Cannabis Disputes Are Business Disputes:

A Clause Primer for the Cannabis Industry

Accessing justice through the courts to resolve cannabis-industry business disputes has been a challenge over the years; some jurisdictions do not recognize authority over disputes in this industry. However, **make no mistake: cannabis disputes are commercial business disputes, and, as a result, the industry has gravitated towards using arbitration to resolve its disputes.**

The crucial first step in doing so is to include a clear arbitration clause in the business contract, as other commercial businesses do—in this case, between partners in a storefront, a grower and a processor, a dispensary and a supplier, or any other business arrangement—to resolve their disputes quickly and less expensively in order to get back to business.

A carefully drafted arbitration clause allows disputing parties to proceed quickly and efficiently through the arbitration process, typically within eight to nine months from initiating an arbitration.

To guard against unnecessary delays and procedural obstacles, drafters should avoid overly complex or ambiguous language or risk creating a direct path to court, forcing parties to argue and litigate certain aspects of the arbitration process. Parties do not want to spend unnecessary time and money on a process that is supposed to provide a quick, efficient disposition of business disputes!

Avoid This: "Your Honor, we are here today to litigate our arbitration clause."

Following are several faulty arbitration clauses from cannabis industry contracts that resulted in unnecessary delays and obstacles for the parties in arbitration.

CONDITION PRECEDENT, JURISDICTION, AND ARBITRATOR SELECTION

In this matter, the disputing parties have two operative agreements, each with different dispute resolution provisions. The Claimant alleges breaches of contract, obligations, duties, and fiduciary responsibilities by several Respondents to the operative agreements over the management and operation of a cannabis growing, distribution, and dispensary business. Additionally, Claimant alleges misappropriation by certain Respondents over intellectual property and other confidential and proprietary information.

Operative Agreement 1

> *If any dispute arises with regard to any matter pertaining to or arising under this Agreement, the Parties hereto agree to make a good faith effort to negotiate the differences between the parties. To effectuate*

such procedure, and as a mandatory prerequisite to any further action, the complaining party shall give written notice of any grievance or complaint and invite the party to participate in personal negotiations for the purpose of seeking a resolution. If such negotiations are not successful in reaching a resolution of the matter despite good faith efforts by both parties, the complaining party must request mediation or a confidential binding arbitration with a competent arbitrator utilizing such applicable rules of arbitration as both parties may agree upon. The parties agree that any unresolved dispute must be settled in either mediation or binding arbitration.

Operative Agreement 2

If the Member and the Managers cannot reach a resolution of any dispute, they shall jointly select an attorney based in Arizona to conduct mediation and try to resolve the dispute. The mediation shall occur in Phoenix, Arizona, at the earliest possible time, based on upon the mediator's schedule. If the Member and the Managers cannot agree upon a mediator, then each shall select an Arizona Attorney, and they will then together select the mediator. The Member and the Managers shall equally split all costs for the mediation. Second, if mediation is not successful, the Member and the Managers agree to pursue arbitration of any dispute through the Commercial Arbitration Rules of the American Arbitration Association® before a competent arbitrator. Any arbitration hearing shall occur in Phoenix, Arizona. Any decision from this arbitration shall be binding upon the parties, and may be entered as a matter of record with the Maricopa County Superior Court or other Court of competent jurisdiction.

Conflicting or Ambiguous Language

- Agreement 1 allows the complaining party to select mediation or arbitration, whereas Agreement 2 implies that mediation is a condition precedent before arbitration.
- Both agreements fail to specify the process for mediator selection in the event the parties reach an impasse selecting a mediator.
- Agreement 1 fails to specify a dispute resolution service or procedural rules for mediation and arbitration and conflicts with Agreement 2, which specifies the rules of the American Arbitration Association (AAA®). It is uncertain if Agreement 2 controls and overrides Agreement 1's dispute resolution process.
- Agreement 2 specifies a venue for the mediation or arbitration; Agreement 1 is silent on this issue.
- Both agreements call for a "competent" arbitrator—but by whose definition of "competent?"

Result of Conflicting or Ambiguous Language

The claimant filed a *Demand for Arbitration* with the AAA, but the Respondent objected to the AAA's authority and jurisdiction, arguing that mediation should be the first step before proceeding with arbitration. Additionally, the responding party argued that the matter is not properly before the AAA, since Agreement 1 does not require the AAA's services or procedural rules. As a result, the parties stipulated to hold the arbitration in abeyance, pending the court's ruling on the AAA's jurisdiction/authority. After more than a month, the court issued a ruling compelling arbitration before the AAA, based on the arbitration provision included in Agreement 2.

After recommencing the arbitration, another dispute arose—this time, over what constituted a "competent" arbitrator. Because the clause did not specify any arbitrator preferences—such as minimum qualifications,

background, or experience, the arbitrator selection process caused additional delay. The AAA afforded each of the parties an opportunity to provide a description of relevant background and desired experience for the potential arbitrator candidates. Based on this information, the AAA provided the parties with a list of potential candidates based on the parties' input and the nature of the dispute.

Time and Cost Impact

Due to the conflicting language contained in both Agreements, the jurisdictional challenge and arbitrator qualifications issues required over three months to resolve before the arbitrator was appointed—twice as long as usual.

How to Avoid This

- Implement identical dispute resolution clauses if more than one agreement governs the parties' relationship, or incorporate a single controlling clause by reference or amendment amongst the contracts.
- Provide an administrative framework for the resolution of issues by specifying an administering organization and/or set of rules to govern arbitration proceedings.
- Balance the avoidance of vague descriptions of arbitrator qualifications with over-specificity where the pool of potential arbitrators meeting the parties' description may become too limited or even fails to exist.

ARBITRATOR SELECTION, CONFLICTING PROCEDURAL PROVISIONS

Similar to the examples above with conflicting arbitration clauses, parties involved in a cultivator growth dispute initially disagreed on the arbitrator selection method while also finding that the use of the word "expedited" created challenges.

Arbitration Clause

> *If, within 30 days after notice provided in Section (5) has been given, a Dispute is not resolved through negotiation or mediation, the parties to the Dispute agree to settle the Dispute exclusively by binding arbitration in accordance with the following provisions: (a) The dispute shall be settled by a single arbitrator and through an arbitration proceeding to be administered by a mutually agreed upon arbitrator (or, if the parties cannot agree, by the American Arbitration Association (or any like organization successor thereto) in Colorado Springs, Colorado, in accordance with the American Arbitration Association's Commercial Arbitration Rules). Each of the parties to this Agreement hereby agrees and consents to such venue and waives any objection thereto. Such arbitration proceeding shall be conducted in accordance with the expedited rules as is then permitted by the applicable commercial arbitration rules of the arbitrator. Both the foregoing agreement of the parties to this Agreement to arbitrate any and all such Disputes, claims and controversies and the results, determinations, findings, judgments and/or awards rendered through any such arbitration shall be final and binding on the parties hereto and may be specifically enforced by legal proceedings.*

Conflicting or Ambiguous Language

- The arbitrator selection provision fails to specify a time period or deadline for the parties to reach an agreement on an arbitrator before resorting to the AAA's assistance with the selection process.
- Reference is made to expedited rules being applied to the AAA's arbitration rules; however, the Expedited Procedures (designed for cases under $75,000) may not address the parties' dispute resolution needs if this matter is more complex and/or involves large dollar amounts at issue.

Result of Conflicting of Ambiguous Language

The parties argued whether the AAA should submit a list for their mutual agreement on an arbitrator or whether the parties should attempt this without the AAA's assistance. Failing after several weeks of efforts to agree on the selection method, the parties ultimately agreed that the AAA should send a list of potential arbitrators.

A second disputed issue arose between the parties after three arbitrators were selected, that of whether the AAA's *Expedited Procedures of the Commercial Arbitration Rules* or *Procedures for Large, Complex Commercial Disputes (LCC)* should be applied in their case. The Expedited Procedures were designed to resolve matters where the claim or counterclaim sought does not exceed $75,000, resulting in a much quicker process. In this matter, the claim and counterclaim exceeded $1,000,000 and involved complex legal issues requiring considerable time for the parties to prepare their respective cases. The arbitrators allowed each side to provide comments as to the appropriate procedures to apply; one side argued in favor of the Expedited Procedures and the other for the Large, Complex Case Procedures. In view of the nature/size of the claim, the requested discovery, and number of expected witnesses and hearing days, the arbitrators determined that it was appropriate to apply the LCC procedures of the Commercial Arbitration Rules to the arbitration proceedings.

Time and Cost Impact

It took the parties close to two months from case initiation to select three arbitrators. While the Expedited versus Large, Complex Case Procedures issue did not result in significant time delay to the process, the time and cost for the attorneys to prepare and present this issue was an avoidable cost to the proceedings.

How to Avoid This

- Be cautious about including requirements for a "mutual agreement" in the clause, whether for arbitrator selection or other administrative matters. Once a dispute has arisen, it may be difficult for parties to collaborate and reach mutual agreement on matters. Formal, established arbitration rules such as the AAA's *Commercial Arbitration Rules* provides for the administrator or the arbitrator to make procedural decisions when the parties are unable to reach agreement. This ensures that the proceedings may continue forward without unnecessary delay.
- Specify a method for arbitrator selection, either in accordance with the administering organization's rules or detail the process in the agreement.

SPECIFYING INAPPROPRIATE PROCEDURES AND DISCOVERY LIMITATIONS

A dispute arose between parties to a cannabis licensing agreement over royalties and other monetary damages owed to Claimant by Respondent. The Respondent was a cannabis grower and manufacturer and the Claimant was the owner of certain cannabis licenses related to growth methods and derivative products.

Arbitration Clause

> *(a) In the event any dispute or deadlock among the Parties cannot be resolved by the Parties after reasonable good faith efforts (an "Arbitrable Dispute"), then any such dispute shall be submitted to binding arbitration under the Commercial Arbitration Rules of the American Arbitration Association that are in effect as of the date of this Agreement (the "Arbitration Rules") before a single arbitrator with experience in the legal marijuana business (Arbitrator"). The place of arbitration shall be Honolulu, Hawaii. In order to avoid a prolonged dispute, the Parties have agreed that notwithstanding anything to the contrary in the Arbitration Rules or this Agreement, the rules for "Expedited Procedures" shall apply to all Arbitrable Disputes arising under this Agreement. The Parties further agree that the "Optional Procedures for Large, Complex Commercial Disputes" shall not apply and not be used to resolve any Arbitrable Dispute under this Agreement. (b) In the event that any Party calls for a determination in arbitration pursuant to the terms of this Section 4.XX, the Parties shall have a period of ten (10) days from the date of such request to appoint the Arbitrator. The dispute shall be decided by the Arbitrator based solely on the submissions of the parties and without discovery or third party testimony, unless the Arbitrator deems such discovery or third party testimony necessary to make a decision. Judgment on the award of the Arbitrator may be entered in any court having jurisdiction over the Party against which enforcement of the award is being sought, and any Party may institute judicial proceedings to compel arbitration in accordance with the provisions hereof.*

INAPPROPRIATE PROCEDURES AND DISCOVERY LIMITATIONS

- The clause specified that the Expedited Procedures would be applied to arbitrable disputes; however, the monetary value of the claim asserted exceeded $1,000,000, which triggered a dispute between the parties as to whether the Expedited Procedures or the Large, Complex Commercial (LCC) Procedures should be applied to the case. This disagreement resulted in additional time and legal cost for the parties. Ultimately, it was decided that, based on the discovery conducted and the preparation needed by the parties, the Expedited Procedures did not in fact apply to these proceedings.
- The stipulation was for a single arbitrator as opposed to a panel of three arbitrators. However, this provision assumes that arbitral disputes would not involve large, complex issues and/or claims that might require more than one arbitrator.
- This clause provides a vague description of the arbitrator's qualification ("experience in the legal marijuana business"). Should the potential arbitrator be an attorney or non-attorney familiar with business and legal issues concerning the marijuana business? How many years of experience and in what capacity?

It is important to note that the AAA's *Expedited Procedures* imposes many procedural and administrative limitations, including:

- Arbitrator lists are due from the parties within seven days (instead of 14 days) and limits the list of potential arbitrators for the selection process to five names, as opposed to the 15-20 names under the Large, Complex Commercial Procedures.
- Hearings must be scheduled to occur within 30 days of affirmation of the arbitrator's appointment.
- Generally, the hearing should not exceed one day.
- Discovery and the filing of motions and briefs are not contemplated.
- The award must be rendered within 14 calendar days (as opposed to 30 under the LCC Procedures) from the date of the closing of the hearing.
- The award is a simple award, with no reasoning provided.

Result of Conflicting or Ambiguous Language

The parties spent more time further identifying mutually agreed-upon industry criteria, selecting an arbitrator after three weeks.

The case involved a claim of $2,000,000 and a counterclaim of $2,500,000, resulting in very complex legal issues and arguments by the parties. Under the LCC Procedures, a panel of three arbitrators could have been appointed to the case to share the workload of reviewing and determining issues presented by the parties; however, just one was appointed.

Under the Expedited Procedures, the parties are to exchange intended hearing exhibits two calendar days prior to the hearing versus 10 days under the Large, Complex Case Procedures. For large, complex cases, which this turned out to be, two days can be a challenging timeframe to manage and prepare for.

Lastly, the Expedited Procedures are silent as to the arbitrator's ability to order discovery and depositions, whereas the Large, Complex Case Procedures provides the arbitrator with that authority.

Time and Cost Impact

The arbitrator selection process required additional legal costs for counsel to collaborate and submit to the AAA agreed-upon criteria for "experience in the cannabis business." Under the AAA's Expedited Procedures, the parties have seven days to select the arbitrator, but in this instance, it took the parties three weeks to select the arbitrator.

The clause drafter contemplated a quick arbitration process by providing for the Expedited Procedures, but the parties' respective post-dispute resolution needs were more complicated and dynamic than anticipated. The arbitrator issued seven orders pertaining to discovery and scheduling matters, and the case took 13 months to conclude. It seems reasonable to consider that the timing of preliminary discovery-related rulings would have been expedited due to a sharing of the workload had a panel of three been appointed.

How to Avoid This

- Focusing on time limits rather than specific procedures is more effective for a quicker resolution. An administering organization's rules specifically address the most common issues in cases by the size of the

dispute and are not "one size fits all." For example, parties can include "hearings shall be held within 120 days of the arbitrator's appointment." Parties must be realistic; if the case is likely to involve large monetary claims, it might not be possible to comply with extremely short deadlines.

- Spell out the required industry expertise, with the caveat noted earlier that too-specific requirements also could create challenges.
- Curbing discovery disputes is a laudable goal, however overly restrictive language can result in higher costs to the parties to litigate discovery disputes. Institutional providers' rules have been developed to provide the most efficient process possible and have been tested over time.

CANNABIS CLAUSE-DRAFTING CODA

Drafting clear, unambiguous clauses contributes to the efficiency of the ADR process for all business disputes, and the cannabis industry is no exception.

Avoid the unintended consequences of overly complex and ambiguous language, which can lead to unnecessary delays and obstacles in the arbitral proceedings. A well-crafted arbitration clause—beginning with the clear intent to arbitrate—avoids having to start the dispute resolution process by litigating the arbitration clause before a judge or arbitrator.

It is not enough to state "disputes arising under the agreement shall be settled by arbitration." While that language indicates the parties' intention to arbitrate and may authorize a court to enforce the clause, it leaves many issues unresolved—such as when, where, how, and before whom a dispute will be arbitrated. Every one of those is subject to disagreement once a controversy has arisen, with no way to resolve them except litigation.

Keep in mind some additional elements when drafting, adopting, or recommending a dispute resolution clause:

- The clause may cover all disputes that may arise or only certain types.
- Specify arbitration if a binding decision is desired or provide an opportunity for non-binding negotiation or mediation.
- Drafters may want to consider specifying threshold monetary values of the case for the appointment of a single arbitrator versus a panel of three arbitrators.
- If the contract includes a general choice of law clause selection, add an explicit choice of law selection to the arbitration clause to minimize and avoid argument as to whether that choice of law also applies to the arbitration proceedings.

For more information, please see **Drafting Dispute Resolution Clauses: A Practical Guide**. For help in drafting a clause, please see the AAA's online tool, ClauseBuilder®, a simple, self-guided process to crafting effective arbitration and mediation agreements.