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PERSPECTIVE

RICO claim dismissal pushes cannabis cultivators off the tightrope

By Priya Sopori

Those in the cannabis business walk a tightrope in California. Businesses must stay balanced entirely on state law. Any misstep into federal interstate commerce risks criminal jeopardy. But if a business does walk that line, pay its taxes, and obtain its licenses, which protections of federal laws can it receive? Not a civil RICO action, according to a recent Ninth Circuit decision.

In *Shulman v. Kaplan, et al.* No. 20-56256, 2023 U.S. App. LEXIS 1093 (9th Cir. Jan 18, 2023), the Plaintiff Shulman alleged she had been a successful farmer for 20 years, beginning with organic fruits and vegetables and later expanding into cannabis cultivation. She claimed to have been defrauded by the Defendants, resulting in losses to her business. Her complaint included a RICO claim. The Defendants moved to dismiss, arguing those in the cannabis business lacked standing in federal courts to bring RICO claims. The District Court, the Honorable Andre Birotte, Jr. presiding, agreed and dismissed the claim together with the pendent state law claims.

Under RICO, an acronym for Racketeer Influenced and Corrupt Organization Act, "[a]ny person injured in his business or property by reason of a violation" of the act, may bring an action to recover treble damages and attorneys' fees. No court had previously decided whether a cannabis business – legal under state law but illegal under the federal Controlled Substance Act – has standing to bring an action under RICO – at least neither the parties nor the court cited any such precedent. The few cited federal cases that involved cannabis did not raise RICO claims. In *Siva Enterprises v. Ott*, No. 2:18-cv-06881-CAS-GJSx, 2018 WL 6844714 (C.D. Cal. Nov. 5, 2018), Plaintiffs alleged misappropriation of proprietary business information and Plaintiffs' identity and reputation. The court held that there was no conflict between the Plaintiffs' claims and federal law as the "plaintiffs [were] not seeking a remedy that would compel either party to violate the Controlled Substances Act."

In two cases, employees of cannabis businesses were permitted to bring claims under the federal *Fair Labor Standards Act. Kenney v. Helix TCS, Inc.*, 939 F.3d 1106 (10th Cir. 2019) and *Greenwood v. Green Leaf Lab LLC*, No. 3:17- CV-00415-PK, 2017 WL 3391671 (D. Or. July 13, 2017).

The Defendants cited *J. Lilly, LLC v. Clearspan Fabric Structures Int'l, Inc.*, No. 3:18-CV-01104-HZ, 2020 WL 1855190 (D. Or. Apr. 13, 2020), but it too did not concern a RICO claim. There, Plaintiff had filed a breach of contract action seeking to recover lost profits. The claim for lost profits was summarily adjudicated in the Defendant's favor because that relief would require an order that Defendant pay for marijuana plants in violation of federal law.

Notably, the Ninth Circuit did not rely on any of the cannabis cases cited by either party, or even discuss them. Instead, the Court first determined whether the Plaintiff had "Article III standing" – that is, whether, *inter alia*, any remedy would contravene federal law. The Court held that the district court could fashion a remedy that would redress the alleged injury. "The fact that Appellants seek damages for economic harms related to cannabis is not relevant to whether a court could, theoretically, fashion a remedy to redress their injuries."

Having addressed the threshold issue of Article III standing, the next issue was statutory standing. RICO permits recovery for injury to "business or property." The Ninth Circuit reasoned that the statute's use of the term "business or property" "must encompass businesses and property engaged in the cultivation, sale, and marketing of cannabis – an enterprise that is legal under California law, but illegal under federal law."

The Court concluded that "looking to RICO as a whole," it is clear that Congress did not intend "business or property" to cover cannabis-related commerce. The Court pointed out that RICO defined "racketeering activity" to include dealing in cannabis. It would be inconsistent, the Court said, for RICO to permit recovery for injury to a business that was illegal under RICO.

The Court's conclusion is logical assuming the phrase "business or property" in RICO was interpreted to include all the illegal activities identified in RICO. But a contrary interpretation would also have been logical. When Congress was referring to "business or property" it was referring to legal businesses. In referring to illegal activity, it said "racketeering." The Ninth Circuit acknowledged that RICO did not

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define "business or property." It would have been reasonable to look to state law even though the court was not "required" to do so – to determine what constitutes a "business."

The Ninth Circuit noted that RICO was enacted the same year as the Controlled Substance Act. The Court said, "Considering the laws in tandem, it is evident that Congress would have considered a cannabis business to be a form of organized crime and Congress would not have intended RICO to provide damages for injury to interests in which it explicitly disclaimed the existence of any property rights." Preliminarily, it is not "evident" at all what Congress considered in passing the two separate laws. It seems unlikely that Congress would have meticulously scrutinized and cross-referenced the multitude of bills it enacts each year such that any inference of intent can be drawn merely because two bills are passed the same year. In any event, RICO does not "explicitly disclaim" the existence of property rights in any business. As the Court stated, RICO does not define "business or property" at all. For that matter, it does not explicitly state whether lawful business under state law is simultaneously "racketeering activity" under federal law. There were no lawful cannabis businesses in 1970. Back then, students were shown the 1936 film *Reefer Madness*.

Moreover, the purpose of civil RICO is to provide remedies for those injured by a pattern of wrongdoing. Not remedying a wrong because of an unrelated wrong proves the old adage: "two wrongs do not make a right," and the party operating legally under state law is denied a remedy against a party that was allegedly defrauding it under both state and federal law.