Proposed Cannabis Reschedule Sidesteps State Law Effects

By **Ian Stewart** (May 28, 2024)

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On May 21, the U.S. Department of Justice's proposed rules to move marijuana to Schedule III of the Controlled Substances Act were published in the Federal Register. Public comments will be solicited for 60 days from that date, and hearings will be scheduled before final rules are adopted.

Despite widespread media reports heralding the "game-changing" nature of this development, the DOJ's proposed rulemaking leaves the cannabis industry with more questions than answers.

The DOJ explicitly warns that (1) "if marijuana is transferred into Schedule III, the manufacture, distribution, dispensing, and possession of marijuana would remain subject to the applicable criminal prohibitions of the CSA [Controlled Substances Act]," and (2) marijuana would remain subject to the limitations within the Food, Drug, and Cosmetic Act.[1]

DOJ Fails to Address Interplay Between State and Federal Laws

Schedule III drugs are defined as having a moderate to low potential for physical and psychological dependence. They do have accepted medical uses but carry a risk of misuse or abuse. They require a prescription and their distribution is regulated. Examples include ketamine, anabolic steroids and Tylenol with codeine.

This prescription drug model is fundamentally incompatible with state adult-use and medical cannabis regulations without additional changes to federal law. The DOJ nevertheless provides no material information or guidance on how the federal government will interact with the existing state cannabis markets.

It instead sidesteps these challenging questions and punts by "seeking comment on the practical consequences of rescheduling marijuana." By way of explanation, the DOJ offers:

DOJ recognizes this action may have unique economic impacts. As stated above, marijuana is subject to a number of State laws that have allowed a multibillion dollar industry to develop. DOJ acknowledges that there may be large impacts related to Federal taxes and research and development investment for the pharmaceutical industry, among other things. DOJ is specifically soliciting comments on the economic impact of this proposed rule. DOJ will revise this section at the final rules stage if warranted after consideration of any comments received.[2]

For an industry that has been eagerly awaiting details on how the federal government will approach rules that address the interplay between existing state cannabis laws and the complex web of federal laws around Schedule III drugs, the DOJ's notice is disappointingly unclear.

The DOJ's decision to avoid the topic suggests that the final rules may not contain an allowance for the U.S. Food and Drug Administration and other federal agencies to prevent disruption to state-regulated cannabis businesses through enforcement discretion and other limiting instructions.

It is a mistake to believe that moving marijuana to Schedule III will result in any immediate change to state regulations. Those regulations will continue to exist and be enforced unless or until a comprehensive federal regulatory plan is created that allows for continued state oversight and control, similar to the way alcohol is regulated. This is harder than it sounds.

Although multiple legalization bills have been introduced in Congress over the past few years, none of them contains an adequately detailed regulatory plan that explains how the federal government will engage with and provide oversight to dozens of disparate state regulatory schemes.

Positive Effects of Rescheduling

One immediate positive effect of moving marijuana to Schedule III is that cannabis companies will avoid the Draconian impact of Section 280E of the Internal Revenue Code, which prevents most business deductions and results in exceedingly high effective tax rates that have impeded profitability for most cannabis companies.

We also can expect better access to commercial banking, new financial services products offered to cannabis companies and new listings on public exchanges. Likewise, access to federal funding for important cannabis research will be relaxed.

In addition, moving marijuana to Schedule III will mean that an insurance company's risk of violation of the Bank Secrecy Act and anti-money laundering statutes will effectively end. The U.S. Department of the Treasury, through its Financial Crimes Enforcement Network, will almost certainly issue new guidelines that clarify this after the final rules are approved. In that event, new insurance companies, underwriters and brokers will likely enter the space and the potential for reputational risk will erode further.

What Happens Next?

The DOJ will accept public comments for 60 days commencing May 21, and we can expect robust commentary from cannabis businesses, state regulators, trade organizations and ancillary industries.

Given the complex issues that federal regulation of marijuana requires, the extent to which the DOJ will incorporate cannabis industry recommendations into the final rules is somewhat dubious, in this author's opinion.

Regardless of the outcome of the final rulemaking, it is evident that any abrupt reversal of enforcement policy by the federal government would be utterly chaotic and disruptive.

For the time being, it appears that the so-called Rohrabacher-Blumenauer protections will continue to serve as a significant protection for medical marijuana operators. That federal budget rider, which has been in place since 2015, limits the ability of the DOJ to spend federal monies to enforce federal law against state-legal medical marijuana commercial activity. The adult-use cannabis market has no such protection against federal enforcement.

In addition, based on public statements and private reporting, FDA officials have little desire or capacity to meaningfully police the state cannabis industry.[3] The experience with the FDA's handling of CBD is instructive in this regard.

After hemp-derived CBD was removed from Schedule I following passage of the 2018 Farm Bill, the FDA frustratingly spun its wheels for years in a rulemaking process while taking no

enforcement action beyond sending a handful of warning letters that focused on companies making improper CBD-related health and medical claims. The FDA finally threw in the towel in early 2023, announcing that "a new regulatory pathway for CBD is needed" and urging Congress to pass legislation that regulates CBD.[4]

We might see another version of this regulatory dysfunction if the DOJ's final rules on marijuana as a Schedule III drug provide inadequate direction to the FDA and other federal agencies on the enforcement of existing federal laws. It seems apparent that clarity through congressional action is needed now more than ever.

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[1] DOJ's Notice of Proposed Rulemaking at p. 1, located at https://www.dea.gov/sites/default/files/2024-05/Scheduling%20NPRM%20508.pdf.

[2] Id. at p. 88.

[3] See e.g., https://www.naturalproductsinsider.com/supplement-regulations/fda-doesn-t-envision-pre-market-approval-for-new-cbd-pathway.

[4] https://www.fda.gov/news-events/press-announcements/fda-concludes-existing-regulatory-frameworks-foods-and-supplements-are-not-appropriate-cannabidiol.