

## Navigating the Maze of Medical Cannabis *Uncertainty and the Challenge of Obtaining Banking and Insurance Services for Marijuana-Related Businesses*

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The current and two immediate past presidents have smoked it. As one leading expert commented during a congressional hearing, perhaps “marijuana is a gateway drug to the White House?” Medical marijuana is now legal in nearly half of the states, including both traditionally Republican and Democratic jurisdictions. It is also, however, illegal under federal law to possess marijuana. This conflict between state and federal views on medical marijuana is the cause of considerable uncertainty in this burgeoning business.

The recent Drug Enforcement Agency (DEA) raids on California and Colorado medical marijuana dispensaries are clear signs that individuals and businesses engaging in state-sanctioned marijuana-related activities remain subject to federal criminal prosecution or other consequences under federal law. Yet, the federal government cannot force states to criminalize conduct that is illegal under federal law, nor can the federal government compel state and local police to enforce federal laws. Further, just this month Congress passed and the President signed a federal spending bill, which precludes the use of federal funds and resources to “prevent states from implementing laws” that authorize the sale and use of medical marijuana. Clearly, there are mixed messages and uncertainty, and it is in these grey areas that marijuana-related businesses are forced to exist.

If the taboo of marijuana is eroding and it is becoming legal in more states, then why is it so difficult to secure insurance and banking services for marijuana-related businesses? In a word, uncertainty. Until the federal and state laws get in sync and until there is a consistent criminal and regulatory scheme in place, it is doubtful that the banking and insurance industries will be enthusiastic about embracing this business. For those operating state-sanctioned medical marijuana businesses, it will be challenging to navigate this industry space under these circumstances.

### Navigating Between the Scylla and Charybdis – Will The Feds Send Me To Jail ?

Marijuana is currently scheduled as a Schedule I controlled substance under the Controlled Substances Act, 21 U.S.C. §§ 812(b)(1) and (c). To be classified as a Schedule I controlled substance means that Congress has made the express finding that marijuana has no accepted medical use. Someday Congress might change this classification, but currently, the federal government’s view has not changed despite the numerous state laws that now legalize medical marijuana. In fact, in *Gonzales v. Raich*, 545 U.S. 1, 27-29 (2005), the United States Supreme Court recognized that federal agents could enforce federal laws against a California woman who legally possessed marijuana solely within the state of California.

### DOJ Enforcement Guidelines – Assurances or More Confusion ?

In an effort to calm some of the uncertainty and risk surrounding marijuana-related industries, the United States Department of Justice (DOJ) has published some guidance regarding its enforcement priorities. In 2013, the DOJ and DEA disseminated written guidelines applicable to state-legal marijuana businesses, outlining the agencies’ enforcement priorities. These guidelines outline those instances or circumstances where the federal government will continue to prosecute, including the following:

- The distribution of marijuana to minors;
- Revenue from the sale of marijuana from going to criminal enterprises, gangs and cartels;

- The diversion of marijuana from states where it is legal under state law in some form to other states;
- State-authorized marijuana activity from being used as a cover or pretext for the trafficking of other illegal drugs or other illegal activity;
- Violence and the use of firearms in the cultivation and distribution of marijuana;
- Drugged driving and the exacerbation of other adverse public health consequences associated with marijuana use;
- Growing of marijuana on public lands and the attendant public safety and environmental dangers posed by marijuana production on public lands; and
- Marijuana possession or use on federal property.

This guidance regarding marijuana enforcement priorities, referred to as the Cole Memorandum, can be reviewed [here](#). While this DOJ guidance is helpful, it provides cold comfort in light of the clear language of the Controlled Substances Act, and the United States Supremacy Clause, which “unambiguously provides that if there is any conflict between federal and state law, federal law shall prevail.” *Gonzales*, 545 U.S. at 29. The DOJ guidance tells industry participants that they are not an enforcement priority, but it is certainly not a promise not to prosecute.

### Is The Pendulum Swinging?

Individuals and businesses engaging in marijuana-related activities are not likely to be prosecuted and sent off to jail, but no one can provide a guarantee against that potentiality. The recent DEA raids on California and Colorado dispensaries show that individuals and businesses engaging in marijuana-related activities that are authorized by state law nonetheless remain subject to criminal prosecution or other consequences under federal law. Clearly, something has to change for the industry to continue to operate effectively.

In fact, some change has begun. The recent omnibus spending bill, or the “Cromnibus” Bill as it has been dubbed, provides fiscal year 2015 funding to most of the government through September 30, 2015. Tucked away in the 1,600-plus pages of the Cromnibus Bill is the following provision:

None of the funds made available in this Act to the Department of Justice may be used, with respect to the States of Alabama, Alaska, Arizona, California, Colorado, Connecticut, Delaware, District of Columbia, Florida, Hawaii, Illinois, Iowa, Kentucky, Maine, Maryland, Massachusetts, Michigan, Minnesota, Mississippi, Missouri, Montana, Nevada, New Hampshire, New Jersey, New Mexico, Oregon, Rhode Island, South Carolina, Tennessee, Utah, Vermont, Washington, and Wisconsin, to prevent such States from implementing their own State laws that authorize the use, distribution, possession, or cultivation of medical marijuana.

According to a number of commentators, Congress intended to prevent the DOJ from using federal funds and resources to prosecute or interfere with state medical marijuana laws. If that is the case, then this provision marks a paradigm shift in national drug policy. Yet, this provision has not been interpreted by DOJ or the courts. The meaning of term “prevent” might refer only to refraining from taking action to stop the creation of a state regulatory framework, as opposed to “prosecuting” violations of the Controlled Substances Act.

No one praises the speed and efficiency with which the United States Congress operates, but it is not intended to be nimble. Our Framers were smart enough to build speed bumps, a/k/a checks and balances, into the system. As more and more states continue to operate as laboratories of democracy and experiment with the legalization of cannabis, Congress will likely be forced into action to modify its classification in the Controlled Substances Act.

### Marijuana Goes to Washington

The fight has now been brought to the backyard of Congress. Voters in Washington, D.C. went to the polls to vote on whether to legalize marijuana, not simply for medical purposes, but all out legalization. This measure, Initiative 71, was passed by two-thirds of voters. Passage of this initiative in the backyard of Congress is an even stronger signal that the issue will need to be addressed on the federal level.

The politicians have already taken sides in the marijuana debate. Dick Durbin, the second highest ranking member of the Senate, has indicated that Congress will have to act soon. At a recent press conference, Durbin said that he supports medical marijuana, although

not full legalization. Durbin stated: "They talk about states being laboratories, and that's what we're seeing. Let's see what happens on the ground there." There has also been legislation that would prohibit federal interference with state medical marijuana laws, although the scope of that legislation has yet to be determined. Additionally, Earl Blumenauer (D-Oregon) introduced the States' Medical Marijuana Patient Protection Act (H.R. 689), which would reschedule marijuana and make the Controlled Substance Act inapplicable to those acting in compliance with state medical marijuana laws.

### The Real Dilemma – Running a Business

The real operational concern of individuals and businesses engaging in marijuana-related activities is the reluctance of insurance and banking industries to provide services. The federal government's unwillingness to lift the ban on medical cannabis is the main reason for the current scarcity of companies willing to offer these critical business services. Where there are insurance or banking options, however, it's often a Hobson's Choice of going without or overpaying due to a lack of competition in those markets serving this emerging industry.

### Banking – FinCEN Guidance

In this uncertain environment, where states say one thing and the federal government says another, the Financial Crimes Enforcement Network (FinCEN) issued guidance to clarify how financial institutions can service marijuana-related businesses consistent with their obligations under federal financial crimes law. The FinCEN guidance was issued concurrently with a subsequent DOJ memorandum.

The FinCEN guidance reflects a practical approach to balancing the difficult uncertainty between state and federal law. The guidance establishes a policy for financial institutions choosing to work with this industry and provides a set of rules for filing Suspicious Activity Reports (SAR) unique to these businesses. A financial institution has to file an SAR each time it handles a transaction for a marijuana-related business. Specifically, the FinCEN guidance requires banks and other financial institutions to file SARs that identify a legal marijuana-related business, its ownership and relationships with other businesses. There are three basic reports to be filed, depending on how a bank views the underlying business to be compliant with relevant state law. The first type of report are referred to as "Marijuana Limited" SAR Reports, and are filed even for marijuana-related businesses that are complying with relevant state laws. The logic for this report is that regardless of state law, marijuana violates the Controlled Substance Act and any business in this space involves "funds derived from illegal activity," and for that reason must be disclosed to ensure federal financial law compliance. Other "Marijuana Priority" SAR Reports are to be filed if a banking entity reasonably believes, based on its customer due diligence, that its customer's conduct implicates one of the Cole Memo priorities or violates state law. Lastly, "Marijuana Termination" SAR Reports are to be filed if a banking entity finds it "necessary to terminate a relationship with a marijuana-related business in order to maintain an effective anti-money laundering compliance program."

The FinCEN guidance was intended to give banks confidence that they will not be punished if they provide services to legitimate marijuana businesses in states that have legalized the medical use of marijuana. Again, the guidance does not grant immunity from prosecution or civil penalties to banks that serve legal marijuana businesses. The banking industry highlighted that the new guidelines may not be sufficient to make banks feel at ease about opening accounts for or granting loans to marijuana businesses because the drug is still illegal under the federal Controlled Substances Act. Further, the federal banking regulators - the Federal Reserve Board, the Federal Deposit Insurance Corporation, the National Credit Union Administrator, and the Office of the Comptroller of the Currency - have yet to formally comment on the FinCEN guidance. The highly regulated banking industry will not likely fully embrace the FinCEN guidance without a clearer indication of approval from these prudential regulators.

### Insurance

Insurance is also another area where participants have not yet moved to embrace this new industry. All businesses try to protect themselves against liability and minimize risk by procuring, among others, general liability, employee theft, errors and omissions, and business interruption coverage. Other coverages are available for products liability, crop insurance, and to cover the costs of defending governmental action. Yet, few participants in the insurance industry have embraced medical marijuana-related businesses. For one reason, actuaries and underwriters have not had much experience in this industry, making it difficult to gauge risk. Also, the laws that affect this industry are in flux, making it difficult to know whether coverage sold today will be binding in the future. As a general rule, insurance typically cannot be sold for conduct that contravenes public policy. While illegal under federal law, it would be hard to say that

marijuana use contravenes public policy since state law has explicitly said that marijuana is legal. Most insurance regulators have not yet even considered this issue. As a spokesman for the State of Washington Insurance Commissioner commented: "We haven't taken a formal look at the issue, but based on what we've seen so far, we think selling such coverage here would be OK."

### Another Concern – Bankruptcy is Not an Option

Further adding uncertainty to banking and insurance relationships is the fact that the bankruptcy process may not be available to marijuana-related businesses. The Bankruptcy Code is a creation of federal law, and there is no state equivalent because the United States Constitution called for a uniform bankruptcy system across all states. This, of course, raises an issue as to what, if any, bankruptcy protection will be afforded to a legitimate, state-sanctioned medical cannabis operation. At present, it appears that no protection will be available. The rationale is that federal law does not recognize their business operations because they are in violation of federal law. As an "illegal activity," bankruptcy courts have nearly uniformly noted that "[v]iolations of federal law create significant impediments to the Debtors' ability to seek relief from their debts under federal bankruptcy laws in a federal bankruptcy court." *In re Arenas*, 514 B.R. 887, 891 (Bankr. D. Colo. 2014). This discrete issue is on appeal in the *Arenas* case, but the higher court will likely find the violation of federal law prevents recourse to bankruptcy.

The other significance of this preclusion is that vendors, suppliers and secured creditors alike will be hesitant to deal with companies where there will be no body of law to govern the effects of a business failure.

### Key Takeaway

There is a degree of uncertainty in all business endeavors, but more so in emerging markets like the medical cannabis industry. Those that thrive on uncertainty and risk will fare well in this emerging industry, but more is required. Since it is an uncertain environment, successful industry participants will be those that have business savvy and success in other fields where they've had to navigate regulatory uncertainty. It is also critically important for industry participants to educate their partners, particularly those in the banking and insurance industries, on how to measure compliant businesses from others. The insurance and banking industries are not enthusiastic about entering an industry surrounded by this much uncertainty, and until there is a change in federal law, it will continue to be challenging for industry participants to navigate this space. It appears that the federal government is inching its way to providing some comfort to those in the medical cannabis business, but as always, that change is slow.

Marijuana-related businesses need holistic advisors in order to navigate this shifting legal landscape. The law firm of Locke Lord LLP has a team of legal professionals advising on all aspects of this industry, including, regulatory compliance, intellectual property, bankruptcy, labor and employment practices, capital markets and funding, and government relations strategies.

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### About the Authors



John Costello focuses his practice on federal and state regulatory compliance. He has substantial experience in handling single and multi-state State Attorney General investigations and litigation. He has also worked with state attorneys general and their organization, the National

Association of Attorneys General (NAAG), and their standing committees as well as various task forces. His practice involves providing the advice and counsel that businesses and individuals need to navigate the complexities of regulatory oversight, ranging from compliance to impacting legislative action to resolving litigation and enforcement actions. Mr. Costello also helps clients with respect to state legislative strategies.



Nick J. DiGiovanni leads Locke Lord's international reinsurance and insurance litigation groups, which include more than 50 lawyers world-wide. Mr. DiGiovanni has over 30 years of experience litigating complex commercial cases and has significant experience in defending

insurers and reinsurers in class actions and individual actions brought pursuant to a variety of state and federal consumer protection statutes and regulations. Mr. DiGiovanni has notable litigation skills in disputes involving directors and officers liability, OFAC economic sanctions, life insurance insolvency actions, Anti-Terrorism Act, catastrophe bonds, energy claims, professional liability, bad faith actions, cyber security issues, and regulatory challenges under most state insurance laws. The issues involved in these disputes include claims for fraud, rescission, scope of coverage, treaty interpretation, and scope of arbitration clauses. Nick also has tried a number of cases involving accountants malpractice, fraud, stock and asset purchase agreements and breach of fiduciary duties.

Mr. DiGiovanni is regularly profiled as one of the industry's leading attorneys in *Euromoney's Guide to the World's Leading Insurance and Reinsurance Lawyers*, *The International Who's Who of Insurance & Reinsurance Lawyers*, *The International Who's Who of Business Lawyers* and the *Chambers USA Guide to America's Leading Business Lawyers*. Additionally, he was acknowledged in *The Legal 500 United States-2014 Edition* and *The Best Lawyers in America*.