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Attorneys and Cannabis Clients: Know Your Risks

The tension between federal and state law creates potential risks for cannabis attorneys.

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As long as marijuana remains a Schedule 1 federally restricted drug, there are still significant risks for lawyers who work with cannabis clients.

In the past few years, almost every state in the country has legalized marijuana for medicinal and/or recreational use. Such new laws have created business opportunities for entrepreneurs, investors, and others—including attorneys, many of whom jumped into a new practice area of advising operators, growers, distributors, dispensaries, and other participants in the cannabis marketplace. However, marijuana remains a Schedule 1 restricted drug under the federal Controlled Substances Act, which prohibits the production, distribution, sale, use, and possession of marijuana. This tension between federal and state law creates potential risks for all those newly minted cannabis attorneys.

Combustion

The principle risk arises from application of the ABA's Model Rules of Professional Conduct, as exemplified by Model Rule 1.2, which provides thus: "A lawyer shall not counsel a client to engage, or assist a client, in conduct that the lawyer knows is criminal." For a discussion about Rule 1.2 and its implications for cannabis attorneys, as well as prudent advice on how to best comply with the rule, see "Advising the Cannabis Client" by Herrick K. Lidstone Jr. and Kylie R. Santos (2020).

Wrecked

Cannabis attorneys can be prosecuted under federal law. While an attorney acting in compliance with Rule 1.2 (or its equivalent in your state) should not be subject to discipline by the applicable state bar for advising cannabis clients in states where the activities of such clients are not criminal, an attorney can still be subject to prosecution under federal law for, among other things, aiding and abetting the client's violation of federal law (18 U.S.C. § 2), engaging in a federal criminal conspiracy (18 U.S.C. § 371; 21 U.S.C. § 846), or even possession of marijuana for personal use (21 U.S.C. § 844(a)).

And conviction under federal law could constitute misconduct, which in turn may result in state bar discipline. ABA Model Rule 8.4 (Misconduct) provides that it is "professional misconduct for a lawyer to . . . commit a criminal act that reflects adversely on the lawyer's honesty, trustworthiness, or fitness as a lawyer in other respects." As a result, even in a state where marijuana has been legalized, there remains the possibility that an attorney may be disciplined, not necessarily for legal advice given (due to Rule 1.2 or its equivalent in your state) but for conviction of a federal crime.

Cashed

Although a number of banks now accept business from the cannabis industry, many banks do not allow for the deposit of funds that are received from a business operated in violation of federal law. Under ABA Model Rule 1.15 (Safekeeping Property), advance fee retainers paid to an attorney must be deposited into a separate trust fund account. In many states, the attorney's trust fund account must be maintained at a bank or other qualifying financial institution. For attorneys working with cannabis clients, the fact that their bank won't accept funds derived from activities that "touch the plant" is no excuse for failing to comply with Rule 1.15. And failure to disclose the purpose of the account, when the attorney knows of the bank prohibition, may constitute misconduct that, in turn, may result in state bar discipline. ABA Model Rule 8.4 (Misconduct) also provides that it is "professional misconduct for a lawyer to . . . engage in conduct involving dishonesty, fraud, deceit or misrepresentation." *See People v. Furtado*, No. 15PDJ056 (Colo. 2015).

In addition, an attorney accepting funds derived from a cannabis business operating in violation of federal law may face possible exposure for money laundering and forfeiture. By accepting a payment of more than $10,000 that the attorney knows came from an unlawful cannabis business, the attorney may be committing a federal money laundering crime, which makes the funds subject to forfeiture. 18 U.S.C. §§ 981(a)(1)(A), 1957.

Up in Smoke

Standard attorney professional liability insurance policies have an exclusion for criminal acts committed by an insured attorney. The insurance carrier may deny coverage under such an exclusion if the attorney participates in a federal crime, such as those referenced above.

Further, if, because of such an exclusion, the attorney knows or reasonably should know that his or her insurance coverage may not extend to matters handled for a cannabis client, the failure of the attorney to disclose such fact to the client may constitute a violation of ABA Model Rule 1.4 (Communications), which requires an attorney to "keep the client reasonably informed about the status of the matter." Some states go further and expressly mandate that the attorney inform a client in writing if the attorney does not have

professional liability insurance. *See, e.g.*, Cal. Rules of Prof'l Conduct r. 1.4.2 (Disclosure of Professional Liability Insurance).

Secret Stash

Attorneys are obligated to not reveal confidential information of their clients. *See* Model Rules of Prof'l Conduct r. 1.6 (Confidentiality of Information). In addition, confidential communications between a lawyer and a client are generally subject to protection pursuant to the attorney-client privilege. Most states, however, have a "crime-fraud exception" to the attorney-client privilege, which generally provides that there is no attorney-client privilege if the attorney's services are obtained to help the client plan or commit a crime. *See, e.g.*, Cal. Evid. Code § 956(a).

Some of the states that have now legalized marijuana have effectively revised their version of the crime-fraud exception to address the tension between state and federal law relating to cannabis. For example, California Evidence Code section 956 was recently amended to provide that the crime-fraud exception "shall not apply to legal services rendered in compliance with state and local laws on medicinal cannabis or adult-use cannabis."

However, the crime-fraud exception reflected in Federal Rule of Evidence 501 does not carve out advice provided to cannabis clients; and where federal law governs a claim of privilege, federal courts do not apply state law privileges. As a result, the federal crime-fraud exception may apply to an attorney's communications with cannabis clients—in other words, such communications would be discoverable in a dispute involving claims governed by federal law in a federal court.

Green Out

Lawyers and law firms advising cannabis clients may be precluded from utilizing the protections afforded by federal bankruptcy law in the event that their businesses become insolvent. The law is clear that businesses that grow or sell cannabis may not take advantage of federal bankruptcy law because, after filing their bankruptcy cases, such entities continue to operate in violation of federal law.

A 2018 federal bankruptcy case extended this preclusion to debtors not directly engaged in a cannabis business. In *In re Way to Grow, Inc.*, a federal bankruptcy case in Colorado (where recreational use is legal), the debtors were businesses that did not "touch the plant" but rather provided consulting services and sold equipment to cannabis growers and distributors for the purpose of enabling such entities to produce or distribute cannabis. The court noted that because the debtors were not growers or dispensers of marijuana, its inquiry needed to focus upon whether the debtors had a specific intent to enable their customers to engage in an activity that violated federal law. The court found that the

debtors had actual knowledge that they were selling equipment used to manufacture a federally controlled substance, and that the debtors would not have a viable business without their clientele in the cannabis industry. On that basis, the court determined that it was compelled to order a dismissal of the bankruptcy cases. *In re Way to Grow, Inc.*, Case No. 18-14330-MER (Bankr. D. Colo. Dec. 14, 2018) (Dkt. No. 379).

The same rationale may apply to lawyers and law firms that focus on advising cannabis clients that engage in businesses that violate federal law.

The Blunt Reality

Even in those states where marijuana has been legalized, as long as marijuana remains a Schedule 1 federally restricted drug, there are still significant risks for lawyers who work with cannabis clients.

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