

THE TIP OF THE SPEAR PIERCING THE REGULATED CANNABIS INDUSTRY: HOW INTOXICATING HEMP CANNABINOIDS AND THE ILLICIT MARKET POSE SIGNIFICANT CHALLENGES TO THE EMERGING INDUSTRY

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Consumer demand and public support for cannabis legalization has led to sweeping reform across the Country. Unfortunately, this appetite combined with a lack of access to regulated marijuana has perpetuated both a robust and unregulated illicit marijuana market, and an unregulated hemp industry where intoxicating hemp-derived cannabinoids like Delta-8 THC, Delta-9 THC, THC-O and HHC are freely sold directly to consumers. In states like New York, New Jersey and Connecticut that are on the cusp of opening their doors to adult-use programs, and in California, the first state to enact cannabis laws, these unregulated marketplaces thrive, accounting for a large majority of cannabis sales. Such unchecked illicit activity, if permitted to continue, will be the tip of the spear piercing and undermining the regulated cannabis industry.

Lawmakers' inability (or unwillingness) to develop and enforce a uniform system of law and rules combatting the illicit market continues to inhibit the industry's emergence into legitimacy. Indeed, the conflicting patchwork of regulatory mandates and lack of enforcement interest materially contribute to uncertain pathways for legitimate businesses as well as perpetuating dangerous public safety issues.

Absent concerted regulatory reform and consistent enforcement efforts at both the state and federal level, the U.S. cannabis industry will continue to have barriers to its ability to participate in capital markets and operate without fear of arbitrary reprisals.

Unregulated Hemp-Derived Intoxicating Cannabinoids

Flourishing in states without adult-use marijuana regulation, hemp-derived intoxicating cannabinoids are a function of market demand and lack of enforcement. While the 2018 Farm Bill legalized hemp and its derivatives, it also fostered an industry laser-focused on manufacturing and retailing intoxicating cannabinoid products for sale in unregulated outlets. In smoke shops, gas stations and farmers' markets across the country, retailers are feeding the demand for intoxicating cannabinoids devoid of mandated and standardized testing causing an assault on public safety and insurmountable competition to the highly regulated (and taxed) marijuana industry. The proliferation of Delta-8 THC, Delta-10 THC, THC-O and HHC products, all of which are derived from hemp-based cannabinoids, has created a substantial regulatory dichotomy that was never contemplated nor intended by the Farm Bill.

The Farm Bill requires *Cannabis Sativa L.* plants to be tested within 15 days of harvest for Delta-9 THC levels and, if below 0.3% Delta-9 THC on a dry weight basis, the plant is labelled as legal “hemp”. If the plant tests above 0.3% Delta -9 THC on a dry weight basis, it is labelled “marijuana” and is illegal. Despite this legislated fiction, the plants are identical and all cannabinoids derived therefrom are molecularly the same. Based on that one test, each *Cannabis Sativa L.* plant is categorized into its regulatory lane and its derivatives specifically regulated notwithstanding whether or not they are intoxicating to consumers.

What wasn’t anticipated was that scientists would extract non-intoxicating cannabinoids - like CBD - from hemp and convert them into intoxicating cannabinoids similar (or identical) to Delta-9 THC. While Delta-8 THC and Delta-10 THC are naturally occurring in very limited quantities in *Cannabis Sativa L.*, they are commonly manufactured through chemical processes involving CBD. On the other hand, THC-O and HHC, both of which reportedly offer greater intoxicating effects than Delta 9-THC, are not found naturally in the plant. All four cannabinoids are intoxicating, offering users varying degrees of the “high” that was supposed to remain outlawed after the Farm Bill and reserved for regulated marijuana programs. All four cannabinoids are currently sold aggressively in unregulated retail outlets throughout the country, including in states like North Carolina and Tennessee where cannabis generally remains illegal. They have also saturated markets like New York, New Jersey, and Connecticut, which are on the verge of opening their adult-use marketplaces.

Nearly two-dozen states have addressed intoxicating hemp-derived cannabinoids via legislation, regulation, or guidance. To date, Congress has remained silent, leaving operators to rely on the Farm Bill to shield their businesses. As a result, intoxicating hemp-derived cannabinoids are free from oversight and the stringent testing mandates governing similar intoxicating products in the regulated marijuana marketplace. This creates not only public safety issues as potential harmful consumables flood unregulated markets but it also undercuts the legalized marijuana industry which is a large driver of tax revenues for states.

Struggling to enact policy that addresses this dichotomy, the Federal Government and its various agencies have played a game of ping-pong, deferring regulatory initiatives while the under-regulated hemp market flourishes. While the USDA was given primary regulatory authority over hemp, it only concerns itself with the plant and not the derivative products extracted from the plant. The FDA has repeatedly punted on offering specific regulatory pathways for cannabis consumption while making broad statements of its view that infusing CBD and THC into food and beverages violate the Food Drug and Cosmetic Act. Yet, the FDA has taken no material steps to enforce this view and consumable cannabis products with intoxicating hemp-derived cannabinoids are aggressively sold throughout the country.

Unfortunately, intoxicating hemp-derived cannabinoids are only the first point on the spear’s tip. The second point is the continued and unfettered illicit market for cannabis products.

The Illicit Market's Continued Dominance

Marijuana has been prevalent in U.S. culture for decades with popularity surging in the 60's. While President Nixon tried to combat the "hippie movement" by adding marijuana to the Controlled Substance Act of 1970, this only served to fuel the illicit market for the plant. For over 70 years, Americans have consumed marijuana through illegal sources. Beginning with California in 1996, marijuana began its march toward legalization in individual states with 39 plus the District of Columbia currently having some form of legalization. Despite this overwhelming support for the plant, marijuana remains an illegal controlled substance at the federal level.

Remarkably, in certain cities like New York, unlicensed retail sales of marijuana products run rampant. Almost daily, stories in the New York Times, the New York Post and other news outlets paint accurate pictures of illicit marijuana being sold in bodegas, out of street "cannabis" trucks and in farmers' markets in Washington Square Park. Similarly, California reports close to 80% of its sales are generated through the illicit market of unlicensed, unregulated growers, processors and distributors. Disregard for law perpetuates across the nation while law enforcement appears indifferent and somewhat complicit through inaction. Indeed, law enforcement efforts are being stymied by confusion as to jurisdiction, priorities and, frankly, past over-aggressiveness and demographic targeting in marijuana arrests.

All the while, legitimate cannabis players invest substantial funds and resources in obtaining licenses, developing facilities and maintaining compliance with state programs, regulations, and rules. Businesses that are committed to toeing the "legal" line deserve protection and support. Casting a blind eye to the illicit market perpetuates lawlessness and denies states the tax revenues they so desperately need. For example, in 2021, California raked in \$1.2 billion in tax revenue. Yet tax was collected on just 20% of the market. Indeed, 80% of California's market operates underground, impervious to regulation and tax collection.

Where Do We Go From Here?

The success of the U.S. cannabis industry demands greater regulatory normalization and consistent application of law because without it, the intoxicating hemp-derived cannabinoid market and illicit marijuana market that comprise the tip of the spear is destined to pierce through the legal industry. Lawmakers must learn and understand the *Cannabis Sativa L.* plant, its efficacies and its form factors. They also need to incorporate their learnings into more thoughtful and pragmatic regulations. How can we continue to allow Delta-9 THC gummies to be sold in unregulated retail stores simply because the cannabinoid was derived from hemp? Not only does this undercut legitimate licensed businesses but also exposes consumers to dangerous untested products.

Similarly, law enforcement agencies need to step up efforts to eradicate the illicit market. We recognize that this is a formidable challenge as this market has become sophisticated and deeply imbedded over the past 70-plus years. Nonetheless, until we attack both points at the

tip of the cannabis regulatory spear, our industry will not move forward into the legitimacy that consumers demand.

Cannabis Disclaimer: Although growing, processing, selling, distributing and using cannabis and cannabis-related products is permitted in many places throughout the United States, these activities are prohibited under federal law as well as many state law regimes. RCCB does not provide guidance regarding the violation of federal or state law in connection with cannabis or cannabis-related products or the federal tax consequences of engaging in cannabis-related businesses, and any guidance that we do provide should not be interpreted as such.

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