The Risk of RICO Claims Against Cannabis Businesses, and Potential Defenses

The Racketeer Influenced and Corrupt Organizations Act (RICO) was designed to prevent mobsters from infiltrating legitimate businesses. Famously defined as the litigation equivalent of a thermonuclear device, a plaintiff in a RICO suit can recover treble damages and attorneys' fees. While federal courts have yet to enter any judgments against cannabis businesses facing RICO claims, it appears that RICO claims will continue to be asserted in litigation against cannabis growers and sellers. Part I of this Article discusses the necessary components of a RICO suit and explores some recent RICO cases unsuccessfully pursued against cannabis industry participants. The majority have not succeeded due to a failure to properly allege injury. Part II explains what types of arguments can be expected in the next waves of RICO litigation, and what decisions in RICO cases involving other industries suggest about whether plaintiffs will be able to plead injury.

I. Civil RICO Overview and Recent Cases Against Companies in the Cannabis Industry

Civil RICO cases have strict pleading requirements. One of the strictest is that RICO plaintiffs must allege that a defendant is committing a pattern of predicate offenses associated with a commercial enterprise. *See* 18 U.S.C. §§ 1961-62. Thus far, federal courts have concluded that operating a marijuana business qualifies as "dealing in a controlled substance . . . as defined in section 102 of the Controlled Substances Act," even in states that have legalized recreational marijuana. *See, e.g.*, *Safe Streets Alliance v. Hickenlooper*, 859 F.3d 865, 882 (10th Cir. 2017).

Fortunately for defendants, RICO has further pleading requirements. RICO confers standing upon "[a]ny person injured in his business or property by reason of a violation of section 1962 of this chapter. . . ." 18 U.S.C. § 1964(c). Courts read this statute as requiring a plaintiff to make two separate showings: 1) that the plaintiff suffered an injury to business or property, and 2) that the plaintiff's injury was proximately caused by the defendant's RICO violation. *Maio v. Aetna, Inc.*, 221 F.3d 472, 483 (3d Cir. 2000). Showing injury requires proving a concrete financial loss. This concrete loss requirement has often prevented plaintiffs from prevailing in RICO cases. The decisions discussed below show instances in which plaintiffs have failed to convince judges or juries that the operations of cannabis businesses have sufficiently injured their businesses or properties:

In *Ainsworth v. Owenby*, residential property owners in Oregon brought an action against neighboring landowners who allegedly maintained a marijuana production and processing operation on their land. *Ainsworth v. Owenby*, 326 F. Supp. 3d 1111, 1115 (D. Or. 2018). In August 2018, the District Court dismissed the action, saying plaintiffs failed to allege concrete financial loss with respect to the fair market value of the property. *Id.* at 1126. The court declined, however, to embrace defendants' argument that a RICO complaint must contain specific allegations of attempts to rent, sell, or otherwise monetize the property interest; instead, the court said that a plaintiff who has not alleged specific prior attempts to monetize a property interest must "plausibly allege at least a present intent or desire to do so." *Id.* at 1125. Plaintiffs subsequently amended their complaint to allege that their property value was depressed and they were unable to obtain a larger home equity loan. *Ainsworth v. Owenby*, 2019 WL 1387681 at *1 (D. Or. Mar. 27, 2019). The court rejected this argument. Because plaintiffs received a smaller loan, the court reasoned, they were placed in a *stronger* financial position than they otherwise would have been as they had less debt on a lower principal. *Id.* at *2. The court contrasted this with impacts that would seem to qualify as concrete financial losses, such as if plaintiffs were charged a higher interest rate, or offered the same loan on less favorable terms. *Id.*

In *Safe Streets Alliance v. Hickenlooper*, two landowners in Pueblo County, Colorado claimed that the smell from a nearby marijuana grow reduced their property's value. *Safe Streets Alliance v. Hickenlooper*, 859 F.3d at 879-80. The District Court dismissed the case, describing plaintiffs' claims as based on mere emotional or personal injuries. *Id.* at 885. The Tenth Circuit reversed. The court first ruled that operating a marijuana cultivation facility "necessarily would involve *some* racketeering activity," providing a RICO predicate act. *Id.* at 882. The court then ruled that plaintiffs had plausibly pled an injury to their property through their nuisance and diminution of value charges. *Id.* at 886-88. The panel held that the plaintiffs had plausibly pled an injury to their property rights via the nuisance charges based on the "noxious odors" from the marijuana. *Id.* at 886. The panel held that plaintiffs had plausibly pled the diminution of value charges based on the psychological effects of a neighboring property buyer knowing they were purchasing land "abutting an openly operating criminal enterprise." *Id.* at 887-88. On remand, the judge informed the jury that *as a matter of law* the marijuana grow had engaged in a RICO violation, and that the jury should simply decide whether there was harm. The jury nevertheless returned a defense verdict.

Bokaie v. Green Earth Coffee LLC involved an unlicensed marijuana grow in Sonoma County, California. The court found it plausible at the motion to dismiss stage that plaintiffs had alleged continuing criminal behavior, but specifically disclaimed the idea that personal annoyance from a nuisance (which the plaintiffs pled as "sickening cannabis odor" and loud noise) could qualify as a predicate act for RICO liability. *Bokaie v. Green Earth Coffee LLC*, 2018 WL 6813212 at *5 (N.D. Cal. Dec. 27, 2018). The court next acknowledged that damages to future interests in the form of a present or future decrease in a home's market value "may be cognizable under RICO." *Id.* at *6. However, defendants shut down the grow a month before trial, and the court ruled that plaintiffs as a result had not sufficiently pleaded an injury to property. *Id.*

Finally, a recently filed complaint in California's Central District shows an additional way that plaintiffs could use RICO law to target cannabis businesses. In *Shulman v. Kaplan*, the plaintiff alleges that defendants, including a vertically integrated cannabis company, defrauded her out of her interest in a cannabis cultivation operation. Complaint at 1, No. 2:19-cv-05413 (C.D. Cal. June 20, 2019). The complaint alleges that the plaintiff owned land capable of producing "tens of millions of dollars in crops in a short amount of time." *Id.* at 4. According to the complaint, the primary defendant, the founder and CEO of the cannabis company, manipulated and deceived the plaintiff to con her out of this valuable property. *Id.* at 5-6. The defendant's alleged wrongdoing included falsely presenting itself to the world as an established and legitimate business in email, telephone, and in-person communications with plaintiffs, investors, and consumers. *Id.* at 78, 86-87, 106, 109. Plaintiffs characterize these representations as violations of 18 U.S.C. § 1341 (mail fraud) and 18 U.S.C. § 1343 (wire fraud). *Id.* at 81. This claim shows yet another way RICO claims could be employed in cannabis industry litigation.

II. Expectations For Future RICO Litigation

RICO cases against cannabis businesses are pending in jurisdictions across the country. One suit in Massachusetts recently settled for a "substantial" amount. *Massachusetts Cannabis RICO Case Settled out of Court for 'Substantial' Amount*, Marijuana Business Daily (Mar. 14, 2019), https://mjbizdaily.com/massachusetts-cannabis-rico-case-settled-out-of-court-for-substantial-amount/. The widely publicized "Pot v. Pinot" case in Oregon District Court, *Momtazi Family, LLC v. Wagner et al.*, involves a winery alleging concrete property harms from a neighboring marijuana facility. The vineyard's April 2019 complaint alleges that the proximity of defendants' "marijuana production site" to the vineyard led customers to cancel their orders for grapes, as they feared the proximity to marijuana would contaminate the grapes and the wine they produced. Complaint at 4, 6-7, No. 3:19-cv-00476 (D. Or. Apr. 2, 2019).

It is important to highlight the types of harm that have been held inadequate to support a RICO cause of action. RICO was "intended to combat organized crime, not to provide a federal cause of action and treble damages to every tort plaintiff." *Oscar v. Univ. Students Coop. Ass'n*, 965 F.2d 783, 786 (9th Cir. 1992), *abrogated*

on other grounds by Diaz v. Gates, 420 F.3d 897 (9th Cir. 2005). Crucial to cannabis industry participants, courts have held that personal injury does not constitute the required harm to support a RICO claim. *See Diaz v. Gates*, 420 F.3d at 900. For example, one court held that personal injuries that resulted from being exposed to a "sickening cannabis odor" and hearing loud noise do not constitute injury for purposes of RICO. *Bokaie*, 2018 WL 6813212 at *5.

In addition, and equally important, courts have held that the economic consequences of personal injuries such as loss of earnings or pecuniary loss due to emotional distress are not compensable under RICO. *Jackson v. Sedgwick Claims Mgmt. Servs., Inc.*, 731 F.3d 556, 564 (6th Cir. 2013); *Doe v. Roe*, 958 F.2d 763, 767 (7th Cir. 1992); *Bast v. Cohen, Dunn & Sinclair, PC*, 59 F.3d 492, 495 (4th Cir. 1995) ("An allegation of personal injury and pecuniary losses occurring therefrom are not sufficient to meet the statutory requirement of injury to business or property.") (internal quotations omitted). *See also Hamm v. Rhone-Poulenc Rorer Pharms., Inc.*, 187 F.3d 941, 954 (8th Cir. 1999) (concluding damage to reputation is a non-compensable personal injury under RICO); *Hughes v. Tobacco Inst., Inc.*, 278 F.3d 417, 422 (5th Cir. 2001) (precluding civil RICO claims based on "personal injury or death" from cigarette smoking) (internal quotations omitted). This principle has been applied in the cannabis context to find that "cleaning, medical, legal, and other expenses" due to the noise and odor created by cultivation stem from personal injuries and are not compensable under RICO. *Bokaie*, 2018 WL 6813212 at *5 (refusing to grant such damages to plaintiffs who lived next door to a cannabis production facility and brought a RICO suit alleging such damages as the harm).

While personal injury and associated costs are inadequate to support RICO standing, there are property injuries that may be sufficient. The Supreme Court, in language that courts have applied to RICO cases, has said that "'property' comprehends anything of material value owned and possessed. Money, of course, is a form of property." *Reiter v. Sonotone Corp.*, 442 U.S. 330, 342 (1979) (citations omitted); *see also Canyon Cnty. v. Syngenta Seeds, Inc.*, 519 F.3d 969, 976 (9th Cir. 2008) (applying this language to RICO). Under RICO, courts consider it "quintessentially a question of state law" whether a particular interest amounts to property, though some have declined to adopt the state definition when doing so would "contravene Congress's intent in enacting RICO." *Doe v. Roe*, 958 F.2d at 768 (citation omitted).

Various types of business or property interests may satisfy the statute. A loss in property value has been the property interest of choice for plaintiffs targeting cannabis businesses in civil RICO suits. In cases outside the cannabis industry, a loss in property value has been found to be properly alleged where, for example, the plaintiff alleged that an extortionate application of zoning standards led to a decrease in property value by depriving plaintiffs of "development potential" on their properties. *Gillmor v. Thomas*, 490 F.3d 791, 797 (10th Cir. 2007). A district court has found that contamination of a property satisfies the "damage" element of a RICO claim, but the resulting health risks are not compensable under RICO. *Abrams v. CIBA Specialty Chemicals Corp.*, 2008 WL 4183344 at *11, n.23 (S.D. Ala. Sept. 10, 2008) (dismissing plaintiffs' RICO cause of action to the extent that it sought relief for plaintiffs' exposure to increased health risks, while permitting the remainder of the claim to proceed). RICO claims based on decreases in property value or contamination of property could be alleged to apply to marijuana farms that use pesticides or fertilizers with harsh environmental effects, for example.

III. Conclusion

Cannabis businesses need to be prepared to defend themselves against RICO claims. Federal courts have held that companies growing and selling cannabis commit predicate offenses as a matter of law. The remaining element that plaintiffs have been unable to allege to date is concrete financial harm, but courts have provided insight into what type of harm would suffice. Still, while industry participants should take RICO claims seriously, the hurdles to pleading damage are high.

***

If you have any questions about the issues addressed in this memorandum, or if you would like a copy of any of the materials mentioned in it, please do not hesitate to reach out to:

Robert Becher
Email: robertbecher@quinnemanuel.com
Phone: 213-443-3182

To view more memoranda, please visit https://www.quinnemanuel.com/the-firm/publications/