise the client on Arizona state law and regulatory issues impacting the client's business? May you advise the client on Federal law and regulatory issues impacting the client's business?

VII. Importance of Staying Informed and Abreast in the Law.

Marijuana is still very much illegal on the Federal level, and in North Carolina. And it can be difficult to discern between marijuana and hemp by sight or smell alone. The legal differentiation between marijuana and hemp boils down to whether or not the Plant contains 0.3% THC or less by dry weight.

Also, given the new state of the industry, and the continuous development and changes in federal and state laws and regulations, it is imperative that attorneys practicing in this field of law keep themselves well educated and abreast of legal updates and implications.

Rule 1.1

Rule 1.1 prohibits a lawyer from handling a legal matter that the lawyer knows or should know he or she is not competent to handle without associating with a lawyer who is competent to handle the matter. Competent representation requires the legal knowledge, skill, thoroughness, and preparation reasonably necessary for the representation.

Example: You maintain a general practice of law. A client comes to you for assistance with an issue that requires specialized knowledge of FDA laws and regulations. Should you take on the representation? If so, do you need to associate in an attorney with greater experience in that field of law?

Rule 1.4

Rule 1.4 requires a lawyer to explain matters to the extent reasonably necessary to permit the client to make informed decisions regarding the representation.

Example: You maintain a general practice of law. A client comes to you for assistance with an issue that requires specialized knowledge of FDA laws and regulations. Are you able to sufficiently explain the law and regulation (and how it impacts that client's issue) in a way that will allow the client to make an informed

decision? Do you have the necessary underlying knowledge to be able to fully understand and identify the risks and challenges that client may face?

Rule 8.4

Rule 8.4 outlines professional misconduct by lawyers. Among other things, it is professional misconduct for a lawyer to violate or attempt to violate the Rules, or knowingly assist or induce another to do so. It is also misconduct for a lawyer to commit a criminal act that reflects adversely on the lawyer's honesty, trustworthiness, or fitness as a lawyer in other respects.

VIII. Other Rules and Impact

Rule 1.6

Rule 1.6 requires a lawyer to maintain as confidential information acquired during the professional relationship with a client unless the client gives informed consent. A lawyer must make reasonable efforts to prevent the inadvertent or unauthorized disclosure of, or access to, information relating to the representation of a client.

Client confidentiality can be a challenge within this industry, and must remain at the top of your mind at all times. The industry is relatively small and there is often overlap between the people, companies, and operations of businesses within the hemp industry. One of your clients (or, the contact at your client organization) may be involved in different lines of business with different people. You must be careful not to disclose information or breach client confidences. Your clients may blur the lines between those efforts and operations, but it is our responsibility to maintain confidentiality at all times.

Rule 1.7

Rule 1.7 prohibits a lawyer from representing a client if the representation involves a concurrent conflict of interest. We must be mindful of conflicts involving our clients and their operations before we accept representation or agree to undertake work. Especially given the overlap that exists within this industry today. Some, but not all, conflicts and potential conflicts can be waived with informed written consent of the clients.

Rule 1.16

Rule 1.16 allows a lawyer to decline or terminate representation of a client in certain instances. A lawyer must decline or terminate representation where that representation will result in a violation of law or the Rules. Even upon withdrawal or termination of the representation, a lawyer must take steps (to the extent reasonably practicable) to protect the client's interests. If client insists on taking

actions that violate state or federal laws or regulations, you may have an obligation to decline representation or to withdraw from further representation of that client.

IX. Closing Summary

Although hemp and hemp-derived CBD are no longer Schedule I controlled substances under the CSA, the decriminalization of those substances has subjected them to extensive regulation by Federal and state authorities. The legal landscape is fluid today, with major developments occurring at a rapid pace. Until the industry matures and final regulations are developed and implemented by the various governing agencies, it is imperative that attorneys and their industry-participant clients stay abreast of those developments.

APPENDIX

PowerPoint Presentations

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HEMP

In NC and Beyond

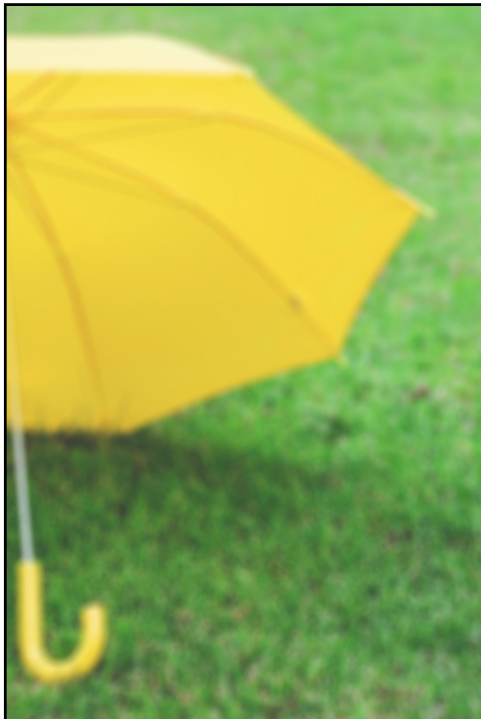
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All information current as of 2/28/20

1



Key Provisions of Law

Section 7606 of the Agricultural Act of 2014 (the "2014 Farm Bill")

North Carolina's Research Pilot Program (N.C. Gen. § 106-568.50 *et seq.*)

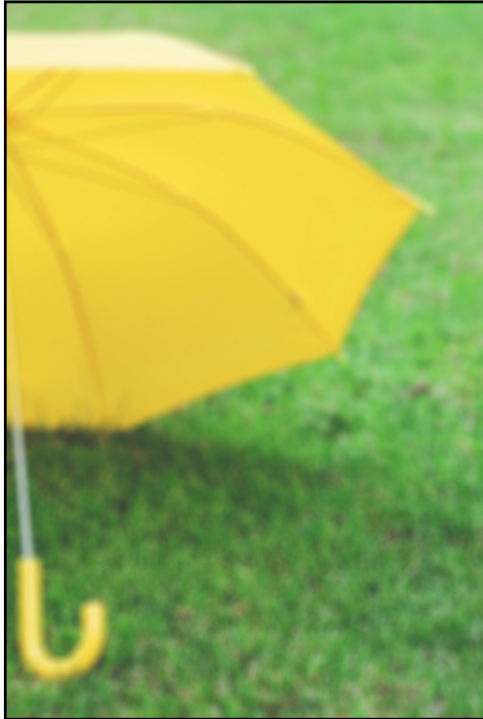
Agriculture Improvement Act of 2018 (the "2018 Farm Bill")

Federal Food Drug and Cosmetic Act

North Carolina Food Drug and Cosmetic Act



2



Key Terms

Hemp: We will use the term "hemp" very generically in our discussion. But there is a difference between the definition of "*hemp*" under the 2018 Farm Bill and the definition of "*industrial hemp*" under the 2014 Farm Bill. If we need to differentiate, we will use the term "*industrial hemp*" or otherwise give specific context in our discussion.

THC: When we refer to "THC" in our discussions, we are referring specifically to delta-9 tetrahydrocannabinol.

CBD: When we refer to "CBD" in our discussions, we are referring specifically to cannabidiol.



3

Hemp vs. Marijuana

They are not the same. But they are closely related.

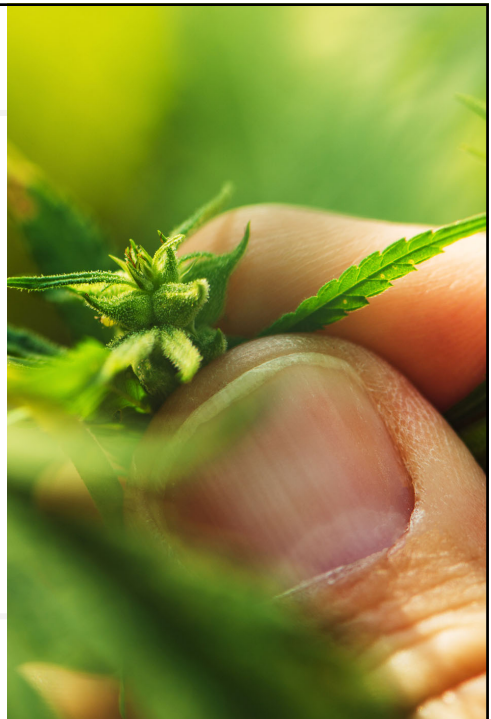
Both are forms of *Cannabis sativa* L., and both share a similar visual appearance and smell.

Hemp contains only trace amounts of THC, the cannabinoid primarily associated with marijuana's intoxicating or psychoactive effects. Hemp will not get you "high".

Marijuana and marijuana-derived THC are Schedule I controlled substances under the Federal Controlled Substances Act.

Hemp and hemp-derived THC are not controlled substances.

Hemp is now an agricultural commodity (just like beans, corn, tobacco, wheat, etc.).



4

Why Hemp?

Three main categories of production from the plant:

- **Flower**, for extraction and use of cannabinoids found in the plant.
- **Fiber**, for numerous industrial uses and applications, including textiles, fabrics, paper, bioplastics, and building materials.
- **Seed and grain**, for hemp seed oils, hemp seed flour, and other food products.



5

What's in the Plant?

Cannabinoids

The active chemical constituents of the cannabis plant. Includes THC, CBD, and over 100 other naturally occurring cannabinoids.

Terpenes

Terpenes are chemical compounds, naturally present in cannabis plants and they contribute to the plant's unique taste, smell and color.

Flavonoids

Compounds that give cannabis plants their pigmentation (color), filter out UV rays, attract pollinators, and prevent plant diseases.



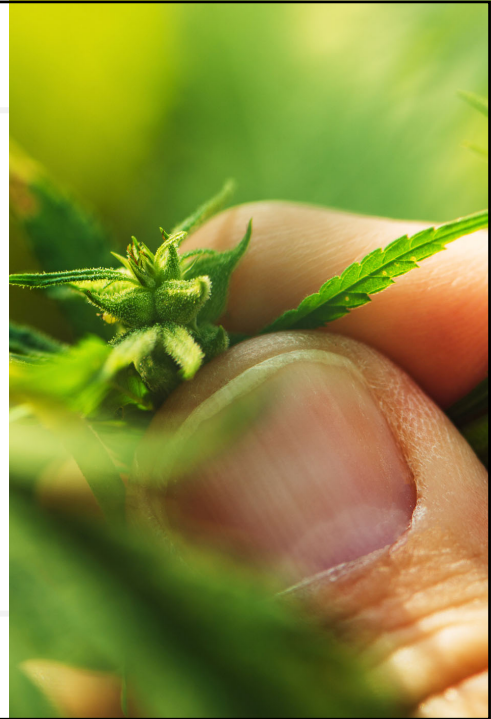
6

Hemp Seed Oil vs. Hemp Extract What's the Difference?

Hemp Seed Oil: Similar in composition to other edible oils, such as canola, flax, walnut, and cottonseed oils. Derived from cold-pressing hemp seeds. Contains no THC, CBD, or other cannabinoids. This product has been Generally Recognized as Safe (GRAS) by the FDA for use in prepared foods, beverages and beverage bases, soups, smoothies, dairy product analogs, dressings, table oils, spreads, sauces, and meat analog products.

Hemp Extract: Does contain cannabinoids that are extracted from the hemp flower, stalks, and leaves. Generally falls into one of the following product categories:

- **Full Spectrum Extracts:** Contains naturally occurring cannabinoids, flavonoids and terpenes – including CBD and up to 0.3% THC.
- **Broad Spectrum Extracts:** Has been refined or distilled to remove some of the naturally occurring cannabinoids, flavonoids, or terpenes. Most commonly, THC has been removed.
- **Isolate Products:** Has been further refined to isolate a single cannabinoid. Most commonly, isolates are nearly pure CBD and contain no THC, other cannabinoids, or terpenes.



7

Historical Treatment of Hemp

Prior to 1937: Cannabis (including hemp) enjoyed periods of broad commercial use, especially in colonial times. Notable appearances were on USS Constitution and in the farm fields of many of the founding fathers.

Marihuana Tax Act of 1937: Practically prohibited all commercial use of cannabis. Briefly loosened during World War II, then practical prohibition returned.

Controlled Substances Act of 1970: Cannabis regulated by the Drug Enforcement Administration ("DEA") as a Schedule I controlled substance pursuant to the (the "CSA"), effectively making it illegal.



8

2014 Farm Bill

- Loosened legal restrictions on the production of hemp.
- Did not change hemp's status as a Schedule I Controlled Substance.
- But did separately define "industrial hemp" as something different than marijuana:

"The plant cannabis sativa L., and any part of such plant, whether growing or not, with a delta-9 THC concentration of not more than 0.3% on a dry weight basis."

- Authorized states to establish agricultural pilot programs to study the growth, cultivation, or marketing of industrial hemp.
- Created a carve out for criminal prosecution under the CSA for those who lawfully produced or possessed hemp under the pilot program rules.
- Created an avenue for the limited cultivation and marketing of industrial hemp if it was grown (1) for research purposes; (2) by an institution of higher education or pursuant to an agricultural pilot program; and (3) in a state that permits industrial hemp cultivation.



9



2014 Farm Bill and Commercial Hemp Markets

- The phrase "marketing of industrial hemp" is not defined in the 2014 Farm Bill.
- Speculation rampant as to whether or not commercial activities beyond mere cultivation were lawful under the 2014 Farm Bill and state-adopted pilot programs.
- In August 2016, FDA, USDA, and DEA released a Statement of Principles aimed at addressing the issue. Not legally binding, however.
- General consensus that the 2014 Farm Bill does allow commercial activities in conjunction with market research, and permits industrial hemp derived products to be produced and transferred among states with agricultural pilot programs authorizing those activities.

10

NC Industrial Hemp Research Pilot Program

Authorized by 2014 Farm Bill. Adopted by NC Legislature in the 2015 legislative session.

Decriminalized hemp production and possession when occurring in compliance with NC laws and rules.

Created the NC Industrial Hemp Commission.

NC only licenses hemp cultivation (production).

NC does not license hemp processing, extraction, manufacturing, or retail or wholesale operations. But, all "processors" (undefined term) must register with the state.

NCGS § 106-568.55 allows a licensed grower to engage in research activities that include "studying the economic feasibility of developing an industrial hemp market... including by commercial marketing and sale of industrial hemp."



11

Requirements for NC Pilot Program Licensure

Licenses may be submitted year round. No cap on licenses.

License requirements include:

- Must provide GPS coordinates and location of all growing and storage locations.
- Must identify the variety name, origin, and seed types that the grower will plant.
- Must have evidence of farming income (bona fide farmers only).
- Must disclose all prior criminal convictions (date and location).
- No license will be issued to an applicant with any felony conviction in the prior 10 years OR a drug-related felony conviction at any time.

Must maintain compliance records, maintain hemp production records for at least 3 years, allow for governmental inspections at any time, and maintain a written agreement with NCSU or NC A&T as a participant in their industrial hemp research programs.



12

Penalties – NC Hemp Pilot Program

NC Gen. Stat. § 106-568.56 authorizes civil penalties of up to \$2,500 per violation for:

- Violations of program rules;
- Manufacturing, distributing, possessing marijuana on property used for hemp production;
- Providing false or misleading information in connection with a license application, renewal, inspection, or any related investigations.
- Tampering with or adulterating a lawfully planted industrial hemp crop.

NC Gen. Stat. § 106-568.57 imposes criminal penalties for:

- Manufacturing, distributing, possessing marijuana on property used for hemp production. Class I felony.
- Providing false or misleading information in connection with a license application, renewal, inspection, or any related investigations. Class 1 misdemeanor.
- Tampering with or adulterating a lawfully planted industrial hemp crop. Class 1 misdemeanor.



13

THC Sampling and Testing Today – NC Pilot Program

All hemp plantings are subject to sampling and testing for THC. Licensees notify NC Department of Agriculture ("NCDA") when the floral buds begin to initiate.

NCDA will take samples of the plants prior to harvest.

Sampling is randomly conducted and based upon availability of NCDA personnel. Not all crops or licensees will be sampled and tested.

Samples sent to third party testing laboratory.

If THC level equals or falls below 0.3% by dry weight, the sample passes. NCDA rounds down, so a 0.39% sample would still pass.

If THC level is above 0.3%, the sample may be retested. NCDA may allow remediation in some instances.

If sample fails (including re-tests), the licensee may harvest, process and use the industrial hemp stalks and seeds. But, the remainder of the plant (including the floral material) must be destroyed in the presence of the NCDA.



14

2018 Farm Bill

Revised definition of "hemp".

Effectively decriminalized hemp and its derivative products by removing them Schedule I list (including THC found in hemp) and by changing the federal definition of "marijuana" under the CSA to expressly exclude hemp and its derivatives.

Mandates that hemp be treated as an agricultural commodity.

Directs USDA to develop U.S. domestic hemp production program and rules.

Directs Federal Crop Insurance Corporation to develop crop insurance program for domestic hemp production.

Phase out of the 2014 Farm Bill and state-level research pilot programs



15

2018 Farm Bill

The definition of "hemp" was greatly expanded by the 2018 Farm Bill:

"The term 'hemp' means the plant Cannabis sativa L. and any part of that plant, including the seeds thereof and all derivatives, extracts, cannabinoids, isomers, acids, salts, and salts of isomers, whether growing or not, with a delta-9 tetrahydrocannabinol concentration of not more than 0.3 percent on a dry weight basis."

Appoints USDA as primary regulator for hemp production.

Allows states, US territories, and Indian tribes to obtain primary authority over hemp activities within their borders after submitting a regulatory plan to USDA.

USDA has 60 days to approve or deny state plans.

As of February 26th, the USDA has approved 8 state plans and 10 plans submitted by Indian tribes. Another 20 states have submitted plans that are under review or have indicated that they intend to submit plans.



16

2018 Farm Bill – State Plan

Requirements

State plans must comply with the following minimum thresholds:

- Data retention procedures for land where hemp is produced.
- Procedure for testing THC concentration levels.
- Procedure for effective disposal of plants and products produced in violation of the law.
- Procedure for annual inspections of hemp production facilities.
- Procedure for submitting important information to USDA regarding state hemp producers. And,
- Certificate that the state, tribe, or territory has the resources and personnel to carry out the required practices and procedures

State plans can be more restrictive than the USDA plan, but cannot be less restrictive.



17

2018 Farm Bill and Interstate

Commerce

Provides that "[n]o State or Indian Tribe shall prohibit transportation or shipment of hemp or hemp products produced in accordance with Subtitle G of the [2018 Farm Bill]... through the State or territory of the Indian Tribe, as applicable."

Still, there have been challenges with interstate transportation of hemp and risks remain.

- Product seizures by UPS, FedEx, USPS
- Product seizures by law enforcement



18

2018 Farm Bill and Interstate

Commerce

Issues in Idaho:

- On January 24, 2019, hemp destined for Colorado was seized by the Idaho State Police, and the driver of the delivery truck was arrested.
- Immediately thereafter, the owner of the hemp sought a TRO and PI in Federal Court based on Section 10114 of the 2018 Farm Bill.
- US District Court for the District of Idaho denied that motion on the grounds that the interstate transportation of hemp that is not cultivated pursuant to the USDA's regulations or a USDA-approved hemp production plan may not be protected by Section 10114 of the 2018 Farm Bill



19

2018 Farm Bill and Interstate

Commerce

West Virginia Gets it Right:

- DOJ filed civil action to seize hemp allegedly grown in violation of the CSA and outside the scope of the 2014 Farm Bill. *United States v. Mallory*, Case No. 18-CV-1289 (S.D. W. Va.)
- DOJ targeted hemp grown by a WV licensed grower under the WV pilot program. Grower used hemp seeds that were shipped from Kentucky under the Kentucky pilot program.
- The *Mallory* court relied on a combination of laws – the 2014 Farm Bill, certain appropriations act provisions, and the 2018 Farm Bill – to dissolve a preliminary injunction and to dismiss entirely the DOJ's case, permitting the WV grower to transport hemp products across state lines for processing and sale.
- The *Mallory* court also noted that the 2018 Farm Bill "expressly allows hemp, its seeds, and hemp-derived products to be transported across State lines."



20

2018 Farm Bill and Interstate

Commerce

In May 2019, USDA's Office of General Counsel (OGC) issued a legal opinion to address the following portions of the 2018 Farm Bill:

- (1) the phase-out of the industrial hemp pilot authority in the 2014 Farm Bill;
- (2) amendment to the Agricultural Marketing Act of 1946 to allow states and Indian tribes to regulate hemp production or follow a USDA plan regulating hemp production;
- (3) provisions ensuring the free flow of hemp in interstate commerce; and
- (4) removal of hemp from the CSA.



21

2018 Farm Bill and Interstate

Commerce

Key Conclusions of USDA OGC's Opinion:

- (1) hemp has been removed from Schedule I of the CSA and is no longer a controlled substance;
- (2) after USDA publishes regulations implementing its hemp production program, states and Indian tribes may not prohibit the interstate transportation or shipment of hemp lawfully produced under a state or tribal plan or under a license issued by the USDA; and
- (3) states and Indian tribes may not prohibit the interstate transportation or shipment of hemp lawfully produced under the 2014 Farm Bill.



22

2018 Farm Bill -

Limitations

- States are not required to allow hemp production at all within their borders.
 - **But**, states may not interfere with lawful interstate transportation and shipment of hemp and hemp products.
- States may adopt rules that are more restrictive than those put in place by the USDA.
 - **But**, 2018 Farm Bill only allows states to regulate how hemp is produced. It does not authorize states to define what "hemp" is and, importantly, what it is not.
 - The Conference Report for the 2018 Farm Bill says that "state and Tribal governments are authorized to put more restrictive parameters on the production of hemp, **but are not authorized to alter the definition of hemp** or put in place policies that are less restrictive
- State laws will vary widely – no uniformity for the industry to rely upon as they do business in different states.



23

2018 Farm Bill -

Limitations

- Appoints the USDA as the primary regulator for hemp production. Does not appoint a primary regulator for post-harvest activities and hemp products.
- Does not impact or modify the Federal Food, Drug and Cosmetic Act or Section 351 of the Public Health Service Act.
- Any food, drug, device, or cosmetic product marketed and sold in interstate commerce is subject to the FD&C Act and applicable state laws.
- FDA has asserted regulatory authority and purview over the CBD industry.



24



Federal and State Regulatory Considerations

On the same day that the 2018 Farm Bill was signed into law, the FDA released a statement which forecast its clear intention to take an active role in regulation and enforcement for hemp and CBD products going forward.

Since then, the FDA has reaffirmed this statement on multiple occasions and it has been actively involved in the industry from an enforcement standpoint.



25

FDA and Hemp

Under its own interpretation of the Federal Food Drug & Cosmetic Act ("FD&C Act"), the FDA has concluded that it is illegal to market or sell food, beverage, and dietary supplement products containing CBD in interstate commerce.

The North Carolina Department of Agriculture has adopted this position for intrastate activities as well, and it has warned CBD companies and consumers of its position in advisory letters.

The FDA has publicly affirmed its desire to establish a regulatory "pathway forward" for hemp-derived CBD and CBD products, but there is no certain timeline for the agency's efforts on that topic.



26

CBD Regulatory Enforcement



- FDA has issued numerous warning letters to CBD companies.
- Most recently, FDA issued 15 warning letters in November 2019.
- Enforcement tends to focus on companies that do the following:
 - Mislabel or make unsubstantiated claims for their products.
 - Sell or market products to children or other vulnerable populations.
 - Make claims about their products curing, mitigating, treating, or preventing any form of diseases, health or medical conditions.
 - Posting 3rd party links or materials on their social media or websites that contain any of these prohibited acts or statements.
 - Posting customer testimonials that contain any of these prohibited acts or statements.
- FTC has joined with the FDA in several warning letters. It asserts authority over the marketing of CBD products under the FTC Act.
- Companies can expect the interest and influence of regulatory agencies like the FDA and FTC to continue to grow and develop as the commercial hemp and CBD industries mature.

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FDA and GRAS Treatment for Hemp



The following product categories have been evaluated by FDA as Generally Recognized as Safe (GRAS), meaning they can be used in food and beverage products without first having to obtain pre-market approval:

- Hulled hemp seed
- Hemp seed protein powder
- Hemp seed oil

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Beer and Hemp

Alcoholic beverages are regulated under the Federal Alcohol Administration Act.

Tax and Trade Bureau (TTB) is the primary federal regulator for alcoholic products. Not FDA.

North Carolina Alcoholic Beverage Commission is the primary regulator for alcoholic products in NC.



29

Beer and Hemp

Formula approval from TTB is required before you can use any hemp ingredients in the production of a malt beverage.

TTB defers to the FDA's interpretations when determining whether or not a hemp ingredient is allowable for use in a malt beverage.

As a result, breweries not allowed to use cannabinoids in any malt beverage products at present.



30

Beer and Hemp

But I've seen "hemp beers" at my grocery store. What gives?

"Hemp beers" on the market today contain either hemp seed oil or sterilized hemp seeds.

The formula approval application must include a laboratory analysis of the hemp ingredients used.

Must show that there are no cannabinoids in the product.



31

Beer and Hemp

Label approval from TTB (called a Certificate of Label Approval or COLA) is required if you plan to sell the hemp malt beverage across state lines.

Labels must identify the hemp ingredient used in a way that clearly shows it is not a controlled substance.

Labels must not give the impression that the beverage contains a controlled substance. Have to be creative with names and artwork.



32

Beer and Hemp

Once federal approvals are received from TTB, the product must also get state approval from the NC ABC Commission.

NC product labels must also identify the brand name of the product, the name and address of the brewer or bottler, the type of product (ale, beer, porter) and the net contents of the product.



33

Beer and Hemp

Thinking about breaking the rules?
Bad call.

TTB does actively look for violations of the rules, including searches of social media and websites.

TTB does issue warning letters for these violations.

Risk fines, revocation of licenses, and significant attorneys' fees to resolve TTB's and NC ABC Commission's concerns



34



Doing Business with the Hemp Industry



35

Landlords, Know Your Tenants

Primary Concerns

Licensure: What is the applicable licensing body? State? USDA? Are the tenants licensed and are they in good standing? How is the landlord positioned to monitor that throughout the tenancy?

Regulatory Compliance: What regulations apply to the tenant's particular business? Is the tenant's business compliant? How is the landlord positioned to monitor that throughout the tenancy?

Protection: What protections are in place in the event the tenant runs afoul of the applicable law or regulations? Indemnity and thoughtful default provisions are critical.

Profit-sharing: Many hemp landlords wish to share in the profits of the tenant. Understanding the life cycle of hemp production and the supply chain is important to understanding how a tenant's business will operate. As with any tenancy, reporting and transparency with regard to financials is crucial.

Default: Traditional or boilerplate default provisions are not sufficient and should be customized to apply to hemp businesses.



36



Insurance

- **Know the Risks.** Will typical general liability policies be sufficient to protect your client and its business from a risk-related event? Understand the real risks and liabilities they may face in their hemp-related operations.
- **Insuring the Crop.** What crop insurance is available and applicable to the operation? Many kinds are partially and conditionally available, but traditional crop insurance is not yet available.
- **Products Liability.** Products liability insurance is important for any company that is making, selling, or re-selling any consumer products intended for consumption or ingestion (or, any ingredients utilized in those ultimate end-use products).



37

Banking Concerns



Banking is Tenuous.

- It is legal for banks to do business with compliant hemp businesses.
- But, many refuse in the face of still-developing banking regulations, and confusion over hemp v. marijuana.
- It is absolutely critical that the hemp business honestly and effectively communicate with the financial institution.

The SAFE Act:

- Currently pending in U.S. Congress. It passed the U.S. House of Representatives with overwhelming support, and awaits action in the U.S. Senate. Recent news reports indicate significant progress towards adoption.
- If passed, it would protect federally regulated financial institutions from being punished for working with state-legal cannabis businesses. This would go a long way towards resolving financial institutions' reluctance to service hemp businesses.

38

Investments and Capital; Financial Services

- **Institutional Capital is Scarce.** As indicated before, banking relationships for hemp businesses can be difficult to obtain. Commercial loans, even when secured by property or equipment, are extremely difficult to secure. There are real access to capital concerns for hemp businesses today.
- **Private Capital is King, for now.** Often, today, hemp-related businesses are funded through private investment (capital raises from accredited investors, private equity groups, and other sources) and/or self-financing of operations by the owners/operators of the companies.
- **Unreliable Financial Services.** Merchant services are often denied to the industry due to its "high risk" status. Few providers are willing to offer credit card services for brick-and-mortar and online sellers. Square has recently begun to accept hemp and CBD businesses back onto its merchant services platform, but the onboarding is occurring selectively and slowly. Hopefully, the financial services available to the industry will continue to grow.



39

Bankruptcy Issues

What happens if a business fails? Can hemp businesses seek protection in federal bankruptcy courts?

Hemp-related operations that are fully and properly licensed and operating in compliance with applicable state and federal laws are afforded protection under the United States Bankruptcy Code.

Some bankruptcy courts have rejected marijuana-related businesses from seeking protection.

If a hemp-related business is not operating in compliance with federal laws and regulations, bankruptcy courts *may* reject those hemp-businesses as well in the event of a filing.

What if your client does not "touch the plant" but still does business with the industry?



40

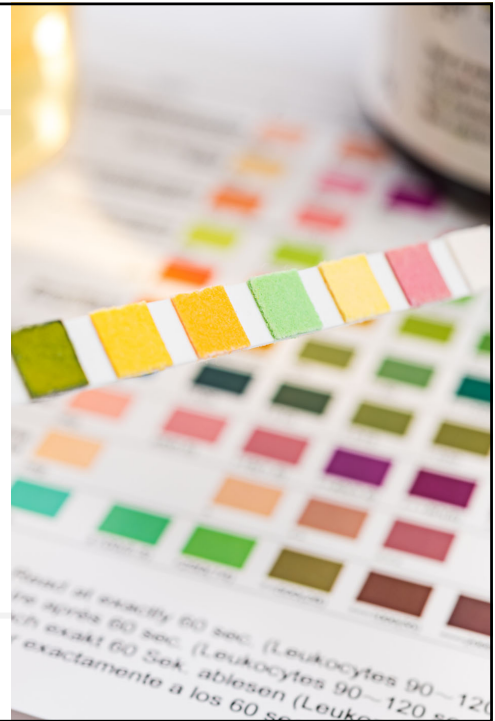
Employment Issues

Broad spectrum CBD products contain THC. THC and other cannabinoids can accumulate in a person's body over time.

What happens if an employee fails a drug test?

How do you know if that drug test failure was due to use of a lawful CBD product vs. marijuana use?

Why should your employer clients care?



41

Employment Issues

In North Carolina, employers may not discriminate against a current or prospective employee based on that person's lawful use of a lawful product during non-working hours absent certain and proper policies and procedures. N.C. Gen. Stat. § 95.28.2.

THC now is a component of a lawful product in hemp, so employers should take care before reacting rashly to a positive test for THC.

Also, CBD is considered to be non-psychoactive, so employers should strongly consider their treatment of CBD use among their employees.



42

Jean Smith v. Manheim Remarketing Inc. and Cox Automotive Vehicle Acquisition Services, LLC, WDNC Case No. 5:19-cv-00086 (October 17, 2019)

Plaintiff was a long-time employee of the defendants. Filings indicate that she was well liked by her employer and co-workers and had no history of discipline or issues at work.

Plaintiff was injured in a work-related accident. As part of worker's compensation, was required to be drug tested. The test came back positive for THC and plaintiff was terminated.

Plaintiff sued. Claimed that her termination violated public policies under N.C. Gen. Stat. § 95-28.2, which protects an employee's lawful use of a lawful product outside of the workplace.

Plaintiff has long suffered from fibromyalgia, chronic pain, and pain-related anxiety. With her doctor's knowledge, she began to use CBD oils to treat her ailments in lieu of taking heavy regimens of opiod drug treatments.

Plaintiff claims she used a lawfully produced and lawfully sold CBD oil brand.



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Jean Smith v. Manheim Remarketing Inc. and Cox Automotive Vehicle Acquisition Services, LLC, WDNC Case No. 5:19-cv-00086 (October 17, 2019)

Lawsuit filed in Iredell County state court.

Defendants removed the case to federal court and subsequently filed a Motion to Dismiss under 12(b)(6) for failure to state a claim for which relief may be granted.

Court denied the Motion to Dismiss. In its order, the Court recognized that:

- Products made from cannabis sativa L. containing less than 0.3% THC by dry weight are no longer illegal drugs. They are lawful commercial products.
- THC found in lawful hemp products has been specifically excepted from the general prohibition against THC found in the NC Controlled Substances Act.
- Plaintiff did not test positive for an *illegal* drug in violation of the employer's policy.

No appeal filed and case was later dismissed. Although it is not a final ruling and provides only limited precedential value, the order denying motion to dismiss is part of a limited body of case law that exists nationwide and is very instructive.



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Regulatory Concerns: Prop 65

- California's Office of Environmental Health Hazard Assessment (OEHHA) has included THC on the Proposition 65 chemical list (Safe Drinking Water and Toxic Enforcement Act of 1986).
- Does not differentiate between hemp-derived THC and marijuana-derived THC.
- No safe harbor despite decriminalization of hemp-derived THC under the 2018 Farm Bill.
- The addition of THC took effect on January 3, 2020. But enforcement of the warning requirements do not begin under January 3, 2021.
- Will apply to products that contain THC regardless of whether or not their end use is intended for ingestion, inhalation, vaping, or topical application.
- Exemption for businesses with less than 10 employees.
- Requires "clear and reasonable" health and safety warnings on product packaging and labels.
- What's the risk? Stiff fines. Legal fees. Enforcement by the CA Attorney General, District Attorneys, and some City Attorneys. Also allows for private enforcement actions by consumers which typically involve large class actions.



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Regulatory Concerns: Class Action Lawsuits

Growing trend of class action lawsuits across the nation that target CBD brands and products for:

- Violations of state consumer protection laws
- False advertising claims – product ingredients; product concentrations; product effectiveness
- Unfair competition claims
- Alleged mislabeling of products

Imperative that companies make truthful claims about their product effectiveness, ingredients, concentrations.

Not always easy due to patchwork of state and federal laws that require (or prohibit) certain types of product labeling, information, and claims made.



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Regulatory Concerns: Class Action Lawsuits

Lawsuits have also been filed to assert claims for alleged discrimination under the Americans with Disabilities Act (ADA) where companies' websites are not compatible with screen-reading software programs utilized by blind or visually-impaired consumers.

Prevention is the best cure for hemp businesses. Follow the World Wide Web Consortium (W3C) guidelines for website accessibility to blind and visually-impaired people.

If a claim is made, have your clients proactively fix the issue. Do not wait for a court order to be entered.



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Regulatory Concerns: Data Privacy Issues

Hacks and data breaches are becoming more common.

Attractive targets because hemp companies are required to collect and retain certain personally identifiable information under applicable law.

Very significant fines, penalties, and legal fees associated with a breach or violation.

Many hemp companies operate across the US (especially retail focused operations with e-commerce platforms). Must be mindful of data privacy laws in other states, not just NC.

CCPA (California Consumer Privacy Act) and GDPR (General Data Protection Regulation) must be on our clients' minds.



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Regulatory Concerns: Hot Hemp Extracts

What are they?

During the extraction process, cannabinoids in the plant flower or biomass are turned into a highly concentrated crude oil.

Why should you care?

Those crude oil extracts can – and do – contain more than 0.3% THC by dry weight.

How does the law and regulation deal with them?

It doesn't. Clients struggle with how they can lawfully produce, sell, ship, or transport those crude oil extracts. Especially an issue for businesses that produce intermediate cannabinoid products – not the end use consumer goods that you see in retail stores.



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Regulatory Concerns: Craft Commodity Hemp Flower

Sometimes referred to as "smokable hemp". But, the product is raw or dried commodity hemp flower.

2018 Farm Bill authorizes the legal production and shipment of all hemp-derived products, including "smokable hemp".

2018 Farm Bill only allows states to regulate how hemp is produced. It does not authorize states to define what "hemp" is and, importantly, what it is not.

The Conference Report for the 2018 Farm Bill says that "state and Tribal governments are authorized to put more restrictive parameters on the production of hemp, **but are not authorized to alter the definition of hemp** or put in place policies that are less restrictive.

Still, many states (NC included) have imposed or attempted to impose bans against smokable hemp. NC has proposed to re-criminalize the production, possession, manufacture, or sale of smokable hemp (Senate Bill 315).

Indiana Lawsuit:

- Filed in US District Court for Southern District of Indiana.
- Challenged Indiana's blanket ban on the possession of smokable hemp under theories of: (1) federal conflict preemption; and (2) violation of interstate commerce clause.
- Hemp industry plaintiffs successfully obtain a preliminary injunction that prohibits the State of Indiana from enforcing its ban. Order was worded surprisingly strongly against the State and the positions it took in briefing and oral arguments.
- The preliminary injunction order is currently on appeal to the 7th Circuit Court of Appeals.



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Multi-Peril Crop Insurance Pilot Program

- NC counties are included in the limited program scope this year.
- Applications are due by March 16th for coverage.
- Must have valid hemp grower license.
- Must have at least 1 year prior history growing hemp.
- Must have a signed contract for the sale of your insured hemp post-harvest.
- Must be growing a minimum of 5 acres of CBD varieties and/or 20 acres of grain or fiber varieties.
- THC tests must be submitted to the insurance company within 72 hours of receiving the results.
- No coverage for losses resulting from crop destruction after a failed THC test.



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Whole Farm Revenue Protection Plan Coverage

- Available for hemp coverage in 2020.
- Must have valid hemp grower license.
- Must have at least 1 year prior history growing hemp.
- Must have a signed contract for the sale of your insured hemp post-harvest.
- No coverage for losses resulting from crop destruction after a failed THC test.



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Noninsured Crop Disaster Assistance Program (NAP)

- Provides coverage for losses stemming from adverse weather conditions.
- Does not cover losses stemming from crop destruction after a failed THC test, even if the spike in THC was caused by adverse weather.
- Available for hemp coverage in 2020.
- Must have valid hemp grower license.
- Must have at least 1 year prior history growing hemp.
- Must have a signed contract for the sale of your insured hemp post-harvest. Deadline for submission to FSA by August 15th.
- THC test results must be submitted to FSA when the lab report is issued.



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USDA's Interim Final Rule on Hemp Production

Issued on October 31, 2019.

Establishes the federal domestic hemp production program. Cultivation only.

Sets out minimum requirements for:

- Licensure by USDA
- Crop sampling requirements and guidelines
- THC testing requirements
- Requirements for cannabinoid testing laboratories
- Data sharing and reporting obligations
- Requirements for disposal of "hot" plants
- Minimum requirements for state hemp production plans



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Interim Final Rule vs. Pilot Production Program What Law Applies?

2018 Farm Bill and the Interim Final Rule (IFR) provide for a phase out of 2014 Farm Bill and state research pilot programs on October 30, 2020.

For this year:

- States with a research pilot program can allow growers to continue to grow under those pilot programs.
- States can submit a plan to USDA for approval and begin licensing growers under their permanent hemp production programs.
- States can decline to submit a plan to USDA and allow the USDA plan to take effect within their borders.
- States can pass laws banning hemp production within their borders.



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Ethical Considerations

- Every interaction with a hemp and CBD client must – to some degree – involve an ethical analysis on the part of the lawyer.
- This is especially true given that Rule 0.1 of the Rules of Professional Conduct (each a "Rule" and collectively the "Rules") requires lawyers to be competent, prompt and diligent, and their conduct to conform to the requirements of the law.



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Who is Your Client?

- Are you representing an individual person? Or an organization?
- Do you also represent the owners or operators of that organization in their individual capacity?
- If an organization, who is authorized to act as an agent of the organization and to give you instructions as the entity's attorney?
- What is the nature of your client's business?
- Do they "touch the plant" or not?
- Do they have all required licenses, approvals, and authorities to lawfully conduct their business in each jurisdiction where they operate?



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Rule 1.2

Rule 1.2 prohibits a lawyer from counseling a client to engage, or assisting a client, in conduct that the lawyer knows is criminal.

A lawyer may discuss the legal consequences of any proposed course of conduct with a client and may counsel or assist a client to make a good faith effort to determine the validity, scope, meaning or application of the law.

Rule 1.2 also allows an attorney to limit the scope of the representation if such limitation is reasonable under the circumstances.



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Rule 1.13

What do you do if an officer or employee of the company you represent is engaged in action (or intends to engage in action) that will violate the law and/or a legal obligation that might reasonably be imputed to the company itself?

Rule 1.13 allows a lawyer employed or retained by an organization to act through that organization's duly authorized representatives.

The lawyer shall proceed as is reasonably necessary to protect the best interests of the organization.

Unless the lawyer reasonably believes that it is not necessary in the best interest of the organization to do so, the lawyer shall refer the matter to higher authority in the organization.

If, despite the lawyer's efforts, the highest authority that can act on behalf of the organization insists upon action, or a refusal to act, that is clearly a violation of law and is likely to result in substantial injury to the organization, the lawyer may reveal that information outside the organization (if permitted by Rule 1.6) and may resign in accordance with Rule 1.16.



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Cross-Border Representation Issues

The hemp and CBD industry regularly touches on interstate commerce. Rarely are operations wholly intrastate in nature. As such, there are almost always cross-border representation issues to consider.



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Rule 5.5

Rule 5.5 prohibits a lawyer from practicing law in a jurisdiction where doing so violates the regulation of the legal profession in that jurisdiction.

And it prohibits a lawyer from assisting another person in the unauthorized practice of law.

However, a lawyer is not prohibited from providing services limited to federal law.



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Importance of Staying Informed and Abreast of the Law

- Marijuana is still illegal on the Federal level and in North Carolina.
- It can be difficult to discern between marijuana and hemp by sight or smell alone.
- The legal differentiation between marijuana and hemp boils down to whether or not the plant or product contains 0.3% THC or less by dry weight.
- Laws and regulations are continuously changing on the state and federal levels.
- It is imperative that attorneys practicing in this field of law keep themselves well educated and abreast of legal updates and implications.



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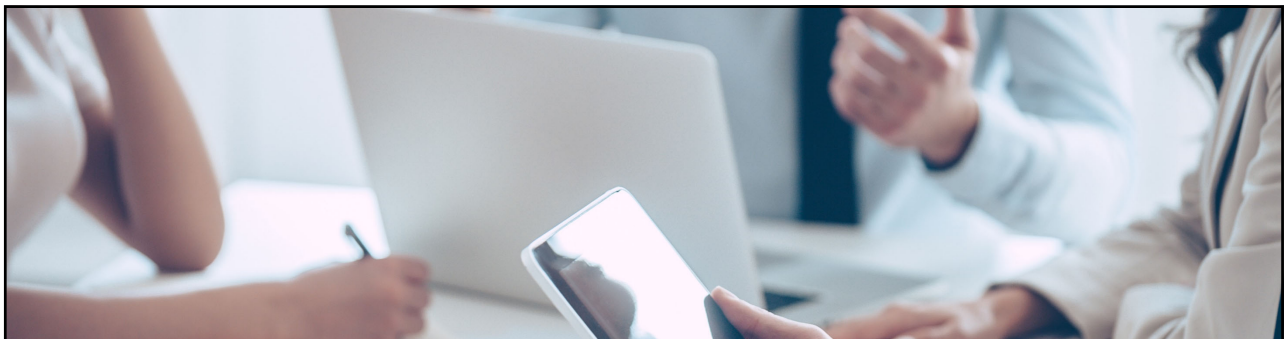
Rule 1.1

Rule 1.1 prohibits a lawyer from handling a legal matter that the lawyer knows or should know he or she is not competent to handle without associating with a lawyer who is competent to handle the matter.

Competent representation requires the legal knowledge, skill, thoroughness, and preparation reasonably necessary for the representation.



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Rule 1.4

Rule 1.4 requires a lawyer to explain matters to the extent reasonably necessary to permit the client to make informed decisions regarding the representation.



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Rule 8.4

Rule 8.4 outlines professional misconduct by lawyers.

Among other things, it is professional misconduct for a lawyer to violate or attempt to violate the Rules, or knowingly assist or induce another to do so.

It is also misconduct for a lawyer to commit a criminal act that reflects adversely on the lawyer's honesty, trustworthiness, or fitness as a lawyer in other respects.



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Rule 1.6

Rule 1.6 requires a lawyer to maintain as confidential information acquired during the professional relationship with a client unless the client gives informed consent.

A lawyer must make reasonable efforts to prevent the inadvertent or unauthorized disclosure of, or access to, information relating to the representation of a client.



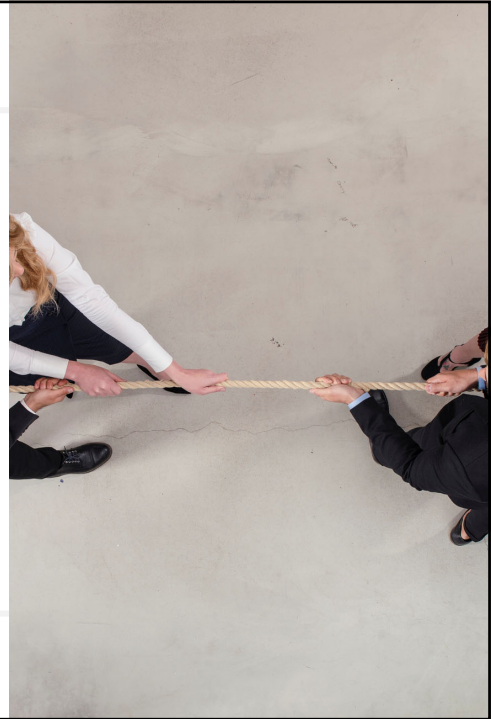
66

Rule 1.7

Rule 1.7 prohibits a lawyer from representing a client if the representation involves a concurrent conflict of interest.

We must be mindful of conflicts involving our clients and their operations before we accept representation or agree to undertake work, especially given the overlap that exists within this industry today.

Some, but not all, conflicts and potential conflicts can be waived with informed written consent of the clients.



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Rule 1.16

Rule 1.16 allows a lawyer to decline or terminate representation of a client in certain instances.

A lawyer must decline or terminate representation where that representation will result in a violation of law or the Rules.

Even upon withdrawal or termination of the representation, a lawyer must take steps (to the extent reasonably practicable) to protect the client's interests.

If client insists on taking actions that violate state or federal laws or regulations, you may have an obligation to decline representation or to withdraw from further representation of that client.



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Closing Summary

Although hemp and hemp-derived CBD are no longer Schedule I controlled substances under the CSA, the decriminalization of those substances has subjected them to extensive regulation by Federal and state authorities. The legal landscape is fluid today, with major developments occurring at a rapid pace. Until the industry matures and final regulations are developed and implemented by the various governing agencies, it is imperative that attorneys and their industry-participant clients stay abreast of those developments.



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Questions?



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