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ARBITRATION CLAUSES IN THE FIELD OF LIFE SCIENCE AND CANNABIS LAW

Zachary Chaikin

Federally, the Controlled Substances Act (CSA) governs the manufacture, importation, possession, and use of drugs. Cannabis is currently included on Schedule I of the CSA, which effectively prohibits profiting from its possession, cultivation, or distribution.¹ However, this stands in direct conflict with certain state laws that expressly allow for the possession, cultivation or distribution of marijuana.² California was the first state to legalize medical marijuana in 1996.³ Since then, medical marijuana has been legalized in 39 states and the District of Columbia.⁴ The recreational or adult-use of cannabis has been legalized in the District of Columbia and 21 states.⁵ The increased acceptance of marijuana across the United States will nevertheless lead to legal complications across the industry. The AAA 2019 Annual Report indicates that the largest claim by industry was in life sciences with a claim of \$1 billion, whereas the cannabis sector represented the largest increases in caseload by industry at 225%.⁶

In *Sensoria, LLC v. Kaweske*, a Colorado district court held that “the Court may not vindicate equity in or award profits from a business that grows, processes, and sells marijuana” and “[r]elief may not be in a form that endorses violating the CSA.”⁷ This case consisted of both parties forming a cannabis business pursuant to Colorado state law, which permits the legal sale

¹ *Fundamentals of Arbitration in the Cannabis Industry*, NEW ERA ADR, <https://www.neweraadr.com/blog/fundamentals-of-arbitration-in-the-cannabis/> [<https://perma.cc/8JCG-8T>].

² *Id.*

³ *Where Marijuana is Legal in the United States*, MJBIZDAILY, <https://mjbizdaily.com/map-of-us-marijuana-legalization-by-state/> [<https://perma.cc/4PQK-UVPY>].

⁴ *Id.*

⁵ *Id.*

⁶ Linda Gerstel, <https://www.law.com/newyorklawjournal/2021/01/08/life-sciences-and-cannabis-arbitrations-reaching-new-highs/> [<https://perma.cc/UV85-8KWE>].

⁷ *Sensoria, LLC v. Kaweske*, 581 F. Supp. 3d 1243, 1260 (D. Colo. 2022).

of cannabis for both medicinal and adult-use purposes.⁸ The district court, however, refused to enforce the parties' contract because the federal Controlled Substance Act still does not allow these types of sales as a matter of law.⁹ Moreover, "[t]his has happened in other states as well, regardless of whether the parties' contracts divided equity interests in their cannabis business or sold a cannabis distribution business.¹⁰ This contradiction between federal and state laws cause numerous issues when it comes to mergers and acquisitions of cannabis companies.¹¹

However, the simple method of arbitration can be used as a solution to these contract issues within the field of cannabis law. The Supreme Court, in *Buckeye Check Cashing v. Cardegna* ("*Buckeye*"), held that "where parties have agreed to arbitrate disputes in a contract it is the arbitrator and not a judge who determines the validity of the contract."¹² Justice Scalia, writing for the majority, went on to say that "regardless of whether the challenge is brought in federal or state court, a challenge to the validity of the contract as a whole, and not specifically to the arbitration clause, must go to the arbitrator."¹³

Consequently, the United States District Court for the Northern District of California in *Williams v. Eaze Solutions* rejected an illegality challenge to a contract asserted by a California resident who downloaded a cannabis mobile application created by Eaze Solutions.¹⁴ The district court's reasoning was simple: the parties' contract expressly provided for arbitration of the parties' disputes and, under the Federal Arbitration Act (FAA) as well as binding Supreme Court

⁸ Brian D. Koosed et. al., *In the Weeds: Why Arbitration May Be the Key to Preserving Enforcement of Cannabis M&A and VC Contracts*, K&L GATES (Mar. 28, 2022), <https://www.klgates.com/In-the-Weeds-Why-Arbitration-May-Be-the-Key-to-Preserving-Enforcement-of-Cannabis-MA-and-VC-Contracts-3-28-2022> [https://perma.cc/MJ4L-MSH3].

⁹ *Id.*

¹⁰ *Id.*

¹¹ *Id.*

¹² Todd A. Wells et. al., *The Enforcement of Cannabis-Related Contracts & Arbitration Awards*, 1 *The Journal of the Institute for Transnational Arbitration* 3, 12 (2019).

¹³ *Id.* at 12.

¹⁴ *Williams v. Eaze Solutions*, 417 F.Supp. 3d 1233, 1236 (N.D. Cal. 2019).

precedent, any issues of illegality were to be determined by the arbitrators, not the federal courts.¹⁵ The court followed the precedent set by the Supreme Court in *Buckeye* and the contract was upheld. The selection of arbitration as the forum for dispute resolution reduces the extent to which public courts can apply public policy and illegality arguments to defeat the contract.¹⁶ Where a money judgment is involved, as opposed to injunctive relief, the Full Faith and Credit Clause also provides a promising avenue for interstate enforcement of a state court judgment that confirms a cannabis-related arbitration award.¹⁷

Arbitration clauses in contracts across the life science and cannabis industries can prove vital to curtailing timely litigation issues and is a step in the right direction for consistent precedent when it comes to certain issues. With more states legalizing marijuana, it is important for this legal field to have a consistent method for contracting. Including arbitration clauses in cannabis contracts is a clear way to navigating around the discrepancy between federal and state laws. More companies should focus on the implementation of these arbitration clauses in the future to avoid petty disputes when buying and selling cannabis companies.

¹⁵ *Id* at 1239.

¹⁶ Wells et. al, *supra* note 12, at 31.

¹⁷ *Id.*