The Limits of Marijuana Legalization in the States

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I. INTRODUCTION

Marijuana regulation in the United States is in a period of unprecedented flux. While the federal government continues to list marijuana as a Schedule I narcotic under the Controlled Substances Act ("CSA")—a drug whose manufacture and sale is a felony punishable by up to life in prison—many states are starting to treat the drug quite differently. The last twenty years have seen an increasing number of states “legalize” marijuana for medical purposes—removing the criminal penalties for those using the drug pursuant to a doctor’s recommendation and setting up regulatory regimes under which qualifying patients may purchase and possess the drug.

This increasingly differential treatment of marijuana under state and federal law creates significant legal uncertainty. The reason for the scare quotes in the previous paragraph, of course, is that states cannot simply legalize that which the federal government prohibits. While a state may remove its own marijuana prohibition and may even create a regulatory

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system under which licensed dispensaries sell marijuana to those who can show a medical need, a state is powerless to insulate its citizens from the threat of federal law enforcement. Also hanging over the states is the specter of federal preemption—the possibility that the federal government will sue in federal court to enjoin the states’ attempts to tax and regulate marijuana on the basis that federal law preempts such state action.²

II. OVERVIEW OF RECENT DEVELOPMENTS

The Obama administration has repeatedly attempted to clarify the legal status of state legalization efforts, but these attempts have often led to far more confusion than certainty. For example, in 2009, Deputy Attorney General David Ogden stated in a memorandum to U.S. Attorneys that individuals or entities operating in clear and unambiguous compliance with state medical marijuana laws were not an appropriate target of federal law enforcement actions.³ This statement led to an explosion in the number of medical marijuana dispensaries opening in Colorado and elsewhere as medical marijuana practitioners read the memo, either sincerely or optimistically, as a major change in federal policy.

Predictably, the expansion of marijuana retailing in the states led to a federal backlash. In 2010, as California prepared to vote on a full legalization initiative—a measure that would have made marijuana legally available to all those over the age of 21, not just those with a medical recommendation⁵—Attorney General Eric Holder publicly voiced his opposition to the measure. He made clear that the CSA was still the law of the land and that any attempt to extend marijuana legalization beyond medical patients would be met with a full federal crackdown.⁶ The following

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². The anti-commandeering doctrine would prevent the federal government from forbidding the states from repealing their own marijuana prohibitions or requiring the states to pass such prohibitions. See New York v. United States, 505 U.S. 144, 162 (1992) (“While Congress has substantial powers to govern the Nation directly, including in areas of intimate concern to the States, the Constitution has never been understood to confer upon Congress the ability to require the States to govern according to Congress’ instructions.”).

³. Memorandum from David W. Ogden, Deputy Attorney Gen., to Selected U.S. Attorneys 2 (Oct. 19, 2009), available at http://www.justice.gov/opa/documents/medical-marijuana.pdf (“[P]rosecution of individuals with cancer or other serious illnesses who use marijuana as part of a recommended treatment regimen consistent with applicable state law, or those caregivers in clear and unambiguous compliance with existing state law who provide such individuals with marijuana, is unlikely to be an efficient use of limited federal resources.”).


year, Deputy Attorney General James Cole, Ogden’s successor, issued a memo stating that the Ogden Memo had been misread by those who saw it as a green light to begin large-scale cultivation and sale of marijuana:

[W]ithin the past 12 months, several jurisdictions have considered or enacted legislation to authorize multiple large-scale, privately-operated industrial marijuana cultivation centers. Some of these planned facilities have revenue projections of millions of dollars based on the planned cultivation of tens of thousands of cannabis plants.

The Ogden Memorandum was never intended to shield such activities from federal enforcement action and prosecution, even where those activities purport to comply with state law. Persons who are in the business of cultivating, selling or distributing marijuana, and those who knowingly facilitate such activities, are in violation of the Controlled Substances Act, regardless of state law.7

Following the Cole Memo, U.S. Attorneys used prosecution and threats of prosecution to shut down a number of marijuana businesses operating under state law throughout the country.8

It would seem, though, that events on the ground quickly outstripped the pace of policy pronouncements from the nation’s capital. In 2012, Colorado and Washington passed legalization initiatives similar to the one rejected in California two years earlier while the federal government remained silent.9 The governors of both states quickly sought guidance from the Justice Department regarding whether the federal government would take steps to block the implementation of the new laws.10 Months of frustrating silence passed without an answer.


8. As I have pointed out elsewhere, federal enforcement was anything but uniform; it was concentrated in those states without robust medical marijuana regulatory regimes. See Kamin, supra note 4, at 987–88. States like Colorado that had such regimes in place largely escaped federal attention. Id. at 988.


Finally, on August 29, 2013—nearly ten months after the passage of the Colorado and Washington initiatives—Cole wrote yet another memo attempting to clarify the legal status of the new laws. In what I have described elsewhere as a major change in federal policy, Cole made clear that the Justice Department would not immediately intervene to block the licensing of recreational marijuana operations in both states, licensing which will now almost certainly go into effect in 2014. While the second Cole Memo kept open the possibility of federal enforcement down the road if the states’ regulation of marijuana was insufficiently robust, it also took the novel step of announcing that those states that wished to regulate marijuana would be largely left alone to handle it on their own. So long as the states regulated marijuana in a way that addressed federal concerns, the Justice Department would not enforce the federal prohibition of marijuana, either civilly or criminally in those states. The second Cole Memo also made clear that the previous bright-line distinction that the federal government had drawn between medical and recreational marijuana legalization would no longer govern enforcement decisions; instead, what mattered crucially was the capacity of a state to minimize the negative externalities of marijuana through robust regulation.

III. CONTINUED TENSION BETWEEN STATE AND FEDERAL MARIJUANA POLICY

As welcome as the second Cole Memo was to those working to regulate marijuana in Colorado and Washington (and to those advocating the repeal of state marijuana prohibitions more generally) it did not end the state–federal tension over marijuana regulation. Even if the federal government promises—in a non-binding way—to forestall enforcement of the CSA in those states enacting rigorous regulations, doing so only eases the most obvious tensions between state and federal law in this area. So long as the federal prohibition remains in place, state policy aimed at removing the

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13. See, e.g., Cole Memo II, supra note 11, at 2–3 (noting the potential for regulatory regimes in such states to further federal enforcement objectives).

14. Id. at 3 (“If state enforcement efforts are not sufficiently robust to protect against the harms set forth above, the federal government may seek to challenge the regulatory structure itself in addition to continuing to bring individual enforcement actions, including criminal prosecutions, focused on those harms.”).

15. Id. at 1–2 (distribution to those not authorized to purchase it, the involvement of organized crime, the use of weapons, the distribution of other illicit substances, etc.).

16. Id. at 3.
impediments to the taxation and regulation of marijuana will necessarily be hamstrung.

Professor Leff’s recent article in the *Iowa Law Review* provides a prime example of the ongoing state–federal tension. He demonstrates the difficulty that a Reagan-era tax provision can pose to marijuana professionals, even to those who do not currently fear arrest or forfeiture of their assets under the CSA. Section 280E of the Internal Revenue Code makes the running of a marijuana business nearly impossible. As Leff points out, § 280E forbids these operators from deducting operating expenses, except the price of the goods themselves, from their taxes. As a result, marijuana practitioners are disadvantaged not just vis-à-vis other legitimate businesspersons but also vis-à-vis those involved in other, more serious, criminal conduct. As Leff points out, the assassin for hire is able to deduct the price of her sniper rifle while the marijuana retailer cannot deduct the cost of paying her employees.

Leff’s solution, which he takes pains to say is not a “loophole,” is clever. Leff’s thesis, that marijuana businesses that cannot qualify as 501(c)(3) corporations might qualify as 501(c)(4) corporations, seems both novel and inventive. What is more, Leff makes a very important point about giving marijuana practitioners incentives to comply with the law: if participation in a legal, regulated marijuana market is made too onerous, many practitioners will remain (or return) underground, society will lose out as tax revenues will not be collected, and the goal of moving marijuana distribution from street corners to regulated dispensaries will be defeated.

However, as the focus of legalization efforts in the states shifts from medical marijuana to recreational or adult-use marijuana, the argument loses some of its currency. While medical marijuana businesses have at least a colorable argument that they are doing good—for both their communities and their patients—it is difficult to see how businesses selling mind-altering substances to anyone of legal age, regardless of medical need, can make the same claim. Unless one can imagine a liquor store in a disadvantaged neighborhood qualifying as a 501(c)(4) non-profit, it is hard to see how a marijuana dispensary would be able to make the same claim. While it is true that adult-use dispensaries will face many of the same tax difficulties that

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18. *See, e.g.*, 21 U.S.C. § 881(a)(7) (2012) (describing as subject to forfeiture “[a]ll real property, including any right, title, and interest (including any leasehold interest) in the whole of any lot or tract of land and any appurtenances or improvements, which is used, or intended to be used, in any manner or part, to commit, or to facilitate the commission of, a violation of this subchapter punishable by more than one year’s imprisonment”).
20. Id. at 532–33.
21. Id. at 533 n.42.
22. Id. at 528.
medical marijuana businesses do—here, the inability to deduct most business expenses—their ability to claim a tax exemption under § 501 (c)(4) will be significantly impaired. If medical marijuana is, as I suspect, the awkward adolescent of marijuana law reform, I worry that Leff’s solution will become increasingly less relevant to marijuana practitioners going forward.

My expertise is in constitutional law and federal courts, not in tax; I cannot speak to the wisdom or plausibility of his solution as a matter of tax law. For me, though, the strength of Leff’s article is that it highlights the hoops that scholars and lawmakers must jump through to accommodate a state’s decision to legalize what the federal government continues to condemn. And it is important to see that this is as true after the second Cole Memo as it was before. If that memo removed—at least for now or for the duration of this administration—the threat that those engaged in the regulated marijuana industry would be sent to prison or would forfeit all of their capital and assets, the continuing existence of a de jure federal prohibition has the effect of unsettling the expectations of marijuana providers and customers in myriad and unexpected ways. Below I provide an illustrative, if not exhaustive, list of these difficulties.

A. Employment

Three recent Colorado cases—one from federal court and two from state court—illustrate the hazards of marijuana being legal under Colorado law, but prohibited under federal law. First, in Coats v. Dish Network, the Colorado Court of Appeals upheld the firing of a quadriplegic medical marijuana patient who had tested positive for marijuana during company-ordered screening. The employer, a national satellite television provider, terminated the employee on the grounds that he violated a company-wide policy prohibiting its employees from using illicit substances whether on the job or off. In response, the employee argued that his termination violated Colorado’s lawful off-duty conduct statute, which prohibits employers in this at-will employment state from firing employees for engaging in lawful conduct while off-duty. As a registered marijuana patient, the employee argued that his use of the drug was lawful and his termination violated the statute designed to protect him. A divided court of appeals panel held that marijuana use was not in fact lawful conduct under the statute because of the continued federal prohibition. Several months later, a Federal District Court for the District of Colorado came to a similar conclusion in Curry v.

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24. Id. at 149.
25. Id.
26. Id. at 150–51 ("[B]ecause activities conducted in Colorado, including medical marijuana use, are subject to both state and federal law... for an activity to be ‘lawful’ in Colorado, it must be permitted by, and not contrary to, both state and federal law." (internal citation omitted)).
THE LIMITS OF MARIJUANA LEGALIZATION IN THE STATES

MillerCoors, Inc. To make matters worse for employees in these situations, a different panel of the Colorado Court of Appeals held that an employee terminated for testing positive for marijuana may, for that same reason, be denied unemployment benefits, notwithstanding Colorado’s law purporting to decriminalize marijuana use.28

While these results clearly frustrated the intent of Colorado voters in seeking to remove the penalties attendant to marijuana use,29 both the state and federal courts considering the interaction of state employment law with the federal marijuana prohibition were simply unwilling to overlook the inconvenient fact that possessing marijuana is not legal. As we shall see in the examples that follow, this fact continues to have salience, even as the administration distances itself from the possibility of enforcing that law in states with robust marijuana regulations.

B. PROBATION OR PAROLE

Using similar logic, courts have held that possession of marijuana by a probationer or a parolee, even one who is a registered marijuana patient, can be grounds for the revocation of the terms of release.30 For example, a Colorado statute explicitly requires that probations include the condition “that the defendant not commit another offense.”31 In People v. Watkins, the Colorado Court of Appeals held, as a matter of first impression, that this provision precluded a judge from permitting a medical marijuana patient to use marijuana while on probation.32 The Watkins court used analysis similar to that employed by the Coats and Curry opinions.33 It reasoned that while a probationer who is a medical marijuana patient is not breaking any state laws by obtaining and using marijuana, she is nonetheless committing another offense (a federal one) by doing so.34 Although courts around the country appear to be split on this matter,35 in a state that requires that probationers comply with all state and federal law, it is difficult to see how a judge can
ignore the fact that a medical marijuana patient who seeks to continue taking the drug is unable to comply with that requirement.

C. CONTRACT

Contracting is fundamental to any successful business. Modern businesses rely on enforceable contracts to facilitate every aspect of their operations—everything from leases to employment agreements to obtaining materials requires the predictability and certainty that contracting provides. When a business’s every transaction violates federal law, however, the certainty that contract law is supposed to provide is necessarily called into question. Perhaps the most public example is a contract suit decided in Arizona state court in 2012. Two Arizona citizens lent $250,000 each to a Colorado marijuana dispensary. When the dispensary defaulted on the loan, the Arizona citizens sought to enforce the loan agreement. On summary judgment, the trial court dismissed the suit:

The explicitly stated purpose of these loan agreements was to finance the sale and distribution of marijuana. This was in clear violation of the laws of the United States. As such, this contract is void and unenforceable. This Court recognizes the harsh result of this ruling. Although Plaintiffs did not plead any equitable right to recovery such as unjust enrichment, or restitution, this Court considered whether such relief may be available to these Plaintiffs. Equitable relief is not available when recovery at law is forbidden because the contract is void as against public policy. . . . The rule is that a contract whose formation or performance is illegal is, subject to several exceptions, void and unenforceable. But this is not all, for one who enters into such a contract is not only denied enforcement of his bargain, he is also denied restitution for any benefits he has conferred under the contract.39

It is important to note that the court held not simply that the plaintiffs could not collect under the terms of the agreement but that they could not collect on any equitable theory either; they were out $500,000 with no remedy at all. The Court seemed aware that its holding would have the perverse result of enriching the very marijuana business federal law purports to disfavor, but believed itself to have no choice but to find the contract unenforceable.41

37. Id. at 2.
38. Id.
39. Id. at 4 (internal citations omitted).
40. Id.
41. Id. (“This Court recognizes the harsh result of this ruling.”).
Of course, the unenforceability of contracts made with marijuana businesses is far from an unalloyed good for the industry more generally. In practice it means that it is virtually impossible for marijuana businesses to order their affairs in the same way that other businesses can. Even marijuana businesses that are licensed and doing business subject to heavy state regulation are denied the same sort of full corporate citizenship that other enterprises take for granted.

D. Banking

One of the most universally acknowledged problems with the current state of affairs, however, is the difficulty that marijuana businesses have in obtaining basic banking services. In his 2011 enforcement memorandum, Deputy Attorney General Cole warned financial institutions against knowingly engaging in transactions with those known to be violating the CSA:

State laws or local ordinances are not a defense to civil or criminal enforcement of federal law with respect to such conduct, including enforcement of the CSA. Those who engage in transactions involving the proceeds of such activity may also be in violation of federal money laundering statutes and other federal financial laws.

Not surprisingly, financial institutions responded to this explicit threat by severing ties with the marijuana industry; those few federally-insured banks that had previously been willing to provide services to the industry ceased to do so.

This is more than a mere inconvenience for those in the industry. It is an impediment to those states that have adopted a public policy of regulating and taxing marijuana like alcohol. If marijuana exists as a cash only business, the risk of illegal diversion and non-payment of taxes is necessarily magnified. Perhaps more crucially, preventing marijuana businesses from engaging in mundane banking transactions creates a self-fulfilling prophecy. If marijuana is a cash business, it will continue to be one that exists at the borders of legality. Marijuana businesses will be a target for criminals who know full well that such businesses are sure to have large amounts of cash on hand. Inevitably, marijuana businesses will become


associated with higher crime rates and the federal government will be justified in cracking down upon it.

For these reasons and others, both state regulators and representatives from states legalizing marijuana have placed a priority on solving the banking question. In an acknowledgment that the states alone cannot solve this conundrum, the governors of Colorado and Washington recently wrote to the Department of Justice asking for federal assistance in allowing licensed marijuana establishments to gain access to bank services. While some of the problems discussed above might be remediable through changes in state law—for example by an express provision that those on probation are entitled to use medical marijuana—banking problems, along with the taxation problem addressed by Professor Leff in his article, simply require a change at the federal level. There is only so much the states can do on their own.

IV. CONCLUSION

As I hope I have shown, the issue raised by Professor Leff and the difficulties faced by running a marijuana business in the light of the continuing federal prohibition are profound. Mechanisms can be created, like the one suggested by Professor Leff for organizing marijuana dispensaries as 501(c)(4) rather than 501(c)(3) nonprofits, that mitigate some of the absurdities and difficulties that typify the state of the law at the moment. Try as we might to mitigate these consequences, the bottom line is that they all follow directly from the fact that the states are trying to legalize that which it is not within their power to legalize. The only solution to this conundrum is a change in federal law; so long as marijuana remains illegal under the Controlled Substances Act, state marijuana policy will inevitably be frustrated.

46. Id.