

Ninth Circuit Reinforces Need for Due Diligence When Doing Business With the Cannabis Industry

In recent guidance, we wrote about what companies should do to [minimize the risk of federal criminal penalties when doing business with or investing in cannabis industry companies](#). One principle we stressed is the need to know your potential partners in the cannabis industry to ensure that they fully comply with the drug laws of the state(s) in which they operate. A recent decision by the U.S. Court of Appeals for the Ninth Circuit, [United States v. Gilmore](#), 886 F.3d 1288 (2018), demonstrates the importance of such due diligence.

By way of background, since 2015, the U.S. Congress has consistently attached a rider in appropriations bills stating that "none of the funds made available" by any particular bill may be used by U.S. Department of Justice (DOJ) to prevent states from implementing their own laws for the "use, distribution, possession, or cultivation of medical marijuana." See Consolidated and Further Continuing Appropriations Act, 2015, Pub. L. No. 113-235, § 538. Congress extended the rider in its most recent legislation to fund the federal government, which became law on March 23, 2018. See Consolidated Appropriations Act, 2018, Pub. L. No. 115-141, § 538. Under a prior appropriations act, the Ninth Circuit, in [United States v. McIntosh](#), 833 F.3d 1163 (9th Cir. 2016), ruled that the rider's practical effect prevented DOJ from using funds appropriated to it by Congress to prosecute defendants, if the defendants fully complied with state law while engaged in authorized medical marijuana activities.

In *Gilmore*, hunters provided a tip to law enforcement regarding marijuana cultivation in El Dorado County, California. Upon executing a warrant, officers found over 100 marijuana plants growing on the property and detained three men. One of the men explained that he had leased the property to grow medical marijuana, which is legal under California state law, and had hired the other two men to grow and to protect the crop. Nevertheless, the government obtained an indictment charging the men with manufacturing marijuana plants because the cultivation site was located on federal land controlled by the Bureau of Land Management.

While one defendant pleaded guilty, the two other defendants contested their prosecution by invoking the appropriations rider, arguing that it prevented DOJ from prosecuting them because medical marijuana is legal in California. The Ninth Circuit, however, rejected their argument because the rider did not limit DOJ's ability to enforce federal drug laws when the marijuana at issue had been growing on federal land.

Instead, the rider applied narrowly to state systems that permitted the use, distribution, possession or cultivation of medical marijuana. The court observed that California's medical marijuana regime did not permit cultivation of medical marijuana on federal land. In other words, the defendants' noncompliance with state law left them open to federal prosecution. The defendants also argued that they did not know their grow operation was on federal land, and therefore lacked intent to violate the law. The court disagreed, holding that the prosecution was not required to prove the defendants knew that their operation was on federal land.

The *Gilmore* defendants' apparent error in executing a lease on federal property exposed them to the full brunt of federal prosecution and destroyed their business. For in-house counsel at companies looking to partner with or invest in cannabis industry companies, due diligence must examine the extent to which operations comply with both federal and state law. Failure to do so could mean not only business losses but also greater exposure to criminal penalties if your company has a significant role in managing the cannabis-related activities, as perceived by a federal prosecutor.

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