CANNABIS LAW ALERT

November 23, 2026

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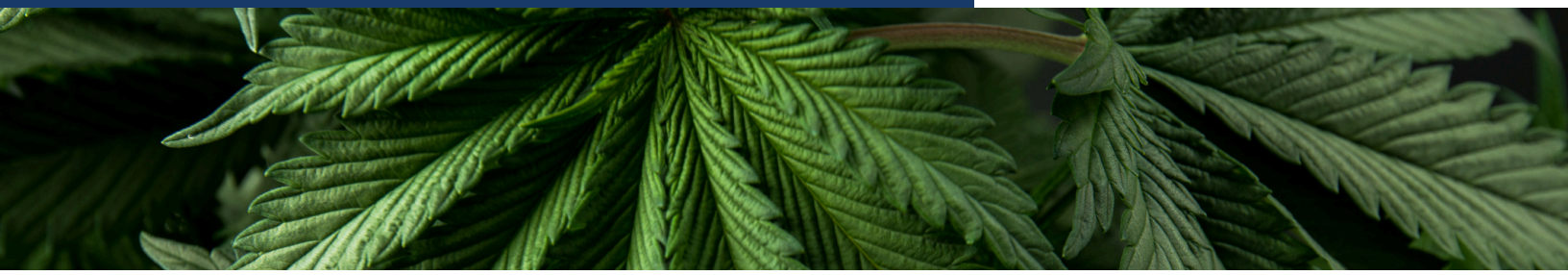

Dormant, but Not Dazed
Can States Protect a Market That Federal Law Prohibits?

Imagine that you are ready to open a cannabis business in another State. You have the capital, the operating team, the compliance plan and even a location. But then that other State says: "Sorry, this license is only for locals." Is that fair? Is it …..*constitutional?*

Can a State erect protectionist cannabis rules which favor its own citizens at the expense of outsiders? The Commerce Clause of the US Constitution would ordinarily have something to say about that. After all, Iowa cannot stop a New Yorker from opening a sneaker shop in Des Moines. The Commerce Clause exists to stop exactly that type of exclusionary practice.

But cannabis is a Schedule I, federally prohibited drug. Does that make a difference? If Congress has outlawed adult-use cannabis entirely, hasn't the right to supervise the industry been ceded to a State to regulate inside its own borders – even to the point of excluding out-of-staters?

Welcome to the confusion of the "Dormant Commerce Clause." The Federal Courts are split. Some Courts say States cannot enact exclusionary rules to protect their home-grown cannabis industries. Other Courts say that cannabis is different because adult-use cannabis is Federally prohibited. And that leaves States free to fashion their own rules and even favor their own residents.

1. The Commerce Clause and Its Dormant Side

For the legally inclined: the Commerce Clause sits in Article I, Section 8, Clause 3 of the US Constitution, which gives Congress the power "*[t]o regulate Commerce . . . among the several States.*"

The Dormant Commerce Clause is the judge-made flip-side of that rule. It provides that even if the Federal government does not affirmatively regulate a specific item of trade, States generally may not wall off their markets or prefer their own residents at the expense of outsiders. The core idea is not technical. The United States should be one thriving national market, and not fifty competing little economic forts.

Since the 19th century, the US Supreme Court has used the Dormant Commerce Clause to strike down State laws that openly favor in-state economic interests over out-of-state competitors. The exceptions to this rule have been few and far between. A State law designed solely to blunt the rights of out-of-state participants in favor of home-grown interests probably has a short shelf-life.

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2. Cannabis Is Messier

However, cannabis is an aberration which complicates the usual Dormant Commerce Clause calculation.

Roughly half of the States now allow adult-use cannabis businesses as legitimate enterprises. But Federal law historically treated cannabis as illegal. Federal rescheduling of medical cannabis may signal a change in attitude on this, but for now adult-use is still prohibited. So, cannabis cases feel different from earlier protectionism fights over milk, wine, waste, taxes, licenses, trucking and fees.

The arguments are straightforward: The pro-trade view is that the sleeping giant, the Dormant Commerce Clause, exists to preserve and even promote lawful national markets and ensure that artificial State boundaries do not kneecap cross-border, nationwide trade. Cool. If you manufacture tires in Kansas, you should be able to open a shop to sell them in New York.

But Congress prohibits an adult-use cannabis market.So, the protectionist mindset asserts that there is no national cannabis market to defend. With no legal national market to promote, there is no justification for Federal involvement inside a State, and States are free to fill that vacuum as they see fit.

3. Where The Courts Stand

The Federal Courts which have addressed the question are divided.

The First Circuit (covering Maine and much of New England) has held that States cannot erect protective barriers against out-of-State entry into a State cannabis business, and a Federal court in New York has reached the same result. The Ninth Circuit (covering much of the West) holds the opposite, namely, that States can erect protective barriers.

Some of these cases were decided at the Federal Courts of Appeals level. That is the Federal Court level immediately beneath the US Supreme Court. So, the nation's highest Court may have to pick the winner of this argument.

A brief note on alcohol; another "sin" industry, where we had hoped that we might see which way the wind was blowing for cannabis. Unfortunately, that view is unclear.

Alcohol differs from cannabis because alcohol is federally lawful, has a recognized national market, and States have room to regulate it under the Twenty-First Amendment. The Supreme Court held in 2019 that a State's protectionist alcohol rule survives if its predominant effect is to advance a public health or safety interest. So, in May 2026, the Sixth Circuit, relying on this rule, struck down protectionist Ohio rules that allowed only Ohio retailers to ship wine to Ohio consumers. But then, in the neighboring Seventh Circuit, Indiana's similar protectionist restrictions were permitted. So, an out-of-state wine shop can ship into Union City, Ohio, but not into Union City, Indiana, a few feet away.

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In May, 2026, the Supreme Court declined to hear the Seventh Circuit's protectionist ruling. And, in October 2026, the Supreme Court declined to entertain the Ohio "pro-trade" case. So, at least for alcohol, both the pro-trade and protectionist rulings now stand. There are any number of reasons why the Supreme Court might deny certiorari, and no inference should be drawn from a cert denial. Nonetheless, reading the tea leaves for cannabis is murky.

4. Practical Consequences for the Industry

There are some practical consequences worth keeping front and center.

For now, State protectionist requirements are vulnerable in some places but safe in others. In the Northeast, the Courts have held that a rule clearly benefiting locals on licenses, ownership, etc. has some serious Dormant Commerce Clause risk. However, out West, in the Ninth Circuit, that same rule is more defensible.

If the Dormant Commerce Clause wins the day, then State social equity programs could be on the chopping block, unless carefully drafted. Courts are comfortable with criteria aimed at real disadvantage which out-of-state applicants can also satisfy. Courts are uneasy with preferences which only in-state residents can satisfy. For example, in New York, a license preference for a person convicted of a New York cannabis crime may fail if the preference does not also extend to out-of-state residents convicted of same crime in other States.

Investment and deal structure can turn on the Circuit. If local-ownership protection rules fall, outside capital and multistate operators gain leverage. If those rules survive, local incumbents may keep a valuable protective moat.

A change in Federal law could reshuffle the deck. The Ninth Circuit's logic depends heavily on Federal illegality. If Congress recognizes adult-use cannabis commerce in some fashion, then the Federal government may be seen as ratifying a national market after all, and the premise of the Ninth Circuit's ruling – that Congress rejects a national cannabis market - would fall away.

5. Could the Dormant Commerce Clause Open Interstate Cannabis Commerce?

If the Dormant Commerce Clause is determined to knock down trade barriers, a natural follow-up question is whether breaching that wall would then extend to allow the free flow of cannabis across State lines. Could an Oregon grower ship product to a New York dispensary, just as a Wisconsin dairy can ship milk anywhere in the country?

That is one step too far at the moment. The First Circuit and New York cases are about who may own and operate a licensed business inside a State. They do not hold that a State must open its borders to out-of-state cannabis product. Moving cannabis across State lines still remains a Federal crime. So, for now, every cannabis-legal State will continue to operate its industry as a siloed-closed system – where cannabis is grown, processed, tested and sold within its borders.

With that said, a lot may hinge on what the Supreme Court says if and when it agrees to take up the question on cannabis. Justice Thomas is already on record as a skeptic of the Federal government's cannabis approach, writing in 2021 that a "….*prohibition on intrastate use or cultivation of marijuana may no longer be necessary or proper to support the Federal Government's piecemeal approach.*" Who knows how far he, or the Court, may go, with State-licensed cannabis becoming more entrenched across the country in the years since.

6. Does This Affect IRC § 280E?

Section 280E of the Internal Revenue Code is a key cannabis issue, but it runs on different Federal fuel. 280E denies deductions and credits for amounts paid or incurred in carrying on a trade or business that "… consists of trafficking in controlled substances (within the meaning of Schedule I and II of the Controlled Substances Act)..." Many operating expenses (e.g., rent, payroll, utilities, etc.) are not deductible, and this produces painful effective tax rates far higher than those of ordinary businesses.

The Dormant Commerce Clause cases do not change that result. Whether a State may favor its own residents is a constitutional question about whose rules are permitted to apply. Section 280E is a federal tax statute designed to deny the tax benefit of deductions to illegal drug businesses.

We can talk about the fascinating cannabis cases challenging 280E during our next talk.

For more information, please contact:

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