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3/22/16

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MEMORANDUM

TO: Rutland County Organics

FROM: Downs Rachlin Martin PLLC

DATE: February 26, 2016

RE: Dormant Commerce Clause Implications of Residency Restrictions on Marijuana Licensing

1. Introduction

The Vermont Legislature is currently considering legislation that would legalize and regulate the recreational use of marijuana by adults over the age of 21. Ostensibly to prevent large corporate interests from coming in and dominating the new market, the proposed legislation includes two residency restrictions on licensing and funding of new marijuana businesses: 1) license eligibility would be restricted to those who were "a resident of this State for at least two years immediately prior to applying for a license," and 2) only those who were "a resident of this State for at least two years immediately prior to filing the application for a license for which the person is serving as a financier" could provide monetary backing to a new marijuana business. The licensing residency restriction would apply to any individual who owns ten percent or more of a business entity seeking a license or who serves as an officer or director of such an entity.

For the reasons set forth below, the proposed residency restrictions likely violate the United States Constitution, and would therefore fall to a court challenge.

2. The Dormant Commerce Clause Prohibits States From Enacting Protectionist Laws, Especially Those That Facially Discriminate Against Out-Of-State Residents and Businesses

The Commerce Clause of the United States Constitution grants Congress exclusive authority to regulate interstate and international commerce. See generally *Gonzales v. Raisch*, 545 U.S. 1 (2005). This power extends to the regulation of wholly in-state, and even non-commercial, marijuana production and use. *Id.* The clause has long been interpreted not only as an affirmative grant of power to the federal government but also as a direct and stringent limitation on the power of states to discriminate against interstate commerce; indeed, federal courts have concluded that preventing such state discrimination is one of the core purposes of the Constitution. See *Hughes v. Oklahoma*, 441 U.S. 322 (1979); *New Energy Co. v. Limbach*, 486 U.S. 269 (1988). This limitation on state power to interfere with or regulate interstate commerce is known as the "Dormant Commerce Clause." *Id.*

Dormant Commerce Clause restrictions on state regulatory power fall into two subcategories, depending on whether the law in question "facially" discriminates against interstate commerce—i.e., by its plain language privileges in-state commercial interests over out-of-state interests—or only "incidentally" burdens interstate commerce—i.e., is written in neutral language but has discriminatory effects as applied. See *Lewis v. B.T. Investment Managers, Inc.*, 447 U.S. 27 (1980) (law facially discriminates if it "overtly prevents foreign [i.e., out-of-state] enterprises from competing in local markets"). This rule applies both to laws regulating the flow of goods and services into and out of states as well and to laws regulating the ownership of local businesses. *Id.*

Of these two subcategories, facial discrimination is subject to the most searching judicial scrutiny: if a court finds that the challenged law facially discriminates against interest commerce "it is virtually *per se* invalid." *Oregon Waste Systems, Inc. v. Department of Environmental Quality*, 511 U.S. 93 (1994). The only way such a law will be upheld against constitutional challenge is where the enacting state can "show that it advances a legitimate local purpose that cannot be adequately served by reasonable non-discriminatory alternatives." *New Energy*, 468 U.S. at 278. While this standard theoretically gives states a basis for defending such laws, the Supreme Court has observed that as a practical matter the "burden of justification is so heavy that facial discrimination by itself may be a fatal defect." *Oregon Waste Systems*, 511 U.S. at 101.

The proposed Vermont legislation facially discriminates against out-of-state individuals and business entities in violation of the Dormant Commerce Clause. It is therefore "virtually *per se* invalid," and will only survive court challenge if the State can show it serves a compelling interest that cannot adequately be protected in a non-discriminatory fashion. It is virtually impossible to conceive of what justification the State could offer that would satisfy this stringent test. For example, accepting as true that the purpose of the facial discrimination in the proposed legislation is to prevent domination of the Vermont marijuana market by large corporate interests, such a purpose could be served by regulations such as limits on the size or corporate structure of an entity seeking a license or wishing to act as a financier to a marijuana business or a restriction on the percentage of the market that could be controlled by any particular licensee or financier—regulations that could serve the same purposes as the proposed residency restrictions but which would apply equally to Vermont and out-of-state actors. It is worthwhile to note that courts regularly strike down residency restrictions in the context of liquor licensing laws—likely the closest analogue to the marijuana licensing at issue here—despite the fact that the 21st Amendment gives the states power to regulate interstate commerce in the liquor context that they lack in any other area (including marijuana or other drugs). See, e.g., *Peoples Super Liquor Stores, Inc. v. Jenkins*, 432 F.Supp.2d 200 (D. Mass. 2006).

3. <u>The Fact That Marijuana Remains Illegal Under Federal Law Is Unlikely To Change Judicial Analysis Of A Dormant Commerce Clause Challenge to Vermont's Proposed Residency Restriction</u>

Despite state forays into legalization, marijuana remains illegal under federal law, and the Supreme Court in *Raisch* stated unequivocally that the Commerce Clause empowers Congress to regulate and prohibit its use even where state law permits it. More recently, the United States Justice Department has taken the position that it will not challenge state legalization initiatives so

long as state legalization laws honor federal priorities such as preventing minors' access to marijuana, stopping the flow of marijuana from legalization states into continued prohibition states, and ensuring that criminal syndicates do not participate in and benefit from more open marijuana markets.[1] The proposed Vermont legislation expressly addresses these concerns, and there is no reason to think the United States will challenge Vermont's legalization law even if it facially discriminates, since the federal government's official policy remains that *interstate* commerce in marijuana is prohibited.

The issue here for Vermont's proposed legislation is that Dormant Commerce Clause challenges are rarely, if ever, brought by the federal government; they are brought by private parties whose business interests are negatively impacted by facially discriminatory regulations. Moreover, it is important to remember that the Dormant Commerce Clause as interpreted by the courts is not dependent on federal statutory law or the will of the federal government more broadly but is rather a direct limitation on state power imposed by the Constitution. The federal executive—acting through the Justice Department—has no power to make the Constitution inapplicable to a particular type of business (and neither does Congress). Here, where a state has elected to create and regulate a market in marijuana and the federal government has elected to tolerate operation of that state market despite its illegality under federal law, it is difficult to see why courts would not find that once the state created such a market its regulatory power was restricted by the constitutional limitations that apply in all other contexts.

Finally, it is worthwhile to note that there is an older line of cases (dating from before the modern eras in both Commerce Clause jurisprudence and drug prohibition law) holding that "things which in their nature are so deleterious or injurious to the lives and health of the people as to lose all benefit of protection as articles or things of commerce" are outside the scope of the Dormant Commerce Clause. *Crutcher v. Kentucky*, 141 U.S. 47 (1891). These cases have been invoked relatively recently to reject Dormant Commerce Clause challenges to state criminal drug laws. See, e.g., *Predka v. Iowa*, 186 F.3d 1082 (8th Cir. 1999). Here, however, Vermont's proposed legalization legislation is predicated on exactly the opposite assumption: that marijuana is not so noxious as to justify a complete prohibition and is in fact both useful for medical purposes and a substance that adults should have a right to use if they wish. Given this position, the State would be hard pressed to argue that marijuana was outside the Dormant Commerce Clause for purposes of facial discrimination against out-of-state interests because it was harmful to health or welfare.

4. Conclusion

Vermont's proposed residency restrictions on marijuana business licensing and financing facially discriminates against interstate commerce, and therefore would likely fall to a Dormant Commerce Clause challenge.

[1] The Justice Department Memorandum is available at http://www.justice.gov/iso/opa/resources/305201382913275685746 7.pdf.