CLIENT ALERTS & INSIGHTS

Government Takes First Steps Toward Federal Legalization

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In a historic move by the federal government, the U.S. Department of Health and Human Services (HHS) on August 30 recommended that cannabis be moved from Schedule I to Schedule III of the Controlled Substances Act.

What is Schedule III?

Schedule I is reserved for drugs that have no medical use, a lack of accepted safety for use under medical supervision, and a high potential for abuse. These drugs are federally illegal in all respects. Schedule III drugs have accepted medical uses and moderate to low physical dependence or high psychological dependence. Examples of Schedule III drugs include testosterone, anabolic steroids, and acetaminophen with codeine.

What Still Has to Happen for Rescheduling to Occur?

The HHS recommendation, which was based on a scientific and medical evaluation by the FDA, was made to the DEA. The DEA will now conduct its own review and make a final determination. While the DEA has certainly never been friendly to cannabis, the independent process is "guided by evidence," as noted White House Press Secretary Karine Jean-Pierre. The agency will have to consider that evidence, which should be robust. The DEA will be hard-pressed to ignore FDA and HHS's medical and scientific findings.

What Does it All Mean?

The biggest immediate effect will be the removal of the immense tax burden that cannabis companies shoulder as a result of Section 280e, an IRS provision enacted to target illegal drug dealers but also applied to the cannabis industry by virtue of its Schedule I status. Rescheduling will also make cannabis much easier to study.

Other than that, Schedule III status brings far more uncertainty than it does clarity. This change would not result in the cannabis industry as it exists today becoming fully legal. Schedule III drugs are subject to significant statutory requirements (pharmaceutical New Drug Applications, medical prescriptions, dispensation by pharmacies, etc.), requirements with which the industry is not remotely designed to comply, especially in the 23 and counting states where cannabis is legal for adult use as well as medical use.

Some of the many questions brought about by a rescheduling include:

Will a Schedule III status encourage more banks to provide services to cannabis companies, and otherwise loosen up capital for the beleaguered industry? It is reasonable to think so, although it remains to be seen if this will be enough for federally chartered banks to jump into the fray.

Will the removal of Schedule I enforcement risk expedite the speed with which current prohibition states enact their own medical and adult use programs, or increase the likelihood that such measures currently up for consideration in statehouses will pass? A rescheduling will certainly encourage the pro-legalization movements in each of these states.

What does Schedule III mean for cross-border transactions and the development of national brands? The highly regulated industry is very siloed, state by state, because raw materials and products cannot be taken across state lines. States that border other legal states, in particular, may find themselves far more open to cross-border transactions.

Will Schedule III status encourage the United States Patent and Trademark Office to finally consider federal trademarks for cannabis brands? There is no reason to think so, given that the USPTO applies its strict approach to ingestible CBD as well, which was made legal under the 2018 Farm Act.

Will a parallel pharmaceutical industry begin to grow alongside the current cannabis industry? For pharmaceutical companies with the means to comply with Schedule III, the above issues, from banking to cross-border transactions to brand protection, disappear. In fact, if the federal government were to truly enforce Schedule III, the existing cannabis industry would be fully replaced by the pharmaceutical industry.

Nevertheless, a move from Schedule I to Schedule III would be a historic rejection of the past decades' War on Drugs. The industry could then find itself sitting in a Schedule III waystation of sorts until cannabis is finally descheduled and treated like alcohol. This was, in fact, the recommendation of the federal group of lawmakers and medical professionals appointed by President Nixon in 1970 to study and recommend how cannabis should be scheduled in the first place. The group's recommendation was ignored then, but is there finally movement forward now?

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