

White-Collar Law

## Unusual Challenges Facing Legal Marijuana Businesses

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Medical marijuana is legal in 23 states. Nine more states—including Pennsylvania—have medical marijuana legislation pending. The legal marijuana industry is big and growing rapidly; it is projected to generate annual revenues of over \$8 billion by 2019. Given this rapid growth, many entrepreneurs are exploring entering the market. These would-be marijuana growers, processors or distributors quickly learn, however, that the legal marijuana industry poses unusual challenges. Some of these challenges are discussed in this article.

### Legal Marijuana is Illegal

Perhaps the oddest aspect of operating a marijuana business sanctioned under state law is that the business is nonetheless illegal under federal law. The federal government classifies marijuana as a Schedule I controlled substance, meaning it has a high propensity for abuse and no medical use. As a result, marijuana is illegal under the federal Controlled Substances Act (CSA). Even in states that have legalized medical marijuana, its cultivation, production, distribution, sale and possession are federal crimes. The U.S. Supreme Court has ruled that the federal government has the right to regulate and criminalize marijuana, even for medical purposes. Therefore, federal law criminalizing marijuana pre-empts state laws legalizing it.

In 2013, U.S. Deputy Attorney General James M. Cole issued a memorandum to guide federal prosecutors on how to exercise their discretion in federal marijuana enforcement. It states that U.S. Department of Justice resources should not focus on prosecution of marijuana-related activity unless the activity affects certain enumerated priorities, such as preventing marijuana-based revenue from going to criminal enterprises, gangs and cartels. In states where medical marijuana is legal and where strong and effective regulatory and enforcement systems for the cultivation, distribution, sale and possession of marijuana have been established, the Cole memo instructs that marijuana activities that comply with state regulations are less likely to affect the enumerated priorities. Primary enforcement in those situations should therefore be left to state and local authorities. Although not stated, state and local authorities cannot prosecute marijuana-related activities that are legal under that state's law.

For law-abiding participants in the legal marijuana industry, the Cole memo provides substantial comfort that federal authorities will leave them alone. But that comfort may be limited. First, the Cole memo is administrative guidance and not a regulation or law, it specifically provides that it cannot be used as a defense against prosecution, and the DOJ has expressly reserved the right to prosecute marijuana activity anywhere. The Cole memo guidance, moreover, can be changed by a new attorney general, whether under President Obama or a new president. Similarly, the DOJ could determine that a particular state's regulatory and enforcement systems were flawed, and take aggressive action against even state-compliant marijuana activity in those states.

While it may seem certain that the Cole memo will remain in place while Obama is in office, that may not be so. Obama's pick for attorney general, Loretta Lynch, in testimony before the Senate Judiciary Committee, bluntly admitted that she did not share Obama's or Attorney General Eric Holder's views concerning marijuana. Her testimony could presage a new policy: "Not only do I not support the legalization of marijuana, it is not the position of the Department of Justice currently to support the legalization. Nor would it be the position should I become confirmed as attorney general."

What this will mean in practice remains to be seen. Notably, a bill that would move marijuana from Schedule I (to Schedule II)

and which would provide other assurances of non-prosecution for state-sanctioned medical marijuana was introduced recently in the U.S. Senate. The co-sponsors—Republican Sen. Rand Paul of Kentucky and Democratic Sens. Kirsten Gillibrand of New York and Cory Booker of New Jersey—show the bipartisan support for efforts to remove federal barriers to state-sanctioned medical marijuana.

### **Your Lawyer Can't Help**

Entrepreneurs willing to accept the risks of shifting federal policy face additional challenges. For example, a prudent businessperson would seek counsel's assistance in setting up a marijuana business and navigating the tricky regulatory landscape. Yet, some lawyers may conclude that advising clients on setting up and operating a business that violates federal law may violate the lawyer's ethical duty not to assist with criminal behavior. State bars have issued guidance to their members, essentially instructing that they can advise clients on how to comply with a particular state's medical marijuana laws and regulations so long as they fully explain to their clients the potential consequences under federal law. While this is the more rational view, some lawyers may have nonetheless shied away from the industry because of this uncertainty or concern about malpractice insurance coverage.

### **You End up Stuck Holding Bags of Cash**

A legal marijuana business can further expect challenges raising capital and establishing banking relationships that more traditional businesses do not. As to potential investors, a new business might have to disclose some eye-popping "risk factors," including the chance that the investor could be charged with federal crimes, or that the assets purchased with the invested funds could be subject to seizure. Suffice to say, traditional lenders (commercial banks, savings and loans, etc.) will be wary about taking such risks. Similarly, landlords may be disinterested in renting locations for the marijuana to be grown, processed or distributed. Luckily, as with attorneys, there are individual and institutional investors willing to invest in legalized marijuana businesses despite these risks.

Not being able to establish a banking relationship is a logistical nightmare. Since the proceeds of marijuana operations are illegal under federal law, most banks have been, understandably, not interested in handling these proceeds. As a result, marijuana businesses frequently operate on an "all cash" basis. And, since they cannot deposit the cash into a bank, they are often left stuck with large volumes of cash. The U.S. Department of the Treasury has issued guidance to banks on handling transactions with marijuana-related businesses. The guidance falls far short of explicit legal authorization for banks to provide services to those businesses. It also places a heavy burden on banks to pay attention to "red flags" and to determine whether its customers are engaged in activities that threaten the federal enforcement priorities. The president of the Colorado Bankers Association (where recreational as well as medical marijuana use is legal) aptly characterized the Treasury's message to bankers as: "Serve these customers at your own risk." To date, few established banks actively seek marijuana business clients, although some specialty financial institutions have been organized to service this industry.

### **Your Intellectual Property is Not Protected**

Marijuana businesses lucky enough to have intellectual property (e.g., brand names, specialty products, packaging, trade dress, etc.) will have a hard time protecting it. The federal law that establishes trademark protection, the Lanham Act, prohibits registration for "immoral, deceptive, or scandalous matter." Since marijuana is illegal under federal law, trademarks on marijuana products are not available and federal trademark protection is therefore not an option. Marijuana businesses might be able to obtain state trademark protection, either through registration or through use. Common-law trademark rights arise when a trademark is used in commerce. These rights are usually limited to the geographic area in which the mark is used. Similarly, most state registries provide protection for the trademark within the state only.

Some marijuana businesses are entering into licensing agreements that allow others to use their brand names, specialty products, business methods, etc., in exchange for a licensing fee. Licenses are especially appropriate for the marijuana industry, since most state laws require local residency and do not allow entities to operate in multiple states. Through licensing, a successful marijuana business can extend its reach to, and earn profits from, other states.

### **Minimizing risks**

The legal marijuana market is fraught with challenges. Seeing profits in those risks, intrepid entrepreneurs will nevertheless continue to flock into this market. They will need lawyers, investors, bankers, landlords, suppliers and others to set up and run their businesses. And while numerous risks inherent to the legal marijuana market cannot be avoided, they can be minimized by scrupulously following relevant state laws and regulations while keeping an eye on the federal government and advocating for federal legislation that will rationalize the conflicting jumble of laws that are making entrepreneurs want to sample the product to relieve frustration.

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