

HOUSE BILL REPORT

ESHB 1794

As Passed House:
March 7, 2019

Title: An act relating to agreements between licensed marijuana businesses and other people and businesses, including royalty and licensing agreements relating to the use of intellectual property.

Brief Description: Concerning agreements between licensed marijuana businesses and other people and businesses, including royalty and licensing agreements relating to the use of intellectual property.

Sponsors: House Committee on Commerce & Gaming (originally sponsored by Representatives Stanford, MacEwen, Blake, Vick, Kirby, Young, Reeves and Appleton).

Brief History:

Committee Activity:

Commerce & Gaming: 2/7/19, 2/14/19 [DPS].

Floor Activity:

Passed House: 3/7/19, 86-11.

Brief Summary of Engrossed Substitute Bill

- Updates terminology regarding authorized agreements that licensed marijuana businesses may enter with other parties related to goods or services with trademark or other intellectual property protections.
- Specifies the authorization encompasses, among other agreements, agreements related to goods or services registered as a trademark under another state's law or international trademark law.
- Lists specific types of contract provisions that may be included in an agreement, such as: (1) royalty fees subject to certain limits; (2) terms giving either party exclusivity to the use of intellectual property; and (3) quality control standards to protect the integrity of the intellectual property.
- Exempts non-licensed parties to authorized intellectual property agreements from qualifying for a marijuana license for purposes of the agreement.
- Provides that authorized intellectual property agreements are subject to recordkeeping requirements established under the Liquor and Cannabis Board's rules.

This analysis was prepared by non-partisan legislative staff for the use of legislative members in their deliberations. This analysis is not a part of the legislation nor does it constitute a statement of legislative intent.

HOUSE COMMITTEE ON COMMERCE & GAMING

Majority Report: The substitute bill be substituted therefor and the substitute bill do pass. Signed by 9 members: Representatives Stanford, Chair; Reeves, Vice Chair; MacEwen, Ranking Minority Member; Blake, Kirby, Kloba, Morgan, Vick and Young.

Minority Report: Without recommendation. Signed by 1 member: Representative Dufault.

Staff: Peter Clodfelter (786-7127).

Background:

A 2017 law addresses the ability of licensed marijuana businesses to enter into licensing agreements or consulting contracts with other individuals and businesses. Such agreements or contracts may relate to any goods or services that are registered as a trademark under federal or state law, any unregistered trademark, trade name, or trade dress, or any trade secret, technology, or proprietary information used to manufacture a cannabis product or used to provide a service related to a marijuana business. All of these agreements entered into by a licensed marijuana business must be disclosed to the Liquor and Cannabis Board (LCB).

Initiative 502 (2012) granted the LCB authority to adopt rules regarding the records to be created and maintained by marijuana licensees, the reports to be made to the LCB, and inspection of the books and records. The LCB adopted these rules, which make marijuana licensees responsible for keeping records that clearly reflect all financial transactions and the financial condition of the business. Under the LCB's rules, specific records must be kept and maintained at the licensed premises for at least five years and made available for inspection upon request.

Summary of Engrossed Substitute Bill:

Terminology referencing authorized agreements related to licensed marijuana businesses and trademarks, trade secrets, and other intellectual property is updated to more broadly describe the types of agreements covered, as well as to more broadly describe the types of business entities that may be parties to any such agreement. Agreements that licensed marijuana businesses may enter involving a registered trademark may also relate to any goods or services registered as a trademark under another state's law or international trademark law, and not only to trademarks registered under federal law or Washington state law.

Any agreement between a licensed marijuana business and another person, business, or entity related to goods or services that are trademarked or otherwise protected may include the following types of provisions:

- a royalty fee or flat rate calculated based on sales of each product that includes the licensed intellectual property or was manufactured or sold using the licensed intellectual property or service, provided the royalty fee is no greater than 10 percent of the licensee's gross sales from the product;
- a flat rate or lump sum calculated based on time or milestones;
- terms giving either party exclusivity or qualified exclusivity as it relates to use of the intellectual property;

- quality control standards as necessary to protect the integrity of the intellectual property;
- enforcement obligations to be undertaken by the licensed marijuana business;
- covenants to use the licensed intellectual property; and
- assignment of licensor improvements of the intellectual property.

A person, business, or entity that enters into an agreement with a licensed marijuana business, where both parties to the agreement are in compliance with the authorization, is exempt from the requirement to qualify for a marijuana business license for purposes of the agreement. A requirement is added that all agreements entered into by a licensed marijuana business under the authorization are subject to the LCB's recordkeeping requirements as established by rule.

Appropriation: None.

Fiscal Note: Available. New fiscal note requested on February 14, 2019.

Effective Date: The bill takes effect 90 days after adjournment of the session in which the bill is passed.

Staff Summary of Public Testimony:

(In support) This bill establishes clear standards for how to address intellectual property issues in the cannabis industry, which will clarify what the Legislature intended when passing a 2017 law. Stakeholders are frustrated that there is a need for this bill, because stakeholders believe the 2017 law was intended to address the same issues this bill addresses. In the 2017 law, the LCB was directed to engage in rulemaking. It is now about 21 months after enactment, and still no rules have been adopted. Draft rules made available would allow only for agreements that bear little resemblance to intellectual property agreements stakeholders assumed were allowed under the 2017 law or to agreements common in other industries, such as retail, technology, and software industries. The agency draft rules have three problems that this bill would fix. First, the draft rules would not allow for royalty based agreements, which are central to many intellectual property agreements. Royalty agreements are commonplace and reward both the licensee and licensor based on the market success of a license brand or technology. This bill allows royalty agreements subject to restrictions, such as a cap of royalty payments at 10 percent of a licensed business's net revenues, which should alleviate any concerns related to undue influence or true party of interest violations. The second problem with the draft rules that this bill fixes is that the draft rules would prohibit the exclusive use of intellectual property. The right to be the sole user of a trade name or trade secret is at the heart of intellectual property licensing agreements; clearly, there is no value in paying to use something that a competitor can use for free. The third problem with the draft rules this bill fixes is that the draft rules would prohibit the licensor from taking action to control how the licensed intellectual property is used. This is another component at the heart of intellectual property agreements.

If covenants and protections of intellectual property are not enforced, the owner actually risks losing control of the intellectual property under intellectual property laws. This bill fixes these problems and supports jobs in the cannabis industry. Intellectual property intensive

industries account for 38 percent of gross domestic product and 28 million jobs in the United States. This bill allows for common sense business practices and removes unwarranted administrative obstacles and arbitrary and capricious agency action in this area. The industry is so frustrated with the current restrictions on intellectual property in the cannabis industry. Washington is supposedly a leader with respect to intellectual property, but certainly not in this instance. Businesses want to follow the law, and agency rules should not be written to the lowest-common denominator and be unreasonably restrictive. This bill removes a huge obstacle to the Washington cannabis industry's success.

(Opposed) Stakeholders that signed in opposed are still reviewing the bill, but may have some initial concerns related to the bill's potential impact on the LCB's ability to investigate marijuana licensees and enforce marijuana laws. Stakeholders advocate a tightly regulated marijuana market. If these types of concerns are warranted, stakeholders would oppose the bill, but to the extent concerns are addressed through amendments stakeholders would be neutral or maybe even supportive.

Persons Testifying: (In support) Representative Stanford, prime sponsor; Chris Marr, Grow-Op Farms; Andy Brassington, Evergreen Herbal; Chris Masse, Miller Nash, and Brooke Davies, Washington CannaBusiness Association.

(Opposed) Seth Dawson, Washington Association for Substance Abuse Prevention.

Persons Signed In To Testify But Not Testifying: None.