

Fox Rothschild Podcast

The Presumption of Innocence Podcast Series: Episode 11

High Stakes: Anti-Money Laundering in the State-Legal Cannabis Business

Featuring Matthew Adams, Joshua Horn and Saverio Romeo of Fox Rothschild LLP

Adams: Hi everyone, and welcome to “The Presumption of Innocence.” My name is [Matt Adams](#), I'll be your host today. I'm also one of the Co-Chairs of the [White-Collar Criminal Defense and Regulatory Compliance Practice](#) at the firm.

Today, we're talking about the evolution of state cannabis laws and how that intersects with federal anti-money laundering provisions that come out of our federal statutes.

We're joined today by two great guests and true leading experts in this area. We have [Josh Horn](#), who is the Co-Chair of Fox Rothschild's [Cannabis Practice](#). Also, we're joined today by [Saverio Romeo](#), who is a member of the White-Collar Criminal Defense Practice at Fox and has some extensive experience navigating the federal anti-money laundering laws in connection with certain legal cannabis businesses that are the byproduct of states gradually moving towards eliminating the legal moratorium on cannabis use and sale.

Now, just some statistics from the outset: According to the National Conference on State Legislatures, as of February 3, 2022, 37 states, four territories and the District of Columbia allow medical use of cannabis products. As of November 29, 2021, 18 states, two territories and the District of Columbia have enacted measures to regulate cannabis for adult non-medical use, or as we say, recreational use. The trend is obviously moving in the direction of states legalizing marijuana, whether it be through a legislative initiative or a ballot initiative, as is the case in New Jersey, where I live. Over the last 18 months, we've been going through an extensive legalization process there.

I want to bring the central issue that we're going to discuss today – this intersection of state and federal law – into full focus. I'm asking you, Saverio, to give us a little bit of background on the federal anti-money laundering regimes that are implicated by the state legalization of cannabis.

Romeo: Thanks, Matt. Happy to be here today with you. I think everybody, lawyers and non-lawyers alike, are pretty familiar with the idea of money laundering. Generally, it refers to the concept of “washing” money. There are two main federal statutes that apply when we're talking about money laundering.

The first one is 18 U.S.C. § 1956. Now within that statute, there are essentially three different types of money laundering. I'll quickly cover all three of them. The first type is called promotion money laundering. That occurs essentially when somebody engages in a monetary transaction, knowing that it involves proceeds of unlawful activity, with the intent to promote the carrying on of a “specified unlawful activity.” That term, as we lawyers know, is a specific term that refers to many different federal crimes – mail fraud, wire fraud, etc. – that are encompassed within that. The second type of money laundering under Section 1956 is known as tax intent money laundering. Again, that's

engaging in a financial transaction with the intent to violate the income tax laws – for example, tax evasion or tax fraud. The third type of money laundering under Section 1956 is known as concealment money laundering. That occurs when someone engages in a financial transaction with the intent to conceal or disguise the nature, location or source of the proceeds involved in that unlawful activity. That would be the more, I think, traditional money laundering that most of us are familiar with, when you're trying to essentially wash money and hide its source.

Now there's another statute, 18 U.S.C. § 1957, which also applies. That one is a little simpler in some ways, and that applies when somebody knowingly engages or attempts to engage in a monetary transaction in criminal derived property that is derived from specified unlawful activity.

Adams: So Saverio, what you're saying is, if we want to bring into focus the issue at hand, the specified unlawful activity is because under federal law, the distribution and even the use and possession of cannabis is prohibited, right?

Romeo: That's right, Matt. That is one of the “specified unlawful activities” that incorporates those laws as well.

Adams: Josh, you're Co-Chair of our firm's Cannabis Practice. You are obviously recognized as an industry-leading cannabis law attorney. You have a background in the regulated professions like the securities industry.

We've got a state framework that says, “Fine, cannabis is legalized” and you can now have these legitimate businesses opening up. On the other hand, you have this federal framework which says essentially that the sale, distribution of cannabis is a specified unlawful activity that could constitute money laundering. How do you reconcile those seemingly conflicting issues?

Horn: Thank you for having me here. It's a great question. It's difficult to reconcile, other than it has become, at least on the federal level, almost a “don't ask, don't tell” kind of policy. There are a couple of things in play. The biggest issue the cannabis companies have, that are in state-legal programs, is access to traditional banking. You can't get a loan from your traditional banks. You can't even deposit money with the traditional bank, the white shoe banks that we all know well in this country.

What do these companies do? Well, the federal government actually contemplated this issue back in 2014. [Financial Crimes Enforcement Network Division of the Treasury](#) (FinCEN) on February 14, 2014, issued guidelines. The guidelines only apply to medical marijuana, but in practical matter, it applies across the board to both medical and adult-use programs. Basically, what FinCEN guidelines say is, “Banks, credit unions, we really don't want your banking in the space, but if you're going to, here's how we want you to do it.”

Banks that do take money ... they have to file suspicious activity reports (SARs) when they take the money. There are three different levels of SARs. The first level of SAR is basically a bank saying, “I'm working with Josh Horn, he's a state-licensed cannabis company compliant with state law.” SAR number two is the intermediate level. It's, “we're banking with Joshua Horn and his cannabis company is licensed in this particular state, and we think he may be doing something wrong.” The last level of SAR is the termination SAR, which is, “We've been doing banking work with Josh Horn, who has a cannabis company licensed in this particular state. But we know he's violating the law. We're terminating his relationship.”

One would think, “Well, gee whiz, banks, why wouldn’t they get it?” Well, if you think about what they have to establish with the first SAR, “I am complying with the state legal program,” basically, the banks that become sub-regulators for the federal government and state government don’t want it. They don’t want to have to have that responsibility. The banks that take on that responsibility charge handsomely for it. We have clients who pay anywhere between \$3,000 and \$10,000 a month just for a bank to take their money and write checks for them. It’s a pretty onerous system, but that’s the system we have at the moment.

Adams: Josh, can I walk into a dispensary tomorrow and buy some legal cannabis on my credit card?

Horn: Short answer is no. The bank associations, namely Visa, MasterCard, American Express, Discovery, will not process card transactions for cannabis. However, there are banks and financial institutions who are trying to come up with workarounds such as stored value cards and closed loop ACH transactions, almost like when you use your debit card. We have clients who have done that, who’ve tried to come up with these workarounds for direct bank-to-bank without working through a card association. I suspect sooner or later, if the SAFE Banking Act ever becomes law, which we can talk about, the card brand associations will be more open to the possibility.

Adams: Now, Saverio, from where you sit – we all know that the Department of Justice (DOJ) carries prosecutorial discretion. They can bring a case or not bring a case as they elect. Are you aware of any money laundering prosecutions in the United States – under the legal framework that you’ve spelled out – that have been brought by the Department of Justice for actors that are in the state-legalized cannabis market?

Romeo: Well, Matt, the short answer there is no. I think what we’ve seen is that the DOJ is not going after companies or individuals, generally, who are complying with state medical marijuana laws, for example, and also companies that are making investments in foreign marijuana companies. That’s another example.

The example I would use is kind of the speeding on the highway example. Clearly, a lot of people speed. There might be a state trooper who sees multiple people speeding and may not pull anybody over. He may choose one person to pull over based on an extenuating circumstance. I think that it’s a smaller scale, obviously, exercise of discretion. But on the larger scale, on the DOJ side, we are not seeing the DOJ exercise its discretion to go after individuals or companies who are complying with state marijuana laws.

Adams: Would you agree with Josh that it’s a “don’t ask, don’t tell” environment?

Romeo: That’s right. I think that’s a very good way of putting it. I agree with that. I think in some ways it goes back to potentially some DOJ guidance that was put in place back in 2013. There was this memorandum from Deputy Attorney General James Cole that actually, technically, was rescinded, but I think still carries some weight and actually was incorporated within the FinCEN guidance that Josh mentioned earlier. Essentially, that Cole memorandum said what we’ve seen take place in practice, which is that the federal government is not going to make it a priority to go after use of marijuana that is in compliance with state law.

Horn: To pick up on a couple of points, there are a couple of other considerations. For one, the federal government – in the budget bills since 2014 up to the present, there have been amendments to it. It was originally called the Rohrabacher–Farr amendment, now it’s the Rohrabacher–Blumenauer amendment, which basically says, in relevant part, that Congress will not fund the DOJ

to go after state-legal medical marijuana companies who are operating in compliance with state law. That spending bill was challenged and went up to the Ninth Circuit Court of Appeals in 2016. That court effectively eviscerated a number of convictions, sent it back to District Court so the District Court could determine whether or not those companies were in compliance with state licensing cannabis laws. So, you have that, which is another impetus for why we don't really see DOJs going after these companies. Although the spending bill limitation only applies in the medical space, it is de facto being applied in the adult-use space as well. As long as these companies are otherwise fully compliant with state law, they're not going to be bothered, up to this point.

Adams: Josh, you counsel lots of legal cannabis businesses. We all know how these industries begin. They start with small niche companies that are maybe micro-cap companies. Then, as the industry emerges and evolves – as is the case, I think, with this industry based on the fact that some form of legal cannabis market exists in 37 of the 50 states and then all of our territories – how do you counsel companies that might be looking to merge with, acquire or otherwise combine forces with this backdrop of what is a nasty patchwork of state and federal law, oftentimes contradicting one another?

Horn: It's a challenge, Matt, and we've worked on the largest merger ever in the space, the merger of a company called [Trulieve with Harvest](#), which was a \$2 billion merger.

Really, at least from my perspective, because my background is really from a regulatory standpoint, every state has its own regulatory environment as to what you do and do not need to do to get a transaction approved. You really have to know the law in every one of the states your clients are operating in to make sure that when you're doing an M&A transaction, you get whatever approvals you need to get, and you get whatever documentation you need to get. Then you close as quickly as you can. So, hopefully the regulations or law doesn't change before you go to close. I mean, it's almost like the proverbial race to the courthouse. It's a race to the closing. You get all the regulatory approvals squared away and close your deal accordingly.

A lot of these companies are now publicly traded. They've been publicly traded on the Canadian Stock Exchange, also known as the Cannabis Stock Exchange, and then dually listed here in the U.S. Even though it's federally illegal, you still have to comply with the SEC requirements in your filings when you're doing a merger of publicly traded companies. It's as if this is just like any other business, but it just happens to be cannabis. It's subject to the same sort of SEC oversight, if they're publicly filed and publicly registered company, as you would if you were any other publicly traded company.

Adams: Saverio, I want to go back to that concept of specified unlawful activity. We've kind of beat around the bush a little bit: Marijuana is still a Schedule I narcotic federally, correct?

Romeo: That's right.

Adams: Okay. This idea of a specified unlawful activity that would bring it within the rubric of the federal anti-money laundering regimes is really dependent upon that federal statute staying put and not changing, right?

Romeo: That's right. I think certainly, factually, I see certain cases where there may be more of a defense to a money laundering charge. For example, when you're talking about certain companies that might make an investment in a foreign cannabis company where they're not directly taking place or profiting from the cultivation of marijuana. They might be investing in a stock, for example. There are certain situations where I could see there being some arguments against the application of the

money laundering laws. But then, we also have clear cases where I think technically the statute could apply. It's really a question of discretion, and whether the DOJ is likely to get involved. We've seen that it just has not done that when we have state-compliant marijuana activities.

Adams: Can you think of another analog, another industry, where it's unlawful at the federal level but lawful at the state level, and then there's this ambiguity about whether it's in fact the specified unlawful activity?

Romeo: I think this is a very unique area of the law. It's very interesting. I mean, if we take marijuana out of the equation, for example, and put in place another drug – take heroin, for example – I don't think there would be any question that the DOJ would not take kindly to a company making the large investment in a cartel in another country. Just because of this unique nature where we have states legalizing marijuana, it has created this unique structure where we have lawful activity under state law, but not under federal law. It creates a bit of a de facto exception, at least in terms of how the federal government is deciding to go after this.

Adams: Josh, can you think of another analog, another industry?

Horn: Nevada has state legal prostitution, where I think maybe the Mann Act is taking people over state line. But I think the point is still there that you have something that's federally illegal and state legal. If you talk to our colleagues who represent state-legal prostitution in Nevada, they beg to be taxed. If they're taxed, then they're deemed to be legitimate businesses in their mind. I think that's a close analog.

The other thing I think is worth noting, is there are so many collateral businesses that are involved in the state legal cannabis, that it's really impractical to think that the federal government is going to go after anyone for money laundering. Just for example, one of the things that we've done a fair amount of is writing SEC regulatory opinions for mutual funds and exchange traded funds who are investing in cannabis companies in the U.S. and Canada and abroad, as well as psychedelics companies. These are funds that are listed on the New York Stock Exchange, again, subject to federal compliance with federal law and the SEC requirements. We have not had an issue of any pushback on having those funds actively traded on the New York Stock Exchange. There are other companies and I'll just name one ... a company called Innovative Industrial Properties, which is a publicly traded REIT, and their business model is doing sales and leasebacks with cannabis companies. Effectively, they're getting paid from the proceeds of a cannabis operation, and they're listed on the New York Stock Exchange. I think in many ways, Matt, the horse has left the barn on this issue, and I don't think it's coming back any time soon.

Adams: In a moment, I want to go down the path of what's next. But I want to go back and drill a little deeper into the M&A activity that surrounds these cannabis businesses, because this is by no stretch small business. This has emerged into the big business space. I think it's only going to get bigger because the trend is obviously there. Is there any specific way that these transactions need to be structured, whether it be from the asset purchase type structure or otherwise, that is prudent in light of some of the issues that we're discussing here today?

Horn: You raised a great question, Matt, and it's interesting because the answer to that question is it depends on the state. For example, in Pennsylvania, where I reside, you cannot do an asset deal. Meaning, you cannot purchase a cannabis permit from a company that wants to sell it. You have to buy the company.

Now, let's go below the Mason-Dixon line. Let's go to Maryland. In Maryland, you have an option. You can just buy a license or you can buy the equity in the whole business. It's really state-specific. There's really no way to avoid this issue of money laundering by structuring, because you're basically using the proceeds of a federally illegal activity to buy another federally illegal business. It's either done with private stock or public stock. It's frequently done with earnouts and cash. Where's that cash coming from? Really, there's no way to structure it where you're going to avoid the potential impact of the money laundering laws, other than the fact that they're just basically ignored for the purposes of these transactions.

The other thing I think that's important to take into account – and you noted at the outset of our discussion here today, Matt – there's 37 states that have medical marijuana programs and 18 states that have adult-use programs. You have to look at some of the most recent states that have come online with programs. Over the last couple of years, you have North Dakota, South Dakota, Utah, Missouri, Georgia. Not states that have traditionally been considered the bastions of liberalism, but yet they are fully embracing these programs for whatever reason, whether it's just another revenue source or because the citizens of their states demand it. In my view, that's the harbinger of things to come. I don't think we're ever going to go back to a world where we don't have some form of legal cannabis. Looking forward, I firmly believe that all states are going to have some program. Even Idaho, which is the staunchest anti-cannabis state in the country.

Adams: Saverio, Josh just said something interesting. He says he doesn't think that we're ever going to go back to a place where we don't have some form of legalized cannabis. I tend to agree with him. I think that the horse has left the barn and putting this all back into the bag, so to speak, will be very difficult.

I'm going to cling to something else that Josh said and ask for you to comment on it. He said, basically, the illegality at the federal level is essentially being ignored for the purpose of these transactions. It seems to me that that could change with the wind because political waves come and go. We've seen it here over the last, say, 12 years where we've had different administrations that had differing views on this particular issue, among others. Do you agree that the horse has left the barn? Does this mean that the trend is inching closer to a federal legalization or descheduling of cannabis?

Romeo: I think as usual, Josh has kind of hit the nail on the head with that. I agree that the horse has left the barn here. A couple other transactions that Josh didn't mention. You know, we're talking about billions of dollars that have been invested in this industry. I'm thinking of Constellation Brands in 2017, for example, invested \$4 billion into a Canadian cannabis company. Clearly, DOJ would have been aware of that and did not take any action. I think the way to answer your question is to look back just in recent history and see what has happened. I referenced earlier the memorandum from James Cole at DOJ that essentially said the federal government is not going to make enforcement on the federal level a priority where medical marijuana is legal under state law.

When you look at what happened when the Trump administration came in, that memo was rescinded. But if you look at the way it was done, it was not signaling an aggressive stance towards marijuana enforcement, for example. What essentially happened was former Attorney General Jeff Sessions rescinded that memorandum and essentially directed prosecutors back to the general guidance that was in place. Then looking at what happened after that, still within the Trump administration, Attorney General Barr at his confirmation hearing made it clear that, at least under his purview, the federal government was not going to go after actors who are in compliance with state medical marijuana law.

I think it's certainly possible DOJ could do an about-face at some point, but I think it's very unlikely, certainly not when we have such large transactions that are taking place and kind of an unofficial exception that has been created to that law. I really do not see it as likely that we would turn to an aggressive federal enforcement stance.

Adams: Josh, if we're inching closer towards the federal legalization, you mentioned the SAFE Banking Act prior. Explain to us what that's about, and any other statutes that might be those incremental steps that might yield to the penultimate crescendo of federal legalization.

Horn: About a year or so ago, Matt, I had our legal research team print out a list of proposed pieces of federal legislation that would either deschedule, reschedule, make legal or decriminalize cannabis. It was about two inches thick. There are a lot of pieces of legislation pending at any given time. The one that people talk about most is SAFE Bank. Basically, what the SAFE Bank Act says is that if there's a state legal program, it's okay for banks to freely bank in those states without fear of any repercussions, such as the Fed window being closed down on a bank. So, that basically opens up traditional banking services in those states that are state legal programs, presumably without these onerous fees, because if it's otherwise legal, they won't have to file a suspicious activity report.

There are things like the MORE Act, which would deschedule cannabis altogether. There is the COMPETES Act. There are all kinds of statutes. Either we decriminalized, reschedule, deschedule. The one that's had the most traction over time has been the SAFE Banking Act. That's gotten through the House a couple of times. It hasn't gotten past the Senate. I don't think it's going to get past the Senate this time, because Chuck Schumer, when it got passed the House in the fall, his point was, "I want full and complete and comprehensive cannabis reform." So, I don't think it's really going anywhere at the moment, which is a shame because that's probably the one thing that I think the industry really needs.

I'm also a cynic, and I don't think the federal government really has much incentive to make it legal on a federal level for the following reason. There's a section of the Internal Revenue Code known as Section 280E. Section 280E basically says, "Okay, you're in an illicit business. Guess what? You've still got to pay tax and oh, by the way, the gift for you paying tax is you don't get any deductions." If you think about it, we as a law firm take all of our deductions that we're otherwise entitled to take under the Internal Revenue Code. Maybe we pay income tax on \$0.60 on the dollar. If you're a cannabis company, particularly a dispensary or retail operation, you're paying tax on \$0.95 on the dollar because it's the only piece you can take your deduction of the pie. A lot of people have tried to circumvent that issue by using services companies to try to run their expenses through. Trust me, the IRS is very keen to that issue. If you think about it, being a complete cynic, why would the federal government ever get rid of this taxing system where you're over-taxing this entire industry to the benefit of the federal government?

Adams: It's all about the money.

Horn: It is all about the money, which is why you see these more conservative states go online with programs. Again, I'll use Pennsylvania as an example. Jim Carville, political commentator – hopefully I'm not dating myself too much – had a great saying. He said, "Pennsylvania is basically three sections. You have Philadelphia in the east, Pittsburgh in the west, Alabama in between."

Pennsylvania is a very conservative state traditionally. But the thing about COVID, there's such a budget shortfall. Now the prospect of adult use is more alive in Pennsylvania than it's ever been. In this current legislative session is the first time an adult-use bill ever got a full discussion at the



committee level. My point is, there's too much money for states and the federal government to make to not at least turn a blind eye to the system and just let it keep chugging along as it has been.

Adams: Well, guys, this is fascinating. We could probably talk all day about it, but we're all out of time. This is truly an area of collaboration between our white-collar defense practice and our cannabis practice. I can't thank you enough for being with us. Until next time, this is "The Presumption of Innocence." Be well, and we'll see you next time.

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