California BUSINESS LAW REPORTER

July 2016
Volume 38
Number 1


Robert L. Elam

Cash on Hand: The Cannabis Business and Banking

Robert L. Elam

Most marijuana businesses are currently denied access to banking services, largely because financial institutions, fearful of potential money laundering, criminal charges, or losing their FDIC coverage, refuse to offer them. Robert Elam explores this problem and the efforts that have been made to address it.

>> See article on *Page 4*

Our Picks for Top Recent Business Law Cases

We do the work for you: Here are the significant recent business law cases, with expert commentary on the most important ones.

- **Employers are permitted to round off employees' work time for payroll purposes, as long as it's done fairly.**
  Corbin v Time Warner Entertainment-Advance/ Newhouse Partnership ..... *Page 15*

- **The Supreme Court has ruled that the U.S. Patent and Trademark Office's decision to institute an inter partes review of patent claims is not appealable.**
  Cuozzo Speed Technols., LLC v Lee ..... *Page 13*

- **Corporations Code §1601, which requires that certain documents be made available for inspection by shareholders, only requires that the records be made available at the office in which they are maintained.**
  Innes v Diablo Controls, Inc. ..... *Page 7*

- **Nevada's application of a special rule permitting a damages award against California in excess of what could have been awarded against a Nevada state agency violated the Constitution's Full Faith and Credit Clause.**
  FTB v Hyatt ..... *Page 11*

>> See more inside: Table of Contents

Afraid of missing something?

Follow CEB on **Twitter** (@ceb_ca) for all CA, 9th Cir, and Supreme Court cases with squibs and links daily.

EXPERT'S TAKE


Danton Richardson

With the Ninth Circuit's decision in *VMG Salsoul, LLC v Ciccone,* the courts in two major music hubs (Los Angeles and Nashville) now have different standards regarding sampling in sound recordings, which can only lead to confusion and uncertainty and fights over choice of forum and law. Whether the "de minimus" exception should apply to sound recordings is an issue that the Supreme Court should weigh in on, and as Danton Richardson explains, the outcome is far from certain. **>> See *Page 12***

CEB® ceb.com

CONTINUING EDUCATION OF THE BAR ■ CALIFORNIA

Reprinted from the *California Business Law Reporter* published by Continuing Education of the Bar – California.
The citation to this article is 38 CEB Cal Bus L Rep 4 (July 2016).

FEATURED ARTICLES

Cash on Hand: The Cannabis Business and Banking

Robert L. Elam

Introduction

No issue faces greater disparate treatment than medical marijuana's legal status in the eyes of our three levels of government—federal, state, and local. At the federal level, it is seen as a serious felony; at the state level, a constitutional right; and at the local level, a taxable public nuisance. As a consequence, state-licensed medical marijuana businesses are systematically denied access to banking services. Financial institutions, fearful of potential money laundering, criminal charges, or losing their FDIC coverage, refuse to offer them. It was not always this way.

Marijuana's "Legal" Status

For most of American history, it was legal to both grow and consume marijuana. But starting in the 1910s, a number of states criminalized the drug. (For a good overview, see Chemerinsky, Forman, Hopper, & Kamin, *Cooperative Federalism and Marijuana Regulation*, 62 UCLA L Rev 74, 81 (2015).) In 1937, the federal government enacted the Marijuana Tax Act (Pub L 75–238, 50 Stat 551), which led to dropping marijuana from the Federal Pharmacopoeia, the list of approved permissible medicines. The American Medical Association (AMA) opposed the reclassification of marijuana, but its opposition was to no avail.

By the 1970s, with President Nixon's "war on drugs" campaign, the federal government had adopted a strict stance. The Controlled Substances Act of 1970 (CSA) (21 USC §§801–904) prohibited marijuana entirely. Along with LSD and heroin, marijuana is listed as a Schedule I drug—the most dangerous category of narcotics under federal law. Under the CSA, the manufacture, distribution, possession, and use of a Schedule I narcotic can lead to punishments of up to 10 years in prison and $2 million in fines. In addition, conspiring to commit an offense under the CSA subjects the accomplice to the same penalties as prescribed for the offense itself. 21 USC §846. Despite repeated efforts to repeal marijuana's illegal status under the CSA, marijuana prohibition remains the law of the land.

Legalization at the State Level

In 1996, California, with the passage of Proposition 215, became the first state in the country to permit the use of medical marijuana. To date, 24 states and the District of Columbia have legalized medical marijuana, and four (Colorado, Washington, Alaska, and Oregon) have legalized its recreational use. In addition, at least a half-dozen states will decide on whether to legalize either the recreational use or

the medical use of marijuana in 2016, including Arkansas, California, Florida, Maine, Massachusetts, Montana and Nevada.

The Current Federal Policy of Nonenforcement

In August of 2013, in reaction to the legalization of recreational use in Colorado and Washington, and entreaties by Governors John Hickenlooper of Colorado and Jay Inslee of Washington for federal guidance, Deputy Attorney General James M. Cole, on behalf of the Department of Justice (DOJ), issued a memorandum (Cole Memo) to all U.S. Attorneys, announcing that the DOJ would not be moving to block implementation. (See https://www.justice.gov/iso/opa/resources/3052013829132756857467.pdf.) The Cole Memo deprioritized the enforcement of federal marijuana laws in states with robust marijuana regulations and specified eight enforcement priorities to help guide state lawmakers. These priorities included the prevention of (1) the distribution of marijuana to minors; (2) revenue from the sale of marijuana going to criminal enterprises and drug cartels; (3) state-authorized marijuana activity from being used as a pretext for trafficking other illegal drugs; (4) violence in the cultivation and distribution of marijuana; (5) drugged driving; (6) the cultivation of marijuana on public lands; and (7) marijuana possession or use on federal property as well as (8) the diversion of marijuana from states that deem marijuana illegal. Cole Memo at 1.

Interestingly, the priorities tacitly omit the sale or possession of marijuana when permitted under state law. By issuing the Cole Memo, the federal government adopted a strategy of nonenforcement concerning state-legalized marijuana: "Enforcement of state law by state and local law enforcement and regulatory bodies should remain the primary means of addressing marijuana-related activity." Cole Memo at 3.

State-Licensed Medical Marijuana Businesses' Need for Basic Banking Services

Most marijuana businesses are currently denied access to banking services, in particular, checking accounts. According to Aaron Smith, the executive director of the National Cannabis Industry Association, banking access is the "most urgent issue facing the legal cannabis industry today." See Hill, *Banks, Marijuana, and Federalism,* 65 Case W Res L Rev 597, 603 (2014–2015). A recent first-of-its-kind survey conducted by *Marijuana Business Daily* found that up to 60 percent of companies operating in the cannabis industry do not have bank accounts. See https://mjbizdaily.com/chart-week-60-cannabis-companies-dont-bank-accounts/. Without bank accounts, they are also unable to accept credit or debit cards as forms of payment.

From a public safety perspective, any business forced to operate as cash-only can become a magnet for crime and violence, since large sums of cash are known to be at certain physical locations. From a regulatory perspective, it is much more difficult to track and tax revenues from cash-only businesses. From a banking perspective, cash earns no interest and is problematic to invest and reinvest into the economy at large. Handling millions of dollars each month in cash, without bank cooperation, also drives up the operating costs of marijuana businesses. Cash accumulates. Medical marijuana businesses are then obligated to purchase vaults and cameras, hire professionally trained guards, and follow rigorous security procedures to protect their cash intake. Armed cash transport services are also retained with the additional expense of insured and bonded storage facilities. Suppliers must be willing to accept payment in cash. If credit lines or loans are needed, they are almost always short-term and at high-interest rates. See Hill at 601. Lacking professional banking services, medical marijuana businesses are forced to pay their employees and third parties, including the Franchise Tax Board and Internal Revenue Service, with cash or money orders purchased through nonbank outlets. Payments of quarterly payroll taxes in cash rather than by wire are assessed an additional 10 percent penalty by the IRS. See Hill at 603.

Big Banks Ignore Justice Department

Although the DOJ's new policies have opened the door for medical marijuana businesses to open bank accounts in California, the banking industry has elected not to seize this opportunity. The American Bankers Association (ABA) has stated that enforcement guidance alone cannot solve the inherent problem of federal prohibition. Buckner, *Rocky Mountain High: The Impact of Federal Guidance to Banks on the Marijuana Industry,* 19 NC Banking Inst 180 (2015). Bank of America and Wells Fargo have reiterated their position: they do not offer banking services to medical marijuana businesses. Hielscher, *The Problem with Financing Pot,* Sarasota Herald-Tribune, Aug. 6, 2014, p A1. They point out that federal law obligates financial institutions to ensure that wrongdoers are not accessing the banking system to further illegal activities.

The primary anti-money-laundering statute is the Currency and Foreign Transactions Report Act of 1970 (commonly known as the Bank Secrecy Act or BSA) (31 USC §§5311–5330). The BSA requires financial institutions to monitor client activity and file suspicious activity reports (SARs) on depositors. 31 USC §5318. SARs are required for, among other things, transactions aggregating $5000 or more that may involve potential money laundering or other illegal activity. The Financial Crimes Enforcement Network (FinCEN) is charged with enforcing the BSA. 31 USC §310. Under the BSA and the Money Laundering Control Act of 1986 (18 USC §§1956–1957), deposits from marijuana businesses can be deemed ill-gotten gains from "a possible violation of law." 18 USC §1956; 31 USC §5318(g). Under the Controlled Substances Act, any financial institution that accepts deposits from an unlawful activity can lose its Federal Deposit Insurance Corporation (FDIC) coverage and be prosecuted. Violations of the BSA include both civil and

criminal penalties of up to $500,000 or 10 years in prison. See 31 CFR §1010.820 (civil penalties); 31 USC §5322 (criminal penalties).

Treasury Department and DOJ Permit Marijuana Businesses to Open Accounts

In contrast to the stern penalties provided by the BSA, the Money Laundering Act, and the CSA, the Cole Memo deprioritizes prosecutions in states with robust regulations—a glaring contradiction. Financial institutions are then left uncertain about whether other parts of the federal government might bring money-laundering charges under the BSA or whether the Cole Memo would carry the day. In an October 2013 letter, the FDIC, the Comptroller of Currency, and the governors of Colorado and Washington appealed to the federal government to issue formal guidance for financial institutions to engage in normal banking transactions. Kamin, *Cooperative Federalism and State Marijuana Regulation,* 85 U Colo L Rev 1105, 1115 (2014); McErlean, *The Real Green Issue Regarding Recreational Marijuana: Federal Tax and Banking Laws in Need of Reform,* 64 DePaul L Rev 1079, 1093 (2014–2015). The Obama administration announced in January 2014 that marijuana businesses should have access to banking services. Healy & Apuzzo, *Legal Marijuana Businesses Should Have Access to Banks, Holder Says,* NY Times, Jan. 23, 2014, p A20.

On February 14, 2014, the DOJ and the Department of Treasury's FinCEN released a pair of memos permitting financial institutions to accept marijuana depositors, and clarifying how financial institutions can provide services to marijuana-related businesses consistent with their legal obligations. (See Cole, Deputy Attorney General, *Memorandum for All United States Attorneys [Re:] Guidance Regarding Marijuana Related Financial Crimes* (Feb. 14, 2014), available at https://www.justice.gov/sites/default/files/usao-wdwa/legacy/2014/02/14/DAG%20Memo%20-%20Guidance%20Regarding%20Marijuana%20Related%20Financial%20Crimes%202%2014%2014%20(2).pdf; Dep't of the Treasury Financial Crimes Enforcement Network, [Guidance Re:] *BSA Expectations Regarding Marijuana-Related Businesses* (FIN-2014-G001, Feb. 14, 2014), available at https://www.fincen.gov/statutes_regs/guidance/pdf/FIN-2014-G001.pdf (FinCEN Memo).

The 2014 memos both reiterate that prosecutors should apply the eight Cole Memo priorities when determining whether to charge financial institutions with violations of anti-money laundering statutes, the BSA, or the CSA. In short, the federal government has given assurances that financial institutions will avoid prosecution if they comply with the FinCEN procedures, consistent with Cole Memo priorities.

Legislative Efforts

Big banks will not do business with medical marijuana depositors unless and until there is passage of more comprehensive and reliable legislation. See Hall, *Until 100% Legal, Banks to Turn Away Marijuana Money,* Forbes (Jan. 25, 2014). For sure, the U.S. Congress has shown its willingness to consider a change in marijuana policy.

In July 2014, the House of Representatives approved the Heck Amendment (HR 5016), seeking to prevent the Treasury Department and FinCEN from taking action against financial institutions that do business with marijuana businesses. However, the bill died in the Senate.

In March 2015, the Compassionate Access, Research Expansion, and Respect States (CARERS) Act was introduced in both the House and Senate (HR 1538; S 683). This comprehensive measure would permit state programs to continue without federal inference, move marijuana out of Schedule I, create access to banking services for legal marijuana businesses, and allow Veteran's Administration doctors to write recommendations in states that have a medical marijuana program. Both bills are currently in committee, but are unlikely to go further this session.

In July 2015, Oregon Senator Jeff Merkley and Colorado Representative Ed Perlmutter introduced the Marijuana Businesses Access to Banking Act of 2015 (S 1726; HR 2076), which would prevent federal banking regulators (*i.e.,* the Consumer Financial Protection Bureau, Federal Deposit Insurance Corporation (FDIC), Federal Reserve Board, and Office of the Comptroller of the Currency) from penalizing a bank that provides financial services to legal marijuana businesses. Again, these bills are both in committee, and are unlikely to pass.

In December 2015, however, Congress did pass and the President signed the Rohrabacher-Farr Amendment to the FY 2016 omnibus appropriations bill. It specifically prohibits the DOJ from spending funds to prevent the implementation of state medical marijuana laws, such as financing raids on medical marijuana businesses.

Frustrated by the lack of a "comprehensive" solution, private and state actors have attempted a run-around. In the private sector, Fourth Corner Credit Union in Colorado opened a new state-chartered credit union specifically catering to marijuana businesses. Although its state charter was approved, the Federal Reserve and National Credit Union Administration (NCUA) denied it access to the national payment and insurance systems and Fourth Corner has appealed for relief in federal court. The case was dismissed in January 2016 by a district court judge, but an appeal to the Tenth Circuit is pending.

Senator Bob Hasegawa in the State of Washington has been advocating for the establishment of a state bank, but his legislation has gone nowhere, since any bank would still need approval from the Federal Reserve and FDIC. The boldest effort has been by Colorado in 2014, creating a cooperative to provide banking services to the marijuana industry. The cannabis credit cooperative does not require FDIC insurance. Colo Rev Stat §§11–33–104(1), 11–33–108(2). Yet, the co-op still requires approval by the Federal Reserve to gain access to the national banking system. This has not occurred and no marijuana business has applied to join.

Basically, no federal agency will "bless" the acts of a business activity that is still illegal at the federal level. But that does not mean that NO path is available for medical marijuana businesses.

The Path Forward

Some smaller banks and credit unions are already opening bank accounts with state-licensed medical marijuana businesses. As of August 2014, 105 financial institutions provide banking services to marijuana businesses. (See Remarks of Jennifer Shasky Calvery, Director of FinCEN, available at http://www.fincen.gov/news_room/speech/pdf/20140812.pdf.) FinCEN Director Calvery states that "from our perspective the guidance is having the intended effect. It is facilitating access to financial services, while ensuring that the activity is transparent and the funds are going into regulated financial institutions responsible for implementing appropriate AML [anti-money laundering] safeguards." Until Congress acts, there is only one authorized path by which banks can establish depositor relationships with medical marijuana businesses: follow the FinCEN Memo procedures in conformity with the Cole Memo priorities.

The FinCEN Memo requires that financial institutions first conduct an extensive background check before opening a bank account with a state-licensed medical marijuana business. This means having the business fill out an application form, submit certain additional materials, and meet with a specialized compliance officer. This initial review can involve phone calls, in-person meetings, and a site visit to the business with detailed notes addressing the FinCEN procedures. If the state-licensed medical marijuana business passes the initial background check, and before opening the account, the financial institution must immediately file its first SAR, which acknowledges to the federal government that this is a medical marijuana business. Similar to reports required by the BSA for cash transactions, there are, however, new categories. (See generally https://www.fincen.gov/whatsnew/html/sar_faqs.html.) FinCEN requires a financial institution to file a continuing activity report every 120 days that also updates the amounts of deposits, withdrawals, and transfers made since the last SAR filing. When any activities appear to implicate the Cole Memo priorities or violate state law, a more extensive "marijuana priority" SAR is filed. The financial institution is always free to terminate the relationship with the medical marijuana business by filing a "Marijuana Termination SAR."

Although they are cumbersome and complicated, the FinCEN procedures represent a path forward in aligning the federal government's treatment of marijuana with state and local governments. Further attempts to fix the cannabis industry's banking problem legislatively are likely, but the success of that legislation may depend on changes in the political landscape.