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Green Means Go? Mitigating Professional Liability Exposure in the Cannabis Arena

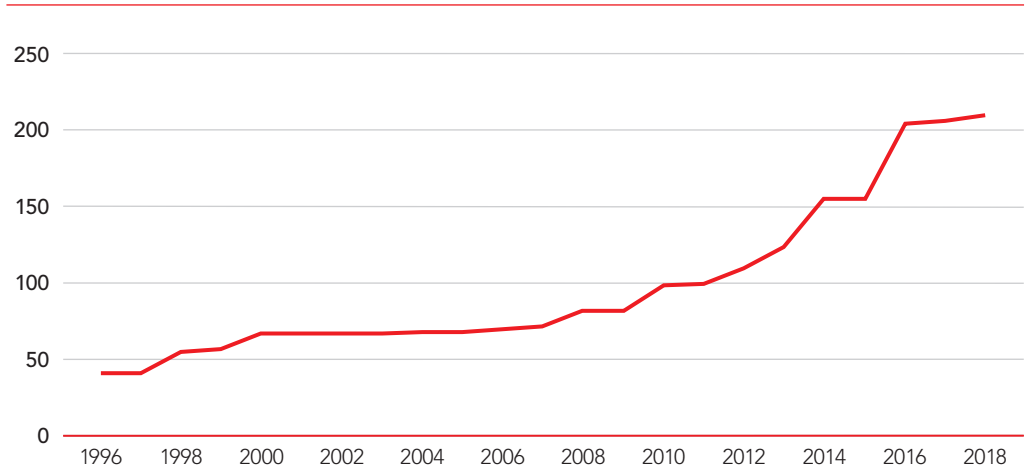
Background

Twenty-two years have passed since California voters passed Proposition 215, permitting the medical use of cannabis in the state. Since then, twenty-nine more states have followed California's lead,[1] with nine of those states and the District of Columbia also authorizing recreational cannabis use.[2] Legalization at the federal level seems inevitable, but predicting a timeline for meaningful, long-term congressional action has so far been a fool's errand.

In the meantime, cannabis growers, dispensaries, and ancillary service providers ("cannabis clients"), along with the professionals who represent them, are captive to the whims of each successive White House administration. Under President Obama, this meant assurances that the federal government would not interfere with state cannabis regimes pursuant to the Cole Memorandum, issued by the U.S. Department of Justice. President Trump, on the other hand, has offered no such assurances, and U.S. Attorney General Jeff Sessions rescinded the Cole Memorandum in January 2018.

Since 2014, however, Congress has continued to include a rider in appropriations bills precluding the use of federal funds to interfere with state medical cannabis programs, but the rider is silent on recreational cannabis. For any purpose, cannabis remains illegal under federal law despite legislation, investment, and rapidly expanding infrastructure at the state level. For attorneys, the cannabis industry presents an opportunity, but also potential ethical, legal malpractice, and even criminal liability risk.

Americans Living under Medical or Recreational Cannabis Regime (millions)



1 Medical cannabis states (30 & DC) with legalization year: AK (1998), AZ (2010), AR (2016), CA (1996), CO (2000), CT (2012), DE (2011), DC (2010), FL (2016), HI (2000), IL (2013), LA (2016), MD (2014), MA (2012), MI (2008), MN (2014), MT (2004), NV (2000), NH (2013), NJ (2010), NM (2007), NY (2014), ND (2016), OH (2016), OK (2018), OR (1998), PA (2016), RI (2006), VT (2004), WA (1998), WV (2017) Recreational cannabis states (9 & DC) with legalization year: AK (2014), CA (2016), CO (2012), DC (2014), ME (2016), MA (2016), NV (2016), OR (2014), VT (2018), WA (2012).

2 Recreational cannabis states (9 & DC) with legalization year: AK (2014), CA (2016), CO (2012), DC (2014), ME (2016), MA (2016), NV (2016), OR (2014), VT (2018), WA (2012).

Ethical Duties

The primary ethical consideration for attorneys representing cannabis clients is American Bar Association ("ABA") Model Rule 1.2(d), which prohibits attorneys from "counsel[ing] a client to engage, or assist[ing] a client, in conduct that the lawyer knows is criminal or fraudulent," but adds that "a lawyer may discuss the legal consequences of any proposed course of conduct with a client and may counsel or assist a client to make a good faith effort to determine the validity, scope, meaning or application of the law." This language has been incorporated into every state's version of Rule 1.2 with only slight variations.

Cannabis is illegal under federal law, and in the wake of state legalization efforts state and local bar associations grappled with the conflict between Rule 1.2 and the cannabis industry's need for legal services. With few exceptions, the majority of ethics opinions concluded that providing advice to cannabis clients is consistent with Rule 1.2 as long as the attorney also advises the client about related federal law and policy. Exactly what this disclosure might entail is discussed in the following section.

Beyond advice and counseling, the more difficult question is whether attorneys may ethically provide active assistance to cannabis clients, as in the preparation of applications or the drafting and negotiation of agreements. In response to the uncertainty on this issue, many jurisdictions have amended their versions of Rule 1.2 to include language, either in the rule itself or its commentary, specifically permitting attorneys to both advise and assist cannabis clients if the clients are also advised of federal law.[3] The Minnesota legislature addressed the issue even more directly, including language in the medical cannabis law itself shielding attorneys from discipline.[4]

As it stands, the risk of discipline under Rule 1.2 for providing legal services to cannabis clients seems remote, but almost all of the relevant opinions and amendments were issued while the Cole Memorandum was in effect. For example, Maryland's Comment 12 to its Rule 1.2 permits attorneys to provide legal services to cannabis clients, but does so only in the "narrow context" of the federal government's position of non-interference with the state's medical marijuana regime—a position the executive branch no longer holds. The State Bar of Arizona in Opinion 11-01 (2011) likewise authorizes attorneys to provide legal services to cannabis clients, but at the same time warns that "a change . . . in the federal government's enforcement policies could affect [its] conclusion." These statements underscore an attorney's duty to keep abreast of changes in cannabis policy and avoid relying too heavily on the status quo.

Attorneys should also be cognizant of ABA Model Rule 8.3(b), which defines attorney misconduct to include "commit[ting] a criminal act that reflects adversely on the lawyer's honesty, trustworthiness or fitness as a lawyer in other respects." In Opinion 14-02, the State Bar of North Dakota concluded that an attorney living in Minnesota, where medical marijuana is authorized under state law, but licensed in North Dakota, where it is not, would violate North Dakota Rule 8.3(b) by using cannabis even under medical supervision. Attorneys, therefore, must be mindful of differing priorities among the states as well as between each state and the federal government.

Protecting Yourself

Assuming an attorney renders professional services in a state where cannabis has been legalized in some form, what must the attorney tell the client about federal law and policy? And how might the conflict between state and federal law impact the representation and potentially give rise to a legal malpractice claim? Although the details of each disclosure will depend in part on the nature and scope of the representation, an attorney representing a cannabis client should explain the following:

Potential Legal Consequences

Cannabis is not truly "legal" anywhere in the United States. It is a Schedule I drug under the Controlled Substances Act, meaning that an individual or entity cultivating, distributing, or possessing cannabis is subject to fines or imprisonment. The U.S. Department of Justice has not granted immunity to any part of the cannabis industry even when acting in compliance with state law. At present, only an appropriations rider, requiring regular congressional approval, prevents the federal prosecution of cannabis businesses within medical cannabis regimes and, as previously noted, the rider is silent on recreational cannabis. This fragile détente could end at any moment, potentially exposing cannabis business owners, financiers, distributors, and outside vendors to federal prosecution.

3 See CO Rule 1.2, cmt. 14, CT Rule 1.2, cmt., IL Rule 1.2(d)(3), MD Rule 1.2, cmt. 12, NV Rule 1.2, cmt. 1, OH Rule 1.2(d)(2), OR Rule 1.2(d), PA Rule 1.2(e), VT Rule 1.2, cmt. 14, WA Rule 1.2, cmt. 18.
4 Minn. Stat. § 152.32, Subd. 2(i).

Risk to Confidentiality

In accordance with the crime-fraud exception to the attorney-client privilege, communications from a client to an attorney are not protected when made with the intention of furthering or concealing a crime. Thus, discussions with a client concerning assistance with a cannabis enterprise in contravention of federal law may not be privileged. In May 2017, for example, the San Diego District Attorney's office used this argument to justify a search of an attorney's client emails.[5] In response, the California legislature amended its codified crime-fraud exception the following January to exempt communications about legal services in compliance with state cannabis laws.[6] Other states have not yet addressed the issue directly and Federal Rule of Evidence 501, which governs privilege in federal claims, offers no such protection.

Limited Federal Access

In most ways, the cannabis industry is barred from federal programs and privileges, which presents a number of difficulties. In December 2017, the director of the Justice Department's Executive Office for U.S. Trustees declared that cannabis businesses have no right to bankruptcy proceedings. In a memorandum, the director explained that the problem extends beyond handling the cannabis itself: "a trustee who liquidated the fertilizer or equipment used to grow marijuana, who collected rent from a marijuana business tenant, or who sought to collect the profits of a marijuana investment" has violated federal law.[7]

Challenges abound in a wide range of practice areas. Registering a trademark with the USPTO requires a demonstration of lawful use in commerce, effectively precluding trademark protection for cannabis businesses, at least with respect to their core products and services. Section 280E of the federal tax code prohibits businesses from recording tax deductions or credits for income associated with cannabis, resulting in an effective tax rate in excess of seventy percent.[8] Commercial transactions are frustrated as the subject matter of a contract may be federally illegal, the primary collateral for a cannabis business is an illicit substance restricted to intrastate sale, and the few financial institutions willing to work with the cannabis industry are subject to onerous rules.

Insurance Coverage

A typical lawyers professional liability policy excludes coverage for criminal acts. Although the profession or business of an attorney's client is generally not relevant to a coverage determination, it is possible that an attorney facing a claim related to services for a cannabis client could face a coverage denial stemming from the policy's criminal acts exclusion. The legal context of cannabis in the United States is in constant flux, however, and coverage would depend on the specific facts and allegations of the claim, as well as the individual policy terms and conditions. Regardless, attorneys should understand the potential risk and convey it to their clients where appropriate.

Discussing these issues with a cannabis client at the client intake stage, and memorializing those communications in writing, are critical components in avoiding professional discipline and liability. Although the Cole Memorandum no longer offers clear federal guidance, from the client's perspective, developing and implementing a strict compliance program to ensure that jurisdictional rules and regulations are followed remains the best strategy for avoiding Justice Department scrutiny. Attorneys should advise their clients accordingly, and it is likely the Cole Memorandum provides accurate, if partial, insight into federal enforcement priorities.[9]

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5 Pishko, Jessica. "District Attorneys Gone Wild: The anti-marijuana San Diego prosecutor's office is out of control." *Slate*. 29 Sept. 2017.
6 See Cal. Evid. Code § 956.
7 White, Clifford J., III, Director, Executive Office for U.S. Trustees. **"Why Marijuana Assets May Not Be Administered in Bankruptcy."** 1 Dec. 2017.
8 Roff, Peter. "Weed Out the Tax Code: Tax reform offers a key chance to lift the costly burdens on legalized marijuana businesses." *U.S. News & World Report*. 16 Nov. 2017.
9 Cole, James M., **"Guidance Regarding Marijuana Enforcement."** 29 Aug. 2013.

Liability Exposure

Many attorneys have skillfully developed strategies to address the aforementioned challenges, but many more adopt a "gold rush" mentality, seeking to capitalize on an industry flooded with cash and eager for legal expertise. Just as money can be made in the cannabis industry, money can be lost, and if a cannabis client's misstep stems from reliance on faulty tax advice, a poorly drafted contract, or an overlooked change in state or federal cannabis policy, an attorney may be held liable for those losses.

In addition to civil liability, attorneys also risk criminal liability should federal enforcement priorities shift. While providing advice to a client would not likely result in prosecution, an attorney who has provided assistance to a cannabis client has technically aided and abetted a criminal enterprise, and an attorney who has accepted more than $10,000 in fees from a cannabis business could theoretically face federal money laundering charges. Even in the absence of a criminal conviction, fees of any amount are potentially subject to forfeiture under federal law due to their illegal source.

Conclusion

In today's climate, and after reflecting on the trajectory of cannabis legalization in the United States, it is hard to imagine the federal government defying public sentiment and dismantling what is already a ten-billion-dollar industry. Nevertheless, attorneys who represent clients in the cannabis arena must first develop the necessary expertise and carefully monitor developments in state and federal policy or risk facing professional discipline, a legal malpractice claim, or far worse.

This article was authored for the benefit of CNA by:
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