IN THE WEEDS: EIGHT CONSIDERATIONS FOR RETAILERS THAT WISH TO SELL CBD PRODUCTS

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When it comes to CBD, recent momentum in the retail space, combined with some fear of being late to the party, is driving a desire for streamlined information and clear direction in regard to risks and logistics. Putting aside for a moment that this is an evolving area and clear direction is not always available, retailers are wise to seek guidance before jumping into these murky waters. The following are some key considerations for retailers thinking of selling CBD products while it remains in a state of legal and regulatory limbo across the United States.

1. WHAT ARE YOU ACTUALLY AGREEING TO SELL?

Let's start here. This may sound too basic, but it is essential to understand that what you are actually selling will dictate all the other logistics—and risks—to assess and plan around. When the 2018 Farm Bill removed hemp from the list of “controlled substances”, many thought cannabidiol (“CBD”), which can be derived from the hemp plant, was green-lighted for commercial play. That's not necessarily the case for a number of reasons. In fact, the technical legal status of hemp-derived CBD across the United States remains unclear and can vary depending on its intended use.

Companies considering selling CBD products need to understand what CBD is, where it comes from, and what it contains before agreeing to sell it. It is presumed that this audience of retailers is intending to buy or carry CBD compounds entirely derived from hemp that do not cause the hallucinogenic effect of tetrahydrocannabinol (“THC”) (since the basic distinction between marijuana and hemp is the concentration of THC). It is essential to verify, though, that the CBD you're selling is extracted entirely from hemp, which is generally defined as cannabis sativa with a total THC less than 0.3 percent dry weight in leaves and buds. CBD products that do not qualify as “hemp” may be regulated by the Drug Enforcement Administration (DEA) as controlled substances. Additionally, not all hemp-derived CBD is created equal; at a minimum, the extracted product may contain other cannabinoids, residual solvents, oils from the plant, herbicides or pesticides, and other organic molecules, which varies especially based on country of origin. As discussed further below, it is important to ensure transparency with your vendor on the sourcing and supply chain of the CBD.

Next, what types of CBD or CBD-containing products are you agreeing to sell? Regardless of legality, it seems that CBD is being added and marketed in food items, supplements, muscle rubs, more purely as oils or elixirs, in cosmetics, wrinkle creams, and hair products, to name a few. Yet, the legal status of these numerous categories varies. The Food and Drug Administration's (“FDA”) interpretation of current law prohibits the addition of CBD to food and dietary supplements because CBD is the active ingredient in an approved drug product. FDA's enforcement has been somewhat limited but it has issued a number of Warning Letters to companies adding CBD to food or supplements, or to companies making unapproved drug claims. Although some believe the wave of CBD food and beverage products hitting the market (despite FDA alleging them to be illegal) will push FDA to find

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a legal pathway for these products, it is just as likely that FDA could take a more aggressive enforcement approach based on its current interpretation of the statute.

Use of CBD in cosmetic products, however, is not illegal on a federal level provided the products are not marketed for medical (i.e., drug) purposes. Some companies remain unclear about what category their products fall into—for example, elixirs and oils—and sometimes attempt to slide into a "cosmetic" category despite that anything ingested is likely a food or supplement and runs afoul of FDA's current application of federal law. Under Section 201(i) of the Act, use as a cosmetic technically means it must be intended for "cleansing, beautifying, promoting attractiveness, or altering the appearance." Notably, certain states, such as New York, are cracking down on products in or near the supplement category. Understanding the products you are selling or considering, the intended use, and the legal status both federally, and in individual states, should be key to your company's commercial decisions.

2. DO YOUR DUE DILIGENCE ON VENDORS/COMMERCIAL PARTNERS.

We hope this is already a standard part of your vendor relationship process, but we also know that is not always the case. Given the heightened risks involved with carrying CBD products, it is crucial to understand certain factors about your CBD vendors before agreeing to sell such products. For example, retailers should seek an understanding of the vendor's history in the industry; its volume, the licenses, and certifications it holds; the vendor's financial health; litigation history, if any (both as a plaintiff and defendant); its safety profile; and its manufacturing practices. Next, understand its practices and the product it is selling, i.e. where it is sourcing, what testing it performs, and what types of assurances they provide regarding their supply chain. Other questions include what other retailers and distributors they work with and the history of those relationships. Utilize the vendor's knowledge and resources and don't be shy about it—do they monitor state by state law and regulation? What materials can they provide you and what resources will you, as the retailer, have available from the vendor to monitor legal and regulatory developments throughout the life of the relationship? In short, go into your vendor meetings prepared with a long and detailed list of questions, all with an eye toward ideal transparency, and how to best protect your company should you decide to go down this road.

3. YOUR RIGHTS AND REMEDIES ARE AS STRONG AS YOUR CONTRACTS.

Most sophisticated retailers don't need to be reminded about the importance of vendor agreements. However, time and time again, contracts fail, as poorly drafted contracts, holes in existing contracts, and even drafting errors give rise to real (but preventable) problems for the retailer. Having good contract counsel with experience in the industry review and revise your vendor agreements is key. He or she will of course pay close attention to maximizing your indemnification rights and ensuring essential industry-specific provisions are included and drafted correctly, such as a proper Section 303(c) guarantee pursuant to the Federal Food, Drug & Cosmetic Act (the "Act") (exempting your company from certain penalties under the Act for misbranded or adulterated products it receives or delivers). It is important to note that a retailer's ability to tender to, or recover from, its vendor/manufacturer/supplier is only as good as that party's solvency. This is particularly important with many CBD vendors, which may be new on the scene, not well-capitalized or over-leveraged, facing large scale risk of its own, and dodging complex legal and regulatory risks with costly potential consequences. For these reasons and more, doing your due diligence and also securing insurance is extremely important.

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4. PAY CLOSE ATTENTION TO INSURANCE POLICIES AND COVERAGE.

Conflicting state and federal laws and regulations concerning the treatment of hemp products has led to some scarcity among major insurance providers offering coverage in this arena. As CBD products continue to hit the shelves in major markets, however, and as industry projections grow, more carriers are entering the ring. Retailers should carefully consider the issue of insurance when entering into a CBD vendor relationship or offering CBD products for sale. Obviously, a starting point is: does the vendor have insurance, and if so, what type of policy? Consider commercial general liability, product liability, commercial property, and possibly cyber insurance, to start. Next, what are the policy limits? Will you be added as an additional insured under the policy? Take a look at the coverage—does it go beyond personal injury claims? Does it extend to recalls? Is there any coverage for fraud-based or marketing claims or business interruption? Retailers should not rely entirely on the vendors' policies either—what coverage, if any, do their own policies provide? Could carrying CBD products affect or negate the company's coverage in the first place? Investing a little time and money up front in insurance coverage could save your business tens of thousands of dollars, or more, should you ever end up in regulatory complications or costly litigation. Asking the questions above and working with an experienced insurance broker and/or insurance coverage counsel can help ensure that you get the right coverage for your needs and aren't left out to dry at a crucial time.

5. REGARDLESS OF THE STATE OF REGULATION, BE WARY OF CONSUMER LITIGATION.

Companies currently selling or developing products containing CBD should continue to monitor FDA regulatory activity in relation to the compound, but a lack of clear FDA enforcement policy does not mean companies are free and clear of legal risk. In fact, the lack of clear regulation typically creates a grey area that plaintiffs' attorneys love to exploit by way of civil litigation, either in the form of consumer class actions for false advertising, or true product liability claims and lawsuits. Issues specific to CBD are ripe for these types of legal actions, including sourcing and quality control, potency and dosing, and perhaps the most controversial of all—access and appeal to children.

Obviously, the lack of scientific study regarding the effects of CBD on the body, especially where there is no established dosage, means companies are likely to face claims of injury and illness. Note that the makers of Epidiolex® (cannabidiol) oral solution (the only CBD drug approved by FDA for the treatment of certain types of seizures in children) warn of potential liver damage and developmental toxicity, in addition to other risks. Perhaps more costly, public, and trendy, however, is the risk of consumer class actions related to marketing claims. The FDA has specifically stated it will use its enforcement powers to police unapproved drug claims related to CBD products. It has, to date, primarily used that power to warn companies promising treatment for serious or life-threatening diseases (such as Alzheimer's, Crohn's disease, diabetes, or cancer). In some cases, however, claims regarding inflammation, anxiety, depression, or skin conditions have also caught FDA's attention. What about a “cosmetic” with CBD that promises to hydrate and reduce redness and/or inflammation? Such a product carries some risk that “inflammation” could be construed as a “drug” claim and may not be substantiated with clinical data. While the class action plaintiffs' bar often rides the wake of FDA warning letters, it is also creative, hungry, and looking for fresh ideas. Thus, companies should have legal counsel carefully review all outward-facing statements to identify any that are even arguably misleading to consumers.

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The bottom line is that any party in the stream of commerce can be sued, and retailers, as the last in line and often the biggest name in the stream, may be seen as the most attractive target. You can mitigate these risks with proper contracting, insurance, close attention to product marketing, by understanding the products, and utilizing only trusted, established vendors.

6. HAVE A PLAN IN PLACE WITH RESPECT TO MINORS.

While there is no federal law prohibiting the sale of CBD products specifically to minors, it is widely believed that FDA and states will inevitably limit sales of CBD products to only adults. Retailers will find that many product manufacturers have already imposed such restrictions, labeling their CBD products with statements such as “Not Intended For Children Under __” or “Keep Out of Reach of Children.” Although manufacturers are likely aware that age-gating is not always possible at the point of sale, such practice is with good reason.

When contemplating potential adverse effects, especially those on children, companies should remember that there is very limited safety and efficacy data on CBD overall. And beyond remembering that CDB's inclusion in food and supplements is currently illegal under FDA's interpretation of federal law, companies should be aware that a concentration limitation of less than 0.3 percent of THC does not control the dose and obviously depends on the amount of product used or ingested. The bottom line is, know your core market and the likely purchasers of CBD products you may introduce. FDA still considers food and supplements containing CBD to be illegal, and while the FDA may not be exercising its enforcement power to the fullest extent, selling any CBD products to minors -- a more vulnerable population -- carries additional risk, including product liability and personal injury litigation. Companies should carefully consider the potential to, and commercial realities of, age-gating. They must also carefully review all planned product marketing—including that of vendors—for exposure stemming from sale to minors.

7. MONITOR STATE BY STATE LEGAL STATUS AND REGULATORY NUANCES.

Keeping track of the constantly evolving status of individual state and local legality and regulation is crucial, though nearly impossible. Retailers may want to avoid certain states still entirely hostile to CBD, such as Idaho, South Dakota, and Nebraska, to name a few. Launching in such states undoubtedly presents a risk. Even in those states where CBD and marijuana are generally legal at the state level (10 states plus D.C.), issues are mounting. Local police and health officials in states such as Maine, New York, and California, have taken action under local regulation to remove CBD-containing food and supplement products from restaurants, health food stores, and other retailers.

While it would be impractical to give a thorough state by state overview herein, legality and regulatory landscape at the state level change almost weekly. More states are launching hemp programs via their departments of agriculture. Many retailers chose to launch in test markets in those states with the most robust hemp programs, with licensing for cultivation, processing, and laboratory testing, such as Arizona, Washington, Oregon, Nevada, Michigan, Indiana, Illinois, Tennessee, and Kentucky.

Shipping across state lines is also a grey area. The United States Postal Service (“USPS”) recently gave some guidance. In March, it issued an advisory on “Acceptance Criteria for Cannabidiol Products Containing CBD,” which states that USPS will mail hemp-CBD products as long as the mailer follows certain formalities such as including a sworn statement (meeting the USPS criteria), include copies of the hemp licenses associated with the

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hemp being mailed, and copies of lab testing of the hemp-CBD products. Other carriers have not given as much guidance. It is important to note, again, that this guidance does not prevent state-level law enforcement from seizing hemp shipments, as the USPS memo has no binding effect on state agencies.

8. BEWARE OF LIMITATIONS FOR ONLINE ADVERTISING, SPECIFICALLY SOCIAL MEDIA.

In addition to various state and federal regulations governing the sale and advertising of CBD, social media has its own ecosystem of considerations, including whether it is permissible—and how—to advertise CBD on mainstream platforms such as Facebook, Instagram, and more.

In short, social media platforms have stringent requirements for CBD advertising, irrespective of existing state and federal laws. Some platforms, including Facebook, prohibit it entirely, and advertising CBD in any fashion could result in a removal of the post (or of the account more broadly) in Facebook's discretion. The removal of an account on these grounds is difficult to appeal and rarely reversed.

Given the traction with which CBD is coming into the market, and given the functionality of social media advertising for nearly any product on the market, most believe that, overtime, CBD advertising on social media will be permissible. In the interim, companies are exploring potential avenues for advertising in several ways, including advertising heavily on industry forums for the time being. Others are looking to Instagram, which is a prolific site for sales of all kinds (though CBD advertising is still prohibited). On Instagram, CBD companies and companies selling CBD products are advertising their brands, core values, or aspirational or metaphorical visions (i.e., a woman dancing in the sunlight) to create intrigue and then linking back to the website of their product. Others are utilizing influencers to test the bounds of social media marketing. Others yet are launching accounts dedicated solely to their CBD products (unrelated to any other company brands or products they might sell) to test the waters, so to speak. This last option could still result in some of the penalties mentioned above, including loss or suspension of other affiliated accounts, should the platform connect the two, but potentially gives some leeway until CBD advertising is more widely permitted.

In short, this area is evolving, and we are watching its developments closely. In the interim, there are ways to walk—and not run—and gauge what may work for a particular social media platform that also fulfills company business objectives.

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