



Financial Fraud Law Report

AN A.S. PRATT & SONS PUBLICATION

JUNE 2014

EDITOR'S NOTE: DECISIONS AND WARNINGS

Steven A. Meyerowitz

U.S. DISTRICT COURT LIMITS PRIVILEGE PROTECTIONS IN COMPLIANCE INVESTIGATIONS

Andrew M. Levine, Andy Y. Soh and Sebastian Ko

APPELLATE COURT RULING LARGELY AFFIRMS DOJ'S AND SEC'S INTERPRETATION OF A FOREIGN STATE "INSTRUMENTALITY" UNDER THE FCPA

Steven A. Tyrrell and Adam G. Safwat

HEADS OF SEC WHISTLEBLOWER OFFICE AND FCPA UNIT WARN AGAINST INTERFERENCE WITH POTENTIAL WHISTLEBLOWERS

Paul R. Berger, Andrew M. Levine, Jonathan R. Tuttle, Ada Fernandez Johnson and Ryan M. Kusmin

INVESTING IN STATE-LEGALIZED MARIJUANA OPERATIONS: UNDERSTANDING YOUR RISKS

Evelina J. Norwinski, Baruch Weiss and Edward A. Deibert

THE CASE THAT COULD SIGNIFICANTLY DISRUPT HOW COMPANIES MANAGE THEIR GIFT CARD PROGRAMS AND COULD CREATE BILLIONS OF DOLLARS IN EXPOSURE

Breton Leone-Quick and Steve Ganis

OFFICIAL REINFORCES DOJ'S COMMITMENT TO RIGOROUS ENFORCEMENT OF THE FCPA

Ike Adams and Brendan C. Smith

THE MONTH IN FINANCIAL FRAUD LAW

Steven A. Meyerowitz

QUESTIONS ABOUT THIS PUBLICATION?

For questions about the **Editorial Content** appearing in these volumes or reprint permission, please call:

Catherine Dillon at 908-673-1531

Email: catherine.dillon@lexisnexis.com

For assistance with replacement pages, shipments, billing or other customer service matters, please call:

Customer Services Department at (800) 833-9844

Outside the United States and Canada, please call (518) 487-3000

Fax Number (518) 487-3584

Customer Service Web site <http://www.lexisnexis.com/custserv/>

For information on other Matthew Bender publications, please call

Your account manager or (800) 223-1940

Outside the United States and Canada, please call (518) 487-3000

Library of Congress Card Number: 80-68780

ISBN: 978-0-7698-7816-4 (print)

ISBN: 978-0-7698-7958-1 (eBook)

Cite this publication as:

Financial Fraud Law Report § [sec. no.] (LexisNexis A.S. Pratt);

Financial Fraud Law Report § 1.01 (LexisNexis A.S. Pratt)

Because the section you are citing may be revised in a later release, you may wish to photocopy or print out the section for convenient future reference.

This publication is sold with the understanding that the publisher is not engaged in rendering legal, accounting, or other professional services. If legal advice or other expert assistance is required, the services of a competent professional should be sought.

LexisNexis and the Knowledge Burst logo are registered trademarks of Reed Elsevier Properties Inc., used under license. A.S. Pratt is a trademark of Reed Elsevier Properties SA, used under license.

Copyright © 2014 Reed Elsevier Properties SA, used under license by Matthew Bender & Company, Inc. All Rights Reserved.

No copyright is claimed by LexisNexis, Matthew Bender & Company, Inc., or Reed Elsevier Properties SA, in the text of statutes, regulations, and excerpts from court opinions quoted within this work. Permission to copy material may be licensed for a fee from the Copyright Clearance Center, 222 Rosewood Drive, Danvers, Mass. 01923, telephone (978) 750-8400.

An A.S. Pratt™ Publication

Editorial Offices

121 Channon Rd., New Providence, NJ 07974 (908) 464-6800

201 Mission St., San Francisco, CA 94105-1831 (415) 908-3200

www.lexisnexis.com

MATTHEW  BENDER

Editor-in-Chief & Board of Editors

EDITOR-IN-CHIEF

Steven A. Meyerowitz

President, Meyerowitz Communications Inc.

BOARD OF EDITORS

Frank W. Abagnale

Author, Lecturer, and
Consultant
Abagnale and Associates

Stephen L. Ascher

Partner
Jenner & Block LLP

Thomas C. Bogle

Partner
Dechert LLP

David J. Cook

Partner
Cook Collection Attorneys

David A. Elliott

Partner
Burr & Forman LLP

William J. Kelleher III

Partner
Robinson & Cole LLP

James M. Keneally

Partner
Kelley Drye & Warren LLP

Richard H. Kravitz

Founding Director
Center for Socially
Responsible Accounting

Frank C. Razzano

Partner
Pepper Hamilton LLP

Sareena Malik Sawhney

Director
Marks Paneth & Shron LLP

Mara V.J. Senn

Partner
Arnold & Porter LLP

John R. Snyder

Partner
Bingham McCutchen LLP

Jennifer Taylor

Partner
McDermott Will & Emery
LLP

Bruce E. Yannett

Partner
Debevoise & Plimpton LLP

The FINANCIAL FRAUD LAW REPORT is published 10 times per year by A.S. Pratt & Sons, 805 Fifteenth Street, NW., Third Floor, Washington, DC 20005-2207, Copyright © 2013 THOMPSON MEDIA GROUP LLC. All rights reserved. No part of this journal may be reproduced in any form — by microfilm, xerography, or otherwise — or incorporated into any information retrieval system without the written permission of the copyright owner. For permission to photocopy or use material electronically from the *Financial Fraud Law Report*, please access www.copyright.com or contact the Copyright Clearance Center, Inc. (CCC), 222 Rosewood Drive, Danvers, MA 01923, 978-750-8400. CCC is a not-for-profit organization that provides licenses and registration for a variety of users. For subscription information and customer service, call 1-800-572-2797. Direct any editorial inquiries and send any material for publication to Steven A. Meyerowitz, Editor-in-Chief, Meyerowitz Communications Inc., PO Box 7080, Miller Place, NY 11764, smeyerow@optonline.net, 631.331.3908 (phone). Material for publication is welcomed — articles, decisions, or other items of interest. This publication is designed to be accurate and authoritative, but neither the publisher nor the authors are rendering legal, accounting, or other

professional services in this publication. If legal or other expert advice is desired, retain the services of an appropriate professional. The articles and columns reflect only the present considerations and views of the authors and do not necessarily reflect those of the firms or organizations with which they are affiliated, any of the former or present clients of the authors or their firms or organizations, or the editors or publisher.

POSTMASTER: Send address changes to the Financial Fraud Law Report, A.S. Pratt & Sons, 805 Fifteenth Street, NW., Third Floor, Washington, DC 20005-2207. *ISSN 1936-5586*

Investing in State-Legalized Marijuana Operations: Understanding Your Risks

By EVELINA J. NORWINSKI, BARUCH WEISS, and EDWARD A. DEIBERT*

The Department of Justice recently issued guidance to federal prosecutors for determining whether to prosecute individuals or entities that engage in financial transactions involving proceeds from marijuana-related businesses. The authors of this article explain the guidance, explore potential state law issues, and advise investors and service providers to carefully consider whether the laws of their state could permit a prosecution or a forfeiture action, and what steps they may take to avoid liability.

BACKGROUND

The question of whether to invest in state-legalized marijuana businesses has garnered a lot of attention. There are opportunities for investment funds and individuals to participate in this new frontier of investments. It has been referred to by some as the new Gold Rush. Yet the risks are not limited to financial ones. In February, the Department of Justice (“DOJ”) issued guidance to federal prosecutors for determining whether to prosecute individuals or entities that engage in financial transactions involving proceeds from marijuana-related businesses. FinCEN issued complementary guidance the same day, seeking to clarify reporting obligations for financial institutions that provide banking services to marijuana-related businesses.

Companies not regulated by the Bank Secrecy Act—like venture capital firms, private equity funds, and real estate companies—may be better positioned. They are not subject to the new FinCEN requirements that impose burdensome due diligence and seemingly continuous monitoring of the activities of any client or customer with a marijuana-related business. Nonetheless, risks remain for any company or individual that wants to invest in or provide services to a marijuana-related business. While now legal in a few states, sales of marijuana remain illegal under federal law, and transactions involving the proceeds of marijuana sales can serve as the basis for a

* Evelina J. Norwinski is a partner in Arnold & Porter LLP’s Litigation practice group in Washington, D.C., where her practice focuses on white collar defense and compliance issues. Baruch Weiss, a partner at the firm, is a trial attorney focusing on white collar, national security, and complex civil litigation. Edward A. Deibert is a partner in the corporate and securities practice at the firm. They may be contacted at evelina.norwinski@aporter.com, baruch.weiss@aporter.com, and edward.deibert@aporter.com, respectively.

federal money laundering prosecution. Further, persons or entities located in states that do not allow the sale of marijuana risk criminal exposure under their own state's laws if they invest in or provide services to marijuana-related businesses, even if the marijuana-related business itself operates in a state like Colorado or Washington that permits such sales. Companies should be aware, for example, that the laws of New York provide for expansive criminal jurisdiction over conduct that touches New York in any way. Because the application of those laws in the context of a marijuana-related business that is legal in another state is novel and uncertain, companies must carefully consider how and where to conduct their transactions in order to avoid or minimize the risk of liability.

The DOJ GUIDANCE

The DOJ Guidance, issued on February 14, 2014, aimed to make it easier for state-regulated marijuana businesses to access basic financial services, like checking accounts and credit cards. The Guidance reiterates, however, that selling marijuana remains a federal crime under the Controlled Substances Act, and hence anyone who invests in or provides services to a marijuana-related business may violate the federal anti-money laundering statutes.¹ The anti-money laundering statutes broadly prohibit transactions that involve the “proceeds” of specified unlawful activity so long as the transaction is intended to promote the unlawful activity, and distribution of marijuana is one of the specified unlawful activities.

Despite its clear view on the illegality of the marijuana trade, DOJ instructed prosecutors to exercise some discretion in the cases they bring. The Guidance instructs prosecutors to focus their limited prosecutorial resources on only the “most significant” marijuana-related cases. In determining what constitutes a “significant” case, federal prosecutors are to consider the following eight priorities:

- Preventing distribution of marijuana to minors;
- Preventing revenue from the sale of marijuana from going to criminal enterprises, gangs, and cartels;
- Preventing the diversion of marijuana from states where it is legal under state law in some form to other states;
- Preventing state-authorized marijuana activity from being used as a cover or pretext for the trafficking of other illegal drugs or other illegal activity;

¹ 18 U.S.C. §§ 1956 and 1957.

- Preventing violence and the use of firearms in the cultivation and distribution of marijuana;
- Preventing drugged driving and the exacerbation of other adverse public health consequences associated with marijuana use;
- Preventing the growing of marijuana on public lands and the attendant public safety and environmental dangers posed by marijuana production on public lands; and
- Preventing marijuana possession or use on federal property.

These priorities apply to individuals or groups directly engaged in the distribution of marijuana, as well as those who finance or service them.

Although the Guidance suggests that prosecutors will focus their attention on conduct other than state-sanctioned and regulated marijuana sales, it provides no safe harbor. The Guidance makes this explicit, stating that it “does not alter in any way the Department’s authority to enforce federal law, including federal laws relating to marijuana, regardless of state law” and that “[n]either the guidance herein nor any state or local law provides a legal defense to a violation of federal law.”

Nonetheless, the Guidance makes it less likely that DOJ will prosecute a private fund that invests in a marijuana-related business in a state where such businesses are allowed, such as Colorado or Washington, so long as the business appears to comply with applicable state laws.

THE EFFECT OF STATE LAW

Relevance

Private funds, real-estate companies, and other service businesses may nonetheless face exposure under their own state laws. Investors or service companies located in states where marijuana remains illegal may be at risk of prosecution under state conspiracy, aiding and abetting, and money laundering statutes, and be at further risk of losing their investments or proceeds under forfeiture statutes. States like New York remain fully able to take action to prevent the proceeds of marijuana businesses from entering their state. Because legalization is so new, it remains to be seen whether New York or any other state would take such action and whether a court would approve it. Companies should be aware of these potentially relevant state laws in considering whether to invest in or service a marijuana-related business and, if they do, how and where to conduct such transactions to reduce potential risk.

Conspiracy/Aiding and Abetting

An individual that invests in or otherwise assists a marijuana-related

business could potentially face criminal liability under state conspiracy or aiding and abetting laws on the theory that the individual has conspired with or assisted another to sell marijuana, conduct that remains a crime in many states. New York's criminal code, for example, provides that a person can be convicted of a crime under New York law if, among other things, any element of the crime occurred within New York, or if a conspiracy or criminal solicitation occurred in New York.² Thus, if any communications between an investment equity fund and a marijuana-related business occurred in New York, or if the fund is based in New York and wired its investment from New York, the fund's conduct may render it vulnerable to prosecution under New York's laws for conspiring or aiding another to sell marijuana.

New York law establishes a safe harbor for those who engage in conduct that is a crime in New York but was consummated in another jurisdiction where the conduct would not be a crime.³ But whether a fund that invests in a marijuana business could rely on the exception is untested: the law uses the term "jurisdiction" rather than state, and selling marijuana remains illegal even in Colorado and Washington under federal law. A recent New York decision held, for example, that New York had jurisdiction to prosecute gun sales in South Carolina because the sales violated federal law, even though the sales did not violate South Carolina law.

Money Laundering

Investors should also be aware of the potential impact of state money laundering statutes. New York's money laundering statute, for example, criminalizes any financial transaction by any person that involves the proceeds of various types of "criminal conduct," including selling drugs. And "criminal conduct" for purposes of the statute includes "conduct committed in any other jurisdiction which is or would be a crime under the laws" of New York.⁴ A New York-based investment fund that invests in a marijuana business must carefully consider whether the money laundering statute would apply, because the transaction involves the proceeds of an activity—selling marijuana—that is criminal in New York. The same is true of a New York-based real estate firm that rents property to a marijuana-related business in another state. The financial transaction must be intended to promote the criminal conduct, but New York prosecutors could try to argue that any

² N.Y. Crim. P. Law § 20.20.

³ N.Y. Crim. P. Law § 20.30.

⁴ N.Y. Penal Law § 470.00.

knowing transaction or service to a marijuana business satisfies that requirement.

Again, New York's exception for crimes consummated in another state where the relevant conduct is legal has uncertain application in this context. The crime of receiving in New York the proceeds of Colorado marijuana sales (unlike the crime of conspiring in New York to sell marijuana in Colorado) arguably qualifies as a crime that is consummated in New York, where the financial transaction takes place. And, in any event, the underlying crime of selling marijuana remains illegal under federal law.

Criminal and Civil Forfeiture

Finally, a company that invests in or services a marijuana-related business should be aware of state forfeiture laws (criminal and civil) that permit the government to seize the proceeds of criminal activity. The financial incentives can be strong: a recent *Wall Street Journal* article noted that the federal government processed US\$1 billion in marijuana-related forfeitures between 2002 and 2012. Civil forfeiture laws, in particular, could provide an alternative for a state (or local police force) that wants to discourage residents from conducting transactions with marijuana-related businesses but believes criminal liability is a bridge too far. Generally, an individual can be required to forfeit property that is the proceeds of a crime even if the individual is not convicted of the crime, and the standard of proof in a civil forfeiture matter will be lower than the standard in a criminal matter. Depending on the state's laws, rather than having to establish liability beyond a reasonable doubt, the state may be required to prove that the money at issue is proceeds of a crime only by either clear or convincing evidence or a mere preponderance of the evidence. For example, New York's civil forfeiture law requires a preponderance standard in certain cases and a clear and convincing standard for others, depending, for example, on the nature of the property at issue and other case-specific details.

Assessing Risks Under State Law

The existence of state conspiracy/aiding and abetting, money laundering, and forfeiture laws does not necessarily mean that an investor or service provider should decline all transactions with a state-legalized marijuana business. Rather, it means that they should proceed with caution. It is important as an initial matter to determine where conduct will occur and to understand the laws of the relevant jurisdictions and how they might apply to the anticipated investment or transaction. The determination of risk is heavily fact and state-dependent and should be examined carefully. Next, consider how and where to conduct the transaction to avoid triggering state

liability, such as conducting key steps or the entire transaction in a state that permits such conduct. Finally, where there is uncertainty, an investor or service provider may have to determine its own risk tolerance.

THE BOTTOM LINE

Investment fund managers and other companies that wish to invest in or conduct transactions with marijuana-related businesses in some respects face fewer requirements than commercial banks, mutual funds, and other entities that are bound by FinCEN's guidance. But risks remain: DOJ's Guidance is not a safe harbor against federal prosecution, and in any event there is potential liability under state law. Before investing in a marijuana-related business, investors and service providers should carefully consider whether the laws of their state could permit a prosecution or a forfeiture action, and what steps they may take to avoid liability.