

## **Quinn Emanuel Cannabis Litigation Practice Alert**

### **Challenging State and Local Cannabis License Denials: Current Trends and Issues, An Update**

#### **I. Background**

Applicants for licenses to operate cannabis businesses challenge denials (or grants to competitors) in courts in a variety of ways, such as by alleging: (1) technical errors in evaluating applications; (2) the arbitrary and capricious application of rules or regulations; and (3) corrupt or illegal practices. This article updates our August 2019 article on these topics ([available here](#)), and also discusses the following new types of challenges by disappointed applicants: (1) challenges based on changes to regulations while an application is pending; and (2) challenges to local ordinances that prevent classes of applicants from obtaining cannabis licenses.

#### **II. Challenges Based on Technical Errors**

A common claim in lawsuits challenging a denial of a license is that the government department with the authority to grant cannabis licenses (hereinafter, the “department”) made technical errors when evaluating the application. A number of departments rank cannabis license applications by score and applicants have successfully challenged departmental decisions by showing that the department incorrectly calculated the score assigned to an application. *See, e.g., 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 which it succeeded in altering its ranking based on a showing that the department omitted points from its score).

Missouri is facing a number of potential appeals based on technical errors. The appeals began in January 2020, when an applicant filed a formal appeal of the Missouri Department of Health and Human Services’ denial of a license and alleged a number of scoring mistakes. *See* Kevin Hardy, Jason Hancock, and Steve Vockrodt, “Hundreds denied Missouri medical marijuana licenses – and it’s not clear why,” [kansascity.com](#) (January 26, 2020). The applicant claims it received a score of zero on several of the department’s application questions even though it submitted lengthy written responses to each question. Although the department uses a neutral third-party vendor to assign scores to every cannabis license application, a number of applicants similarly report irregularities in the scoring system. *Id.*

By March 2020, failed applicants had filed over 800 appeals. *See* Kurt Erickson, “More than 800 appeals filed by jilted pot companies in Missouri licensing fight,” [stltoday.com](#) (March 2, 2020). For example, in Administrative Hearing Commission (“AHC”) Case No. 20-0180, petitioner Missouri Medical Marijuana Collective, LLC alleges in its First Amended Petition that its two applications – one for manufacturing and one for cultivation – received significantly different scores “even though both applications contained a number of answers that were virtually identical.” *Missouri Medical Marijuana Collective, LLC v. Missouri Dep’t of Health and Senior Services*, Case No. 20-0180. Another applicant, Union Medical Marijuana Dispensary, LLC, similarly filed an appeal alleging that but for “erroneous or negligent scoring, computational errors, technological issues, and/or other unacceptable scoring-related mistakes” it would have received a license. *Union Medical Marijuana Dispensary, LLC v. Missouri Dep’t of Health and Senior Services*, Case No. 20-1205. The AHC has not ruled on these appeals yet, but these alleged scoring discrepancies will be an area to watch going forward.

In addition, some passed-over Missouri applicants have challenged the scoring system itself as arbitrary and capricious. For example, in addition to its claims based on technical errors, Missouri Medical Marijuana Collective, LLC alleges that the state’s licensing allocation process was arbitrary and capricious because it allocated “economic impact bonus points to applicants based on the unemployment rate in the applicant’s zip code.” *Missouri Medical Marijuana Collective, LLC v. Missouri Dep’t of Health and Senior Services*, Case No. 20-0180. Missouri Medical Marijuana Collective argues that the “use of the unemployment rate in a specific zip code is unrelated to any of the criteria stated in Article XIV” of the Missouri Constitution. As of September 30, 2020, the parties are still conducting discovery and were ordered in the Order of September 30, 2020 to notify the court when they “are ready to set a hearing on the merits of this case.” *Id.*

New Jersey is also in the midst of resolving a number of appeals of its licensing process based on alleged technical errors. Last year, five medical marijuana growers who were denied cannabis licenses filed appeals of those denials. The appeals focused on inconsistencies in the application scoring process stemming from the department's inability to access PDF files the applicants submitted in support of their applications. *See* Susan Livio, "Court puts new medical marijuana licenses on hold after N.J. denied some on technical issue," [nj.com](https://www.nj.com) (Dec. 23, 2019). The Superior Court of New Jersey Appellate Division granted a stay in favor of the denied applicants, ordering the department to cease reviewing applications pending the applicants' appeals of the department's decision to deny those applications. ***Core Empowerment NJ LLC v. New Jersey Dep't of Health***, Case No. A-001286 (Order Granting Stay, Dec. 19, 2019). This year, the Court clarified that the Department must stay "all administrative activities relating to the entire administrative review process, including but not limited to, ranking of applications, scoring of applications, awarding permits and publishing results" while the appeals related to the technical issues are ongoing. *Id.* (Order Clarifying Stay, Jan. 13, 2020). The appeals will be useful to watch in order to understand the ability of denied applicants to successfully appeal based on technical errors, particularly in light of New Jersey's pending ballot initiative to legalize adult use of cannabis. *See* Sophie Nieto-Munoz, "N.J.'s marijuana ballot question likely to pass, new poll says," [nj.com](https://www.nj.com) (Oct. 9, 2020).

### III. Challenges Alleging that Rules Governing the Grant of Licenses Were Applied in an Arbitrary and Capricious Manner

Another common claim in lawsuits challenging the denial of a license is that the department acted in an arbitrary and capricious manner in applying applicable statutory schemes or regulations. In general, courts have found that a department acted in an arbitrary and capricious manner either if it lacked sufficient justification for its actions, or if it failed to make a decision based on the facts and circumstances of the case.

In ***Premium Leaf, Inc. v. Arizona Dep't of Health Servs.***, 2019 WL 6769663, at \*1 (Ariz. Ct. App. Dec. 12, 2019), the Arizona Court of Appeals upheld the grant of a cannabis license in a suit alleging that the department wrongfully awarded a license to Premium Leaf's competitor. The Court followed ***Compassionate Care Dispensary, Inc. v. Arizona Dep't of Health Servs.***, 244 Ariz. 205 (Ct. App. 2018), which determined that because the relevant laws did not 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 an applicant who had not procured a conditional use permit from the local municipality. The court in ***Premium Leaf*** held that because the license applicant had provided documentation from the local jurisdiction showing that its proposed location complied generally with local zoning restrictions, the department did not act arbitrarily or capriciously. 2019 WL 6769663, at \*6.

### IV. Challenges Based on Corrupt or Otherwise Unfair Licensing Processes

Applicants also challenge license denials based on allegations of corruption, or other unfair and illegal practices. Disappointed applicants have filed cases alleging corruption or other unfair practices. Two cases in California, ***Washington, LLC v. City of San Bernardino***, Case No. CIVDS1905710, and ***EEL Holdings, LLC v. City of San Bernardino***, CIVDS1906467, have progressed since our August 2019 article. In these cases, the plaintiffs allege that San Bernardino allocated cannabis licenses to "benefit politically favored applicants/donors, to settle political scores, to effect political vendettas, and to lure the other applicants 'not to rock the boat' based on ex post facto promises and/or implications that, if they just stayed silent and did not speak up, they ultimately also would obtain a license down the road." [Docket](#), Case No. CIVDS1906467. The City of San Bernardino's motion to bifurcate and to stay discovery was denied in late August 2019. Due to the COVID-19 pandemic, the trial date has been continued. This case continues to be one to watch to understand the efficacy of a corruption-based challenge to a license denial.

On April 16, 2020, social equity applicants filed a Petition for Peremptory Writ of Mandate in Los Angeles Superior Court seeking to compel the Los Angeles Department of Cannabis Regulation to either review the applications of all social equity applicants who were not chosen for retail licenses or institute a

new application system. They alleged in a Petition for Writ of Mandate that applications for 100 retail licenses under the Social Equity Program were supposed to be issued to the first 100 filers starting at 10:00 a.m. on September 3, 2019. They claimed this process was not followed because “more than 226 applicants were allowed to begin the application process earlier than 10:00 am” by signing onto the application platform, and at least 14 applicants were actually able to access the application before 10:00 a.m. [Docket, \*Social Equity Owners and Workers Association, Inc. v. City of Los Angeles\*](#), Case No. 20STCP01426.

Petitioners also filed an application for a temporary restraining order and preliminary injunction prohibiting Respondents from taking any further actions to carry out the licensing process, “including issuing approvals of any nature such as issuing temporary or permanent licenses, under the Social Equity Program.” *Id.* Respondents argued that their opening of the application website 14 seconds before 10:00 a.m. had been “to allow applicants to access the [] application by 10:00 a.m.” and that “all user accounts ... were simultaneously re-enabled at 9:59:46 a.m. on September 3, 2019” so there had been no unfairness in the application process. *Id.* Before the court ruled on this application, the parties filed a notice of settlement on July 9, 2020, and the case was dismissed. Despite the settlement, this case is indicative of the fact that allegations of seemingly minor instances of unfairness can lead to litigation.

## V. Challenges to Changing Regulations

A new area of litigation involves challenges based on regulations that changed during the pendency of an application.

For example, in late January 2020, at least five Detroit businesses were denied cannabis licenses due to confusion caused by changes to a local cannabis ordinance. The businesses allege that at the time they applied for licenses in early November 2019, they met all the criteria for recreational marijuana licenses. In particular, the businesses applied at a time when Detroit did not ban recreational marijuana. But the Detroit City Clerk refused to sign a form stating that the city did not have an ordinance forbidding recreational marijuana because, *after* the applications were submitted, Detroit implemented a temporary ban on recreational marijuana, which took effect on November 12, 2019. However, the relevant state law states that the department “shall approve a state license” if the city “doesn’t notify the department that the proposed marijuana establishment is not in compliance with an ordinance ... *at the time of application.*” (emphasis added). Several businesses, including Utopia Gardens, filed mandamus petitions against the Marijuana Regulatory Agency on this basis.<sup>1</sup> [Docket, \*Utopia Gardens, LLC v. Marijuana Regulatory Agency\*](#), Case No. 20-000028-MB. The Court of Claims rejected the plaintiffs’ arguments. *Id.* In July 2020, the Michigan Court of Appeals rejected the plaintiffs’ motion for peremptory reversal. [Docket, \*Utopia Gardens, LLC v. Marijuana Regulatory Agency\*](#), Docket No. 353739; [Docket, \*Brightmoore Gardens, LLC v. Marijuana Regulatory Agency\*](#), Docket No. 353698. The case is moving forward with briefing and oral argument; plaintiffs filed their opening brief in July 2020, and defendants filed a response in August 2020.

The resolution of these appeals will provide insight about how courts will handle changes to regulations that take place while applications are pending.

## VI. Challenges to Local Zoning Ordinances

An area of litigation that was not discussed in our prior article involves challenges targeting local zoning ordinances that prevent large classes of applicants from obtaining licenses. In particular, lawsuits have recently challenged local restrictions that made it difficult or impossible for applicants to obtain cannabis licenses.

In Massachusetts, a Superior Court judge ruled in January that Cambridge’s ordinance prohibiting Registered Medical Dispensaries (“RMDs”) from seeking adult-use cannabis licenses until 2021 violated state law. *See* Melissa Schiller, “Judge Rules Cambridge, Mass., Cannot Delay Licensed Medical Cannabis Dispensaries from Entering Adult-Use Market,” [cannabisbusinesstimes.com](https://cannabisbusinesstimes.com) (February 3, 2020). The Superior Court issued a preliminary injunction prohibiting the city from implementing the ordinance and allowed the RMDs to immediately seek recreational cannabis licenses. [Docket, \*Revolutionary Clinics II\*](#),

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<sup>1</sup> Other businesses including Brightmoore Gardens filed mandamus petitions on the same basis. [Docket, \*Brightmoore Gardens, LLC v. Marijuana Regulatory Agency\*](#), Case No. 20-000029-MB, *available through* <https://courts.michigan.gov/courts/coc/pages/case-inquiry.aspx>.

*Inc. v. City of Cambridge*, (Middlesex Cty. Sup. Ct.) Case No. 1981CV03035. In its decision, the Superior Court granted the preliminary injunction because Cambridge’s “permitting ordinance appears to exceed the limited power [state law] granted to municipalities to regulate adult-use marijuana businesses.” *Id.* The Superior Court further explained that the ordinance, which would have allowed *only* “Economic Empowerment” applicants and not existing medical marijuana facilities to apply for recreational marijuana licenses, conflicts “with the [Cannabis Control Commission’s] regulations’ method for giving priority review to [Economic Empowerment] applicants and [existing medical cannabis facility] applicants” and “circumvents” this licensing process by “allowing only [Economic Empowerment] applicants to obtain the local permitting necessary to submit a license application to the CCC.” *Id.* Because the local ordinance appeared to conflict with state law, the court held Revolutionary Clinics II demonstrated a likelihood of success on the merits. *Id.*

However, in April 2020, the Massachusetts Appeals Court reversed the preliminary injunction, holding that the lower court erred in finding the permitting ordinance conflicts with the CCC’s priority application scheme and, “simply put, nothing in the ordinance conflicts with this regulation in any manner.” [Docket](#), *Revolutionary Clinics II Inc. v. City of Cambridge*, (Mass. Ct. App.) Case No. 2020-J-0086. The Court also determined “the dispensary failed to make a showing of irreparable harm in its papers filed in the Superior Court,” but “express[ed] no opinion whether the dispensary could make the requisite showing” in the future, particularly given that “events since the issuance of the preliminary injunction have no doubt changed the economic circumstances immensely.” *Id.* The Appeals Court left open the possibility that Revolutionary Clinics could obtain an injunction on other grounds, but Revolutionary Clinic’s renewed motion for a preliminary injunction on remand was also denied. [Docket](#), Case No. 1981CV03035. In September 2020, the parties each filed a motion for summary judgment, and in October 2020 Revolutionary Clinics filed for interlocutory review of the Superior Court’s denial of its renewed motion for a preliminary injunction. This case will be worth following moving forward as the court resolves the summary judgment motions. Potential applicants facing harsh local ordinances should consider whether to challenge the ordinance itself to clear the path to obtaining a license.

## VII. Conclusion

Challenges involving technical mistakes continue to be fairly successful, comparatively. Challenges based on allegations of corruption or otherwise illegal or unfair conduct remain an unknown. New areas to watch are cases involving challenges related to changing regulations as well as those involving draconian local zoning ordinances, both of which may provide relief to applicants.

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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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