

Bank Fraud for Facilitating Marijuana Transactions

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A recent guilty conviction, after a jury trial, shows how complex and fraught the zigzag path to marijuana legalization is in the payments space. At a time when the federal government has signaled that criminal prosecutions in states that have legalized marijuana are a low to non-existent priority, this prosecution highlights that federal criminal authorities will not hesitate to prosecute bank fraud that involves transaction laundering or other attempts to disguise the source of payments or the true nature of a transaction. This case underscores the importance for banks to maintain reasonably designed AML compliance programs to protect themselves from becoming unwitting vehicles for illicit activity. These programs may not thwart all criminal activity but, at the very least, they can provide a defense to potential regulatory and criminal liability.

A U.S. Southern District of New York jury convicted two individuals of conspiracy to commit federal bank fraud. The transaction laundering scheme related to a California-based company that provides a website and phone app for on-demand delivery of marijuana products. While an increasing number of states, including most recently New York and New Mexico, have legalized marijuana, it remains a controlled substance under the federal Controlled Substances Act,¹ and financial institutions that provide services to marijuana-related businesses have stringent due diligence and suspicious activity reporting obligations under the Bank Secrecy Act.² Consequently, most banking institutions and credit card companies maintain policies that prohibit providing financial services to marijuana-related businesses.³ In light of these limitations from financial services sector, the two individuals were indicted for devising and implementing a scheme that deliberately misled banking institutions and card companies into processing over \$150 million in debit and credit card transactions for the marijuana-related company.⁴

¹ 21 U.S.C. § 812.

² Financial Crimes Enforcement Network, FIN-2014-G001, BSA Expectations Regarding Marijuana-Related Businesses (Feb. 14, 2014).

³ As of the end of 2020, FinCEN reported that there were only 684 financial institutions providing banking services to cannabis-related businesses.

⁴ Earlier in the court proceedings, the defendants had motioned to dismiss the indictment by invoking the Rohrabacher-Farr Amendment, a congressional appropriations rider that prohibits the Department of Justice from using funds to prevent states that have legalized medical marijuana from implementing their medical marijuana laws. The court denied the motion because the defendants had been charged not with a Controlled Substances Act violation but instead with bank fraud, which the court concluded was not protected by the Rohrabacher-Farr Amendment or the Ninth Circuit's McIntosh decision.

The facts may be helpful to those who are analyzing whether the case might have an impact on their own situation. A credit card transaction between a merchant and a consumer typically goes through three intermediaries: the merchant's bank, consumer's bank and card network. After a consumer initiates the payment, (1) the consumer's bank approves sending payment through the card network, (2) the card network forwards payment to the merchant's bank and (3) the merchant's bank approves sending payment to the merchant. The prosecution alleged that because the intermediaries would have declined transactions where the merchant is known to be a marijuana-related business, the two individuals established fictitious companies that pretended to sell dog products, face creams, green tea and diving gear, all with the goal of obscuring the actual identity of the marijuana-related company. These fake merchants were supported by bank accounts and websites, which did not mention marijuana or the actual marijuana-related company. Website traffic was also generated to create the impression that the fictitious businesses engaged with real customers. To further facilitate the scheme, the two individuals coordinated with others to provide false information about the transactions between the merchant bank and the card network. The information included false merchant category codes to describe the merchant's products and services.

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