Challenging State and Local Cannabis License Denials: Current Trends and Issues

Applicants denied licenses or permission to operate a cannabis-related business have challenged unfavorable determinations in a variety of ways. One common basis for challenging the denial of a license or other form of permission to operate a cannabis business ("cannabis license") has been to argue that the rules governing the grant of licenses were applied in an arbitrary and capricious manner. Litigants have also challenged cannabis license decisions by alleging that the process was corrupt. This article focuses on some of the more common challenges to cannabis license decisions and what can be learned from the outcomes to date.

I. Challenges Alleging Arbitrary and Capricious Application of the Licensing Scheme

Many lawsuits challenging decisions granting or denying cannabis licenses include a claim that the government department empowered to grant or deny cannabis licenses (the "department") applied the statutory scheme and/or its own rules in an arbitrary and capricious manner. The arbitrary and capricious standard varies by jurisdiction but generally seeks to determine whether the department lacked sufficient justification for its actions and/or decisions based on the facts and circumstances of the case. Cases applying this standard have involved issues such as whether a successful applicant provided all of the required paperwork to qualify for consideration or whether a department considered sufficient evidence prior to denying a license.

Of the cases that have been appealed, the courts often have sided with the department over a disappointed applicant. Although the court decisions to date have focused on compliance with the state and local statutory schemes, they have given substantial deference to the relevant department's interpretation of the statutory scheme, except where such interpretation conflicts with state or federal constitutional provisions or exceeds the department's power.

For instance, two cases, one in Arizona and one in Nevada, allege that the relevant departments acted arbitrarily and capriciously by granting a cannabis license to their competitor even though the competitor failed to provide the requisite paperwork showing compliance with local zoning laws. In each case, the court found that the statutory scheme—and the department's interpretation of it—allowed for the licenses to be granted absent that paperwork.

In Compassionate Care Dispensary, Inc. v. Arizona Dep't of Health Servs., 244 Ariz. 205 (Ct. App. 2018), the applicant challenged the department's grant of a cannabis license to its competitor on the grounds it had not procured a conditional use permit from the local municipality allowing the competitor to operate its cannabis business. The court held that because the relevant laws did not in fact require a conditional use permit at the application stage but only required a showing of compliance with local zoning laws, the department did not act arbitrarily and capriciously in granting a license to the competitor.

Similarly, in ***Nuleaf CLV Dispensary, LLC v. State Dep't of Health & Human Servs., Div. of Pub. & Behavioral Health***, 134 Nev. 129 (2018), two medical marijuana companies—GB Sciences, LLC and Acres Medical, LLC —challenged the grant of a license to Nuleaf CLV Dispensary, LLC ("Nuleaf") because its application did not contain a permit showing it was in compliance with local zoning laws. The court found that the statutory requirement for the permit was ambiguous and determined that the Nevada Department of Health and Human Services could issue a provisional license subject to Nuleaf obtaining the zoning permit.

Litigants seeking to challenge their competitors' applications should review whether the statutory scheme requires specific types of documents be included in the application or not, as well as how the requirements function holistically.

In New Jersey, there also have been unsuccessful challenges to the department's initial licensing application process. ***In re Inst. for Health Research & Abunda Life Ctr.***, 2013 WL 4458982 (N.J. Super. Ct. App. Div. Aug. 22, 2013), involved two low-scoring applicants—Institute for Health Research and Abunda Life Center, and Abatin Wellness Center. They challenged the Department of Health and Senior Services' ("DHSS['s]") issuance of licenses prior to the formal adoption of the regulations governing applications. A third, high-scoring applicant, Garden State Medical Marijuana Associates, Inc. ("GSMMA"), challenged the use of geographical diversity as a basis to deny its application in favor of the next ranked applicant. The court found that the DHSS acted within its statutory authority that (1) permitted it to pursue granting licenses prior to the formal adoption of regulations; and (2) directed it to ensure sufficient access to medical marijuana across New Jersey. Further, the court specifically declined to address GSMMA's argument that it was better positioned to serve more people in New Jersey than its successful competitor, because doing so would require the court to substitute its own judgment for the DHSS's findings on that issue.

Nat. Med., Inc. v. New Jersey Dep't of Health & Senior Servs., 428 N.J. Super. 259 (App. Div. 2012), is similar. Natural Medical, Inc., a for-profit entity, challenged the limit of the initial license grant to six non-profit entities. The court determined that such limitation met the statutorily-required minimum number of licenses and type of facilities and was a reasonable approach to the initial grant of licenses.

A Colorado challenge on the basis that the relevant department failed to consider adequate evidence before denying an applicant a license and therefore acted arbitrarily and capriciously was also unsuccessful. In ***Rocky Mountain Retail Mgmt., LLC v. City of Northglenn***, 2017 CO 33 (2017), the unsuccessful applicant asserted there was not substantial evidence to justify the city's decision to deny its application for a license. The Colorado Supreme Court found that the type of evidence considered by the city was consistent with the statutory scheme for a cannabis license and thus was sufficient to support the denial of the license. The Court did not require a particular quantum of evidence, although it noted that the City Council held two hearings and the parties presented significant evidence. Instead, the Court focused on whether the city considered evidence for each category outlined in the city code—here, number, type and availability of facilities as well as other relevant information—and found that it had.

Although courts frequently have found thus far in favor of the department or entity that made the decision to grant or deny a cannabis license, the outcome was different in a suit where the department reversed its own decision without providing an applicant an opportunity to cure subsequently discovered defects. In ***Medical Marijuana of Mass., Inc. v. Barlett***, the Massachusetts Department of Public Health faced public pressure due to newspaper reports about problems with its licensing process and revoked a license granted to Medical Marijuana of Massachusetts ("MMM") even though it was the highest scored applicant after the first review. The department's main justification for the revocation was that MMM paid a high percentage of fees to management. After the revocation, MMM cut the fees paid to management in half. The court found the department had acted improperly by conducting a second, unplanned review of the application, finding defects and not providing MMM an opportunity to cure. In addition, the court noted that the department had approved cannabis licenses for other entities with similar business structures. See Shelley Murphy, "Judge orders marijuana licenses restored," BostonGlobe.com (Apr. 28, 2015); see also Docket, ***Medical Marijuana of Mass., Inc. v. Barlett***, Case No. 1484CV02722, (last visited Aug. 20, 2019). Litigants contesting a denial of their application should therefore consider whether the relevant department subjected their application to reviews that were not sanctioned by the regular licensing process.

II. Challenges Based on Technical Errors

Applicants have been successful in challenging licensing decisions where the relevant department committed a technical error in evaluating the application. For instance, in Las Vegas, where applicants are ranked by score, Acres Medical, LLC succeeded in altering its ranking from in the thirties to number thirteen by filing suit against the Nevada's Department of Health and Human Services and showing that the department had omitted points from its final score. See ***Nuleaf CLV Dispensary, LLC v. State Dep't of Health & Human Servs., Div. of Pub. & Behavioral Health***, 134 Nev. 129, 131 (2018) (describing Acres Medical LLC's separate lawsuit).

In Michigan, unlicensed dispensaries successfully delayed the closure of their businesses for two weeks by arguing that they were denied licenses due to the state erroneously recording their tax payments. See Amy Biolchini, "Michigan judge thwarts crackdown at 50 unlicensed medical marijuana shops," MLive.com (Mar 29, 2019), michigan-judge-thwarts-crackdown-at-50-unlicensed-medical-marijuana-shops.html. On April 30, 2019, the state of Michigan was ordered not to close the dispensaries until it reviewed each of their applications and made a determination. See Amy Biolchini, "Michigan Judge Slams State for 'Freakish' Regulation of Medical Marijuana Businesses," MLive.com (Apr. 30,2019)[1].

III. Challenges Based on Corruption Allegations: An Area To Watch

Alongside other allegations, disappointed applicants have alleged varying degrees of corruption in this process. Litigants have accused state and local officials of (i) operating a pay for play licensing scheme[2]; (ii) awarding licenses to entities whose attorneys wined and dined them while denying licenses to entities who did not[3]; and (iii) colluding with a successful applicant to create a monopoly and awarding a license without any public decision-making process[4].

There are at least two pending cases where the party challenging the decision has alleged corruption. The first is a San Bernardino, California suit alleging that successful licensees donated to the mayor's reelection campaign as part of a pay for play scheme. See "San Bernardino says no to discovery in Cannabis lawsuit," IEBusinessDaily.com (Apr. 26, 2019). If this challenge succeeds, future litigants can consider their competitors' political donations as a basis to challenge a license decision[5].

The second case involves nearly forty applicants that were denied licenses in Nevada. During the three-month-long injunction hearing, Jorge Pupo, deputy executive director of the Department of Taxation, admitted to having lunches and dinners with an attorney, Amanda Conner, who represented dispensary owners. Three of Ms. Conner's clients ultimately procured licenses. Although Mr. Pupo denied that the application process was tainted because he joined Ms. Conner for meals, he admitted that he was aware at the time of the meals

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[1] The Governor disbanded the licensing board, and licensing was then transferred to the Michigan Marijuana Regulatory Agency, which has been able to process applications more quickly than the board. *See* Amy Biolchini, "Michigan Speeds Up Medical Marijuana Licensing As Recreational Launch Looms," MLive.com (June 13, 2019), https://www.mlive.com/news/2019/06/michigan-speeds-up-medical-marijuana-licensing-as-recreational-launch-looms.html.

[2] http://iebusinessdaily.com/san-bernardino-says-no-to-discovery-in-cannabis-lawsuit/

[3] https://www.washingtontimes.com/news/2019/jun/21/official-denies-lawyer-outings-skewed-nevada-pot-l/?utm_source=email&utm_medium=enl&utm_campaign=higherlaw&utm_content=20190627&utm_term=law

[4] https://mjbizdaily.com/colorado-man-sues-town-alleges-it-created-mmj-monopoly/

[5] Currently, discovery is stayed until the court issues an order on the city's motion to bifurcate, which remains pending. Mins. Mot. to Bifurcate, *Washington, LLC v. City of San Bernardino, et al.*, Case No. CIVDS1905710 (Aug. 2, 2019),*available through* http://openaccess.sb-court.org/OpenAccess/.

that Ms. Connor represented cannabis companies. See Associated Press, "Official denies lawyer outings skewed Nevada pot licensing," APNews.com (June 21, 2019); Bryan Horwath, "State cannabis official reaffirms fairness of application process in his last day on stand," LasVegasSun.com (July 1, 2019). In later testimony, he continued to defend his exchanges with Ms. Connor, including email exchanges regarding the application. See Michaela Chesin, "Top State Marijuana Regulator Questioned Again in Dispensary License Case; Winners Say They're Losing Money Amid Court Delays," TheNevadaIndependant.com (Aug. 14, 2019). Future litigants can consider the relationships government officials have to their competitors or their competitors' attorneys.

Against this backdrop, on August 15, 2019, the Federal Bureau of Investigations ("FBI") released a short podcast claiming that it saw a threat of public corruption emerging with the expansion of legal marijuana, stemming from the high value associated with marijuana licenses. The FBI asked for tips into any "illegally obtained licenses" or suspected public corruption. "FBI, This Week: Public Corruption Threat Emerges in Marijuana Industry," FBI.gov (Aug. 15, 2019); see also Tom Angell, "FBI Seeks Tips On Marijuana Industry Corruption," Forbes.com (Aug. 16, 2019). Should the FBI pursue corruption charges against state officials, disappointed applicants could bolster their corruption-related challenges to a department's licensing decisions.

IV. Conclusion

Based on the licensing challenges alleging an arbitrary or capricious decision that have been considered by appellate courts to date, courts have frequently sided with the relevant department except where some serious error or omission occurred in the licensing process. Challenges involving technical mistakes that alter an entity's ranking or lead to denials have encountered greater success. Corruption—or the appearance of corruption—in the licensing process remains a wild card in the licensing challenge deck.

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If you have any questions about the issues addressed in this memorandum, or if you would like a copy of any of the materials mentioned in it, please do not hesitate to reach out to:

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