

## Decriminalized Marijuana and the Promise of Legal Profits

By **Barbara Rowland**

Marijuana's legal uses likely will expand following the recent decriminalization of recreational marijuana in Colorado and Washington, coupled with the growing number of states (currently 20, plus the District of Columbia) that have legalized medical marijuana. The availability of marijuana products on the store aisle next to beer and wine, or in wider use in clinical studies for medical treatment, is only as distant as the time needed to develop and test a comprehensive legal framework for controlling the manufacture, distribution and sales of this substance, still classified as highly addictive and dangerous by the Drug Enforcement Administration (DEA) but yet no more dangerous than alcohol, according to a recent interview with President Obama.

Pressure is building on federal, state and local governments to reconsider the criminal laws regarding marijuana and to allow interests as diverse as medical research, business entrepreneurs, and tax authorities to benefit from the new legal marijuana industry. Recent guidance memoranda by the U.S. Department of Justice (DOJ) and Department of Treasury (Treasury) have informally decriminalized some marijuana-related conduct, although many legal marijuana supporters and business interests complain that the guidance does not go far enough.

The key issues addressed in those memoranda are:

- Criminal law enforcement priorities given marijuana's continued status as an illegal

controlled substance regulated by DEA and state drug enforcement agencies; and

- Handling of proceeds of legal marijuana sales by financial institutions without violating the Bank Secrecy Act and related statutes.

The federal government makes clear that it is not challenging the states' legalization of marijuana, but rather it seeks to assure that marijuana-related businesses operate with the same diligence as other businesses whose products implicate public health and safety concerns or generate profits that can fund criminal organizations. Businesses that enter the legal marijuana industry will have to carefully monitor and follow the patchwork of formal regulations and less formal guidance memoranda slowly being issued by government authorities. While perhaps not a risk-free endeavor, these enterprises can look to models and standards from other highly regulated industries to minimize criminal exposure.

### MARIJUANA AS A CONTROLLED SUBSTANCE

The federal government classifies marijuana as a Schedule I illegal controlled substance under the Controlled Substances Act, the same classification given to heroin and LSD. Schedule I drugs have a high potential for abuse, no currently accepted medical use in treatment in the United States, and lack accepted safety for use of the substance under medical supervision. 21 U.S.C. § (b)(1) and (c).

The DEA contends that smoked marijuana has no known medical benefits and provides the following caution:

Legalization of marijuana, no matter how it begins, will come at the expense of our children and public safety. It will create dependency and treatment issues, and open the door to use of other drugs, impaired health, delinquent behavior, and drugged drivers. ... This is not the mari-

juana of the 1970s; today's marijuana is far more powerful.

The DEA Position on Marijuana, at 25 (April 2013), [1.usa.gov/1d0W407](http://1.usa.gov/1d0W407).

Likewise, the Food and Drug Administration (FDA), which is responsible for approving drugs as safe and effective medicine, has thus far declined to approve smoked marijuana for any condition or disease. Indeed, the FDA has noted that "there is currently sound evidence that smoked marijuana is harmful," and that "no sound scientific studies support medical use of marijuana for treatment in the United States, and no animal or human data support the safety or efficacy of marijuana for general medical use." *Id.* at 2, citing "Inter-Agency Advisory Regarding Claims That Smoked Marijuana Is a Medicine," U.S. Food and Drug Administration (April 20, 2006) available at [1.usa.gov/gwq0rR](http://1.usa.gov/gwq0rR).

In the absence of regulatory action rescheduling marijuana from Schedule I, the DOJ has sought to balance states' decriminalization of marijuana with both the public health and safety concerns attendant to a Schedule I controlled substance and law enforcement and resource allocation priorities.

### DOJ GUIDANCE

On Aug. 29, 2013, the DOJ issued guidance for all federal enforcement in all states regarding criminal and civil enforcement in matters involving marijuana. This guidance provides legal marijuana operations the classic "cold comfort" that they will not be prosecuted for dealing in a Schedule I substance so long as they do not run afoul of the DOJ's law enforcement priorities or the states' regulatory schemes. Deputy Attorney General James M. Cole identified the Department's objectives as:

1. Preventing the distribution of marijuana to minors;
2. Preventing the revenue from the sale of marijuana from going to criminal enterprises, gangs, and cartels;

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3. Preventing the diversion of marijuana from states where it is legal in some form to other states;
4. Preventing state-authorized marijuana activity from being used as a cover or pretext for the trafficking of other illegal drugs or other illegal activity;
5. Preventing violence and firearm use in the cultivation and distribution of marijuana;
6. Preventing drugged driving and other adverse public health consequences associated with marijuana use;
7. Preventing the growing of marijuana on public lands; and
8. Preventing marijuana possession or use on federal property.

Memorandum re Guidance Regarding Marijuana Enforcement, at 1-2, Deputy Attorney General James G. Cole (Aug. 18, 2013) ("Cole I Memorandum").

These objectives are similar to the DOJ's enforcement priorities in states passing medical marijuana laws. Memorandum re Investigations and Prosecutions in States Authorizing the Medical Use of Marijuana, Deputy Attorney General David W. Ogden (Oct. 19, 2009) (Ogden Memorandum).

The Cole I Memorandum places responsibility for pursuing criminal conduct involving marijuana on state and local authorities — "The Department's guidance ... rests on its expectation that states and local governments that have enacted laws authorizing marijuana-related conduct will implement strong and effective regulatory and enforcement systems that will address the threat those state laws could pose to public safety, public health, and other law enforcement interests." Cole I Memorandum at 2. Failure to establish robust and effective controls at the state and local level could result in the federal government challenging the government's "regulatory structure" and bringing criminal enforcement actions itself. *Id.* at 3.

The Cole I Memorandum identifies baseline parameters of a regulatory system: "Indeed, a robust system may affirmatively address [federal] priorities by, for example, implementing effective measures to *prevent diversion* of marijuana outside of the regulated system and to other states, *prohibiting access* of marijuana to minors, and replacing an illicit marijuana trade that funds criminal enterprises with a *tightly regulated market in which revenues are tracked and accounted for.*" *Id.* at 3 (emphasis added).

Businesses already dealing with legal controlled substances, like pharmaceutical manufacturers, distributors, and pharmacies, will

recognize these requirements from the DEA's "closed system" for the manufacture, distribution, and sale of controlled substances. Their experiences with government licensing and regulatory demands, and their development of strong compliance programs, should serve them well if they enter the legal marijuana industry or, alternatively, act as a model for new businesses.

In the meantime, existing marijuana businesses must invest in tracking changes in laws and regulations, maintaining appropriate licenses, developing "red flags" for risky or illegal sales and training employees in those "red flags," taking action when customer behavior triggers a "red flag," and partnering with local law enforcement by promptly reporting employee theft and questionable customer behavior. While not a "Get Out of Jail Free" card, such genuine and demonstrable efforts will go a long way to addressing the DOJ's law enforcement interests.

#### BANKING ISSUES

As marijuana sales in Colorado take off, the issue of cash transactions has become a law enforcement concern. Mainstream banks and other financial institutions fear violating the Bank Secrecy Act by serving legal marijuana businesses, driving sellers to deal in cash only.

On Feb. 14, 2014, in joint announcements, the DOJ and Treasury lifted the prohibition against marijuana-related bank transactions and modified reporting requirements for suspicious transactions. Memorandum re BSA Expectations Regarding Marijuana-Related Businesses, FIN-2014-G001, Department of Treasury Financial Crimes Enforcement Network (Feb. 14, 2014) (FINCEN Memorandum); Memorandum re Guidance Regarding Marijuana Related Financial Crimes, Deputy Attorney General James G. Cole (Feb. 14, 2014) (Cole II Memorandum).

For marijuana businesses, financial institutions must undertake regular due diligence reviews to "know their customers." Banks must, for example, regularly verify and review customers' state licenses and related documentation; develop an understanding of each business's "normal and expected activity;" monitor publicly available sources for adverse information about businesses and related parties; and monitor businesses for "red flags" of suspicious activity. FINCEN Memorandum at 2-3. These "red flags" seek to identify outwardly legal marijuana businesses that are fronts or pretexts for money laundering for other criminal activity or marijuana-related activity not authorized by state law. *Id.* at 5-7.

The FINCEN Memorandum requires financial institutions to continue to file Suspicious Activity Reports (SARs), although modified to track, not investigate, legitimately operating businesses and focus the government's investigative resources on questionable and improper business activity. Three types of SARs can be filed: 1) "Marijuana Limited" SARs to identify financial services provided to businesses that, through a due diligence review, meet the state law requirements and do not violate Cole I Memorandum priorities; 2) "Marijuana Priority" SARs directed at businesses reasonably believed to violate state law or one or more Cole I Memorandum priorities; and 3) "Marijuana Termination" SARs in the event a financial institution terminates a business relationship to be in compliance with its anti-money laundering program.

FINCEN's focus on due diligence reviews and "red flag" behavior does not relieve financial institutions of the risk inherent in dealing with an industry that was formerly illegal. Banks can, however, mitigate the risk by enhancing systems to monitor, detect, and report "red flags," taking into account the expense and complexity of monitoring new businesses, mostly small or entrepreneurial, operating in a newly regulated market. Until this due diligence process is pressure-tested, query whether larger, mainstream banks will service marijuana businesses, leaving smaller banks to meet the challenges of FINCEN's requirements.

#### CONCLUSION

The federal government's guidance memoranda reflect a substantial shift in the government's view of marijuana use. However, they do not provide the low risk or risk-free comfort that many businesses, particularly those that are publicly traded or have other regulated business operations, require for entry to the legal marijuana industry. For now, the industry will likely be comprised of smaller, entrepreneurial operators, whose experiences will be the testing ground prior to the entry of larger, traditional companies. The foundation for further legislative and regulatory changes has been laid, though, and entrepreneurs and financial institutions would be well advised to track them.