# NEW RULES FOR CANNABIS: The Coming Wave of California False Advertising and Unfair Competition Claims

February 2018


NATIONAL CANNABIS INDUSTRY ASSOCIATION
**FINANCE AND INSURANCE COMMITTEE**
**Risk Management Subcommittee**
Ian A. Stewart, Vice Chair





National Cannabis Industry Association
TheCannabisIndustry.org
California Cannabis Industry Association
CACannabisIndustry.org


ADVOCACY. EDUCATION. COMMUNITY.


*126 C St. NW, Suite 300, Washington, D.C. 20001 • (888) 683-5650*

The cannabis industry in California should expect to see a sharp increase in false advertising and unfair competition claims in 2018. These claims will be premised on violation of the state cannabis regulations, but will be actionable under state consumer protection laws. There are many possible bases for such claims, including that the cannabis product at issue is misbranded or adulterated due to mislabeling, deficient packaging, inadequate manufacturing/packing conditions, actual contamination or numerous other technical violations of the regulations. Having a solid grasp of both the cannabis regulations and the unfair competition laws will help a cannabis business to fairly compete in the new cannabis marketplace and to avoid unwittingly committing expensive errors.

## CALIFORNIA'S CONSUMER PROTECTION LAWS

The state cannabis regulations provide ample fodder for opportunistic plaintiffs' attorneys to identify technical violations upon which to make consumer fraud claims based on alleged misbranded or adulterated products. California has powerful consumer protection statutes that have broad scope and a range of expensive remedies. The two primary statutes are California's Unfair Competition Law (UCL) and the Consumers Legal Remedies Act (CLRA). The UCL is codified at California Business & Professions Code §17200 and §17500. The CLRA is California Civil Code §1770.

The UCL prohibits any unlawful, unfair or fraudulent business act or practice and any unfair, deceptive, untrue or misleading advertising. The purpose of the UCL "is to protect both consumers and competitors by promoting fair competition in commercial markets for goods and services." The scope of the UCL is very broad, covering almost anything that can properly be called a business practice and is forbidden by law. The CLRA also is broad, protecting consumers from 23 activities that constitute unfair and deceptive business practices.

With respect to false advertising claims, the UCL and CLRA prohibit not only advertising that is false but also advertising that, although true, is either actually misleading or has the tendency to deceive or confuse the public. A true statement made in a manner that is likely to mislead or deceive the consumer (by failing to disclose other relevant information, for example) is therefore actionable. The state cannabis regulations contain very similar prohibitions on false advertising, discussed in greater detail below.

The UCL allows for monetary damages, restitution, disgorgement of profits and injunctive relief, including penalties of up to $6,000 per day for intentional violations of an injunction. Attorneys' fees and punitive damages are not recoverable under the UCL; the CLRA allows recovery of attorneys' fees, statutory damages and punitive damages.

## MISBRANDING & ADULTERATION UNDER CALIFORNIA'S CANNABIS REGULATIONS

Cannabis or a cannabis product may be considered "misbranded" or "adulterated" under the state regulations for many reasons. To avoid inadvertently becoming the target of an expensive consumer fraud claim, it is essential for all cannabis manufacturers and retailers to understand their legal obligations, some of which are decidedly burdensome.

**Misbranding**

The regulations state that a cannabis product is *misbranded* if its labeling is "false or misleading in any particular" or if its labeling or packaging "does not conform to the requirements of the regulations."

*Packaging and Label Requirements*

Section 26120 of California's Business & Professions Code sets forth requirements for the packaging and labeling of cannabis and cannabis products, which "shall be labeled and placed in a re-sealable, tamper-evident, child-resistant package and shall include a unique identifier for the purposes of identifying and tracking" the product. All labels and inserts for cannabis shall include the following statement, in bold print:

**GOVERNMENT WARNING: THIS PACKAGE CONTAINS CANNABIS, A SCHEDULE I CONTROLLED SUBSTANCE. KEEP OUT OF REACH OF CHILDREN AND ANIMALS. CANNABIS MAY ONLY BE POSSESSED OR CONSUMED BY PERSONS 21 YEARS OF AGE OR OLDER UNLESS THE PERSON IS A QUALIFIED PATIENT. CANNABIS USE WHILE PREGNANT OR BREASTFEEDING MAY BE HARMFUL. CONSUMPTION OF CANNABIS IMPAIRS YOUR ABILITY TO DRIVE AND OPERATE MACHINERY. PLEASE USE EXTREME CAUTION.**

The label and inserts for cannabis products also must state: "THE INTOXICATING EFFECTS OF CANNABIS PRODUCTS MAY BE DELAYED UP TO TWO HOURS." For a medicinal

cannabis product sold at a retailer, the statement “FOR MEDICAL USE ONLY” also must be included.

In addition, the label and inserts for all cannabis and cannabis products must identify the:

- Source and date of cultivation
- Type of cannabis or cannabis product
- Date of manufacturing and packaging
- List of pharmacologically active ingredients, including THC, CBD and other cannabinoid content
- THC and other cannabinoid amount in milligrams per serving
- Servings per package
- THC and other cannabinoid amount in milligrams for the package total.

Also required is information associated with the unique identifier issued by the California Department of Food and Agriculture.

All edible cannabis products must be marked with a universal symbol for cannabis. The edible product also must be “provided to customers with sufficient information to enable the informed consumption of the product, including the potential effects of the cannabis product and directions as to how to consume the cannabis product, as necessary.”

*False Advertising*
Cannabis products are subject to strict limitations on how they may be legally advertised and marketed. Section 26152 of the Code mandates that a licensee shall not “advertise or market in a manner that is false or untrue in any material particular, or that, irrespective of falsity, directly, or by ambiguity, omission, or inference, or by the addition of irrelevant, scientific, or technical matter, tends to create a misleading impression.”

*Definition of a Cannabis Advertisement:* Cannabis advertisements include “any written or verbal statement, illustration, or depiction which is calculated to induce sales of cannabis or cannabis products,” except that it does not include any product label or any editorial or other reading material for which “no money or valuable consideration is paid or promised … and which is not written by or at the direction of the licensee.” The licensee’s license number must be included on all cannabis advertisements.

*Substantiation of Claims and the Determination of Falsity:* Section 26151 requires that all advertisements and marketing must be "truthful and appropriately substantiated." For claims brought under the UCL and CLRA, only governmental prosecuting authorities have the power to demand that advertisers produce substantiation for advertising claims. Private plaintiffs are not authorized to demand substantiation. This allows the government to protect consumers while limiting undue harassment of advertisers by competitors or other private citizens.

The regulations are silent on how falsity is determined. However, one may look for guidance in how the courts have determined the truthfulness of claims made by the dietary supplement industry. Courts have held that the falsity of an advertising claim may be established by testing, scientific literature or anecdotal evidence. One cannot prove literal falsity, however, when the scientific evidence is equivocal.

"The existence of studies supporting the advertisements would mean that a jury finding for the plaintiff has simply found that the evidence supporting one of two permissible judgments (namely, that the products do not work as advertised, or that they do) is more persuasive, but not that the advertisements themselves are literally false." ***Korolshteyn v. Costco Wholesale Corp.***, 2017 WL 3622226 at p. 5 (S. Dist. Cal., August 23, 2017).

Dismissal is appropriate in that circumstance because otherwise a defendant essentially would be required to affirmatively substantiate its advertising claims to avoid liability for false advertising, which a private plaintiff is not allowed to require. A false advertising claim is therefore not viable when a defendant presents admissible expert testimony that there is scientific support for the alleged misrepresentations "because the mere existence of such evidence makes it impossible for a jury to find that all reasonable experts agree or that the evidence is unequivocal that the advertising claims are false." *Id*.

*Child Protection and Age Verification/Age Affirmation:* It is prohibited to advertise or market "in a manner intended to encourage persons under 21 years of age to consume cannabis or cannabis products." Packaging must not be "attractive to children" and advertising signs are prohibited within 1,000 feet of a day care center, school, playground or youth center.

Cannabis advertisers and marketers also are subject to strict requirements on age verification and age affirmation. Any broadcast, cable, radio, print or digital communications "shall only be displayed where at least 71.6 percent of the audience is reasonably expected to be 21 years of age or older, as determined by reliable, up-to-date audience composition data." This requirement shifts the traditional burden of audience verification from the media outlet to the cannabis business. Similarly, any advertising or marketing that involves "direct, individualized communication or dialogue controlled by the licensee" shall use "a method of age affirmation to verify that the recipient is 21 years of age or older." The method of age affirmation may include "user confirmation, birth date disclosure or other similar registration method."

There also are limitations on health-related statements, which includes "any statement related to health, and includes statements of a curative or therapeutic nature that, expressly or by implication, suggest a relationship between the consumption of cannabis or cannabis products and health benefits, or effects on health." Section 26154 of the Code prohibits any label or advertising/marketing that contains "any health-related statement that is untrue in any particular manner or tends to create a misleading impression as to the effects on health of cannabis consumption."

*Beware Making Claims of "Organic":* Section 26062 of the Code provides that by January 1, 2021, the California Department of Food and Agriculture shall establish a program for cannabis that is comparable to the National Organic Program, which is overseen by the U.S. Department of Agriculture (USDA). In the meantime, cannabis companies should be wary of marketing products with the term "organic." In 2015, the California Supreme Court held that under state law, claims of intentional mislabeling of produce as organic are not preempted by the Organic Food Act, a federal statute.

In ***Quesada v. Herb Thyme Farms, Inc.***, 361 P. 3d 868, Cal: Supreme Court (2015), the plaintiff alleged that the "Fresh Organic" label was misleading because the packages included herbs processed from organic farms certified by the United States Department of Agriculture (USDA) as well as conventional nonorganic farms. Although the Organic Food Act regulates organic labeling, the California Supreme Court nevertheless held that state law claims and remedies were not preempted by federal law and could be pursued by the plaintiff. The court reasoned that allowing state law claims promoted Congress's intent to play a more peripheral role in food-labeling oversight.

**Adulteration**

A cannabis product is *adulterated* for various reasons, including if:

- It has been subject to unsanitary conditions
- It contains any filthy substance
- It contains any poisonous or harmful substance
- It contains a level of THC substance that exceeds the allowed limits
- Its concentration or purity differs from that represented
- It is manufactured or packaged not in conformance with practices established by the regulations
- A substance has been mixed or packed with an edible cannabis product after testing to reduce its quality or concentration.

Section 26130 of the Code provides product standards for edible cannabis products that mandate that edible products must not be designed to be appealing to children or easily confused with commercially sold candy or foods that do not contain cannabis. The standard concentration of 10 milligrams of THC per serving must not be exceeded, and the product must be delineated into standardized serving sizes if it contains more than one serving and is an edible cannabis product in solid form. All edible cannabis products must be homogenized to ensure uniform disbursement of cannabinoids throughout the product, and "must be manufactured and sold under sanitation standards that are similar to the standards for preparation, storage, handling, and sale of food products."

**FEDERAL LIMITATIONS**

Although the FDA, the Federal Trade Commission (FTC) and other federal agencies do not currently regulate the cannabis industry, any cannabis business that advertises or markets its product would be well advised to understand federal law as it relates to false advertising and deceptive trade practices, and the interplay with the state-regulated market. The FDA and FTC may enforce claims that violate the law, including disease claims, unsubstantiated claims, and claims that are deceptive, false or misleading. Any company that markets a dietary supplement must have adequate substantiation for any health claim being made. In August 2017, the FDA and FTC issued a joint public statement requesting that consumers report dietary supplements that "didn't work as promised," or that are marketed with "unbelievable" claims. Enforcement options include warning letters, recalls, seizures, injunctions and civil penalties.

**CONCLUSION**

In sum, cannabis businesses must be extremely vigilant against falling prey to false advertising and unfair competition claims brought by the government, competitors and private "bounty hunter" attorneys who seek relief that includes monetary damages, restitution, disgorgement of profits, injunctive relief, punitive damages, attorneys' fees and statutory penalties. These claims may be predicated on seemingly minor technical violations of the state cannabis regulations, which place onerous burdens on every California cannabis licensee.

Further complicating matters, insurance companies often decline coverage for these claims, leaving the company to fend for itself. This has proven disastrous for the dietary supplement industry over the past decade, with many companies forced to shut down after being found liable for uninsured damages and fees. Hopefully, history will not repeat itself with the cannabis industry. Although claims brought under the UCL and CLRA will be very difficult to avoid as the California cannabis market expands, a well-informed licensee may nevertheless effectively mitigate its risk through vigilance and by instituting best practices consistent with the regulations.

*The opinions and views expressed in this white paper are the committee's own and do not reflect the view of National Cannabis Industry Association.

**Finance and Insurance Committee Roster**

Patrick McManamon - Chair
**Cannasure**

Ian Stewart - Vice Chair
**Wilson Elser**

Mike Aberle
**Next Wave Insurance**

John Balian
**Wood Gutmann & Bogart Insurance Brokers**

Chris Casseses
**Faces Human Capital Management**

Sam Fensterstock
**AG Adjustments**

Jason Horst
**Horst Legal Counsel**

Marco Materazzi
**Emerge Law Group**

James Nelson
**New Growth Insurance**

Dean Rocco
**Wilson Elser**

Jeffrey Rosen
**CBZ Insurance**

Jeffrey Samuels
**Alpharoot**

Jamie Shetzer
**Venbrook Insurance Services**

Hailey Stephenson
**Norick Risk Funding Concepts**

Jeffrey Ward
**Next Wave Insurance**