The Michigan Cannabis Industry and the Dormant Commerce Clause

By Scott F. Roberts and Griffin Kas

At a Glance

The dormant commerce clause looms in the background of the U.S. cannabis industry. Many Michigan municipalities have enacted licensing schemes that favor local residents over other Michiganders or out-of-state economic actors. Moreover, Michigan, like other states, prohibits the importation of cannabis and requires cannabis sold in Michigan to be grown and processed in the state. This article explores how the application of the dormant commerce clause could challenge local preferences in municipal licensing and force Michigan and other states to accept imported cannabis into its licensed marketplace.

Authors' note: Since the writing of this article, the United States District Court for the Eastern District of Michigan issued a temporary restraining order against the City of Detroit for its ordinance regulating licensing for recreational marijuana shops, finding that it likely violates the dormant commerce clause.

The federal dormant commerce clause is an issue lurking silently in the background of the Michigan cannabis industry.[1] Under the dormant commerce clause, states cannot enact economic protectionist laws that favor in-state products, services, or residents over out-of-state interests. This article explores the application of the dormant commerce clause doctrine to the cannabis industry, how it could be applied to municipal ordinances granting local residency preferences, and how the doctrine could affect the state's budding cannabis industry if the federal government decriminalizes, reclassifies, or legalizes cannabis.

The state of Michigan's cannabis industry

Many Michigan municipalities have enacted licensing schemes that favor local applicants or companies with local ownership.[2] This is routinely done through merit-based scoring which grants local residents and locally owned businesses additional points non-resident applicants are ineligible to receive.[3] An even more extreme version of this preference can be seen in Detroit, which recently amended its ordinance to allow for adult-use licensing. Detroit's ordinance specifically reserves at least 50 percent of its adult-use cannabis licenses for companies that are majority owned by long-time city residents.[4] These regulatory schemes serve to give an edge to local companies and residents over out-of-state operators who lack local ownership. These schemes are ripe for challenge under the dormant commerce clause.

Additional regulatory barriers prevent out-of-state cannabis producers from selling in Michigan. Michigan, much like other states which have legalized cannabis, requires all cannabis products to be produced at licensed facilities within the state's borders.[5] This type of restriction is in part due to the current classification of non-hemp cannabis as a controlled substance and limitations placed upon interstate commerce involving such substances.[6]

The trend among Michigan cannabis companies is vertically integrating their operations. This has given rise to construction of hundreds of indoor cultivation facilities and a growing number of outdoor and greenhouse cultivation operations. The question then becomes, what if federal legislation opened up the industry such that cannabis products could travel freely across state lines?

Such a scenario may not bode well for Michigan cultivators, who would be at a competitive disadvantage compared to states with more suitable climates and year-round sunshine.[7] This competitive disadvantage may extend beyond just outdoor and greenhouse cultivation. States such as California and Colorado, which both receive approximately 300 days of sunshine a year, can better utilize affordable solar energy for more efficient indoor cultivation. Moreover, countries such as Colombia could likely produce cheaper cannabis than even California due to a combination of advantageous weather conditions and lower labor costs.

As a result, breaking down state and national borders would result in winners and losers, with cultivation moving toward areas with lower production costs. Given Michigan's notoriously gloomy winters and the possibility of climate change legislation levying carbon taxes or additional regulations on energy-intensive indoor cannabis facilities, the state's cultivators could be at a substantial disadvantage should the cannabis industry open to interstate and international commerce.

Applying the dormant commerce clause doctrine to the cannabis industry

As the U.S. Court of Appeals for the First Circuit succinctly stated, the dormant commerce clause prohibits "protectionist state regulation designed to benefit in-state economic interest by burdening out-of-state competitors."[8] Two tests determine whether a state or local law violates the clause.

Laws that explicitly discriminate against out-of-state economic interests are generally found to directly violate the

dormant commerce clause "unless [the regulation] furthers a legitimate local objective that cannot be served by reasonable nondiscriminatory means."[9] On the other hand, laws that "regulate...evenhandedly and ha[ve] only incidental effects on interstate commerce" will pass scrutiny "unless the burden imposed on [interstate] commerce is clearly excessive in relation to the putative local benefits."[10]

However, one important exception applies where Congress has expressly authorized a state to enact such a law. In that case, the clause would not apply because Congress has exercised its powers, meaning the matter is no longer dormant.[11]

Regarding cannabis, there are two important scenarios where the dormant commerce clause can come into play. The first involves licensing schemes that favor in-state or municipal residents over out-of-state residents. The second deals with regulatory schemes that require in-state production of cannabis products. Both scenarios apply to numerous state and municipal laws already on the books.

The dormant commerce clause and municipal residency requirements

In the first scenario, states and municipalities seek to discriminate against out-of-state cannabis companies and their owners. It is becoming increasingly common for municipalities and states to enact licensing schemes that discriminate — or in some cases entirely prohibit — nonresidents from owning or controlling cannabis business licenses. This type of regulation was reviewed in 2019 by the U.S. Supreme Court in *Tennessee Wine and Spirits Association v. Thomas*. In that case, two out-of-state businesses challenged Tennessee's residency requirements for liquor store licenses. The Court found that Tennessee discriminated against nonresident economic actors and the state's claim for such discrimination was not narrowly tailored to advance a legitimate local purpose.[12]

Even more recently, the dormant commerce clause was used to challenge a Maine law that required Maine residents to own a controlling interest in the state's newly issued adult-use cannabis licenses.[13] In the complaint filed against the state, an out-of-state cannabis business challenged the residency requirements, claiming that Maine's "Residency Statute violates the dormant Commerce Clause...by explicitly and purposefully favoring Maine residents over non-residents."[14] The state eventually settled the case by agreeing to no longer enforce the residency statute against out-of-state interests.

The same plaintiff that successfully challenged Maine's residency statute also obtained a preliminary injunction against the city of Portland, Maine, from enforcing a municipal licensing scheme that favored its residents.[15] In that case, the city of Portland argued that the dormant commerce clause did not apply because Congress's passage of the Controlled Substances Act demonstrated its intent to regulate cannabis under the commerce clause and Congress "chos[e] to prohibit it."[16] The trial court disagreed with this argument, finding that "although the Controlled Substances Act criminalizes cannabis, it does not affirmatively grant states the power to burden interstate commerce in a manner which would otherwise not be permissible."[17] The city also argued that its ordinance served legitimate local purposes because the local preferences "ensure[d] that the City understood the amount and quality of oversight and could easily verify past violations."[18] Again, the trial court rejected this argument, finding that Portland's claimed "legitimate interest" lacked "concrete record evidence" and further characterized the city's claim as to the "amount and quality of oversight" as being "mere speculation."[19]

Here in Michigan, more municipalities are looking to favor its residents in their licensing process. No municipality has gone quite as far in this regard as Detroit. The city's newly amended adult-use ordinance grants a minimum of 50 percent of its adult-use cannabis licenses to companies whose majority owners are long-time Detroit residents; the ordinance also provides discounted fees and land-bank properties for what it calls "legacy" applicants.[20]

This licensing scheme is already under scrutiny in Michigan's courts. A complaint was recently filed against the city by a longtime Detroit resident who did not qualify for legacy status. The plaintiff in that case, who lived in nearby River Rouge and resided out of state for a time, claims that both locations were disproportionately impacted by the federal war on drugs. In a supporting brief, the plaintiff argues that Detroit's licensing scheme consists of little more than "naked economic protectionism" designed to favor certain "legacy Detroiters" over everyone else and that, despite its claims, the ordinance is not reasonably tailored to advancing the goal of promoting "social equity."[21]

In places such as Detroit, the question becomes whether the city's stated purpose for the local preference — that its residents have been disproportionately impacted by the war on drugs and have been historically excluded from ownership opportunities because of it — would be considered a legitimate interest that could not be served by reasonable non-discriminatory means.

While few would argue that providing opportunities to those who have been disproportionately impacted by the war on drugs is not a legitimate interest, out-of-state companies could argue there are non-discriminatory means to reach that goal, including Michigan's current social equity program.[22] For example, out-of-state residents who have been disproportionately impacted by the war on drugs may be excluded from ownership opportunities, as was the case of the plaintiff in *Lowe v. City of Detroit*.[23] Further, plenty of Detroit residents in wealthier areas of the city may not have been disproportionately impacted or may have been provided ownership opportunities in the industry. Since Detroit could have found another way to achieve its legitimate goals, it could be argued that its residency preference could have been better served

While Michigan would almost certainly be able to maintain its own strict testing requirements through its retained police powers, that does not mean all regulations would pass constitutional muster.

by factors unrelated to residency such as income tests, conviction for drug crimes, or other means.

The dormant commerce clause and interstate transport

The second scenario, and the one most formidable for Michigan cultivation companies, would be application of the dormant commerce clause to the state's current sales requirements. Under state law, all cannabis sold in Michigan provisioning centers and retailers must be produced at a Michigan-licensed cultivation or processing facility.[24] For now, cannabis companies are likely unable to successfully challenge current state regulatory schemes because "[d]ormant Commerce Clause restrictions apply only when Congress has not exercised its Commerce Clause power to regulate the matter at issue."[25] In relation to cannabis, the Controlled Substances Act and federal drug trafficking laws[26] could be seen as regulating the interstate transport of drugs, meaning the issue is not dormant and the clause does not apply.[27]

Under the Controlled Substances Act, Congress has chosen to prohibit interstate and intrastate transportation of cannabis. However, this is not likely to remain the case forever. For example, the Marijuana Opportunity Reinvestment and Expungement Act of 2020,[28] or MORE Act, is currently being reviewed by the Senate. While this bill is slowly moving through Congress, it may be the first real step toward federal legalization; the MORE Act would remove cannabis from the list of controlled substances and establish a federal tax on cannabis, among other items. However, it would not legalize cannabis altogether. Instead, each individual state would be able to utilize its retained police powers to prohibit cannabis under its respective laws. In other words, the MORE Act does not specifically legalize cannabis, but Congress would repeal its federal illegality.

Passage of the MORE Act or similar legislation may expose the Michigan cannabis industry to future dormant commerce clause challenges brought by out-of-state cannabis producers. While Michigan would almost certainly be able to maintain its own strict testing requirements through its retained police powers,[29] that does not mean all regulations would pass constitutional muster. This could lead to the state no longer being able to limit its licensed provisioning centers and retailers from selling only Michigan-produced cannabis products. Nondiscriminatory measures would need to be implemented to appease out-of-state companies looking to expand.

For a dormant commerce clause challenge to be successful once cannabis is removed from the list of controlled substances, recategorized, or federally legalized, an out-of-state cannabis producer would need to establish that the state's requirement does not further a legitimate objective that cannot be served by reasonable non-discriminatory means. Here, it is difficult to imagine a legitimate state objective that would survive this heightened level of scrutiny. Many of the potential arguments that could be made were shot down by the U.S. Supreme Court in the aforementioned *Tennessee Wine and Spirits* case.[30]

However, if the MORE Act is ratified by Congress, courts may struggle to determine whether the matter of cannabis transportation has been federally decided or if states may continue to maintain siloed regulatory systems through Congress's delegation of its commerce clause powers to the states. The

version of the MORE Act introduced by now Vice President Kamala Harris in 2019 contained no such authorization or explicit delegation. Thus, passage of the MORE Act or similar legislation could open the proverbial floodgates for out-of-state cannabis products to enter Michigan's licensed market.

There is a chance that federal legislation reclassifies, decriminalizes, or legalizes cannabis and explicitly delegates Congress's commerce clause power over cannabis to individual states. If such a law is passed, states like Michigan would be able to continue with their current approach to the market. In this scenario, Michigan could choose to allow out-of-state cannabis into its licensed system or continue to require all cannabis products to come from state-licensed facilities.

Conclusion

By allowing such specific residency preferences and requirements, Michigan and its municipalities have potentially exposed themselves to future dormant commerce clause challenges from out-of-state economic interests. In addition, with federal reform of cannabis on the horizon, Michigan cultivators may need to prepare for the interstate transport of cannabis. For highly efficient cultivators, this may present an opportunity to expand their customer base to other states and possibly other countries. For many, however, this represents a threat to their business models due to increased competition from out-of-state businesses in locations more suitable for cannabis cultivation. ■

Scott Roberts is the founder and managing member of Scott Roberts Law, a boutique firm specializing in cannabis business law. Roberts works with single licensees, multi-licensed companies, and multi-state operators in Michigan and Illinois, helping them achieve and maintain licensure under the laws in those states. Scott Roberts Law has helped more than 200 companies achieve pre-licensure with the Michigan Marijuana Regulatory Agency.

Griffin Kas is an associate corporate attorney at Scott Roberts Law and a graduate of Western Michigan University Thomas M. Cooley Law School. Kas has worked with Michigan cannabis businesses since 2018, assisting with both state and municipal licensure. She is a member of the State Bar of Michigan Business Law and Marijuana Law sections.

ENDNOTES

1. US Const, art I, § 8, cl. 3 and *W Lynn Creamery, Inc v Healy*, 512 US 186, 192; 114 S Ct 2205; 129 L Ed 2d 157 (1994).
2. *Michigan's Marijuana Regulatory Agency Announces Social Equity Program Expansion*, Marijuana Regulatory Agency, DLARA (May 19, 2020), available at <https://www.michigan.gov/mra/0,9306,7-386-79784-529549--,00.html> [https://perma.cc/NBW5-G2DG]. All websites cited in this article were accessed June 4, 2021.
3. Hogan, *Lapeer to use merit system for marijuana dispensary licenses*, The County Press (March 14, 2018) <https://thecountypress.mihomepaper.com/articles/lapeer-to-use-merit-system-for-marijuana-dispensary-licenses./> [https://perma.cc/Q3FS-KXKU].
4. Detroit Ordinance No. 2020-1, Chapter 20, Article VI (February 6, 2020).
5. *Recreational Marijuana Laws: What You Need to Know*, Health Project, Mercy Health <https://mchp.org/recreational-marijuana-laws-what-you-need-to-know/> [https://perma.cc/3QE2-K2H4].
6. 21 USC 331 and 21 USC 812.
7. Kanuckel, *Top 10 Cloudiest US States*, Farmers' Almanac (January 28, 2021) <https://www.farmersalmanac.com/top-10-cloudiest-u-s-states-22480> [https://perma.cc/W3Q9-XD77]. Michigan was listed as the seventh cloudiest state in the country.
8. *Wine & Spirits Retailers, Inc v Rhode Island*, 481 F3d 1, 10 (CA 1, 2007) (internal quotations omitted).
9. *Id.* at 10–11 and *Tenn Wine & Spirits Retailers Ass'n v Thomas*, 139 S Ct 2449, 2461; 204 L Ed 2d 801 (2019) ("[A] state law [that] discriminates against out-of-state goods or nonresident economic actors...can be sustained only on a showing that it is narrowly tailored to advance[e] a legitimate local purpose.") (internal quotations omitted).
10. *Wine & Spirits Retailers*, 481 F3d at 11 and *Pike v Bruce Church, Inc*, 397 US 137, 142; 90 S Ct 844 (1970).
11. E.g., *Western and Southern Life Insurance Co v State Bd of Equalization of California*, 451 US 648, 653; 101 S Ct 2070; 68 L Ed 2d 514 (1981) (holding that a discriminatory tax against out of state insurance companies does not violate the dormant Commerce Clause because the McCarran-Ferguson Act delegates the regulation and taxation of insurance to the states).
12. *Tenn Wine & Spirits Retailers Ass'n*, 139 S Ct at 2476.
13. *Northeast Patients Group v Maine Dept of Admin and Financial Services*, unpublished opinion of the United States District Court for the District of Maine, issued March 23, 2021 (Case No. 1:20-cv-00107-NT).
14. *Id.*
15. *NPG LLC v City of Portland*, unpublished opinion of the United States District Court for the District of Maine, issued August 14, 2020 (Case No. 2:20-cv-00208-NT).
16. *Id.* at 10.
17. *Id.*, quoting *New England Power Co v New Hampshire*, 455 US 331, 341; 102 S Ct 1096; 71 L Ed 2d 188 (internal quotations omitted).
18. *NPG LLC v City of Portland* at 11.
19. *Id.* at 10.
20. Detroit Ordinance No. 2020-1.
21. *Lowe v City of Detroit*, unpublished plaintiff's brief in support of her motion for a preliminary injunction, filed with the Wayne County Circuit Court on March 11, 2021 (Case No. 21-002831-CZ).
22. *Social Equity*, Marijuana Regulatory Agency, LARA <https://www.michigan.gov/mra/0,9306,7-386-93535---,00.html> [https://perma.cc/TQR5-Z8NP].
23. Detroit Ordinance No. 2020-44 (January 11, 2021) and MCL 333.27958; *Lowe v City of Detroit*.
24. MCL 333.27961 § 11(b).
25. *Tenn Wine & Spirits Retailers Ass'n*, 139 S Ct at 2465.
26. E.g., 21 USC 841(b)(1)(A)(vii).
27. Of note, in *Gonzales v Raich*, 545 US 1, 18; 125 S Ct 2195; 162 L Ed 2d 1 (2005), the Supreme Court stated that Congress has the ability to regulate purely intrastate cannabis cultivation because the "failure to regulate that specific class of activity would undercut the regulation of the interstate market in that commodity."
28. HR 3884 — MORE Act of 2020, 116th Congress (2019–2020).
29. Dormant Commerce Clause cases have typically given deference to state and municipal "health, life and safety" laws. See, e.g., *Sligh v Kirkwood*, 237 US 52; 35 S Ct 501; 59 L Ed 835 (1915).
30. Such arguments that were struck down include: 1) licensees are subject to process in state courts, 2) the residency requirement ensures that only law-abiding and responsible applicants receive licenses, 3) the state's need to maintain oversight over licensees, and 4) it would promote responsible consumption because local licensees know the local community better. *Tenn Wine & Spirits Retailers Ass'n*, 139 S Ct at 2465–2470.