Clerk of the Superior Court
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SUPERIOR COURT OF ARIZONA
MARICOPA COUNTY

CV 2021-017808 01/31/2022

HONORABLE RANDALL H. WARNER

CLERK OF THE COURT
A. Meza
Deputy

ACRE 41 ENTERPRISES L L C, et al. JAMES M COOL

v.

STATE OF ARIZONA, et al.

ROOPALI HARDIN DESAI
DOCKET-CIVIL-CCC
JUDGE WARNER

MINUTE ENTRY

Plaintiffs' Application for Preliminary Injunction and Defendants' Motion to Dismiss are under advisement in this action challenging the Arizona Department of Health Services' "social equity ownership program" rules for recreational marijuana. Because the rules satisfy the broad requirements of the statute that mandates them, the Motion to Dismiss is granted. The Application for Preliminary Injunction, which Plaintiffs asked to be treated as a motion for judgment on the pleadings, is denied.

1. <u>Background</u>.

In November 2020, Arizona voters approved Proposition 207, a ballot measure legalizing recreational marijuana. Part of Proposition 207 was a requirement that the Department of Health Services (DHS) create a "social equity ownership program," described as follows:

> The creation and implementation of a social equity ownership program to promote the ownership and operation of marijuana establishments and marijuana testing facilities by individuals from communities disproportionately impacted by the enforcement of previous marijuana laws.

A.R.S. § 36-2854(A)(9). DHS is required to issue 26 new marijuana establishment licenses to entities "qualified pursuant to the social equity ownership program." A.R.S. § 36-2854(A)(1)(f).

Soon after Proposition 207 was passed, DHS began developing rules to implement it. In May 2021, it released draft rules for the social equity ownership program ("the Rules"). After obtaining public input, DHS published the Rules in June 2021, and published a revised version in October 2021.

The Rules make the 26 new marijuana licenses available to qualified applicants. To qualify for one of these new licenses, an applicant must be at least 51% owned by someone who meets at least three of the following four criteria:

1. An annual household income less than 400% of poverty level in at least three of the years 2016 through 2020.

2. Has been adversely affected by the enforcement of previous marijuana laws because they have been granted expungement pursuant to A.R.S. § 36-2862, or were convicted of a violation of marijuana or marijuana paraphernalia law.

3. Has been adversely affected by the enforcement of previous marijuana laws because they are or were related to someone who was convicted of a violation of marijuana or marijuana paraphernalia law, or who is or was eligible for expungement pursuant to A.R.S. § 36-2862.

4. Has lived for at least three of the years 2016 through 2020 in an area DHS identifies as "disproportionately affected by the enforcement of Arizona's previous marijuana laws."

A.A.C. R9-18-303(B).

Applications for the 26 new licenses were due by December 14, 2021 and the Department received over 1,500 of them. The Department is currently reviewing applications to determine which satisfy the requirements of the Rules. Once DHS completes its review, a lottery will determine which of the qualified applicants receives one of the 26 licenses.

2. <u>Legal Standard</u>.

The issue here is whether the Rules comply with Proposition 207's directive, in particular the language of A.R.S. § 36-2854(A)(9). To decide this issue, the Court must decide whether

DHS acted within the scope of its statutory authority. *See Canon Sch. Dist. No. 50 v. W.E.S. Const. Co.*, 177 Ariz. 526, 530, 869 P.2d 500, 504 (1994) (administrative agency "must exercise its rule-making authority within the parameters of its statutory grant").

When interpreting a statute, the Court does not defer to an administrative agency. *Saguaro Healing LLC v. State*, 249 Ariz. 362, 364, 470 P.3d 636, 638 (2020). But when a statutory directive is broad, the Court's role is limited to deciding whether the agency acted within the scope of the directive. *See Sharpe v. Arizona Health Care Cost Containment Sys.*, 220 Ariz. 488, 494-95, 207 P.3d 741, 747-48 (App. 2009) (an agency's power is measured by the statute); *see also, e.g., Raymond Proffitt Found. v. U.S. Army Corps of Engineers*, 343 F.3d 199, 210 (3d Cir. 2003) (recognizing the limited scope of court review of agency action when a statute vests the agency with broad discretion); *Pro. Drivers Council v. Bureau of Motor Carrier Safety*, 706 F.2d 1216, 1221 (D.C. Cir. 1983) ("The permissive nature of the statute implies broad agency discretion in selecting the appropriate manner of regulation."). This is because when a legislative body—in this instance, the voters exercising their initiative power—gives broad instructions to an agency, it is presumed to intend the agency will utilize its expertise and discretion in implementing the instructions. *See, e.g., AT & T Corp. v. Iowa Utilities Bd.*, 525 U.S. 366, 397 (1999) ("Congress is well aware that the ambiguities it chooses to produce in a statute will be resolved by the implementing agency").

To hold otherwise would require the Court to usurp DHS's role and decide for itself how best to design and implement a social equity ownership program. That is the opposite of what the voters intended by delegating the task to DHS.

3. <u>Plaintiffs' Challenges To The Rules</u>.

Plaintiffs challenge the Rules on essentially four grounds. They do not argue that there was any deficiency in the rulemaking process. Rather, they claim the Rules do not comply with the voters' statutory directive.

Plaintiffs first argue that the Rules do not establish a program for the ownership and operation of marijuana businesses because they fail to preclude or regulate the subsequent transfer of licensed entities to people who are not qualified under the Rules. A qualified entity, Plaintiffs point out, can obtain one of the 26 licenses then turn around and sell it to people who are not "from communities disproportionately impacted by the enforcement of previous marijuana laws."

Nothing in A.R.S. § 36-2854(A)(9) requires that DHS restrict or prohibit the owners who obtain one of the 26 licenses from selling them. Had the authors of Proposition 207 intended that—to create essentially two classes of recreational marijuana licenses, one that is freely

transferrable and one with restrictions—they could have specified such a requirement in the statute. Instead, they left it up to DHS to decide how best to promote social equity ownership and operation.

DHS determined the best way to do that was to award the 26 licenses to entities majority owned by people from disproportionately impacted communities. It further developed training for licensees. Plaintiffs present a number of hypothetical scenarios, predicting that with no restriction on alienation, most of the 26 licenses will end up in the hands of large businesses rather than benefitting the communities they were intended for. It is too soon to know whether that prediction will come true, but DHS could reasonably conclude that the best way to promote the ownership and operation of marijuana businesses by those the law intends to benefit is by awarding them licenses and giving them the freedom to structure, operate, and profit from their businesses as they see fit. Whether this was the best way to structure the program is not for the Court to decide.

DHS also had to consider potential legal challenges to a program that restricts alienation, or that imposes greater legal restrictions on some owners than others. Regardless of whether such a program would ultimately be deemed illegal, DHS could reasonably structure the program the way it did to avoid any such challenge.

Next, Plaintiffs argue that the Rules do not provide for ongoing regulation and oversight to promote the operation of marijuana businesses by qualified persons, not just ownership. Again, nothing in A.R.S. § 36-2854(A)(9) requires the program to be ongoing or to impose oversight or regulation that is not imposed on other dispensaries. Plaintiffs focus on the word "operation" in the statute, but DHS could reasonably conclude that granting licenses to entities majority owned by qualified persons promotes the operation of those establishment by those persons. It does not guaranty that this will occur, but the statute does not require DHS to "ensure" the establishments and facilities will be operated by qualified individuals, only that the program "promote" it.

Third, Plaintiffs argue that the Rules should regulate not only the owners of licenses, but entities with whom they might contract for services, like management companies. They note that, even though qualified persons will have 51% control over the licensed entities, the Rules "do not prohibit the licensed entity from diverting significant portions of those sale proceeds to third-party retail management companies owned and controlled exclusively by entities that are not SEOP-eligible." *See* Plaintiffs' Response/Reply at 20. They predict the same stratagem medical marijuana dispensaries use to circumvent the statutory non-profit requirement will be "deployed to prevent SEOP-eligible owners from fully realizing the proceeds generated by a license." *Id.* at 19-20.

But A.R.S. § 36-2854(A)(9) does not require the owners of the 26 licenses to keep expenditures or profits in their communities. The Rules place control in the hands of people from those communities, and leaves to them how to utilize that control. DHS could reasonably conclude that this is the best way to accomplish the statute's expressed objective.

Defendants finally argue that the eligibility criteria in the Rules are "irrational and problematic," providing counter-examples of people who would not qualify for the social equity ownership program even though they are from communities the law was intended to benefit. Developing eligibility criteria for a program like this requires making choices, and it is hard to imagine any airtight criteria for which one could not come up with counter-examples. The criteria in the Rules focus on income, community, and the past adverse effects of marijuana laws. They are reasonably designed to achieve the objectives of A.R.S. § 36-2854(A)(9).

The voters left to DHS how the social equity ownership program should work, and the Rules DHS developed comply with the law and are reasonably designed to meet its objectives. Having concluded that the Rules are within the parameters of DHS's statutory grant, it is unnecessary to resolve Defendants' other arguments for dismissal.

4. Orders.

IT IS ORDERED granting Defendants' December 13, 2021 Motion to Dismiss.

IT IS FURTHER ORDERED denying Plaintiffs' November 18, 2021 Application for Preliminary Injunction.

IT IS FURTHER ORDERED that a form of judgment be lodged and any request for costs or attorneys' fees be filed within 30 days.

NOTE: Due to the spread of COVID-19, the Arizona Supreme Court Administrative Order 2021-109 and the Maricopa County Superior Court Administrative Order 2021-119 require all individuals entering a court facility in Maricopa County to wear a mask or face covering at all times that they are inside the facility. Any person who refuses to wear a mask or face covering as directed by court personnel will be denied access to the facility. If a participant is denied physical access to a courthouse for refusing to wear a face covering, the participant must contact the assigned judicial division to determine whether the person can participate in the proceeding using an audio or video connection.