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Cannabis companies need financial services; D.C. says don't bank on it

The legal marijuana trade is a reality. Medicinal sales are permitted in 29 states, including Illinois, and several jurisdictions allow limited recreational use. A study cited in a recent Forbes article estimates the industry's market value at more than \$7 billion in 2016 and projects a 17 percent annual growth rate that could generate 250,000 jobs in three years.

Like all businesses, cannabis companies require basic banking services — operating accounts for deposits, expenses and payroll, merchant services for credit card processing and loans for working capital.

The financial sector is poised to fill the needs of this high-potential industry.

Not so fast, say federal authorities. Marijuana is a Schedule I drug under the Controlled Substances Act, and banks that serve state-licensed cannabis businesses could be violating federal law.

Money laundering and the Bank Secrecy Act

The federal government's power to invalidate state marijuana laws is subject to debate, but few dispute its authority to decide whether financial institutions can serve state cannabis providers.

Under the Bank Secrecy Act, for example, banks must have procedures to detect and report suspected money laundering. Because marijuana is illegal under federal law, failing to report marijuana-related transactions can violate the act.

Further, electronic fund transfer rights are federally controlled and have been denied to state-chartered institutions seeking to serve marijuana merchants. In *Fourth Corner Credit Union v. Federal Reserve Bank of Kansas City*,

154 F. Supp. 3d 1185 (D. Colo. 2016), a state credit union serving state-authorized cannabis entities sought a master account with electronic transfer privileges. The U.S. District Court dismissed the case because permitting the master account would "facilitate criminal activity."

The judge insisted "[a] federal court cannot look the other way," but hoped the issue would "soon be addressed and resolved by Congress." An appeal to the 10th U.S. Circuit Court of Appeals is pending.

Even Chapter 11 bankruptcy plans that include state-authorized marijuana income are rejected, due to federal law. See *In re Arm Ventures, LLC*, 564 B.R. 77 (Bankr. S.D. Fla. 2017).

Banks deterred by mixed messages from executive branch

The Department of Justice could exercise discretion and provide common-sense, bright-line enforcement standards that permit financial services for authorized marijuana businesses. Instead the DOJ's equivocal statements have led to uncertainty and fear of prosecution.

As a case in point, an Obama era DOJ memorandum purports to offer "guidance" to banks that serve state-licensed cannabis companies, but the advice is murky and conflicted at best.

Issued by deputy attorney general James Cole in 2014, the memorandum instructs federal prosecutors to focus on specific "priority" factors regarding marijuana that endanger children or the public or otherwise encourage illegal trafficking and gang activity.

Citing concurrent "guidance" from the Department of the Treasury, Cole directs banks to screen their cannabis-related customers' accounts for the

BANK BEAT

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"priority" factors. Suspected "priority" transactions must be reported in a detailed marijuana priority report to the Treasury Department.

However, if a bank determines the accounts comply with state marijuana laws and do not implicate any "priority" factors, a streamlined marijuana limited report should be filed instead.

Because marijuana is illegal under federal law, failing to report marijuana-related transactions can violate the [Bank Secrecy Act].

Although the memorandum implies banks will not be sanctioned for serving customers named in marijuana limited reports, the message is mixed. While it "may not be appropriate" to bring charges based on a marijuana limited report, Cole writes, "[t]his memorandum does not alter in any way the

department's authority to enforce federal law, including federal laws relating to marijuana, regardless of state law."

The court in *Fourth Corner Credit Union* recognized the Cole memorandum was pointless, because "it does not change the law" and merely says "prosecutors and bank regulators might 'look the other way' if financial institutions don't mind violating the law."

The Trump administration has doubled down on the uncertainty for banks with loose and inconsistent proclamations. On the one hand, press secretary Sean Spicer suggests the president understands medical marijuana can alleviate pain and suffering. On the other hand, Attorney General Jeff Sessions says medical use "has been hyped, maybe too much."

With unclear federal policies and inconsistent political discourse, most banks and credit unions refuse to work with legitimate marijuana providers. The few that are willing to assume the risks face substantial compliance costs.

Cannabis companies feel the squeeze

The lack of a consistent federal message on banking has put state-approved cannabis licensees in a difficult spot. "The situation is beyond frustrating," confirmed Jeremy Unruh, general counsel for Pharmedica.

As legal counsel for a growing medical marijuana provider with 11 cultivation centers and dispensaries in Illinois and New York, 150 employees and expansion planned for other states, Unruh described some of the difficulties in obtaining basic financial services.

First, finding one of the handful of institutions willing to open

accounts is a “needle-in-the-haystack” proposition, according to Unruh. Keeping the accounts is another challenge, because banks will drop marijuana-related customers if the costs are too high or the political climate changes.

Next, the financial reporting burdens for a basic checking account are overwhelming. To assist the bank with periodic marijuana limited reports detailing all account activity, Unruh’s company must substantiate its most routine expenses. “It’s like being under audit, 24/7,” Unruh noted.

And this intensive regulation is not cheap. Due to federal reporting requirements and the resulting risks, basic banking service costs are astronomical.

Lastly, the IRS penalizes authorized cannabis companies by deeming them traffickers in a controlled substance under Internal Revenue Code Section

208(e), which eliminates all deductible expenses aside from costs of goods sold.

Although PharmaCannis is moving ahead despite those obstacles, Unruh confessed the “two-steps-forward-one-step-back” process has been a challenge. “This industry needs clear federal guidance to the banks,” he concluded.

Illinois state treasurer seeks answers from president

If Illinois State Treasurer Michael Frerichs gets his way, medicinal marijuana providers will have their clear federal guidance, sooner than later.

As collector of taxes and fees from licensed cultivation centers and dispensaries, Frerichs experiences first-hand the difficulties with an industry that lacks basic banking services.

Frerichs recently discussed his concerns, and his efforts to solve the federal/state impasse.

Frerichs first emphasized that

Illinois legalized marijuana to treat people’s serious physical ailments. “We are talking about citizens with debilitating symptoms,” he explained, and “the process of supplying needed medications must be as smooth as possible.”

Forcing authorized cannabis businesses to operate without bank accounts obstructs that important purpose, Frerichs went on. Cash-only enterprises are inherently risky. “Just imagine paying all your bills in cash. The practice encourages spotty record keeping, and companies without conventional lending can fall prey to unprincipled investors or criminal elements.”

Not to mention that regulating, auditing and collecting taxes from cash-heavy organizations has become extraordinarily difficult. “Deterring banks from serving licensed and regulated facilities lacks plain common sense,” Frerichs said.

Frerichs finds the need for banking services so imperative that he written twice to President Donald Trump already this year, requesting assurances that banks with state-approved medical marijuana companies as customers will not be prosecuted.

So far, no response from the president. Frerichs is frustrated but will not relent. “The stakes are too important,” he emphasized. “The president has been in office for 100 days. He needs to step up and address the problem. Avoidance is not an option.”

In sum, as Frerichs points out, the time for federal silence or ambiguous warnings is over. The nation’s call for marijuana as a legitimate medical treatment is now a crescendo, and banking services are key to the production and delivery platforms. It’s time for the federal government to get out of the way.