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HIGH CRIMES: LIABILITY FOR DIRECTORS OF RETAIL MARIJUANA CORPORATIONS

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> We aspire to lead, legitimize and define the future of our industry by building the world's most trusted cannabis company.[1]
>
> I think the current situation is . . . untenable and really has to be addressed. It's almost like a backdoor nullification of federal law.[2]

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1. TILRAY, https://www.tilray.com/ (last visited Aug. 9, 2019).

2. *Confirmation Hearing on the Nomination of William Barr to Be Attorney General of the United States: Hearing Before the S. Comm. on the Judiciary* (C-SPAN broadcast Jan. 15, 2019), https://www.c-span.org/video/?456626-1/attorney-general-nominee-william-barr-confirmation-hearing&start=14049 (remarks of Mr. William Barr, Nominee).

INTRODUCTION

Selling retail marijuana in the United States is illegal—or is it? A rising number of states have legalized the retail sale of marijuana and are busily regulating these sales and the compa-

nies that make them.[3] At the same time, the sale of marijuana is a federal crime.[4] Are companies that sell retail marijuana duly sanctioned, productive contributors to their state economies, or are they felons just waiting for the wheels of justice to turn in their direction? Right now, no one can answer that question with certainty.[5]

What is certain is that more companies are being formed each day for the purpose of selling retail marijuana.[6] Many of the businesses established for the cultivation, production, and/or distribution of retail marijuana are formed as corporations ("Retail Marijuana Corporations").[7] The majority of Retail Marijuana Corporations are small businesses with one or only a few shareholders; a few are publicly traded and even listed on the major U.S. stock exchanges.[8] Large or small, Retail Marijuana Corporations are governed by the same state laws that govern corporations formed for other purposes and

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3. *See infra* Section I.B. regarding state retail laws legalizing retail marijuana sales.

4. *See infra* Section I.A. about the legal status of marijuana sales under federal law.

5. *See infra* Section I.C. concerning federal preemption of state marijuana laws.

6. For example, as of January 29, 2020, there were 580 active licenses for retail marijuana retailers in California. BUREAU OF CANNABIS CONTROL CAL., https://aca5.accela.com/bcc/customization/bcc/cap/licenseSearch.aspx (search performed Jan. 29, 2020). California began issuing temporary licenses to marijuana retailers in December 2017. *California Issues First Licenses for Its Legal Pot Market*, NBC NEWS (Dec. 14, 2017), https://www.nbcnews.com/storyline/legal-pot/california-issues-first-licenses-its-legal-pot-market-n829936. There are also numerous companies that engage in the production, distribution, and sale of medical marijuana, which is currently legal under state law in thirty-three states. *See* Sean Williams, *A State-by-State Look at Where Cannabis Is Legal*, THE MOTLEY FOOL, https://www.fool.com/investing/2019/08/05/a-state-by-state-look-at-where-cannabis-is-legal.aspx (last updated Aug. 28, 2019). This Article concentrates on retail (i.e., recreational) marijuana because it is the less "sympathetic" type; even those who are in favor of legalizing medical marijuana may object to its legalization for recreational use. Moreover, retail marijuana is less likely to be legalized at the federal level in the near term than medical marijuana is, which means retail marijuana sales may remain a thorny issue for longer.

7. For example, of the 580 active marijuana retailer licenses in California as of January 29, 2020, 439 were issued to corporations. BUREAU OF CANNABIS CONTROL CAL., *supra* note 6.

8. *See infra* Section II.D.1 regarding registration of Retail Marijuana Corporations' securities.

are subject to the same federal criminal statutes and securities laws. This means that, like other corporations, Retail Marijuana Corporations are governed by boards of directors who owe their companies the traditional duties of loyalty and care.[9] What sets the directors of Retail Marijuana Corporations apart from other directors is their precarious legal circumstances. Directors of Retail Marijuana Corporations sit at the helm of companies that are knowingly violating federal law. In overseeing these companies' businesses and guiding them toward profitability, these directors may be subject to substantial criminal and civil liability.

This Article examines the potential liability of Retail Marijuana Corporations' directors under state and federal laws. Part I provides a brief outline of the laws regulating retail marijuana at the federal and state level. It then argues that corporations cannot be formed for purposes of engaging in the retail marijuana business under state law doctrines forbidding incorporation for illegal purposes and acts beyond the corporations' powers. Part II surveys the various sources of liability directors of Retail Marijuana Corporations face. It first addresses liability for breach of fiduciary duty under state fiduciary duty principles. Next, it outlines criminal aiding and abetting liability under the federal statute prohibiting marijuana sales. It then discusses directors' exposure under the Racketeer Influenced and Corrupt Organizations Act ("RICO").[10] Last, it analyzes directors' potential liability under selected antifraud provisions of the federal securities laws. Finally, Part III concludes with thoughts about why director liability matters to investors of Retail Marijuana Corporations.

I.
The Marijuana Laws

Marijuana is subject to regulation at the federal, state, and local levels.[11] This Part first describes marijuana's legal status

9. *See infra* Section II.A. regarding state fiduciary duty law.

10. Racketeer Influenced and Corrupt Organizations Act (RICO), 18 U.S.C. §§ 1961–68 (2018).

11. Various localities have their own laws pertaining to the sale of marijuana. *See, e.g.*, Denver, Colo. Code of Ordinances §§ 6-200–220 (2013) (retail marijuana code for the City and County of Denver). For simplicity, this Article largely ignores the local laws.

under federal law. It then briefly introduces the state laws governing retail marijuana-related businesses. Next, it considers whether the federal Controlled Substances Act ("CSA")[12] preempts these state laws. Finally, it contemplates the consequence of retail marijuana's legal status on the formation of corporations.

A. *Federal Law*[13]

The CSA, enacted in 1970, criminalizes the sale of marijuana.[14] Section 841(a)(1) of the CSA provides that it is "unlawful for any person knowingly or intentionally . . . to manufacture, distribute, or dispense, or possess with intent to manufacture, distribute, or dispense, a controlled substance," except as authorized by the CSA.[15] The CSA designates marijuana a "Schedule I" controlled substance, meaning it "has a high potential for abuse," "has no currently accepted medical use in treatment," and "[t]here is a lack of accepted safety" for its use under medical supervision.[16] Schedule I is the most restrictive controlled substance designation in the CSA.[17]

The only purpose authorized under the CSA for a Schedule I substance is its use in a federally authorized study.[18] This means that the manufacturing, distribution, or dispensing of marijuana (or the possession with intent to do one of those things) is a federal crime—a felony.[19] Despite repeated calls to remove marijuana from Schedule I,[20] the federal government

12. Controlled Substances Act, 21 U.S.C. §§ 801–904 (2018).

13. For a detailed history of marijuana regulation in the United States, see Erwin Chemerinsky et al., *Cooperative Federalism and Marijuana Regulation*, 62 UCLA L. REV. 74, 89–91 (2015).

14. 21 U.S.C. §§ 801–904.

15. *Id.* § 841(a)(1).

16. *Id.* § 812(b)(1), Schedule I (c)(10).

17. *See id.* § 812(b).

18. *See id.* § 872(e) (permitting the Attorney General to "authorize the possession, distribution, and dispensing of controlled substances by persons engaged in research" and to exempt those researchers from prosecution).

19. *Id.* §§ 841(b)(1)(B), (D).

20. *See, e.g.*, All. for Cannabis Therapeutics v. Drug Enf't Admin., 15 F.3d 1131 (D.C. Cir. 1994); All. for Cannabis Therapeutics v. Drug Enf't Admin., 930 F.2d 936 (D.C. Cir. 1991); Nat'l Org. for Reform of Marijuana Laws v. Drug Enf't Admin., 559 F.2d 735 (D.C. Cir. 1977); Respect States' and Citizens' Rights Act of 2013, H.R. 964, 113th Cong. (2013); Respect States' and Citizens' Rights Act of 2012, H.R. 6606, 112th Cong. (2012).

has consistently refused to do so,[21] and federal courts have upheld these refusals.[22]

While the federal government has steadfastly refused to remove marijuana from Schedule I, federal policy regarding enforcement of the CSA has varied in the face of state laws legalizing medical and retail marijuana.[23] California became the first state to legalize the sale of marijuana for medical use in 1996 with the passage of Proposition 215.[24] Others soon followed California's lead. When President Barack Obama was sworn into office in 2009, medical marijuana laws had been passed in thirteen states.[25] During his campaign, President Obama seemed friendly to state marijuana legalization, saying, "I'm not going to be using Justice Department resources to try to circumvent state laws on this issue."[26] Shortly after President Obama took office, Attorney General Eric Holder indicated that this campaign promise would be the new federal policy.[27]

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21. *See e.g.*, Denial of Petition to Initiate Proceedings to Reschedule Marijuana, 81 Fed. Reg. 53,688 (Aug. 12, 2016); Denial of Petition to Initiate Proceedings to Reschedule Marijuana, 76 Fed. Reg. 40,552 (July 8, 2011).

22. *See, e.g.*, Americans for Safe Access v. Drug Enf't Admin., 706 F.3d 438, 440 (D.C. Cir. 2013) (holding the federal Drug Enforcement Agency's denial of a petition to reschedule marijuana survived review under the arbitrary and capricious standard).

23. *See* Chemerinsky et al., *supra* note 13, at 86–90 (discussing fluctuations in the federal government's degree of antagonism toward marijuana following President Obama's election); Luke Scheuer, *The "Legal" Marijuana Industry's Challenge for Business Entity Law*, 6 WM. & MARY BUS. L. REV. 511, 524–28 (2015) (calling the federal government's responses to state marijuana laws "inconsistent" and describing the various responses).

24. 1996 Cal. Legis. Serv. Prop. 215 (codified as the Compassionate Use Act of 1996, CAL. HEALTH & SAFETY CODE § 11362.5 (West 2007)).

25. *See 28 Legal Medical Marijuana States and DC: Laws, Fees, and Possession Limits*, PROCON, http://medicalmarijuana.procon.org/view.resource.php?resourceID=000881 (last updated Feb. 24, 2017, 3:18 PM) (listing California (1996), Alaska (1998), Oregon (1998), Washington (1998), Maine (1999), Nevada (2000), Colorado (2000), Hawaii (2000), Montana (2004), Vermont (2004), Rhode Island (2006), New Mexico (2007), and Michigan (2008) as having medical marijuana laws in place prior to 2009).

26. Tim Dickinson, *Obama's War on Pot*, ROLLING STONE (Feb. 16, 2012), http://www.rollingstone.com/politics/news/obamas-war-on-pot-20120216 (quoting President Obama).

27. *See* Stu Woo & Justin Scheck, *California Marijuana Dispensaries Cheer U.S. Shift on Raids*, WALL ST. J. (Mar. 9, 2009, 12:01 AM), http://www.wsj.com/articles/SB123656023550966719 ("The attorney general signaled recently that states will be able to set their own medical-marijuana laws, which

Soon thereafter, Deputy Attorney General David Ogden released a memorandum to U.S. attorneys in states that had legalized medical marijuana discouraging prosecution of "individuals whose actions are in clear and unambiguous compliance with existing state laws providing for the medical use of marijuana."[28] Thus, all signs from the early days of the Obama presidency indicated that the federal government would not enforce the CSA in states that legalized marijuana sales.

Despite these early indications, the federal government did not turn out to be as friendly to marijuana businesses as anticipated. A new Department of Justice memorandum from Deputy Attorney General James M. Cole to U.S. attorneys in 2011 declared that "[t]he Department of Justice is committed to the enforcement of the Controlled Substances Act in all States" and that

> [t]he Ogden Memorandum was never intended to shield [commercial marijuana] 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.[29]

A wave of enforcement actions in California,[30] Montana,[31]

President Barack Obama said during his campaign that he supported. What Mr. Obama said then 'is now American policy,' Mr. Holder said.").

28. U.S. DEP'T OF JUSTICE, OFFICE OF THE DEPUTY ATTORNEY GENERAL, MEMORANDUM FOR SELECTED UNITED STATES ATTORNEYS: INVESTIGATIONS AND PROSECUTIONS IN STATES AUTHORIZING THE MEDICAL USE OF MARIJUANA 2 (Oct. 19, 2009), http://www.justice.gov/sites/default/files/opa/legacy/2009/10/19/medical-marijuana.pdf.

29. U.S. DEP'T OF JUSTICE, OFFICE OF THE DEPUTY ATTORNEY GENERAL, MEMORANDUM FOR UNITED STATES ATTORNEYS: GUIDANCE REGARDING THE OGDEN MEMO IN JURISDICTIONS SEEKING TO AUTHORIZE MARIJUANA FOR MEDICAL USE 1–2 (June 29, 2011), http://www.justice.gov/sites/default/files/oip/legacy/2014/07/23/dag-guidance-2011-for-medical-marijuana-use.pdf.

30. *See* Press Release, U.S. Attorney's Office for the Cent. Dist. of Cal., California's Top Federal Law Enforcement Officials Announce Enforcement Actions Against State's Widespread and Illegal Marijuana Industry (Oct. 7, 2011) (https://www.justice.gov/archive/usao/cac/Pressroom/2011/144a.html) (describing "coordinated enforcement actions targeting the illegal operations of the commercial marijuana industry in California").

31. *See* John S. Adams, *Medicinal Marijuana Raids in Montana Stun Advocates*, USA TODAY, http://usatoday30.usatoday.com/news/nation/2011-03-

and Colorado[32] followed shortly thereafter. But, after Colorado and Washington State passed initiatives permitting recreational marijuana sales,[33] a third memorandum in 2013 from Deputy Attorney General Cole suggested that the federal government would permit those laws to stand and would not seek to enforce the CSA against those operating in compliance with state laws.[34]

Federal priorities appeared to change again during the Trump administration. In January 2018, Attorney General Jeff Sessions rescinded all earlier guidance on federal enforcement of the marijuana laws and directed federal prosecutors to "follow the well-established principles that govern all federal prosecutions . . . including federal law enforcement priorities set by the Attorney General, the seriousness of the crime, the deterrent effect of criminal prosecution, and the cumulative impact of particular crimes on the community."[35] Yet, in June 2018, President Donald Trump appeared to break with his attorney general, indicating he would likely support a Senate bill that would largely exempt marijuana from the CSA in states that have passed their own laws regulating marijuana production and sales (the Strengthening the Tenth Amendment Through Entrusting States Act ("STATES Act")).[36] Sessions'

18-medmarijuanaraids18_ST_N.pdf (last updated Mar. 18, 2011, 12:16 AM) (reporting twenty-six raids on Montana's medical marijuana facilities across thirteen cities).

32. *See Medical Marijuana Crackdown in Colorado: 10 More Dispensaries Near Schools Forced to Shut Down*, HUFFINGTON POST, http://www.huffingtonpost.com/2012/09/19/medical-marijuana-crackdo_n_1896385.html (last updated Sept. 19, 2012, 9:50 AM) (noting that fifty-seven Colorado medical marijuana dispensaries located near schools had complied with orders from U.S. Attorney John Walsh to shut down since January 2012).

33. *See infra* note 41 and accompanying text.

34. *See* U.S. DEP'T OF JUSTICE, OFFICE OF THE DEPUTY ATTORNEY GENERAL, MEMORANDUM FOR ALL UNITED STATES ATTORNEYS: GUIDANCE REGARDING MARIJUANA ENFORCEMENT 2–3 (Aug. 29, 2013), http://www.justice.gov/iso/opa/resources/3052013829132756857467.pdf (suggesting the Department of Justice would not challenge state laws legalizing marijuana unless "state enforcement efforts are not sufficiently robust to protect against the harms" identified as the federal government's enforcement priorities).

35. U.S. DEP'T OF JUSTICE, OFFICE OF THE ATTORNEY GENERAL, MEMORANDUM FOR ALL UNITED STATES ATTORNEYS: MARIJUANA ENFORCEMENT 1 (Jan. 4, 2018), https://www.justice.gov/opa/press-release/file/1022196/download.

36. Eileen Sullivan, *Trump Says He's Likely to Back Marijuana Bill, in Apparent Break with Sessions*, N.Y. TIMES (Jun. 8, 2018), https://www.nytimes.com/

successor, Attorney General William Barr, said during his confirmation hearings in January 2019 that, although he finds the current failure to enforce federal law "untenable," he would not "go after companies that have relied on the Cole Memorandum."[37] Barr later suggested in testimony before a Senate Appropriations subcommittee that he would be open to supporting the STATES Act.[38]

If the STATES Act (or similar legislation) becomes law, the conflict between state and federal marijuana laws will be resolved. Until then, despite the ebb and flow of the federal government's enforcement vigor, the sale of marijuana remains illegal at the federal level.

B. *State Marijuana Laws*

Notwithstanding federal prohibitions on the sale of marijuana, states continue to pass legislation for its legalization. At the time of this Article, eleven states—Alaska, California, Colorado, Illinois, Maine, Massachusetts, Michigan, Nevada, Oregon, Vermont, and Washington—and the District of Columbia have passed laws legalizing recreational marijuana sales,[39] al-

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2018/06/08/us/politics/trump-marijuana-bill-states.html; *see* Strengthening the Tenth Amendment Through Entrusting States Act, S. 3032, 115th Cong. (2018), https://www.congress.gov/bill/115th-congress/senate-bill/3032/text?q=%7B%22search%22%3A%5B%22Strengthening+the+Tenth+Amendment+Through+Entrusting+States+Act%22%5D%7D&r=1&s=9.

37. C-SPAN, *supra* note 2, at 3:55:08, 3:55:34.

38. *Justice Department Fiscal Year 2020 Budget Request*, at 59:22 (C-SPAN broadcast Apr. 10, 2019), https://www.c-span.org/video/?459640-1/attorney-general-barr-thinks-spying-occurred-trump-campaign#&start=3498.

39. *See State Marijuana Laws in 2019 Map*, GOVERNING, https://www.governing.com/gov-data/safety-justice/state-marijuana-laws-map-medical-recreational.html (last updated June 25, 2019). The District of Columbia's marijuana legislation technically does not authorize recreational marijuana sales; rather, it permits a person to possess, use, purchase, and transport marijuana, but not to transfer it to another person for remuneration. Legalization of Possession of Minimal Amounts of Marijuana for Personal Use Initiative of 2014, D.C. Act 20-565 (Dec. 3, 2014) (codified as amended at D.C. CODE ANN. § 48-904.01 (West 2001) (effective Feb. 26, 2015)), http://lims.dccouncil.us/Download/33230/B20-1064-SignedAct.pdf. This leaves the District of Columbia in a somewhat strange situation, in that it is legal under D.C. law to possess, use, and even purchase marijuana for recreational purposes, but it is not legal to sell it. *See id.* § 48-904.01(a)(1). The situation in Vermont is similar. Vermont's law legalizes the possession of limited amounts of marijuana, but does not permit marijuana sales. 2018 Vermont

most all beginning with a ballot initiative.[40] The ballot initiatives for Colorado and Washington passed in 2012.[41] Those for Alaska, Oregon, and the District of Columbia passed in 2014.[42]

Laws No. 86 (H.511) (January 22, 2018) (codified as amended at 18 V.S.A. § 4230) (effective July 1, 2018) ("An act relating to eliminating penalties for possession of limited amounts of marijuana by adults 21 years of age or older."). Legislation to establish a retail market stalled in Vermont's state legislature, though lawmakers are set to resume work on passing legislation in the 2020 legislative session. *See* B. S. 54 (passed by Senate Mar. 1, 2019), https://legislature.vermont.gov/Documents/2020/Docs/BILLS/S-0054/S-0054%20As%20passed%20by%20the%20Senate%20Official.pdf; Stephen Mills, *Push for Retail Cannabis Market Revived*, BARRE MONTPELIER TIMES ARGUS (Jan. 9, 2020), https://www.timesargus.com/news/local/push-for-retail-cannabis-market-revived/article_baebf697-0425-5b4a-9894-68c6786edd09.html; Wilson Ring, *Vermont, New Hampshire Both Could Delay Marijuana Proposals*, CBS BOSTON (May 18, 2019), https://boston.cbslocal.com/2019/05/18/vermont-new-hampshire-could-delay-recreational-marijuana-proposals/.

40. For an overview of the ballot initiative process and history, see K.K. DuVivier, *State Ballot Initiatives in the Federal Preemption Equation: A Medical Marijuana Case Study*, 40 WAKE FOREST L. REV. 221, 228–48 (2005) (describing the history of ballot initiatives and the relative benefits and drawbacks of the ballot initiative process).

41. *See* COLO. CONST. amend. art. XVIII, § 16, http://www.sos.state.co.us/pubs/elections/Initiatives/titleBoard/filings/2011-2012/30Final.pdf; *Election 2012: Colorado*, N.Y. TIMES, https://www.nytimes.com/elections/2012/results/states/colorado.html (last visited Feb. 14, 2020); Initiative Measure No. 502 (codified as amended in scattered sections of WASH. REV. CODE §§ 69.50, 46.20, 46.61, 46.04) (2011), http://sos.wa.gov/_assets/elections/initiatives/i502.pdf; *Election 2012: Colorado*, N.Y. TIMES, https://www.nytimes.com/elections/2012/results/states/washington.html (last visited Feb. 14, 2020).

42. *See* ALASKA DIVISION OF ELECTIONS, BALLOT MEASURE NO. 2-13PSUM: AN ACT TO TAX AND REGULATE THE PRODUCTION, SALE, AND USE OF MARIJUANA (2014), https://www.elections.alaska.gov/doc/bml/BM2-13PSUM-ballot-language.pdf; *2014 Alaska Ballot Measures Results*, POLITICO, http://www.politico.com/2014-election/results/map/ballot-measures/alaska (last updated Nov. 15, 2014, 1:36 AM); Legalization of Possession of Minimal Amounts of Marijuana for Personal Use Initiative of 2014, D.C. Act 20-565 (Dec. 3, 2014) (codified as amended at D.C. CODE § 48-904.01 (2014) ; *2014 District of Columbia Ballot Measures Results*, POLITICO, http://www.politico.com/2014-election/results/map/ballot-measures/district-of-columbia (last updated Nov. 15, 2014, 1:36 AM); Control, Regulation, and Taxation of Marijuana and Industrial Hemp Act, Measure 91 (codified as amended at OR. REV. STAT. § 475B (2015)), http://www.oregon.gov/olcc/marijuana/Documents/Measure91.pdf; *2014 Oregon Ballot Measures Results*, POLITICO, http://www.politico.com/2014-election/results/map/ballot-measures/oregon (last updated Nov. 15, 2014, 1:37 AM). Though the District of Columbia's recreational marijuana law went into effect in early 2015, an act of Congress effec-

Successful initiatives in California, Maine, Massachusetts, and Nevada followed in 2016 and in Michigan in 2018.[43] Vermont's state legislature authorized adult recreational marijuana use in 2018, with legislation set to establish a retail mari-

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tively blocked the sale and taxation of recreational marijuana in the District. *See* Consolidated and Further Continuing Appropriations Act, 2015, Pub. L. No. 113-235, § 809(a), 128 Stat. 2130, 2394 (2014) ("None of the Federal funds contained in this Act may be used to enact or carry out any law, rule, or regulation to legalize or otherwise reduce penalties associated with the possession, use, or distribution of any schedule I substance under the Controlled Substances Act . . . ."); *see* Joseph Bishop-Henchman & Morgan Scarboro, *Marijuana Legalization and Taxes: Lessons for Other States from Colorado and Washington*, TAX FOUND. (May 12, 2016), http://taxfoundation.org/article/marijuana-legalization-and-taxes-lessons-other-states-colorado-and-washington. However, thanks to an order issued in 2016 by the Superior Court of the District of Columbia upholding the Local Budget Autonomy Act of 2012, which permits the District to spend its revenues without first receiving a congressional appropriation, recreational marijuana sales could be possible if the D.C. statute were amended to permit transfers of recreational marijuana for remuneration. *See* Local Budget Autonomy Act of 2012, 60 D.C. Reg. 1724 (July 25, 2013); Bowser v. DeWitt, No. 2014 CA 2371 B (D.C. Super. Ct. 2016); Chloe Sommers, *D.C. Superior Court Clears Hurdle for Legal Marijuana Sales*, MARIJUANA TIMES (Mar. 30, 2016), https://www.marijuanatimes.org/d-c-superior-court-clears-hurdle-for-legal-marijuana-sales; *see also supra* note 39.

43. *See* Letter from Lance H. Olson, Partner, Olson Hagel & Fishburn LLP, to Ashley Johansson, Initiative Coordinator, Office of the Attorney Gen. (Dec. 7, 2015), https://www.oag.ca.gov/system/files/initiatives/pdfs/15-0103%20(Marijuana)_1.pdf; *2016 California Ballot Measures Election Results*, POLITICO, http://www.politico.com/2016-election/results/map/ballot-measures/california (last updated Dec. 13, 2016, 1:57 PM); Marijuana Legalization Act, ME. REV. STAT. ANN. tit. 7 §§ 2441–2454 (repealed 2015), http://www.regulatemaine.org/wp-content/uploads/2015/10/initiative-text.pdf; *2016 Maine Ballot Measures Election Results*, POLITICO, http://www.politico.com/2016-election/results/map/ballot-measures/maine (last updated Dec. 13, 2016, 1:57 PM); *2016 State Election Question 4: Legalization, Regulation, and Taxation of Marijuana*, SECRETARY OF THE COMMONWEALTH OF MASS., http://www.sec.state.ma.us/ele/ele16/full_text-question-4.pdf (last visited Mar. 2, 2017); *2016 Massachusetts Ballot Measures Election Results*, POLITICO, http://www.politico.com/2016-election/results/map/ballot-measures/massachusetts (last updated Dec. 13, 2016, 1:57 PM); *Michigan Proposition 1*, CNN, https://www.cnn.com/election/2018/results/michigan/ballot-measures/1 (last updated Dec. 21, 2018, 2:06 PM); BARBARA K. CEGAVSKE, SEC'Y OF STATE, STATE OF NEVADA: STATEWIDE BALLOT QUESTIONS 2016, at 14–17 (2016), http://nvsos.gov/sos/home/showdocument?id=4434; *2016 Nevada Ballot Measures Election Results*, POLITICO, http://www.politico.com/2016-election/results/map/ballot-measures/nevada (last updated Dec. 13, 2016, 1:57 PM).

juana market still pending in 2020.[44] Finally, in 2019, the state legislature of Illinois became the first to legalize the commercial sale of marijuana.[45] The first retail marijuana sales began in Colorado in January 2014,[46] and state-licensed retail marijuana stores have since opened in Alaska, California, Massachusetts, Nevada, Oregon, and Washington.[47] Maine began accepting applications for retail marijuana stores in December 2019 and hopes to open its first retail stores by spring 2020.[48] Retail marijuana stores opened in Illinois in January 2020.[49]

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44. *See supra* note 39.

45. *See* H.B. 1438, 101st Gen. Assembly (Ill. 2019); *see* Amber Phillips, *How Illinois Became the First State Legislature to Legalize Marijuana Sales*, DAILY HERALD, https://www.dailyherald.com/news/20190605/how-illinois-became-the-first-state-legislature-to-legalize-marijuana-sales (last updated Jun. 5, 2019, 10:46 AM).

46. *See* Michael Martinez, *Colorado's Recreational Marijuana Stores Make History*, CNN, http://www.cnn.com/2013/12/31/us/colorado-recreational-marijuana (last updated Jan. 1, 2014, 8:47 PM).

47. *See* Kirk Johnson, *Sales of Recreational Marijuana Begin in Washington State*, N.Y. TIMES (July 9, 2014), https://www.nytimes.com/2014/07/09/us/washington-to-begin-sales-of-recreational-marijuana.html; Laurel Andrews, *Marijuana Milestone: Alaska's First Pot Shop Opens to the Public in Valdez*, ANCHORAGE DAILY NEWS (Oct. 29, 2016), https://www.adn.com/alaska-marijuana/2016/10/29/anticipation-builds-as-alaskas-first-marijuana-store-set-to-open-to-the-public; Or. Liquor Control Comm'n, *Frequently Asked Questions*, OREGON.GOV, http://www.oregon.gov/olcc/marijuana/Pages/Frequently-Asked-Questions.aspx#Personal_Use (last visited Feb. 8, 2017); Thomas Fuller, *Recreational Pot Is Officially Legal in California*, N.Y. TIMES (Jan. 1, 2018), https://www.nytimes.com/2018/01/01/us/legal-pot-california.html; Gintautas Dumcius, *The First Massachusetts Marijuana Retail Shops Are Finally Open,* MASS LIVE (Nov. 11, 2018), https://expo.masslive.com/news/erry-2018/11/a049dbaa834979/massachusetts-marijuana-retail.html; Kalhan Rosenblatt, *Nevada Goes Green With Recreational Marijuana, and Alcohol Industry Wants a Piece of the Pot,* NBC NEWS (June 29, 2017), https://www.nbcnews.com/news/us-news/nevada-goes-green-recreational-marijuana-alcohol-industry-wants-piece-pot-n778261.

48. Associated Press, *Dozens Apply to Open Marijuana Businesses in Now-legal Maine*, WGME (Dec. 13, 2019), https://wgme.com/news/marijuana-in-maine/dozens-apply-to-open-marijuana-businesses-in-now-legal-maine.

49. *See* John O'Conner, *Illinois Becomes 11th State to Allow Recreational Marijuana*, AP NEWS (June 25, 2019), https://www.apnews.com/7b793d88f3c84417b83db0f770854960; Ally Marotti, *Illinois Marijuana Dispensaries Sold More Than $10.8 Million Worth of Recreational Weed in the First Five Days of Sales. Now, Some Have Halted Recreational Sales Amid Product Shortages*, CHI. TRIB. (Jan. 7, 2020), https://www.chicagotribune.com/marijuana/illinois/ct-biz-legal-weed-shortages-close-dispensaries-20200106-xhy3lmtjnzdbnbotfibhpdir74-story.html.

The following Section briefly considers whether these state retail[50] marijuana laws are preempted by the CSA.

C. *Federal Preemption of the Marijuana Laws*

When states and the federal government regulate the same subject matter, the question arises of which one takes precedence in the case of conflict. This question—the question of preemption—is a complicated one as it pertains to whether the CSA preempts state marijuana laws.[51]

The preemption doctrine arises out of the Constitution's Supremacy Clause, which provides that federal law is the "supreme Law of the Land," such that federal law supersedes conflicting state laws.[52] Courts have found preemption to occur when Congress includes express preemption language within a statute, when "Congress intends federal law to 'occupy the field,'" when it is impossible to comply simultaneously with both state and federal law, and when the state law frustrates the purpose or operation of the federal law.[53] Thus, the CSA could preempt state marijuana laws if it were found that an impermissible "conflict" (in any of these senses) exists between the state laws and the CSA.[54]

Countervailing the preemption doctrine is the Tenth Amendment's anti-commandeering doctrine, which prevents the federal government from forcing states to enact laws or requiring state officers to assist in enforcing federal laws within the state.[55] Under the anti-commandeering doctrine, "[a] state

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50. All of the states that have legalized recreational marijuana sales have also legalized sales of medical marijuana. *See State Medical Marijuana Laws*, NCSL (Oct. 16, 2019), http://www.ncsl.org/research/health/state-medical-marijuana-laws.aspx. To avoid any confounding issues, this Article focuses on retail marijuana sales. *See also supra* note 6.

51. As constitutional law is not this Article's focus, the discussion of preemption herein is brief. For an in-depth discussion of the preemption issues described in this Section, *see* Chemerinsky et al., *supra* note 13, at 102–13; Sam Kamin, *Medical Marijuana in Colorado and the Future of Marijuana Regulation in the United States*, 43 McGeorge L. Rev. 147, 158–62 (2012); Robert A. Mikos, *Preemption Under the Controlled Substances Act*, 16 J. Health Care L. & Pol'y 5, 9–15 (2013) [hereinafter Mikos, *Preemption*].

52. U.S. Const. art. VI, cl. 2.

53. *See* Chemerinsky et al., *supra* note 13, at 105.

54. *See id.* at 102.

55. *See* U.S. Const. amend. X; Printz v. United States, 521 U.S. 898, 912 (1997) (noting "state legislatures are *not* subject to federal direction" and

can constitutionally decide not to criminalize conduct under state law even if such conduct offends federal law. While states cannot stop the federal government from enforcing federal law within their territory, the federal government cannot command the state to create a law criminalizing the conduct."[56] Accordingly, the anti-commandeering doctrine prevents the federal government from requiring states to enact or maintain laws that criminalize marijuana sales.[57]

Section 903 of the CSA contains express language pertaining to preemption, providing that the CSA trumps state law in the event of a "positive conflict":

> No provision of this subchapter shall be construed as indicating an intent on the part of the Congress to occupy the field in which that provision operates, including criminal penalties, to the exclusion of any State law on the same subject matter which would otherwise be within the authority of the State, unless there is a positive conflict between that provision of this subchapter and that State law so that the two cannot consistently stand together.[58]

Some scholars have argued that the CSA does not preempt state marijuana laws because section 903's preemption language is written narrowly.[59] Among these, leading constitutional law scholar Dean Erwin Chemerinsky et al. argue that there is no "positive conflict" between permissive state laws

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rejecting the idea that state officers would have to participate actively in implementing federal law); 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.").

56. Chemerinsky et al., *supra* note 13, at 103.

57. *Id.* at 102–03.

58. Controlled Substances Act, 21 U.S.C. § 903 (2018).

59. *See, e.g.*, Chemerinsky et al., *supra* note 13, at 107 ("[T]he CSA does not preempt more lenient state marijuana laws because such state laws are consistent with the CSA's purposes and objectives."); Robert A. Mikos, *On the Limits of Supremacy: Medical Marijuana and the States' Overlooked Power to Legalize Federal Crime*, 62 VAND. L. REV. 1421, 1423–24 (2009) ("States may continue to legalize marijuana because Congress has not preempted—and more importantly, *may not* preempt—state laws that merely permit (i.e., refuse to punish) private conduct the federal government deems objectionable.").

and the CSA as required for preemption under section 903 because

> [i]t is not physically impossible to comply with both the CSA and state marijuana laws [since] nothing in the more liberal state laws requires anyone to act contrary to the CSA. Only if a state law required a citizen to possess, manufacture, or distribute marijuana in violation of federal law would it be impossible for a citizen to comply with both state and federal law.[60]

Courts that have applied section 903 in challenges to state marijuana laws have tended to read it more broadly[61] than Chemerinsky et al. do, although they have not ruled uniformly either for or against preemption.[62] This lack of uniformity re-

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60. Chemerinsky et al., *supra* note 13, at 106.

61. *See* Mikos, *Preemption*, *supra* note 51, at 13–15 (observing instances in which courts struck down state marijuana laws based on an assumption that Congress intended the CSA to preempt all conflicts).

62. Cases in which courts found the CSA preempted state marijuana laws include People v. Crouse, 2017 CO 5, ¶ 8 (state medical marijuana law requiring law enforcement officials to return seized medical marijuana to patients was preempted because of a positive conflict with the CSA); Garcia v. Tractor Supply Co., 154 F. Supp. 3d 1225, 1230 (D.N.M. 2016) (finding state medical marijuana laws did not compel employer to accommodate employee's medical marijuana use because of conflict with the CSA); Forest City Residential Mgmt. *ex rel.* Plymouth Square Dividend Hous. Ass'n v. Beasley, 71 F. Supp. 3d 715, 727 (E.D. Mich. 2014) (state medical marijuana statute conflicted with CSA and was therefore preempted); Montana Caregivers Ass'n v. United States, 841 F. Supp. 2d 1147, 1148 (D. Mont. 2012), *aff'd*, 526 F. App'x 756 (9th Cir. 2013) (medical marijuana raid was not unconstitutional because CSA trumped state medical marijuana statute); and Emerald Steel Fabricators, Inc. v. Bureau of Labor & Indus., 230 P.3d 518, 529 (Or. 2010) (state statute affirmatively authorizing medical marijuana use was preempted as an obstacle to the implementation of the CSA's purposes and objectives). Courts finding no preemption include *In re* Rent-Rite Super Kegs West Ltd., 484 B.R. 799, 805 (Bankr. D. Colo. 2012) (finding no preemption of the Retail Marijuana Amendment or the section of Colorado's constitution authorizing medical marijuana use because "both make it clear that their provisions apply to state law only" and "[a]bsent from either enactment is any effort to impede the enforcement of federal law" (footnote omitted) (citation omitted)); Reed-Kaliher v. Hoggatt, 347 P.3d 136, 141 (Ariz. 2015) (finding no preemption of state medical marijuana statute by the CSA for lack of a positive conflict and commenting that "the CSA does not expressly preempt state drug laws or exclusively govern the field"); Kirby v. County of Fresno, 195 Cal. Rptr. 3d 815, 832 (Ct. App. 2015), *cert. denied*, 2016 Cal. Lexis 1002 (2016) (state statute preventing arrest of medical marijuana users with a qualifying identification card for certain medical mari-

flects the fact that the Supreme Court has not yet spoken definitively on this issue.[63] The Court's ultimate ruling on the CSA's preemptive power is somewhat difficult to predict.[64]

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juana-related activities was not preempted by the CSA); and Ter Beek v. City of Wyoming, 846 N.W.2d 531, 541 (Mich. 2014) (state medical marijuana statute was not preempted because there was no positive conflict with the CSA).

63. The Supreme Court has touched upon the CSA's preemptive power in *Gonzales v. Raich*, in which the Court held that the CSA was a valid use of Congress's power to regulate under the Commerce Clause, even as applied to use of medical marijuana that was permitted under California law. Gonzales v. Raich, 545 U.S. 1, 8–9 (2005). Some courts have relied upon *Raich* in suggesting that the CSA generally preempts state law regulating marijuana. *See, e.g.*, United States v. McWilliams, 138 F. App'x 1, 2 (9th Cir. 2005) (stating *Raich* forecloses the argument that compliance with state medical marijuana act provides a shield against criminal liability under the CSA and suggesting the CSA preempts state law); United States v. Washington, 887 F. Supp. 2d 1077, 1100 (D. Mont. 2012) (stating that, after *Raich*, "under the Supremacy Clause of the Constitution there is no viable Tenth Amendment claim based on federal prosecution of marijuana distribution activity that is legal under state law"). Yet the Court in *Raich* did not expressly state that the California law was preempted; based on this, other courts have declined to interpret *Raich* as standing for the proposition that the CSA preempts state marijuana laws. *Accord* Cty. of San Diego v. San Diego NORML, 165 Cal. App. 4th 798, 825 (Ct. App. 2008); *see* White Mountain Health Ctr., Inc. v. Maricopa Cty., 386 P.3d 416, 429 n.18 (Ariz. Ct. App. 2016) ("*Raich* addressed whether the CSA's criminalization of marijuana . . . was constitutional under the Commerce Clause, not whether state laws permitting medical marijuana were preempted by the CSA."); City of Garden Grove v. Superior Court, 68 Cal. Rptr. 3d 656, 673 (Ct. App. 2007), *cert. denied*, 555 U.S. 1044 (2008) (noting the sole issue in *Raich* was not preemption, but rather "whether Congress had the constitutional authority under the Commerce Clause to prohibit the manufacture and possession of marijuana"); *see also* Orde F. Kittrie, *Federalism, Deportation, and Crime Victims Afraid to Call the Police*, 91 IOWA L. REV. 1449, 1490 (2006) (observing that the Supreme Court did not invalidate California's marijuana laws on preemption or other grounds); Mikos, *Preemption*, *supra* note 51, at 7 (noting the Supreme Court has not yet opined upon whether the CSA preempts state marijuana laws). Further muddling the debate, the Supreme Court also cautioned in *Printz v. United States* that the anti-commandeering rule is limited in scope, observing that it does not eliminate state officials' duty "to enact, enforce, and interpret state law in such fashion as not to obstruct the operation of federal law." Printz v. United States, 521 U.S. 898, 913 (1997).

64. *See* David S. Schwartz, *High Federalism: Marijuana Legalization and the Limits of Federal Power to Regulate States*, 35 CARDOZO L. REV. 567, 625 (2013) ("[I]t is far from clear that a majority of the Supreme Court will redefine

In light of the uncertainties regarding the CSA's preemptive power—and for the sake of argument—this Article assumes that the CSA does not preempt state marijuana laws. That is to say, this Article assumes that the use and retail sale of marijuana in accordance with state marijuana laws is legal under state law but illegal under federal law. Of course, if Congress passes the STATES Act or similar legislation,[65] the issue of preemption will be moot.

D. *The Illegal Purpose and Ultra Vires Doctrines*

The retail marijuana business's questionable legality is consequential for the formation of Retail Marijuana Corporations. Generally speaking, it is relatively simple to form a corporation. For example, in Nevada, one or more persons can form a corporation by filing articles of incorporation with the Secretary of State of Nevada.[66] The articles of incorporation must contain certain required information, such as the corporation's name, the name and address of the corporation's registered office or agent, the number of shares it is authorized to issue, and the names and addresses of the incorporators and/or initial directors.[67] Many state statutes require that the articles of incorporation state the purpose for which the corporation is organized, but the stated purpose may "include the transaction of any or all lawful business."[68] Other state statutes permit, but do not require, a statement of the corporation's purpose.[69]

The statutory requirements regarding a corporation's purpose are significant because they make clear the—perhaps obvious—point that corporations can only be formed for a lawful purpose. Even the most general statement of corporate purpose—"any lawful business"—restricts the corporation to conducting legal activities. Indeed, corporations cannot be formed for an illegal purpose, or for a lawful purpose that will

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anti-commandeering doctrine at the expense of preemption in order to save state marijuana legalization laws.").

65. *See supra* text accompanying notes 36–38.

66. 7 NEV. REV. STAT. § 78.030(1) (effective Oct. 1, 2013).

67. *E.g.*, 7 NEV. REV. STAT. §§ 77.310, 78.035; *see* 8 FLETCHER CYCLOPEDIA OF THE LAW OF CORPORATIONS §§ 137–46, Westlaw (database updated Nov. 2018).

68. 8 FLETCHER CYCLOPEDIA OF THE LAW OF CORPORATIONS § 139.

69. *Id.*

be pursued in an unlawful way.[70] Moreover, courts will not enforce or uphold illegal contracts,[71] including organizational documents (such as a corporation's articles or bylaws) that contemplate an illegal purpose,[72] or other corporate agree-

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70. *E.g.*, NEV. REV. STAT. § 78.030(1) (2013) (permitting formation of a "corporation for the transaction of any lawful business, or to promote or conduct any legitimate business or purpose . . . . [and prohibiting] establish[ment of] a corporation for any illegal purpose or with the fraudulent intent to conceal any business activity . . . ."); Smith v. Dir., Corp. & Sec. Bureau, 261 N.W.2d 228, 230 (Mich. Ct. App. 1977) (affirming the state commerce department's rejection of proposed articles of incorporation that stated an unlawful corporate purpose); 8 FLETCHER CYCLOPEDIA OF THE LAW OF CORPORATIONS § 139.

71. *See, e.g.*, Kaiser Steel Corp. v. Mullins, 455 U.S. 72, 77 (1982); McMullen v. Hoffman, 174 U.S. 639, 654 (1899); Merrimack Coll. v. KPMG LLP, 108 N.E.3d 430, 439 (Mass. 2018); Godding v. Hall, 140 P. 165, 173, (Colo. 1914); *see also* 5 WILLISTON ON CONTRACTS § 12:1, Westlaw (database updated May 2019) ("[W]henever the performance of an act would be either a crime or a tort, a promise or agreement to do that act would also be illegal and void or unenforceable."). It is important here to distinguish illegal contracts and those that violate public policy. Both are grounds for refusal to enforce a contract. *See* Waddell v. Traylor, 64 P.2d 1273, 1275 (Colo. 1937) (en banc) ("Courts will not lend their aid to the enforcement of terms of a contract which will result in the consummation of a criminal act, or one contrary to the public policy of the state."). However, they are distinct grounds. Not all conduct that violates public policy is illegal. For example, the Colorado Supreme Court has held that a waiver of attorney's fees in a marital agreement would violate public policy and be unenforceable if one spouse lacked the financial resources to litigate the dissolution of the marriage. *In re* Marriage of Ikeler, 161 P.3d 663, 670 (Colo. 2007) (en banc). Yet such an agreement to waive attorney's fees is not illegal; it is not a criminal act or otherwise in violation of applicable law. This distinction is significant because states are able to declare retail marijuana-related contracts as not in violation of public policy, and not unenforceable on that ground. For example, a provision of Colorado's statute declares that "[i]t is the public policy of the state of Colorado that a contract is not void or voidable as against public policy if it pertains to lawful activities authorized by" Colorado's retail marijuana laws. COLO. REV. STAT. ANN. § 13-22-601 (West 2018). Thus, in Colorado, a contract pertaining to retail marijuana sales would not be unenforceable in Colorado because it violated public policy. It would still, however, be unenforceable contract because its subject matter is illegal, as a criminal violation of the CSA. Colorado's statute is powerless to change this result.

72. *E.g.*, Smith, 261 N.W.2d at 230; Guy v. State, 839 P.2d 578, 581 (Nev. 1992); C.D. Johnson Lumber Co. v. Leonard, 232 P.2d 804, 805 (Or. 1951). A corporation's articles of incorporation and bylaws are considered contractual in nature. *E.g.*, Brigade Leveraged Cap. Structures Fund Ltd. v. PIMCO Income Strategy Fund, 995 N.E.2d 64, 69 (Mass. 2013) ("A corporation's articles of organization and its bylaws are a contract between the shareholder

ments that violate positive law or public policy.[73] This Article refers to this doctrine as the "illegal purpose doctrine."[74]

The illegal purpose doctrine sometimes overlaps with the ultra vires doctrine. An act or contract is ultra vires if it is "not one within the express or implied powers of the corporation as fixed by its charter, governing statutes, or the common law."[75] Though courts frequently refer to illegal acts or contracts as ultra vires, the two categories of acts are distinct.[76] An ultra vires act is "beyond the powers conferred upon the corporation by its charter"; an illegal act is "one expressly prohibited by the charter or a general statute or that is immoral or against public policy."[77] An ultra vires act or contract is not necessarily illegal, but an illegal act or contract is also ultra vires because illegal acts and contracts are beyond the corporate power.[78] Ultra vires contracts are void,[79] though modern ultra vires cases generally hold that unanimous shareholder consent is effective to ratify an ultra vires act or contract, so long as the act or contract is merely ultra vires and not also illegal.[80] An illegal act or contract is not enforceable, even if shareholders unanimously consent to it.

The sale of retail marijuana is legal under state law in those states that have legalized it, but it remains unlawful

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ers and the corporation."); Dentel v. Fid. Sav. & Loan Ass'n, 539 P.2d 649, 650–51 (Or. 1975) ("The bylaws of the corporation have been termed a contract between the members of the corporation, and between the corporation and its members. . . . The articles of incorporation constitute 'a contract between the corporation and the state, between the corporation and its owners, and between the owners themselves.'") (citation omitted) (quotation omitted).

73. *E.g.*, Stevens v. Boyes Hot Springs Co., 298 P. 508, 509 (Cal. Ct. App. 1931) (refusing to enforce a promissory note delivered in exchange for shares of the corporation's capital stock in light of a statute prohibiting corporations from purchasing their capital stock, and stating, "A contract which is either malum per se or mala prohibitum cannot be enforced . . . .").

74. For more on the illegal purpose doctrine, see Lauren A. Newell, *Up in Smoke? Unintended Consequences of Retail Marijuana Laws for Partnerships*, 38 CARDOZO L. REV. 1343, 1360–62 (2017).

75. 7A FLETCHER CYCLOPEDIA OF THE LAW OF CORPORATIONS § 3399, Westlaw (database updated Sept. 2019) (footnote omitted).

76. *Id.* § 3400.

77. *Id.*

78. *Id.*

79. *Id.* § 3399.

80. *Id.* § 3432.

under federal law. In order for the sale of retail marijuana to be a "legal" (or "lawful") purpose for which to form a corporation, that sale must be permitted under both state and federal law.[81] Logically, then, since selling retail marijuana is illegal as a violation of the CSA, a corporation cannot be formed for that purpose,[82] and the retail sale of marijuana is ultra vires. Because the retail marijuana business is illegal, the secretaries of state (or equivalent agents) in states that have legalized retail marijuana sales would be within their discretion to reject Retail Marijuana Corporations' articles of organization.[83] State

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81. *See* Ross v. RagingWire Telecomms., Inc., 174 P.3d 200, 204 (Cal. 2008) (citations omitted) ("No state law could completely legalize marijuana for medical purposes because the drug remains illegal under federal law, even for medical users."); Coats v. Dish Network, L.L.C., 2013 COA 62, ¶ 14, *aff'd sub nom.* Coats v. Dish Network, LLC, 2015 CO 44 (en banc) ("[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. Conversely, an activity that violates federal law but complies with state law cannot be 'lawful' under the ordinary meaning of that term."); *Illegal*, BLACK'S LAW DICTIONARY (11th ed. 2019) (defining "illegal" as "[f]orbidden by law; unlawful"); *Illegal*, OXFORD ENGLISH DICTIONARY (2d ed. 1989) (defining "illegal" as "[n]ot legal or lawful; contrary to, or forbidden by, law").

82. *See also* Newell, *supra* note 74, at 1364–68 (discussing whether the retail marijuana business is "legal" in connection with the formation of partnerships).

83. *See* ALASKA STAT. ANN. § 10.06.205 (West 2019); COLO. REV. STAT. § 7-102-103 (2004); ME. REV. STAT. ANN. tit. 13-C, § 203 (West 2019); Smith v. Dir., Corp. and Sec. Bureau, 161 N.W.2d 228, 230 (Mich. Ct. App. 1977). This assumes that the proposed articles of incorporation have a specific statement of purpose relating to the sale of retail marijuana. It is much more likely that a corporation would have as its stated purpose "any lawful business," or would omit a statement of purpose in states in which such statements are not mandatory. In this case, even if the secretary of state were inclined to reject the articles of a Retail Marijuana Corporation based on the illegal purpose doctrine, the secretary would have difficulty doing so. However, there is an argument that the secretary's role is purely ministerial, and that the only question is whether the articles of incorporation meet the requirements of the state's corporation statute. If the secretary of state's role is ministerial, then the secretary has no discretion to look beyond the "four corners" of the state's corporation statute to inquire whether the corporation's purpose is unlawful under federal law. *See* People ex rel. Hardin v. Emmerson, 146 N.E. 129, 129 (Ill. 1924) ("When a statement of incorporation which conforms to the provisions of the General Corporation Act is presented to the Secretary of State, he must file it and must issue a certificate of incorporation to the incorporators; but if the statement of incorporation

attorneys general could justifiably bring actions to revoke the charters of Retail Marijuana Corporations in their states or to dissolve the corporations after they are formed,[84] even if they are unlikely to do so. And, since retail marijuana sales are illegal as well as ultra vires, courts could certainly refuse to grant relief under contracts pertaining to the retail marijuana business or to enforce Retail Marijuana Corporations' articles of organization or bylaws, even if the contract or organizational document at issue had received unanimous shareholder consent.

II.
Sources of Liability for Directors of Retail Marijuana Corporations

Assuming the illegal purpose and ultra vires doctrines do not dissuade anyone from incorporating Retail Marijuana Corporations in the states that have legalized retail marijuana sales,[85] there will presumably continue to be Retail Marijuana Corporations with people serving as their directors. This Part examines the perils of serving in that role. First, this Part addresses the typical duties of corporate directors when acting on behalf of the corporation. Then, it considers various potential sources of liability the directors of Retail Marijuana Corpo-

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presented to him is not in conformity with the act, he must refuse to file it. His duties in this regard are ministerial."); *see also* Newell, *supra* note 74, at n.123 (discussing whether the filing of an LLP statement of registration is purely ministerial); *c.f.* Jackson v. Dep't of Energy, Labor & Econ. Growth, No. 297762, 2011 WL 2507840, at *2 (Mich. Ct. App. June 23, 2011) (commenting that the administrator's act of receiving and filing LLC articles of organization is purely ministerial and that the administrator has no "discretion to look beyond the documents actually submitted; he or she must simply review the documents, determine whether the documents substantially conform with the LLC Act's requirements, and, if they do, must endorse and file them"). *But see* State ex rel. Gorman v. Nichols, 82 P. 741, 743 (Wash. 1905) (rejecting the argument that the secretary of state's duties are purely ministerial and recognizing the secretary is "under no duty to file articles not entitled to be filed, and . . . [the] court will not compel him to do a vain or illegal act") (citing State ex rel. Osborne, Tremper & Co. v. Nichols, 80 P. 462 (Wash. 1905)).

84. *See* Cal. Corp. Code § 1801 (West 1975); Colo. Rev. Stat. § 7-114-301 (2016); Wash. Rev. Code Ann. § 23B.14.200 (West 2015).

85. Judging by the number of Retail Marijuana Corporations already incorporated, these doctrines are not striking fear into the hearts of those seeking to start retail marijuana businesses. *See, e.g.*, *supra* note 6.

rations face, namely (1) liability for breach of fiduciary duty, (2) criminal aiding and abetting liability under the CSA, (3) liability under RICO, and (4) liability under the federal securities laws.

A. *Liability for Breach of Fiduciary Duty*[86]

The first potential source of liability for directors of Retail Marijuana Corporations is for breach of fiduciary duty. Directors are agents of the corporation and owe to the corporation and its stockholders the fiduciary duties of care and loyalty.[87] The duty of care requires directors to act on behalf of the corporation with the degree of care an ordinarily prudent person in a like position would exercise under similar circumstances.[88] It applies in the context of overseeing the corporation's affairs and whenever directors are making decisions for the corporation.[89] The duty of loyalty requires directors to act in the best interests of the corporation, not for their personal

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86. For more on the impact of state fiduciary duty law on companies that sell marijuana, see Scheuer, *supra* note 23, at 537–46.

87. *E.g.*, CAL. CORP. CODE § 309(a) (West 1987) ("A director shall perform the duties of a director . . . in good faith, in a manner such director believes to be in the best interests of the corporation and its shareholders and with such care, including reasonable inquiry, as an ordinarily prudent person in a like position would use under similar circumstances."); WASH. REV. CODE ANN. § 23B.08.300 (West 1989) ("A director shall discharge the duties of a director . . . : (a) In good faith; (b) With the care an ordinarily prudent person in a like position would exercise under similar circumstances; and (c) In a manner the director reasonably believes to be in the best interests of the corporation."); Rosenthal v. Rosenthal, 543 A.2d 348, 352 (Me. 1988) (acknowledging that directors owe fiduciary duties of care and loyalty to the shareholders); Demoulas v. Demoulas Super Mkts., 677 N.E.2d 159, 179 (Mass. 1997) (stating that directors stand in a fiduciary relationship to the corporation and owe a duty of care and loyalty).

88. *E.g.*, Rude v. Cook Inlet Region Inc., 322 P.3d 853, 857 (Alaska 2014) ("[C]orporate directors must exercise their duties 'in good faith, in a manner the director reasonably believes to be in the best interest of the corporation, and with the care, including reasonable inquiry, that an ordinarily prudent person in a like position would use under similar circumstances.'") (quoting ALASKA STAT. § 10.06.450(b) (1989)).

89. *See In re* Reg'l Diagnostics, LLC, 372 B.R. 3, 28 (Bankr. N.D. Ohio 2007) ("The duty of care . . . requires directors to exercise a requisite degree of care in the process of making decisions and in other aspects of their directorial responsibilities.") (citation omitted); ROBERT A. RAGAZZO & FRANCES S. FENDLER, CLOSELY HELD BUSINESS ORGANIZATIONS: CASES, MATERIALS, AND PROBLEMS 449 (2d ed. 2012) ("Th[e] duty of care encompasses two distinct

interests.[90] The duty of loyalty includes both an affirmative duty to protect the corporation's interests and also an obligation to refrain from conduct that could harm the corporation or its stockholders.[91] Related to both the duty of care and loyalty is the directors' duty to act in good faith.[92] Acting in good faith requires "act[ing] at all times with an honesty of purpose and in the best interests and welfare of the corporation" and "a true faithfulness and devotion to the interests of the corporation and its shareholders."[93] In contrast, acting with a lack of good faith would include, among other things,

> intentionally act[ing] with a purpose other than that of advancing the best interests of the corporation. . . act[ing] with the intent to violate applicable positive law . . . [and] intentionally fail[ing] to act in the face

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settings in which director responsibilities arise: oversight and decision-making").

90. *E.g.*, *Demoulas*, 677 N.E.2d at 180 (commenting on "the principle that corporate directors and officers are bound by their duty of loyalty to subordinate their self-interests to the well being of the corporation."); Shoen v. SAC Holding Corp., 137 P.3d 1171, 1178 (Nev. 2006) ("[T]he duty of loyalty requires the board and its directors to maintain, in good faith, the corporation's and shareholders' best interest over anyone else's interests."); J.A. Morrissey, Inc. v. Smejkal, 6 A.3d 701, 706 (Vt. 2010) ("The duties of good faith and loyalty require that a director must not allow personal interests to interfere with or supersede the interests of the corporation.").

91. *See, e.g.*, 1 JERRY J. BURGDOERFER ET AL., ILLINOIS BUSINESS ENTITIES § 19.06 (2009) ("[A] public policy . . . has established a rule that demands of a corporate officer or director, peremptorily and inexorably, the most scrupulous observance of his duty, not only affirmatively to protect the interests of the corporation committed to his charge, but also to refrain from doing anything that would work injury to the corporation, or to deprive it of profit or advantage which his skill and ability might properly bring to it, or to enable it to make in the reasonable and lawful exercise of its powers.").

92. *In re* Walt Disney Co. Derivative Litig., 906 A.2d 27, 65 (Del. 2006) (observing "issues of good faith are (to a certain degree) inseparably and necessarily intertwined with the duties of care and loyalty . . . ," while noting that gross negligence, without more, does not constitute bad faith) (internal quotation omitted); Stone v. Ritter, 911 A.2d 362, 370 (Del. 2006) (quoting Guttman v. Huang, 823 A.2d 492, 506 n. 34 (Del. Ch. 2003)) ("[T]he requirement to act in good faith 'is a subsidiary element[,]' i.e., a condition, 'of the fundamental duty of loyalty.'").

93. In re *Walt Disney Co. Derivative Litig.*, 907 A.2d 693, 755 (Del. Ch. 2005), *aff'd* 906 A.2d 27 (Del. 2006).

> of a known duty to act, demonstrating a conscious disregard for [the director's] duties.[94]

Directors enjoy four primary sources of protection from personal liability when acting on the corporation's behalf: (1) the presumption of the business judgment rule; (2) exculpation provisions in the corporation's articles of incorporation; (3) indemnification from the corporation; and (4) director and officer insurance. These protections from personal liability are important inducements to serving as directors.[95] Without them, qualified people would likely refuse to serve as directors because of the fear of significant liability, even when they have acted reasonably and in good faith.[96] This Section describes each protection and explains why directors of Retail Marijuana Corporations stand to lose them all. It then discusses three caveats: first, the unclean hands and *in pari delicto* doctrines, which limit investors' ability to bring claims against directors of Retail Marijuana Corporations; second, the principles of shareholder consent and ratification, which authorize directors' acts; and, third, whether directors' non-marijuana-related conduct could still be entitled to customary director protections.

1. *The Business Judgment Rule*

The business judgment rule is "a presumption that in making a business decision the directors of a corporation acted on an informed basis, in good faith and in the honest belief that the action taken was in the best interests of the com-

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94. *Id.*

95. *See, e.g.*, Robert H. Rosh, *New York's Response to the Director and Officer Liability Crisis: A Need to Reexamine the Importance of D & O Insurance*, 54 BROOK. L. REV. 1305, 1317 (1989) (discussing amendments to New York's corporation statute to expand its indemnification and insurance provisions, which amendments were "premised on the notion that without increasing director and officer protection, executives may not only engage in risk averse behavior, but more importantly, they may even be reluctant to accept positions with New York corporations").

96. *Cf.* Julianne DeLeo, Note, *If the Shoe Fits: Sizing Up the Applicability of IvI Exclusions to the FDIC*, 49 SUFFOLK U. L. REV. 109, 111 (2016) ("According to an American Association of Bank Directors survey, the ill effects of bank directors' fear of personal liability are widespread. The survey indicated that almost one-quarter of bank respondents have lost directors, been told 'no' by director candidates, or lost members or potential members of their board loan committees from fear of personal liability.").

pany."[97] When the presumption applies, courts will uphold the directors' decision unless it cannot be attributed to any rational business purpose.[98] Plaintiffs can rebut the presumption of the business judgment rule in a duty of care case and cause the court to apply a more stringent standard of review by showing that the directors acted in bad faith, with gross negligence, or without an honest belief that the action taken was in the corporation's best interests (including by showing a conflict of interest).[99] While the business judgment rule exists as a matter of common law in Delaware (the leading corporate law state), many states have codified it.[100] The business judgment rule offers corporate directors powerful protection against liability for a breach of the duty of care because it is highly deferential to directors' decisions. When the business judgment rule applies, it is very difficult for plaintiffs to succeed on a duty of care claim.[101]

The consequence of losing the business judgment rule's protection is the application of the entire fairness standard.[102] Under this standard, the court performs an exacting review of the challenged action or transaction, with the burden on the defendant director to prove that the challenged action or transaction was entirely fair to the corporation and its shareholders, in terms of both fair dealing and fair price:

> The former embraces questions of when the transaction was timed, how it was initiated, structured, negotiated, disclosed to the directors, and how the approvals of the directors and the stockholders were obtained. The latter aspect of fairness relates to the

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97. Aronson v. Lewis, 473 A.2d 805, 812 (Del. 1984), *overruled in part on other grounds by* Brehm v. Eisner, 746 A.2d 244 (Del. 2000) (citations omitted).

98. *See* Sinclair Oil Corp. v. Levien, 280 A.2d 717, 720 (Del. 1971).

99. *See Aronson*, 473 A.2d at 812; Wynn Resorts, Ltd. v. Eighth Judicial Dist. Court of Nev., 399 P.3d 334, 343 (Nev. 2017).

100. *E.g.*, MASS. GEN. LAWS ANN. ch. 156D, § 8.30(a) (West 2003); MICH. COMP. LAWS ANN § 450.1541a(1) (West 1989); WASH. REV. CODE § 23B.08.300(1) (1989).

101. *See* Lewis H. Lazarus & Brett M. McCartney, *Standards of Review in Conflict Transactions on Motions to Dismiss: Lessons Learned in the Past Decade*, 36 DEL. J. CORP. L. 967, 972 (2011) ("The business judgment standard of review is the most difficult for a plaintiff's complaint to survive a motion to dismiss.").

102. *See* Cede & Co. v. Technicolor, Inc., 634 A.2d 345, 361 (Del. 1993).

> economic and financial considerations of the proposed merger, including all relevant factors: assets, market value, earnings, future prospects, and any other elements that affect the intrinsic or inherent value of a company's stock.[103]

The entire fairness standard is much less favorable for the defendant director and is more likely to lead to a finding of breach of fiduciary duty.[104] Different jurisdictions have different names and slightly different formulations of the fairness standard, but the substance is the same: "[t]he essence of the test is whether or not under all the circumstances the transaction carries the earmarks of an arm's length bargain."[105]

Directors of Retail Marijuana Corporations will have difficulty availing themselves of the business judgment rule because they are intentionally causing the corporation to violate the law (i.e., the CSA). As a result of this intentional violation of law, plaintiffs will be able to rebut the presumption of the business judgment rule in a suit against these directors. First, it is axiomatic that intentionally violating applicable law is acting in bad faith.[106] A director who has acted in bad faith loses the protection of the business judgment rule in a duty of care case.[107] Second, acting in bad faith by intentionally violating the law is a breach of the duty of loyalty, which makes the busi-

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103. Weinberger v. UOP, Inc., 457 A.2d 701, 711 (Del. 1983).

104. *See* Mills Acquisition Co. v. Macmillan, Inc., 559 A.2d 1261, 1279 (Del. 1989) (stating that under entire fairness review, "the challenged transaction must withstand rigorous judicial scrutiny. . .").

105. Pepper v. Litton, 308 U.S. 295, 306-07 (1939) (footnote omitted); *see* Kim v. Grover C. Coors Tr., 179 P.3d 86, 93 (Colo. App. 2007) (commenting that the fairness tests in Delaware, Colorado, and most other jurisdictions are functionally the same).

106. *See, e.g.*, *In re* Walt Disney Co. Derivative Litig., 907 A.2d 693, 755 (Del. Ch. 2005), *aff'd* 906 A.2d 27 (Del. 2006) ("A failure to act in good faith may be shown . . . where the fiduciary acts with the intent to violate applicable positive law . . . ."); Melvin A. Eisenberg, *The Duty of Good Faith in Corporate Law*, 31 DEL. J. CORP. L. 1, 31 (2006) ("A well established principle under the duty of good faith is that a manager may not knowingly cause the corporation to violate the law, even when it is rational to believe that the violation would maximize corporate profits and shareholder gain . . . .").

107. *See* Aronson v. Lewis, 473 A.2d 805, 812 (Del. 1984), *overruled in part on other grounds by* Brehm v. Eisner, 746 A.2d 244 (Del. 2000); Wynn Resorts, Ltd. v. Eighth Judicial Dist. Court of Nev., 399 P.3d 334, 343 (Nev. 2017).

ness judgment rule inapplicable.[108] This is true even if directors believe that violating the law is in the corporation's best interests.[109] For instance, it would certainly save the corporation money if its directors chose to cause the corporation not to pay its taxes. The good intentions (saving the corporation money) do not cleanse the bad act (violating tax laws). In the same way, the good intentions of causing a Retail Marijuana Corporation to prosper by selling as much marijuana as possible do not cleanse the bad act of violating the CSA. Thus, the conduct of Retail Marijuana Corporations' directors should be analyzed under the more stringent entire fairness standard in a breach of fiduciary duty case.

Though this is the result the law calls for, a state court in a state that has legalized the retail marijuana business may exercise its discretion and apply the more lenient business judgment rule standard of review. As issues of fiduciary duty typically arise under state law, a state court could potentially decide to treat directors of Retail Marijuana Corporations as not having committed knowing violations of the law so long as the corporations are acting in accordance with state law. Also, if directors are acting pursuant to counsel's advice[110] that they

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108. *See* CDX Liquidating Tr. v. Venrock Assocs., 640 F.3d 209, 215 (7th Cir. 2011); *In re* Tri-Star Pictures, 634 A.2d 319, 333 (Del. 1993); RONALD J. COLOMBO, LAW OF CORPORATE OFFICERS & DIRECTORS: RIGHTS, DUTIES & LIABILITIES § 2:16 (2019) ("The business judgment rule also will not protect a director who breached his or her duty of loyalty through a failure to act in good faith.").

109. Eisenberg, *supra* note 106, at 31.

110. In the early days of marijuana legalization, attorneys' ability to counsel clients on compliance with state marijuana law was limited by professional ethics rules. *See* Sam Kamin & Eli Wald, *Marijuana Lawyers: Outlaws or Crusaders?*, 91 OR. L. REV. 869, 899–905 (2013) (describing the ethical limitations on attorneys' ability to counsel clients regarding marijuana law). More recently, states that have legalized recreational marijuana have permitted their lawyers to engage in greater client counseling on marijuana-related issues, while cautioning them to stay abreast of potential changes to federal law. *See, e.g.*, COLO. RULES OF PROF'L CONDUCT r. 1.2 cmt. 14 (COLO. BAR ASS'N 2016), https://www.cobar.org/For-Members/Opinions-Rules-Statutes/Rules-of-Professional-Conduct/Rule-12-Scope-of-Representation-and-Allocation-of-Authority-Between-Client-and-Lawyer (permitting Colorado lawyers to "counsel a client regarding the validity, scope, and meaning" of Colorado's medical and retail marijuana laws, and to "assist a client in conduct that the lawyer reasonably believes is permitted by" Colorado's marijuana laws, provided that the lawyers must also "advise the client regarding related federal law and policy"); Maine Prof'l Ethics Comm'n, Op. 215

are complying with the law and the directors' reliance on this advice is reasonable,[111] state courts could decline to find a knowing violation of law. This could permit application of the business judgment rule to the directors' conduct, which would more likely result in a favorable judgment for the directors.

Such an exercise of discretion would prove difficult in certain jurisdictions. For instance, in *Coats v. Dish Network, LLC*, the Colorado Supreme Court held that an activity cannot be "lawful" for purposes of a state statute unless it is lawful under both state and federal law.[112] In *Coats*, the court rejected the plaintiff-employee's claim that his licensed medical marijuana use was a "lawful activity" and that Colorado's Lawful Activities Statute prohibited Dish Network from terminating his employment because of this use.[113] After *Coats*, it would be difficult

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(2017), https://www.mebaroverseers.org/attorney_services/opinion.html?id=734620 ("[N]otwithstanding current federal laws regarding use and sale of marijuana, Rule 1.2 [prohibiting lawyers from assisting in criminal activity] is not a bar to assisting clients to engage in conduct that the attorney reasonably believes is permitted by Maine laws regarding medical and recreational marijuana . . . . The Commission cautions that, because the DOJ guidance on prosecutorial discretion is subject to change, lawyers providing advice in this field should be up to date on federal enforcement policy, as well as any modifications of federal and state law and regulations, and advise their clients of the same."); Washington State Bar Ass'n, Advisory Op. 201501 (2015), http://mcle.mywsba.org/IO/print.aspx?ID=1682 (permitting Washington lawyers to assist clients with conduct that complies with Washington's marijuana laws, though cautioning that this guidance "may have to be reconsidered" if "the federal government changes its position and again seeks to enforce the CSA against the kinds of activities made lawful under" Washington's state marijuana laws).

111. Though it is not an absolute defense to liability, directors are typically entitled to rely upon the advice of counsel within the scope of counsel's expertise, so long as that reliance is reasonable, either by statute or as a matter of common law. *See, e.g.*, ALASKA STAT. ANN. § 10.06.450(b)(2) (West 1989) (permitting directors "to rely on information, opinions, reports, or statements . . . prepared or presented by . . . (2) counsel . . . as to matters that the director reasonably believes to be within the person's professional or expert competence[ ]"); IOS Capital, Inc. v. Phoenix Printing, Inc., 808 N.E.2d 606, 614 (Ill. App. Ct. 2004) ("While an officer or director may not blindly accept counsel's advice to avoid liability, he may rely on such advice when he does not have knowledge of his actions causing such reliance to be unwarranted.").

112. Coats v. Dish Network, LLC, 2015 CO 44, ¶ 4 (en banc).

113. COLO. REV. STAT. ANN. § 24-34-402.5 (West 2007); *Coats*, 2015 CO 44, ¶ 4 (holding "an activity such as medical marijuana use that is unlawful under federal law is not a 'lawful' activity" under the state statute).

for a Colorado court to find that engaging in the retail marijuana business does not involve a violation of law, and so it would be difficult to avoid application of an entire fairness standard of review.

Though a stricter standard of review may be unavoidable for directors of Retail Marijuana Corporations, it may not prove fatal. Presumably, a court could find directors' conduct on behalf of a Retail Marijuana Corporation to be entirely fair to the corporation, even as the court recognizes that the conduct violates federal law. For instance, imagine that a shareholder of a Retail Marijuana Corporation brings a claim against the directors, arguing that the directors breached their duty of care when approving a large marijuana distribution contract. Clearly, this contract violates the CSA, and in approving the contract the directors are aiding the corporation in violating (or inducing the corporation to violate) the CSA. The directors are not entitled to business judgment rule protection on the duty of care claim because they have acted in bad faith, in that they have knowingly violated applicable law. The court should apply a fairness test to determine whether the contract is fair to the corporation. Normally, acting in bad faith would be highly detrimental to the directors' efforts to prove that they have treated the corporation fairly. Assuming the only strike against the directors was the CSA violation, a court could still find that they treated the corporation fairly in approving the distribution contract because they acted in accordance with state marijuana laws and, accordingly, that they did not breach their duty of care. Though a fairness finding would not insulate the directors from other duty of loyalty claims or otherwise revive the customary protections directors of Retail Marijuana Corporations stand to lose,[114] the exercise of state courts' discretion might at least protect directors against liability for breach of the duty of care.

2. *Exculpation Provisions*

A second source of protection for corporate directors is a provision in the corporation's articles of incorporation that eliminates or limits directors' personal liability to the corporation for monetary damages arising from a breach of the duty of care. These exculpation provisions are authorized under

114. *See infra* Sections II.A.2, 3, 4 for a discussion of these protections.

many state corporation statutes.[115] Exculpation provisions typically apply only to breaches of the duty of care, not to breaches of the duty of loyalty (i.e., conduct that involves bad faith or conflicts of interest).[116] While exculpation provisions do not prevent courts from granting injunctive relief for fiduciary duty breaches, they do protect directors from having to pay damages for these breaches out of their own pockets. Exculpation provisions are very common and they are clearly highly desirable from a director's perspective.[117]

Directors of Retail Marijuana Corporations do not stand to benefit fully from exculpation provisions because of the nature of their corporations' business. The Massachusetts exculpation statute is illustrative. It permits corporations to include in their articles of incorporation

> [a] provision eliminating or limiting the personal liability of a director to the corporation for monetary damages for breach of fiduciary duty as a director

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115. *E.g.*, ALASKA STAT. ANN. § 10.06.210(M) (West 2015) (permitting "a provision eliminating or limiting the personal liability of a director to the corporation or its stockholders for monetary damages for the breach of fiduciary duty as a director," but not for "a breach of a director's duty of loyalty to the corporation or its stockholders" or "acts or omissions not in good faith or that involve intentional misconduct or a knowing violation of law"); CAL. CORP. CODE § 204(10) (West 2018) (permitting "[p]rovisions eliminating or limiting the personal liability of a director for monetary damages in an action brought by or in the right of the corporation for breach of a director's duties to the corporation and its shareholders, . . . provided, however, that (A) such a provision may not eliminate or limit the liability of directors (i) for acts or omissions that involve intentional misconduct or a knowing and culpable violation of law, [or] (ii) for acts or omissions that a director believes to be contrary to the best interests of the corporation or its shareholders or that involve the absence of good faith on the part of the director"); MICH. COMP. LAWS ANN. § 450.1209 (West 1997) (permitting "[a] provision eliminating or limiting a director's liability to the corporation or its shareholders for money damages for any action taken or any failure to take any action as a director, except liability for any of the following: . . . . (iv) An intentional criminal act"); VT. STAT. ANN. tit. 11A § 2.02(b)(4) (West 1993) (permitting "a provision eliminating or limiting the liability of a director to the corporation or its shareholders for money damages for any action taken, or any failure to take any action, solely as a director, based on a failure to discharge his or her own duties . . . . , except liability for: . . . (D) an intentional or reckless criminal act").

116. *See, e.g.*, *supra* note 115.

117. Julian Velasco, *How Many Fiduciary Duties Are There in Corporate Law?*, 83 S. CAL. L. REV. 1231, 1256 (2010).

> notwithstanding any provision of law imposing such liability; *but the provision shall not eliminate or limit the liability of a director* (i) for any breach of the director's *duty of loyalty* to the corporation or its shareholders, (ii) for acts or omissions *not in good faith* or which involve intentional misconduct or a *knowing violation of law*[.][118]

Thus, the Massachusetts statute's express terms do not permit corporations—including Retail Marijuana Corporations—to insulate their directors from liability if they breach their duty of loyalty, act in bad faith, or knowingly violate the law. Since directors of Retail Marijuana Corporations do breach their duty of loyalty and act in bad faith by knowingly violating the CSA, their liability to the corporation arising from their marijuana-related activity cannot be reduced by an exculpation provision in the corporation's articles of incorporation.

However, it is important to emphasize that exculpation provisions protect directors only from having to pay money damages "to the corporation."[119] As discussed below,[120] suits brought by or in the right of a Retail Marijuana Corporation or its shareholders may be of limited success because of the unclean hands or *in pari delicto* defenses, which means directors may be in less need of exculpation provisions in connection with these suits. Moreover, the statutory language does not bar exculpation for directors for conduct that does not arise out of the directors' violations of the CSA. Presumably, they could still be protected from paying damages for breaches of care unrelated to the CSA violations.[121]

3. *Indemnification*

The third source of protection from liability for directors is indemnification. Indemnification statutes guard directors from personal liability by permitting, or in some cases mandat-

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118. MASS. GEN. LAWS ANN. ch. 156D, § 2.02(b)(4) (West 2003) (emphasis added).

119. *E.g., id.* Exculpation provisions are not intended to reduce directors' liability to third parties.

120. *See infra* Section II.A.5.a.

121. For a discussion of whether any of Retail Marijuana Corporation directors' conduct would be considered non-marijuana-related, and therefore eligible for exculpation, see *infra* Section II.A.5.c.

ing, that the corporation reimburse the directors for their legal fees, judgments, settlement amounts, and other costs incurred in actions and proceedings to which the directors are party because of their service as directors.[122] Indemnification statutes typically permit corporations to indemnify directors who acted in good faith and in a manner reasonably believed to be in (or not opposed to) the corporation's best interests and who, in a criminal action, did not have reasonable cause to believe their conduct was unlawful.[123] They generally mandate indemnification for expenses incurred in actions and proceedings in which a director was successful, on the merits or otherwise.[124] Statutory indemnification provisions typically

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122. *E.g.*, ALASKA STAT. ANN. § 10.06.490 (West 1988) ("A corporation *may indemnify* a person who was, is, or is threatened to be made a party to a completed, pending, or threatened action or proceeding, whether civil, criminal, administrative, or investigative, . . . by reason of the fact that the person is or was a director, officer, employee, or agent of the corporation[ ] . . . .") (emphasis added); ME. REV. STAT. tit. 13-B §714(2) (1981) ("[T]o the extent that a director, officer, or agent of a corporation has been successful on the merits or otherwise in defense of any action, suit or proceeding . . . , or in defense of any claim, issue or matter therein, *he shall be indemnified* against expenses, including attorney's fees, actually and reasonably incurred by him in connection therewith.") (emphasis added).

123. *E.g.*, ALASKA STAT. ANN. § 10.06.490 (West 1980) ("Indemnification may include reimbursement of expenses, attorney fees, judgments, fines, and amounts paid in settlement actually and reasonably incurred by the person in connection with the action or proceeding if the person acted in good faith and in a manner the person reasonably believed to be in or not opposed to the best interests of the corporation, and, with respect to a criminal action or proceeding, the person had no reasonable cause to believe the conduct was unlawful."); 805 ILL. COMP. STAT. ANN. 105/108.75 (West 2012) ("A corporation may indemnify any person who is a party to any threatened, pending, or completed action, suit or proceeding[ ] . . . if such person acted in good faith and in a manner he or she reasonably believed to be in, or not opposed to the best interest of the corporation, and, with respect to any criminal action or proceeding, had no reasonable cause to believe his or her conduct was unlawful.").

124. *E.g.*, WASH. REV. CODE ANN. § 23B.08.520 (West 1989) ("Unless limited by its articles of incorporation, a corporation shall indemnify a director who was wholly successful, on the merits or otherwise, in the defense of any proceeding to which the director was a party because of being a director of the corporation against reasonable expenses incurred by the director in connection with the proceeding."). Directors can be "otherwise" successful if claims brought against them are dismissed for technical reasons, such as for lack of jurisdiction. Waltuch v. Conticommodity Servs., Inc., 88 F.3d 87, 96 (2d Cir. 1996) (applying Delaware law) ("[V]indication, when used as a syn-

also permit the advancement of expenses prior to a proceeding's final resolution,[125] and may permit broader indemnification rights by agreement among the corporation and its directors and stockholders.[126] Indemnification is a highly valuable protection for directors, whose legal fees and related costs can total millions of dollars.

This valuable protection is likely lost for directors of Retail Marijuana Corporations. The very text of the statutes—permitting indemnification for acts in good faith and in circumstances under which the directors do not have cause to believe their conduct was unlawful—bars indemnification of directors engaged in retail marijuana-related activity. As ad-

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onym for 'success' under [Delaware's mandatory indemnification statute provision], does not mean moral exoneration. Escape from an adverse judgment or other detriment, for whatever reason, is determinative."). In *Waltuch*, the Second Circuit held that an officer was entitled to indemnification when his employer paid a settlement on his behalf, since he personally did not have to pay the settlement amount. *Id.* at 97.

125. *E.g.*, MASS. GEN. LAWS ANN. ch. 156D, § 8.53 (WEST 2003) ("A corporation may, before final disposition of a proceeding, advance funds to pay for or reimburse the reasonable expenses incurred by a director who is a party to a proceeding because he is a director if he delivers to the corporation: (1) a written affirmation of his good faith belief that he has met the relevant standard of conduct [for indemnification] . . .; and (2) his written undertaking to repay any funds advanced if he is not entitled to mandatory indemnification . . . ."); WASH. REV. CODE ANN. § 23B.08.530 (West 1989) ("A corporation may pay for or reimburse the reasonable expenses incurred by a director who is a party to a proceeding in advance of final disposition of the proceeding if: (a) The director furnishes the corporation a written affirmation of the director's good faith belief that the director has met the standard of conduct . . . [required for indemnification]; and (b) The director furnishes the corporation a written undertaking[ ] . . . to repay the advance if it is ultimately determined that the director did not meet the standard of conduct.").

126. *E.g.*, ME. REV. STAT. ANN. tit. 13-B, § 714 (1981) ("The indemnification provided by this section shall not be deemed exclusive of any other rights to which those indemnified may be entitled under any bylaw, agreement, vote of disinterested directors or otherwise[ ] . . . ."); WASH. REV. CODE ANN. § 23B.08.560 (West 1989) ("If authorized by the articles of incorporation, a bylaw adopted or ratified by the shareholders, or a resolution adopted or ratified, before or after the event, by the shareholders, a corporation shall have power to indemnify or agree to indemnify a director made a party to a proceeding, or obligate itself to advance or reimburse expenses incurred in a proceeding, without regard to the limitations in [the indemnification statute provisions], . . ." with certain limitations).

dressed above, knowingly violating the law is bad faith.[127] Moreover, directors of Retail Marijuana Corporations serve as directors knowing that the retail marijuana business is criminal under federal law; they most certainly have reasonable cause to believe that their conduct is unlawful. Many of the statutes expressly prohibit indemnification of directors for expenses incurred in connection with a knowing violation of law, even when the statutes otherwise expand the scope of permissible indemnification.[128] Thus, directors of Retail Marijuana Corporations are not entitled to indemnification for expenses arising out of their retail marijuana-related activities.

4. *D&O Insurance*

The fourth protection that corporations frequently provide to their directors and officers is insurance against personal liability, known as director and officer insurance ("D&O insurance"). Corporations purchase D&O insurance on behalf of their directors and officers; the policies reimburse directors and officers when they incur liability from their service as agents of the corporation.[129] Statutes typically permit D&O insurance to cover liability for which directors and officers can-

127. *See supra* note 106 and accompanying text.

128. *E.g.*, COLO. REV. STAT. § 7-109-109 (2018) ("A provision treating a corporation's indemnification of, or advance of expenses to, directors that is contained in its articles of incorporation or bylaws, in a resolution of its shareholders or board of directors, or in a contract, . . . is valid only to the extent the provision is not inconsistent with" the statutory limits on indemnification, including under section 7-109-102(1)(c), which permits indemnification only if "[i]n the case of any criminal proceeding, the person had no reasonable cause to believe the person's conduct was unlawful"); WASH. REV. CODE ANN. § 23B.08.560 (West 1989) (No indemnification may be authorized by the articles of incorporation, bylaws, or shareholders for any "[a]cts or omissions of the director finally adjudged to be intentional misconduct or a knowing violation of law").

129. *See* CAL. CORP. CODE § 317(i) (Deering 1995) (permitting corporations to purchase D&O insurance); COLO. REV. STAT. 7-109-108 (2019) (same). Corporations may also purchase D&O insurance to reimburse the company for indemnification payments or other specified losses. L. William Caraccio, *Void Ab Initio: Application Fraud as Grounds for Avoiding Directors' and Officers' Liability Insurance Coverage*, 74 CAL. L. REV. 929, 937 (1986); Sean Griffith, *Uncovering a Gatekeeper: Why the SEC Should Mandate Disclosure of Details Concerning Directors' and Officers' Liability Insurance Policies*, 154 U. PA. L. REV. 1147, 1164 (2006).

not be indemnified.[130] Thus, even if a Retail Marijuana Corporation could not indemnify its directors for expenses they incur because of conduct related to the retail marijuana business because of limitations on indemnification, it may be able to insure its directors against those losses.

However, D&O insurance is generally subject to various exclusions. Not all director and officer conduct is insurable. One common exclusion is losses arising from dishonest, fraudulent, criminal, or willful acts.[131] Losses arising from this type of conduct are typically expressly excluded by the policy's language; they may also be uninsurable by statute.[132] The likely result is that directors of Retail Marijuana Corporations cannot be insured against losses sustained because of their marijuana-related conduct. This conduct is certainly willful, in that they are knowingly and intentionally serving as directors of Retail Marijuana Corporations, and it is also criminal under the CSA. If either the insurance policy or the relevant state statute excludes insurance coverage for willful misconduct or criminal conduct, directors of Retail Marijuana Corporations will lose this valuable protection.[133]

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130. *E.g.*, ALASKA STAT. ANN. § 10.06.490(g) (West 1988) (permitting a corporation to purchase D&O insurance on behalf of a director "whether or not the corporation has the power to indemnify" that director); 805 ILL. COMP. STAT. ANN. 5/8.75(g) (West 2012); *see also* August Entm't, Inc. v. Phila. Indem. Ins. Co., 52 Cal. Rptr. 3d 908, 913 (Cal. Ct. App. 2007).

131. HON. H. WALTER CROSKEY ET AL., CALIFORNIA PRACTICE GUIDE: INSURANCE LITIGATION, Ch. 7F-C 7:1677 (database updated Aug. 2018); Bernard Black, Brian Cheffins & Michael Klausner, *Outside Director Liability*, 58 STAN. L. REV. 1055, 1086 (2006); Tom Baker & Sean Griffith, *The Missing Monitor in Corporate Governance: The Directors' & Officers' Liability Insurer*, 95 GEO. L. J. 1795, 1820 (2007).

132. *See, e.g.*, CAL. INS. CODE § 533 (West 2019) ("An insurer is not liable for a loss caused by the wilful [sic] act of the insured . . . ."); Aug. Entm't, Inc., 52 Cal. Rptr. 3d at 913 (recognizing that California's corporation statute "does not authorize an insurance company to cover a risk that it could not lawfully cover in the statute's absence. For instance, a D & O policy cannot insure against willful wrongdoing."); Mez Indus., Inc. v. Pac. Nat'l Ins. Co., 90 Cal. Rptr. 2d 721 (Cal. Ct. App. 1999) (holding that the Directors could not be insured from losses arising from their willful conduct resulting in a patent infringement suit where the company induced its customers to infringe upon a competitor's patent); CROSKEY ET AL., *supra* note 131, at 1677.

133. The problem is greater for directors in two scenarios: first, directors of corporations in states with statutes that prohibit insurance of criminal conduct (or similar language); and, second, directors of corporations that

5. *Caveats*

Though directors of Retail Marijuana Corporations stand to lose significant protections from personal liability under state fiduciary duty law, there are three limiting factors to the above analysis. First, equitable defenses may be available to directors in suits brought by shareholders of Retail Marijuana Corporations. Second, shareholders may consent to or ratify actions taken by directors and thereby eliminate potential claims otherwise available to the corporation or its shareholders. Third, courts may be willing to distinguish between the directors' unlawful, marijuana-related conduct and other lawful, non-marijuana-related acts. This Section discusses all three caveats in turn.

a. Unclean Hands and *In Pari Delicto*

The first caveat comes in the form of two important equitable doctrines that may mitigate directors' liability to shareholders:[134] the doctrines of unclean hands and *in pari delicto*. The unclean hands doctrine provides that a person will not get relief from a court of equity if his or her conduct has not been fair, equitable, and honest in relation to the subject of the re-

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secured D&O insurance before the corporations entered (or contemplated entering) the retail marijuana business. In the first scenario, insurers and the corporation cannot contractually agree to insure against losses arising out of marijuana-related activity because they do not have the power to override the statute by contract. In the second, the insurance policy was likely obtained with an exclusion for criminal activity; unless the insurer agrees to amend the policy to insure against marijuana-related losses, the policy language likely would not protect the directors against those losses. In contrast, if a Retail Marijuana Corporation sought a D&O insurance policy in a state without a statute prohibiting insurance of criminal conduct (or, more likely, in a state in which retail marijuana sales are legal under state law and state courts would not strike down an insurance contract covering retail marijuana-related activity as a matter of public policy), the corporation and the insurer could agree upon policy language that would protect the corporation's directors even as they engage in retail marijuana-related activities.

134. Directors generally do not owe fiduciary duties to corporate creditors, so there is not the same concern about personal liability for breach of a fiduciary duty owed to a creditor. Jonathan C. Lipson, *The Expressive Function of Directors' Duties to Creditors*, 12 STAN. J.L. BUS. & FIN. 224, 225 (2007). That said, directors may still face liability to creditors for fraud under the federal securities laws. *See infra* Section II.D.

quested relief.[135] The *in pari delicto* doctrine is similar. Literally, it means "in equal fault."[136] As a defense, *in pari delicto* prevents the plaintiff from recovering damages arising or resulting from the plaintiff's own wrongdoing or misconduct; the court denies relief when the parties "have acted with the same degree of knowledge as to the illegality of the transaction" and leaves the parties as it found them, without resolving the claim in either's favor.[137] Because shareholders in Retail Marijuana Corporations know (or are chargeable with knowing) that they are investing in an illegal business, they may be denied equitable relief and be barred from recovering damages under the unclean hands and/or *in pari delicto* doctrines.[138] However, in light of retail marijuana's shifting legal status, there is no guarantee that a court would apply either of these defenses to a claim brought by a plaintiff shareholder of a Retail Marijuana Corporation in the context of a state fiduciary duty claim.[139]

These doctrines also may not apply to shareholders who invested in a corporation before it became a Retail Marijuana Corporation. For example, Fortune 500 alcoholic beverage maker Constellation Brands, Inc. ("Constellation") has invested over four billion dollars in Canopy Growth Corporation ("Canopy Growth"), a Canadian Retail Marijuana Corporation, which investment could give Constellation greater than

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135. *See* Salzman v. Bachrach, 996 P.2d 1263, 1269 (Colo. 2000) (en banc); 27A AM. JUR. 2D *Equity* § 98 (2020).

136. 27A AM. JUR. 2D *Equity* § 24 (2020).

137. *Id.*

138. See Casey W. Baker, *Marijuana's Continuing Illegality and Investors' Securities Fraud Problem: The Doctrines of Unclean Hands and In Pari Delicto*, 12 J. BUS. ENTREPRENEURSHIP & L. 93, 110–15 (2019) for a fuller discussion of the unclean hands and *in pari delicto* doctrines as applied to investors in marijuana-related businesses.

139. *See* Sangamon Assocs., Ltd. v. Carpenter 1985 Family P'ship, Ltd., 165 S.W.3d 141, 145–46 (Mo. 2005) (en banc), *as modified on denial of reh'g* (July 12, 2005) (The unclean hands doctrine "should be applied when it promotes right and justice by considering all of the facts and circumstances of a particular case. . . . [C]ourts have stated that the doctrine of unclean hands is not one of absolutes and can be used in the discretion of a court of equity.") (internal citations and quotations omitted); Baker, *supra* note 138, at 112–15 (discussing application of the unclean hands and *in pari delicto* defenses to securities fraud claims brought by investors in marijuana-related businesses); see also *infra* Section II.D.2.a.iv for a discussion of the *in pari delicto* defense as applied to federal securities law claims.

fifty percent ownership of Canopy Growth.[140] Constellation is also working with Canopy Growth to produce and sell marijuana-infused beverages.[141] A shareholder who invested in Constellation prior to Constellation's initial purchase of Canopy Growth stock in October 2017[142] presumably would not be barred by the unclean hands or *in pari delicto* defenses from bringing a breach of fiduciary duty claim against Constellation's directors on the basis of Constellation's marijuana-related activities, though a later investor could be.[143]

b. Shareholder Consent or Ratification

The second potential limitation on directors' liability is shareholder consent or ratification. Shareholders with knowledge of the material facts can give their prior consent to directors to act on behalf of the corporation in ways that the directors would otherwise not be authorized to do.[144] They can also ratify the directors' acts after the fact. Ratification is affirmance of an unauthorized (or ambiguously authorized) act

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140. Press Release, Constellation Brands, Constellation Brands to Invest $5 Billion CAD ($4 Billion USD) in Canopy Growth to Establish Transformative Global Position and Alignment (Aug. 5, 2018), https://www.canopygrowth.com/wp-content/uploads/2018/08/CBI-CG-Press-Release-FINAL.pdf.

141. David Reid, *Corona Beer Owner Set to Buy Into World's Largest Cannabis Grower*, CNBC (Oct. 30, 2017, 10:36 AM), https://www.cnbc.com/2017/10/30/cannabis-drinks-planned-as-constellation-brands-invests-in-canopy-growth-corporation.html.

142. Press Release, Constellation Brands, Constellation Brands to Acquire Minority Stake in Canopy Growth Corporation (Oct. 30, 2017), https://www.cbrands.com/news/articles/constellation-brands-to-acquire-minority-stake-in-canopy-growth-corporation.

143. This assumes that, by investing in a Retail Marijuana Corporation and working to produce marijuana-infused beverages, Constellation has engaged in the retail marijuana business as well, or that its directors otherwise have engaged in conduct that would support a breach of duty claim for knowing violation of law. The press release announcing Constellation's initial investment in Canopy Growth assured that Constellation had "no plans to sell any cannabis products in the U.S. or any other market unless or until it is legally permissible to do so at all government levels." *Id.* Obviously, a plaintiff investor would need to point to a violation of law in order to bring a fiduciary duty claim on that basis.

144. *See* 3 FLETCHER CYCLOPEDIA OF THE LAW OF CORPORATIONS § 998, Westlaw (database updated Sept. 2019); *see also* Alvest, Inc. v. Superior Oil Corp., 398 P. 2d 213, 216 (Alaska 1965).

done on another's behalf.[145] Ratification has the same legal effect as prior authorization, meaning the act or contract is treated as if it were originally authorized, subject to third parties' intervening rights.[146] If shareholders have actual knowledge of the material facts of a director's act or transaction and they give their prior consent or later ratify it, the director will not face liability to the corporation or the shareholders on the basis of that act or transaction.[147] Shareholders can ratify directors' actions or contracts on behalf of the corporation if the directors have acted without authority or have exceeded their authority, provided that those actions or contracts are ones that the shareholders had the power to authorize at the outset.[148] They cannot ratify an act that is within the directors' exclusive province under the corporation's charter.[149] Shareholder ratification may be express, at a duly held shareholder meeting (or by written consent), or it may be implied under certain circumstances.[150] Ratification can be implied from words or conduct, including by accepting and retaining the benefits of an act or contract with full knowledge of the material facts, acting in a way that is consistent with adopting the act or contract, or acquiescing or failing to repudiate the act or contract.[151]

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145. 2A FLETCHER CYCLOPEDIA OF THE LAW OF CORPORATIONS § 752, Westlaw (database updated Sept. 2019); *see also* Edwards v. Carson Water Co., 34 P. 381, 389 (1893).

146. *Edwards*, 34 P. at 389.

147. 3 FLETCHER CYCLOPEDIA OF THE LAW OF CORPORATIONS § 998, Westlaw (database updated Sept. 2019).

148. 2A FLETCHER CYCLOPEDIA OF THE LAW OF CORPORATIONS § 752, Westlaw (database updated Sept. 2019).

149. *Id.* § 764; *see also, e.g.*, Milligan v. G.D. Milligan Grocer Co., 233 S.W. 506, 510 (Mo. Ct. App. 1921) ("Since the stockholders had no power to declare a dividend in the first instance, they could not, by any form of ratification of the illegal act of another, impart life to that which they were powerless to create. Ratification, to be effective, must be by the same body invested with the power to act in the first instance.").

150. *See* 2A FLETCHER CYCLOPEDIA OF THE LAW OF CORPORATIONS §§ 752, 767, Westlaw (database updated Sept. 2019).

151. *Id.* § 767; *see also* Inn Foods, Inc. v. Equitable Coop. Bank, 45 F.3d 594, 597 (1st Cir. 1995) ("[R]atification can be implied when a principal with knowledge makes no effort to repudiate a transaction."); *In re* Bennett Funding Grp., Inc., 336 F.3d 94, 100–01 (2d Cir. 2003) (implying ratification where shareholders were aware of the CEO's fraud and personally benefitted from it); Frank v. Wilson & Co., 32 A.2d 277, 283 (Del. 1943) ("Where

Generally, a disinterested majority of shareholders is required to consent to or ratify directors' acts, as shareholders holding less than a majority of the corporation's voting power cannot be said to have acted for the corporation.[152] An ultra vires act requires unanimous shareholder approval,[153] though even unanimous consent cannot validate an act that violates a statute or that is against public policy.[154] Nor can shareholders thwart claims against the corporation by creditors or the state through consent or ratification.[155] Thus, consent and ratification are primarily useful to directors insofar as they clarify directors' authority or authorize a previously unauthorized act, and thereby eliminate some potential claims shareholders could otherwise bring against the directors.

Shareholder consent or ratification may insulate directors of Retail Marijuana Corporations against shareholder claims that the directors' actions violated fiduciary duties owed to the corporations or their shareholders. For example, imagine that an investor purchases shares in a Retail Marijuana Corporation that operates a dispensary in Colorado. This investor almost certainly could not mount a direct claim against the corporation's directors for breach of fiduciary duty on the basis that the directors have caused the corporation to engage in illegal activity by operating the dispensary. A court would surely find that the shareholder consented to the corporation's engagement in the retail marijuana business by purchasing the shares.[156] Similarly, the shareholder would have difficulty bringing a derivative claim on the corporation's behalf,

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the conduct of a complainant, subsequent to the transaction objected to, is such as reasonably to warrant the conclusion that he has accepted or adopted it, his ratification is implied through his acquiescence.").

152. 2A FLETCHER CYCLOPEDIA OF THE LAW OF CORPORATIONS § 764, Westlaw (database updated Sept. 2019).

153. *Id.*; *see supra* Section I.D. (discussing ultra vires acts).

154. 2A FLETCHER CYCLOPEDIA OF THE LAW OF CORPORATIONS § 764, Westlaw (database updated Sept. 2019).

155. *See* 7A FLETCHER CYCLOPEDIA OF THE LAW OF CORPORATIONS § 3432, Westlaw (database updated Sept. 2019).

156. *Cf.* Bangor Punta Operations, Inc. v. Bangor & A. R. Co., 417 U.S. 703, 710 (1974) ("[A] shareholder may not complain of acts of corporate mismanagement if he acquired his shares from those who participated or acquiesced in the allegedly wrongful transactions."). This claim would presumably also be barred under the unclean hands or *in pari delicto* doctrines as well. *See supra* Section II.A.5.a.

since a court would likely find that a majority of shareholders had impliedly ratified the board's actions in causing the corporation to operate the dispensary. (Set aside for the moment the fact that the shareholders cannot ratify the corporation's engagement in the retail marijuana business in the sense that they cannot, even by unanimous consent, make it legal to engage in that business.)

The same is likely true for shareholders who invest in a corporation before it engages in the retail marijuana business and remain invested without objection after the corporation can be considered a Retail Marijuana Corporation. For instance, Constellation's October 2017 investment in Canopy Growth was widely publicized. Constellation investors who owned stock in Constellation prior to October 2017 and subsequently learned that Constellation had invested in Canopy Growth and still retained their Constellation shares without objection could be found to have consented to the Canopy Growth investment. This argument becomes stronger after Constellation's second-stage investment in Canopy Growth in 2018: presumably, a Constellation investor who objected to the Canopy Growth investment had ample time to object or to sell his or her shares prior to the second stage of investment. Failing to object and remaining invested with full knowledge of the Canopy Growth investment could forestall that shareholder's individual claims for breach of duty. Further, a court could find implied ratification by the corporation (i.e., a majority of shareholders) in failing to object to either of the board's decisions to invest in Canopy Growth.

It is important not to overstate things. Not every silence constitutes implied consent or ratification. Moreover, shareholders do not have the power to manage the corporation, nor the right to vote on every business decision the corporation makes. This power is entrusted to the board.[157] The claim for ratification through failure to object is stronger in smaller corporations, in which shareholders may have more power and

157. *E.g.*, CAL. CORP. CODE § 300 (West, Westlaw through 2019 Reg. Sess.) ("[T]he business and affairs of the corporation shall be managed and all corporate powers shall be exercised by or under the direction of the board."); ME. STAT. tit. 13-C, § 801 (Westlaw through 2019 First Reg. Sess.) ("All corporate powers must be exercised by or under the authority of, and the business and affairs of the corporation managed under the direction of, the corporation's board of directors . . . .").

can more easily amass voting majorities, and weaker in public companies, in which individual shareholders may hold only a fraction of the voting power.

Consent and ratification probably matter most in two senses. First, to the extent the shareholders expressly consent to or ratify the board's decision to engage in retail marijuana-related activity, they likely close off claims by the shareholders or the corporation that the board has violated their fiduciary duties[158] by causing the corporation to engage in the retail marijuana business. Second, the doctrines of implied consent and ratification provide avenues for courts to deny individual shareholders' standing to bring claims for breach of fiduciary duty, whether direct or derivative, on the theory that those shareholders have knowingly acquiesced or participated in the activity giving rise to their claims.

c. Non-Marijuana-Related Conduct

This Section has considered all conduct of Retail Marijuana Corporations' directors as being in furtherance of the corporations' purposes of producing, distributing, and/or selling retail marijuana and, therefore, in violation of the CSA. It is also plausible that some director conduct would be viewed as unrelated to the retail marijuana business and, therefore, not unlawful. For instance, perhaps approving a merger agreement between the Retail Marijuana Corporation and another company is severable from the corporation's marijuana-related activity. If so, perhaps this decision would be entitled to review under the business judgment rule because it is not a knowing violation of the law in the same way that marijuana-related decisions are. A director making this decision should also be entitled to indemnification for the expenses incurred in defending it, as well as to insulation from personal liability for monetary damages under an exculpation clause, and to insurance proceeds under a D&O policy. In other words, the director's

158. Notably, even unanimous shareholder consent or ratification could not insulate the board against criminal liability for their marijuana-related activities. Neither would consent or ratification prevent any securities fraud claims, discussed *infra*, on the basis of directors' material misstatements or omissions, since the predicate for shareholder consent or ratification is full knowledge of the material facts.

non-marijuana-related decisions should arguably receive the benefit of customary director protections.

The counterargument is that every act a director takes on behalf of a corporation is for its benefit and helps it achieve its purposes. If the purpose of a Retail Marijuana Corporation is to manufacture and sell retail marijuana products, then every decision a director makes that contributes to the corporation's financial wellbeing and ability to achieve its business purpose is an act in furtherance of the manufacture and sale of marijuana. Under this interpretation, *every* act of a Retail Marijuana Corporation's director on the corporation's behalf is illegal, as it is aiding and abetting a CSA violation.[159]

This second interpretation probably goes too far. It seems unrealistic to say that every act of a director would be considered a separate instance of criminal activity. Courts would likely draw some line between marijuana-related and non-marijuana-related director conduct. But even if some conduct were unobjectionable, there would remain enough acts by the directors in furtherance of the retail marijuana business that they would likely face the consequences outlined in this Section. After all, if a person buys a candy bar at a convenience store and an hour later robs the store at gunpoint, it is little consolation to say that the candy bar purchase was entirely lawful. In the same way, directors who potentially face prison time, civil damages, and criminal penalties for their actions on behalf of a Retail Marijuana Corporation would likely not find it a great comfort that a portion of their decisions would enjoy customary director protections.

B. *Criminal Aiding and Abetting Liability*

The second potential source of liability for directors of Retail Marijuana Corporations is criminal aiding and abetting liability. Under Title 18, § 2(a), of the United States Code, a person who "aids, abets, counsels, commands, induces or procures" the commission of a crime against the United States "is punishable as a principal."[160] This section "reflects a centuries-old view of culpability: that a person may be responsible for a crime he has not personally carried out if he helps another to

159. *See infra* Section II.B. (discussing aiding and abetting liability).
160. 18 U.S.C. § 2(a) (2018).

complete its commission."[161] The Supreme Court has held that "under [Title 18 U.S.C.] § 2 'those who provide knowing aid to persons committing federal crimes, with the intent to facilitate the crime, are themselves committing a crime.' "[162] A person incurs aiding and abetting liability for a crime "if (and only if) he (1) takes an affirmative act in furtherance of that offense, (2) with the intent of facilitating the offense's commission."[163] The aider and abettor need not participate in every element of the offense.[164]

Accordingly, it follows that even if directors of a Retail Marijuana Corporation do not themselves "manufacture, distribute, or dispense" marijuana in violation of the CSA,[165] they could be found to be aiding, abetting, or inducing the corporation to do so, and could be held personally liable for that crime.[166] A Retail Marijuana Corporation would be the principal that actually produces and sells the controlled substance; a director of that corporation would certainly be taking affirmative acts in furtherance of the manufacture and distribution of marijuana with the intent of facilitating that manufacture and distribution. For example, corporate directors might engage in activities such as approving the acquisition of a distribution facility, hiring an officer in charge of sales, or ratifying a distribution contract. Each of these acts would aid the corporation in distributing marijuana in violation of the CSA, so any of these acts could potentially give rise to aiding and abetting liability for those directors. If the purpose of a Retail Marijuana Corporation is to produce and sell retail marijuana products, then any actions a director takes on the corporation's behalf and in furtherance of that purpose can be considered acts in furtherance of the corporation's CSA violations.

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161. Rosemond v. United States, 572 U.S. 65, 70 (2014) (citation omitted).

162. *Id.* at 71 (quoting Cent. Bank of Denver, N.A. v. First Interstate Bank of Denver, N.A., 511 U.S. 164, 181 (1994)).

163. *Id.* (citations omitted).

164. *Id.* at 73.

165. Controlled Substances Act, 21 U.S.C. § 841(a)(1) (2018).

166. *See* Bourgoin v. Twin Rivers Paper Co., 2018 ME 77, ¶ 16, 187 A.3d 10, 17 (finding an employer would be subject to aiding and abetting liability under the CSA if it subsidized its employee's medical marijuana purchase as required under Maine's medical marijuana act).

The penalties for violating the CSA are severe. Manufacturing, distributing, or dispensing one thousand or more marijuana plants or one thousand kilograms or more of a substance containing a detectible amount of marijuana carries a penalty of not less than ten years' imprisonment, and up to life in prison, and a fine up to $10 million.[167] Even the lightest penalty, imposed for manufacturing, distributing, or dispensing fewer than fifty marijuana plants or less than fifty kilograms of a marijuana-containing substance, is a prison term of up to five years and/or a penalty of up to $250,000.[168] Because Retail Marijuana Corporations likely cannot insure their directors against liability for their service to the corporation,[169] these directors will probably bear the full brunt of any monetary penalties assessed. The prospect of prison time and hefty fines would be enough to give any potential director pause.

C. *RICO Liability*

The third potential source of liability for directors of Retail Marijuana Corporations is criminal liability under RICO. RICO provides that it is "unlawful for any person employed by or associated with any enterprise engaged in, or the activities of which affect, interstate or foreign commerce, to conduct or participate, directly or indirectly, in the conduct of such enterprise's affairs through a pattern of racketeering activity. . . ."[170] "Racketeering activity" is defined as "any offense involving . . . fraud in the sale of securities, or the felonious manufacture, importation, receiving, concealment, buying, selling, or otherwise dealing in a controlled substance or listed chemical (as defined in section 102 of the Controlled Substances Act), punishable under any law of the United States[.]"[171] A "pattern of racketeering activity" means "a series of related predicates [specified state or federal offenses]

167. 21 U.S.C. § 841(b)(1)(A)(vii).

168. 21 U.S.C. § 841(b)(1)(D).

169. *See supra* Section II.A.4.

170. Racketeer Influenced and Corrupt Organizations Act, 18 U.S.C. § 1962(c) (2018). Further, RICO prohibits anyone who receives income directly or indirectly derived from "a pattern of racketeering activity" from investing any of that income (or its proceeds) in establishing, operating, or acquiring an interest in any enterprise engaged in or affecting interstate or foreign commerce. 18 U.S.C. § 1962(a).

171. 18 U.S.C. § 1961.

that together demonstrate the existence or threat of continued criminal activity."[172] Finally, an "enterprise" "includes any . . . partnership, corporation, association, or other legal entity."[173]

The Supreme Court has held that "RICO is to be read broadly."[174] In *Reves v. Ernst & Young*,[175] the Supreme Court adopted an "operation or management" test for determining RICO liability, holding that a person who "participate[s] in the operation or management of the enterprise itself" is deemed to have "conducte[d] or participate[d] . . . in the conduct of such enterprise's affairs."[176] RICO liability does not require a formal position in, or control over, the enterprise, "but *some* part in directing the enterprise's affairs is required."[177] Under the *Reves* test, a corporate director would clearly fall within the scope of possible RICO defendants.

RICO claims may be brought either as federal criminal or civil proceedings.[178] Criminal penalties include fines, imprisonment up to twenty years (or life, in certain circumstances), and forfeiture of property.[179] Public civil remedies include divestiture, restrictions on future business activities and investments, and dissolution or reorganization of enterprises.[180] Moreover, there is a private cause of action under RICO for "[a]ny person injured in his business or property by reason of a violation of" RICO, with remedies including treble damages, costs, and fees.[181] Thus, a successful RICO "plaintiff must plead and ultimately prove: (1) that the defendant violated § 1962 [RICO's substantive provision]; (2) that the plaintiff's business or property was injured; and (3) that the defendant's violation is the cause of that injury."[182]

Private plaintiffs have begun bringing RICO claims against defendants engaged in the sale of marijuana. In *Safe*

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172. RJR Nabisco, Inc. v. European Cmty., 136 S. Ct. 2090, 2096–97 (2016).
173. 18 U.S.C. § 1961(4).
174. Sedima, S.P.R.L. v. Imrex Co., 473 U.S. 479, 497 (1985).
175. Reves v. Ernst & Young, 507 U.S. 170 (1993).
176. *Id.* at 179, 185; *see also* 18 U.S.C. § 1962(c).
177. *Reves*, 507 U.S. at 180.
178. 18 U.S.C. §§ 1963, 1964.
179. 18 U.S.C. § 1963(a).
180. 18 U.S.C. § 1964(a).
181. 18 U.S.C. § 1964(c).
182. Safe Sts. All. v. Hickenlooper, 859 F.3d 865, 881 (10th Cir. 2017).

Streets Alliance v. Hickenlooper,[183] private plaintiffs alleged that a recreational marijuana business located next to plaintiffs' property caused injury actionable under RICO by reducing their property value and constituting a nuisance due to the odor of marijuana, thereby diminishing their ability to use their property and further reducing its value.[184] The Tenth Circuit found that "cultivating marijuana for sale . . . is by definition racketeering activity" under RICO.[185] It also found that the actions defendants took to establish and operate their marijuana cultivation activities constituted the requisite pattern of racketeering activity under RICO.[186] Finding that the plaintiffs plausibly pleaded nuisance and diminution of their property value, the Tenth Circuit concluded that the defendants' marijuana operations were the proximate cause of those injuries, and remanded for further proceedings on the property-related injuries.[187] Though the jury did not ultimately award the *Safe Streets* plaintiffs any damages,[188] this case opened the door for private plaintiffs to bring RICO suits against persons involved in state-sanctioned retail marijuana operations.

Cases filed in Massachusetts,[189] Oregon,[190] and California[191] followed suit. Though cases like these—which allege injury to property from nearby marijuana operations—are highly fact intensive and may not be ultimately successful, they are worrisome to directors of Retail Marijuana Corporations for a number of reasons. First, retail marijuana operations have been held to be squarely within the conduct prohibited by RICO—a "pattern of racketeering activity." Second, directors of Retail Marijuana Corporations would certainly be proper defendants under the *Reves* "operation or manage-

183. *Id.*
184. *Id.* at 879–80.
185. *Id.* at 882.
186. *Id.* at 884.
187. *Id.* at 889–91.
188. Verdict Form, Safe Streets Alliance v. Alternative Holistic Healing, LLC, No. 1:15-cv-00349-REB-SKC (D. Col. Oct. 31, 2018), ECF No. 254.
189. Crimson Galeria Ltd. P'ship v. Healthy Pharms, Inc., 337 F. Supp. 3d 20, 26 (D. Mass. 2018).
190. Underwood v. 1450 SE Orient, LLC, No. 3:18-CV-1366-JR, 2019 WL 2871097, at *1 (D. Or. June 14, 2019), *report and recommendation adopted*, No. 3:18-CV-01366-JR, 2019 WL 2870819 (D. Or. July 3, 2019).
191. Bokaie v. Green Earth Coffee LLC, No. 18-CV-05244-JST, 2018 WL 6813212, at *1 (N.D. Cal. Dec. 27, 2018).

ment" test, as they are employed by the Retail Marijuana Corporations and direct their affairs. Third, RICO suits are attractive to plaintiffs because they afford treble damages, costs, and attorney's fees. Even if the suits are unsuccessful, they are damaging in terms of directors' time and attention and negative publicity for the corporation.

More importantly, though this discussion has focused largely on private RICO claims, there remains the possibility that the federal government could choose to institute RICO actions against Retail Marijuana Corporations and their directors. This is potentially much more worrisome for directors because the government need not prove injury; merely violating RICO by engaging in retail marijuana sales—i.e., a pattern of racketeering activity—could lead to criminal fines, imprisonment, divestiture, and other remedies. That the government thus far has not opted to pursue RICO claims against businesses operating lawfully under state law is cold comfort for those who stand to face the penalties if enforcement priorities change.

D. *Liability Under the Federal Securities Laws*

The fourth potential source of liability for directors of Retail Marijuana Corporations is the federal securities laws.[192] This Section briefly describes the requirements for registering securities under those laws. It then considers the difficulties in listing securities for a Retail Marijuana Corporations on a U.S. securities exchange. Next, this Section outlines the exposure to liability directors of Retail Marijuana Corporations face under two selected antifraud provisions of the federal securities laws: section 10(b) of the Securities Exchange Act of 1934, 15 U.S.C. § 78 ("Exchange Act");[193] and section 11 of Securities Act of 1933, 15 U.S.C. § 77a ("Securities Act").[194] To illus-

192. Although recognizing that Retail Marijuana Corporations and their directors may also face significant liability under state securities laws, this Article omits discussion of state laws to avoid duplication.

193. Securities Exchange Act of 1934, 15 U.S.C. § 78 (2018).

194. Securities Act of 1933, 15 U.S.C. § 77 (2018). This Article omits a discussion of other federal antifraud provisions—notably Sections 12(a)(2) and Section 17 of the Securities Act—to avoid repetition, while recognizing that these are also significant sources of potential liability. *See* 15 U.S.C. §§ 77a–77aa, 77*l*. Aspects of the cause of action under Section 12(a)(2) are similar to those under Section 10(b) and Section 11, including the relevant

trate the construction of these statutory sections and how they may prove problematic for directors of Retail Marijuana Corporations, this Section analyzes the registration documents of Tilray, Inc. ("Tilray"), a publicly traded Retail Marijuana Corporation.

1. *Registering Securities of Retail Marijuana Corporations*

a. Registration of Retail Marijuana Corporations' Securities Generally

No securities may be offered, bought, or sold in the United States unless they are registered in accordance with the Securities Act or they qualify for an exemption from registration.[195] Common exemptions from registration under the Securities Act include exemptions of specific types of securities (such as securities issued by federal, state, or municipal governments) and specific types of transactions (such as offerings of limited size, offerings limited largely to sophisticated purchasers, private offerings to small numbers of investors, and intrastate offerings).[196] Registration under the federal securities laws brings with it a number of onerous disclosure requirements, both in the initial registration document, known as the registration statement (Form S-1),[197] and in the company's

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materiality standard and certain available defenses (i.e., the bespeaks caution doctrine and a forward-looking statement safe harbor). *See* Rombach v. Chang, 355 F.3d 164, 178 n.11 (2d Cir. 2004) (noting the materiality standard is the same under Section 12(a)(2) as under Section 10(b) and Section 11); P. Stolz Family P'ship L.P. v. Daum, 355 F.3d 92, 97 (2d Cir. 2004) (applying the bespeaks caution doctrine and forward-looking statement safe harbor to Section 12(a)(2)); *see also infra* text accompanying notes 282–290 regarding the bespeaks caution doctrine and forward-looking statement safe harbor. Likewise, the analysis under Section 17 is quite similar to that under Section 10(b) and Rule 10b-5. There is no private cause of action under Section 17, though the SEC can bring civil actions under this section and the Department of Justice can utilize it in criminal prosecutions. Securities Act §§ 20, 24, 15 U.S.C. §§ 77t, 77x; Maldonado v. Dominguez, 137 F.3d 1, 12–13 (1st Cir. 1998). Rule 10b-5's language is based upon Section 17's wording, with little difference between the two. Samuel W. Buell, *What Is Securities Fraud?*, 61 DUKE L. J. 511, 541 (2011). Further, courts have sometimes interpreted Rule 10b-5 and Section 17 similarly. *Id.* at 541–42.

195. 15 U.S.C. § 77(e).

196. Securities Act §§ 3(a)(2), 3(a)(11), 3(b), 4(a)(2), 15 U.S.C. §§ 77c(a)(2), 77c(a)(11), 77c(b), 77d(a)(2) (2018); Regulation D, 17 C.F.R. § 230.506 (2019).

197. Securities Act Form S-1, 17 C.F.R. § 239.11 (2019).

ongoing required disclosures under the Exchange Act.[198] The first part of the registration statement, the prospectus, must set forth a variety of information, including descriptions of the following: (1) the company's business operations;[199] (2) any "material pending legal proceedings" to which the company, any of its subsidiaries, or any of its or their property is subject;[200] (3) "the most significant risk factors that make an investment in the . . . [company] speculative or risky";[201] (4) the company's financial condition and results of operations;[202] and (5) the company's management.[203] The prospectus must also include audited financial statements.[204] Thus, a Retail Marijuana Corporation that wishes to register its securities for sale on a U.S. stock exchange would have to provide a great deal of information about its marijuana-related activities, thereby potentially subjecting itself and its directors to the types of liability discussed earlier.[205]

Regardless of whether it is wise, from a liability perspective, for a Retail Marijuana Company operating in the United States to publicly list its securities, it is questionable whether

198. Securities Exchange Act of 1934, 15 U.S.C. § 78a. Under the 2012 Jumpstart Our Business Startups Act, companies that qualify as "emerging growth" companies under section 2(a)(19) of the Securities Act have reduced disclosure requirements. *See* Jumpstart Our Business Startups Act, § 102, Pub. L. 112-106, 126 Stat. 306 (2012) (codified at 15 U.S.C. § 77g(a)(2) (2018)). A company that has not undergone an initial public offering of its common stock and that had $1.07 billion (adjusted for inflation) in total annual gross revenues in its most recently completed fiscal year can qualify as an emerging growth company. Securities Act of 1933 § 2(a)(19), 15 U.S.C. § 77b(a)(1).

199. Form S-1, Item 11(a); Regulation S-K Item 101, 17 C.F.R. § 229.101 (2019).

200. Form S-1, Item 11(c); Regulation S-K Item 103, 17 C.F.R. § 229.103 (2019).

201. Form S-1, Item 3; Regulation S-K Item 105, 17 C.F.R. § 229.105 (2019).

202. Form S-1, Items 11(f)–(g); Regulation S-K Items 301-303, 17 C.F.R. §§ 229.301–03 (2019).

203. Form S-1, Items 11(k)–(m); Regulation S-K Items 401-404, 17 C.F.R. §§ 229.401–04 (2019).

204. Form S-1, Item 11(e); Regulation S-X, 17 C.F.R. §§ 210.3-01 to -20 (2019).

205. *See supra* Sections II.A., B., C. *See also* Melanie L. Fein, Fiduciary Investments in Cannabis Securities, 11–22 (2019) (unpublished manuscript), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3326205 (regarding registration and trading of marijuana-related securities).

one could successfully do so. The primary U.S. exchanges—the New York Stock Exchange ("NYSE") and Nasdaq Stock Market ("Nasdaq")—can reject listing applications in their discretion. For example, the NYSE listing application cautions applicants that

> the Exchange has broad discretion regarding the listing of any security. Thus, the Exchange may deny listing or apply additional or more stringent criteria based on any event, condition, or circumstance that makes the listing of an Applicant Issuer's security inadvisable or unwarranted in the opinion of the Exchange. Such determination can be made even if the Applicant Issuer meets the Exchange's listing standards.[206]

There are not currently any U.S. stock exchange-listed securities of Retail Marijuana Corporations with operations in the United States.[207] There are exchange-listed companies incorporated in Canada, where retail marijuana sales are legal (for example, Canopy Growth, NYSE trading symbol CGC; Cronos Group Inc., Nasdaq trading symbol CRON). There are also companies like Tilray, which are incorporated in the United States but conduct the bulk of their operations outside of the United States in places where retail marijuana sales are fully legal. Under the current circumstances, it seems unlikely that a Retail Marijuana Corporation that sells marijuana products in the United States would be able to list its securities on a U.S. exchange.[208] However, it is not only companies whose se-

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206. NEW YORK STOCK EXCHANGE, LISTING APPLICATION 7, https://www.nyse.com/publicdocs/nyse/listing/Full_Application.pdf. At least one company's listing application has been rejected: The Nasdaq rejected the listing application of MassRoots, Inc. ("MassRoots"), a Delaware corporation that permits users to rate and review different marijuana products. MassRoots, Inc., Annual Report (Form 10-K) (Apr. 6, 2019) at 1. According to a MassRoots press release, its application was denied because of the Nasdaq's concern that MassRoots is "'aiding and abetting' the distribution of an illegal substance under Federal law[.]" MassRoots, Inc., Current Report (Form 8-K) (May 24, 2016) at 4.

207. Fein, *supra* note 205, (manuscript at 12).

208. Securities of companies that are not listed on exchanges are often traded in decentralized over-the-counter ("OTC") markets. *See* Fein, *supra* note 205, (manuscript at 15). There are OTC platforms that facilitate trades between broker-dealers and their customers (customer markets) and those for trades between dealers (interdealer markets). *Over-the-Counter Market*,

curities are listed on an exchange that face potential liability under the federal securities laws. All securities transactions—registered or unregistered—are subject to the federal antifraud provisions.[209] Also, even companies whose securities are not publicly traded may become subject to the Exchange Act's reporting requirements, which means they are required to file periodic reports with the SEC, which reports may give rise to liability in the ways contemplated below.[210]

b. Tilray's Registration

Shares of Tilray began trading on the Nasdaq in July 2018.[211] Tilray is incorporated in Delaware and has offices in Seattle (and elsewhere) but is headquartered in Canada.[212] Through its subsidiaries, Tilray distributes medical marijuana in Canada, Europe, Australia, and Latin America, and grows

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U.S. SEC. & EXCH. COMM'N, https://www.sec.gov/divisions/marketreg/mrotc.shtml#targetText=The%20Financial%20Industry%20Regulatory%20Authority,traded%20in%20the%20OTC%20market. The Financial Industry Regulatory Authority ("FINRA") regulates U.S. broker-dealers operating in U.S. OTC markets, but OTC markets are generally subject to less regulation than exchanges are. *Id.*; *see* Fein, *supra* note 205, (manuscript at 15). They are also less transparent and considered somewhat riskier than exchange markets are. *See* J.B. Maverick, *The Risks of Over-the-Counter Trading*, INVESTOPEDIA, (Oct. 22, 2018), https://www.investopedia.com/ask/answers/020515/what-are-risks-involved-otc-overthecounter-trading.asp (describing the lack of transparency and risks of OTC market trading). MassRoots is an example of a company whose securities trade OTC. *See Investor Relations*, MASSROOTS, INC., https://ir.massroots.com/ (last visited Aug. 13, 2019).

209. That said, not every antifraud provision applies to every securities transaction. For example, Section 11 of the Securities Act applies only to fraud in a registration statement. Securities Act § 11(a), 15 U.S.C. § 77k(a) (2018). A company without a registration statement is not in danger of violating this section.

210. *See* Exchange Act § 12(g)(1)(A), 15 U.S.C. § 78*l*(g)(1)(A) (2018) (requiring registration of securities of every issuer engaged in interstate commerce with total assets exceeding $10 million and a class of equity security (other than exempted securities) held by at least either (1) two thousand persons or (2) five hundred non-accredited investors).

211. Danya Hajjaji, *Canadian Cannabis Company Tilray Soars in NASDAQ Debut*, REUTERS (July 19, 2018), https://www.reuters.com/article/us-tilray-ipo-debut/canadian-cannabis-company-tilray-surges-in-nasdaq-debut-idUSKBN1K926D.

212. Tilray, Inc., Prospectus (Form S-1) (Jul. 16, 2018) at 5–6.

medical and recreational marijuana in Canada.[213] In its discussion of Tilray's business, Tilray's prospectus states the following (referred to herein as the "Operations Statements"):

> *We operate only in countries where cannabis is legal*, by which we mean the activities in those countries are permitted under all applicable federal and state or provincial laws. *We do not produce, process or distribute cannabis in the United States*, where it remains a controlled substance under U.S. federal law despite being authorized for medical and adult use by many U.S. states.[214]

Among its risk factors, Tilray provides the following cautions (referred to herein as the "CSA Statement"):

> We are subject to a variety of laws in the United States, Canada and elsewhere. In the United States, despite cannabis having been legalized at the state level for medical use in many states and for adult use in a number of states, cannabis continues to be categorized as a Schedule I controlled substance under the federal Controlled Substances Act, or the CSA. . . . *Our activity in the United States is limited to certain corporate and administrative services, including accounting, legal and creative services, and we do not produce or distribute cannabis products in the United States. Therefore, we believe that we are not subject to the CSA* . . . . Nonetheless, violations of any U.S. federal laws and regulations, such as the CSA . . . , could result in significant fines, penalties, administrative sanctions, convictions or settlements arising from civil proceedings initiated by either the U.S. federal government or private citizens or criminal charges, including, but not limited to, disgorgement of profits, cessation of business activities or divestiture.[215]

Thus, in its prospectus, Tilray implicitly or explicitly states the following: (1) Tilray legally exists and has the authority to sell its securities in the United States; (2) Tilray does not oper-

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213. Tilray, Inc., Annual Report (Form 10-K) (Dec. 31, 2018) at 2. Tilray also grows medical marijuana in Europe. *Id.*

214. Tilray, Inc., Prospectus (Form S-1) (Jul. 16, 2018) at 76 (emphasis added).

215. *Id.* at 24 (emphasis added).

ate in the United States; (3) Tilray (and those others responsible for the registration statement) do not believe Tilray is violating the CSA; and (4) there is no material information regarding Tilray's potential liability under the CSA that Tilray has failed to disclose. This Section examines Tilray's implicit and explicit statements in the context of two of the federal securities law antifraud provisions.[216]

2. *Rule 10b-5 Liability*

The "catchall" antifraud provisions under the federal securities laws are Section 10(b) of the Exchange Act[217] and the accompanying Rule 10b-5.[218] Section 10(b) states, in relevant part,

> [i]t shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce or of the mails, or of any facility of any national securities exchange—
>
> . . . .
>
> b. To use or employ, in connection with the purchase or sale of any security . . . any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors.[219]

Section 10(b) is not self-executing; it calls upon the Securities and Exchange Commission ("SEC") to develop appropriate rules for the prohibition's implementation. The rule developed for this purpose, Rule 10b-5, provides

> [i]t shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of the mails or of any facility of any national securities exchange,
>
> a. To employ any device, scheme, or artifice to defraud,
>
> b. To make any untrue statement of a material fact or to omit to state a material fact necessary in order to

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216. For a brief summary of other federal antifraud provisions, see *supra* note 194.

217. 15 U.S.C. § 78j (2018).

218. 17 C.F.R. § 240.10b-5 (2018).

219. 15 U.S.C. § 78j.

> make the statements made, in the light of the circumstances under which they were made, not misleading, or
>
> c. To engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person,
>
> in connection with the purchase or sale of any security.[220]

Section 10(b) and Rule 10b-5 may be enforced by the SEC through civil actions in U.S. district courts and by the Department of Justice ("DOJ") through criminal prosecutions.[221] There is also a judicially implied private cause of action for investors who have been harmed by fraud actionable under Section 10(b) and Rule 10b-5.[222]

Defendants under Rule 10b-5 include any persons who commit the relevant fraudulent acts. A director can be held liable if the director "makes" the misstatement or omission and/or "controls" the corporation. Under Rule 10b-5, "the maker of a statement is the person or entity with ultimate authority over the statement, including its content and whether and how to communicate it."[223] Moreover, under Section 20(a) of the Exchange Act,

> [e]very person who, directly or indirectly, controls any person liable under any provision of this chapter or of any rule or regulation thereunder shall also be liable jointly and severally with and to the same extent as such controlled person to any person to whom such controlled person is liable, unless the controlling person acted in good faith and did not directly or indirectly induce the act or acts constituting the violation or cause of action.[224]

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220. 17 C.F.R. § 240.10b-5.

221. 15 U.S.C. § 78u(d)(1) (2018) (granting the SEC authority to bring actions in U.S. district courts to enjoin violations of the securities laws and to seek monetary penalties therefore and authorizing the SEC to transmit evidence to the attorney general to pursue criminal proceedings).

222. *See* Superintendent of Ins. v. Bankers Life & Cas. Co., 404 U.S. 6, 13 (1971); Herman & MacLean v. Huddleston, 459 U.S. 375, 387 (1983).

223. Janus Capital Grp., Inc. v. First Derivative Traders, 564 U.S. 135, 142 (2011).

224. 15 U.S.C. § 78t(a) (2018).

Under Exchange Act Regulation C, "control" means "the possession, direct or indirect, of the power to direct or cause the direction of the management and policies of a person, whether through the ownership of voting securities, by contract, or otherwise."[225] Directors are not automatically control persons,[226] though they may be deemed control persons if they exercise the requisite control.[227] Outside directors who are not involved in the business are unlikely to be found to be control persons.[228]

a. Cause of Action

The Supreme Court has defined six elements in a private Rule 10b-5 claim involving publicly traded securities:[229]

(1) a material misrepresentation (or omission);
(2) scienter, i.e., a wrongful state of mind;
(3) a connection with the purchase or sale of a security;
(4) reliance, often referred to in cases involving public securities markets (fraud-on-the-market cases) as "transaction causation";
(5) economic loss; and
(6) "loss causation," i.e., a causal connection between the material misrepresentation and the loss.[230]

In SEC regulatory actions, there is generally no need to prove reliance, economic loss, or loss causation, other than to the extent necessary to establish the extent of a defendant's profits for disgorgement purposes.[231] The same is true for DOJ prosecutions, unless the DOJ seeks to require the defendant to

225. 17 C.F.R. § 230.405 (2015).

226. Arthur Children's Tr. v. Keim, 994 F.2d 1390, 1396 (9th Cir. 1993) ("A director is not automatically liable as a controlling person.").

227. *Id.* at 1397.

228. *See* Burgess v. Premier Corp., 727 F.2d 826, 832 (9th Cir. 1984).

229. Though much of the discussion in this Section focuses on private claims involving publicly traded securities, it is important to note that Section 10(b) and Rule 10b-5 apply to all securities transactions, not only to publicly traded securities. *See* 15 U.S.C. § 78j(b) (2018) (subjecting both "any security registered on a national exchange" and "*any security not so registered*" to antifraud liability) (emphasis added).

230. Dura Pharms., Inc. v. Broudo, 544 U.S. 336, 341–42 (2005) (citations and emphasis omitted).

231. *See, e.g.*, Securities Exchange Act of 1934 § 21, 15 U.S.C. § 78u-2(b)(1)–(2) (2018); SEC v. Rana Research, Inc., 8 F.3d 1358, 1363–64 (9th

pay restitution.[232] Thus, the "core" elements of a Rule 10b-5 claim are (1) "manipulation or deception (including by the misrepresentation of, or omission to state, a material fact)"; (2) "in connection with the purchase or sale of a security"; (3) "with scienter."[233] This Section briefly describes each of these core elements in turn.[234]

i. Manipulation or Deception

Although Section 10(b) proscribes the use of manipulation or deception, it does not define either term. Nor are there definitions in the Exchange Act or in any SEC rule or regulation under Section 10(b).[235] This has left the task of defining these statutory terms to the federal courts.[236] The Supreme Court has viewed the term "manipulative" as "virtually a term of art when used in connection with securities markets," commenting that "[i]t connotes intentional or willful conduct designed to deceive or defraud investors by controlling or artificially affecting the price of securities."[237] Rule 10b-5 encompasses a variety of different types of manipulative or deceptive conduct that could be the basis of liability under Section 10(b)

Cir. 1993) (noting there is no need for the SEC to prove reliance); Buell, *supra* note 194, at 546.

232. Buell, *supra* note 194, at 547.

233. Joan MacLeod Heminway, *Martha Stewart Saved! Insider Violations of Rule 10b-5 for Misrepresented or Undisclosed Personal Facts*, 65 MD. L. REV. 380, 383 (2006).

234. Regarding the additional elements, see, e.g., Cent. Bank of Denver, N.A. v. First Interstate Bank of Denver, N.A., 511 U.S. 164, 180 (1994) (reliance); Huddleston v. Herman & MacLean, 640 F.2d 534, 549 n.24 (5th Cir. 1981), *aff'd in part, rev'd in part on other grounds*, 459 U.S. 375 (1983) (loss causation); *Dura Pharms.*, 544 U.S. at 338 (damages/economic loss). There are also standing requirements for plaintiffs in private actions. Only actual purchasers and sellers of securities, not those who opted not to purchase or sell securities because of the manipulation or deception in question, have standing to bring suit. Blue Chip Stamps v. Manor Drug Stores, 421 U.S. 723, 731–34 (1975). There are additional substantive and procedural requirements applicable to Rule 10b-5 class actions. *See* Securities Exchange Act of 1934 § 21D, 15 U.S.C. § 78u-4 (2018) (additional requirements for private class actions).

235. *See* Heminway, *supra* note 233, at 384.

236. *See id.* at 384–85.

237. Ernst & Ernst v. Hochfelder, 425 U.S. 185, 199 (1976).

but does not provide greater clarity on the statutory terms' definitions.[238]

The primary path to liability under Rule 10b-5 and Section 10(b)—making "any untrue statement of a material fact or . . . omit[ting] to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading"[239]—raises the question of what constitutes materiality. In *Basic Inc. v. Levinson,* the Supreme Court adopted a materiality standard for Section 10(b) and Rule 10b-5[240] that it had previously applied in the proxy solicitation context under Section 14(a) of the Exchange Act[241]: a misstatement or omission is material "if there is a substantial likelihood that a reasonable shareholder would consider it important in deciding how to vote."[242] Stated differently, an omission is material if there is "a substantial likelihood that the disclosure of the omitted fact would have been viewed by the reasonable investor as having significantly altered the 'total mix' of information made available."[243] Further, "with respect to contingent or speculative information or events, . . . materiality 'will depend at any given time upon a balancing of both the indicated probability that the event will occur and the anticipated magnitude of the event in light of

238. *See* Heminway, *supra* note 233, at 384.

239. 17 C.F.R. § 240.10b-5 (2005).

240. 485 U.S. 224, 231 (1988).

241. 15 U.S.C. § 78n(a) (2018).

242. *Basic*, 485 U.S. at 231 (quoting TSC Indus., Inc. v. Northway, Inc., 426 U.S. 438, 449 (1976)). The *Basic* Court noted that there was no dispute that the Section 14(a) materiality standard applies to Section 10 as well. *Id.* at 232 n.8. *Basic* does not expressly apply this standard to a misstatement, as the facts before it concerned an omission. *See id.* at 231. However, this materiality standard has since been used to analyze the materiality of both misstatements and omissions. *See, e.g.*, Heminway, *supra* note 233, at 386 (discussing the *Basic* standard as applicable to both misstatements and omissions).

243. *Basic*, 485 U.S. at 231–32 (quoting *TSC Indus.*, 426 U.S. at 449). Both the *TSC Industries* and *Basic* Courts present these two standards as mere restatements, or further explanations, of each other, though they have also been described as alternatives. *See TSC Indus.*, 426 U.S. at 449 (describing the second standard as the first one "[p]ut another way"); *Basic*, 485 U.S. at 231–32 (describing the second formulation as a further explanation of the first one); Heminway, *supra* note 233, at 386 (describing the two as "alternative standards").

the totality of the company activity.' "[244] Materiality is "a mixed question of law and fact"[245] and necessarily involves a "fact-specific inquiry."[246]

Statements of directors' opinions or beliefs can also be material because investors deem them important.[247] Directors face potential liability for statements of opinion or belief if the opinions are about matters that are objectively verifiable and the plaintiff can prove the statements were knowingly false.[248] For example, if a director stated, "I think we're having a great quarter" and the plaintiff can show that the company was actually having a bad quarter, the director could face liability for making a statement of belief about an objective fact in circumstances in which the belief could not be supported. On the other hand, merely having an "unclean heart" is insufficient for liability; the plaintiff must prove more than that the director did not actually hold the stated belief.[249]

The second path to liability under Rule 10b-5 and Section 10(b) comes under Rule 10b-5(a) or (c). Courts have referred to these claims as "scheme liability."[250] Scheme liability focuses not on deceptive statements, but on deceptive conduct.[251] Because the Supreme Court has rejected a theory of aiding and abetting liability for private Rule 10b-5 actions,[252] a finding of scheme liability requires "an inherently deceptive act that is

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244. *Basic*, 485 U.S. at 238 (quoting SEC v. Tex. Gulf Sulphur Co., 401 F.2d 833, 849 (2d Cir. 1968)).

245. Ganino v. Citizens Utils. Co., 228 F.3d 154, 162 (2d Cir. 2000).

246. *See Basic*, 485 U.S. at 240.

247. *See* Va. Bankshares, Inc. v. Sandberg, 501 U.S. 1083, 1090–91 (1991).

248. *See id.* at 1095 (construing Section 14(a)).

249. *See id.* at 1096 (quotation omitted).

250. *See, e.g.*, Pub. Pension Fund Grp. v. KV Pharm. Co., 679 F.3d 972, 987 (8th Cir. 2012); *In re* DVI, Inc. Sec. Litig., 639 F.3d 623, 643 n.29 (3d Cir. 2011), *abrogated on other grounds by* Amgen Inc. v. Conn. Ret. Plans & Trs. Funds, 133 S. Ct. 1184 (2013); Pacific Inv. Mgmt. Co. v. Mayer Brown, LLP, 603 F.3d 144, 150 (2d Cir. 2010); Desai v. Deutsche Bank Sec. Ltd., 573 F.3d 931, 938 (9th Cir. 2009). *But see* Lorenzo v. SEC, 139 S. Ct. 1094, 1102 (2019) (noting the "considerable overlap among the subsections" of Rule 10b-5 and commenting that the subsections are not "mutually exclusive").

251. *E.g.*, *In re DVI*, 639 F.3d at 643 n.29 ("We refer to claims under Rule 10b-5(a) and (c) as 'scheme liability claims' because they make deceptive conduct actionable, as opposed to Rule 10b-5(b), which relates to deceptive statements.").

252. Cent. Bank of Denver, N.A. v. First Interstate Bank of Denver, N.A., 511 U.S. 164, 191 (1994). The Private Securities Litigation Reform Act of

distinct from an alleged misstatement," such as purposefully manipulating stock prices.[253] However, in a decision that found scheme liability through dissemination of materially misleading information via email, the Supreme Court recently opened the door to recognizing scheme liability in connection with making a misrepresentation or omission.[254]

ii. "In Connection with" Requirement

The second core element of a Rule 10b-5 claim, the "in connection with" requirement, is construed broadly.[255] Privity is not required in Rule 10b-5 actions.[256] The Supreme Court has found the "in connection with" requirement satisfied when the "securities transactions and breaches of fiduciary duty coincide[d]"[257] and when an investor "suffered an injury as a result of deceptive practices touching its sale of securities as an investor."[258] Lower courts have found sufficient connection where the misstatement "occurs in a medium calculated

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1995 makes clear that the SEC may bring aiding and abetting allegations in its Rule 10b-5 suits. *See* 15 U.S.C. § 78t(e).

253. Fogel v. Vega, 759 F. App'x 18, 25 (2d Cir. 2018) (quoting SEC v. Kelly, 817 F.Supp.2d 340, 344 (S.D.N.Y. 2011)); *see also* Pub. Pension Fund Grp., 679 F.3d at 987 ("We join the Second and Ninth Circuits in recognizing a scheme liability claim must be based on conduct beyond misrepresentations or omissions actionable under Rule 10b-5(b)."). Some examples of conduct giving rise to scheme liability include engaging in trading that manipulated stock prices by creating an appearance of an active market for those shares, *see* SEC v. U.S. Envtl., Inc., 155 F.3d 107, 112 (2d Cir. 1998), and defrauding customers into buying securities with unreasonable price markups. *See* SEC v. First Jersey Sec. Inc., 101 F.3d 1450, 1471–72 (2d Cir. 1996). In another case of scheme liability involving a "u-turning" scheme, one broker sent his commodity price to another brokerage house; the second broker in turn sent the same price back to the first brokerage house and represented it as an independent quote. SEC v. Lee, 720 F. Supp. 2d 305, 334 (S.D.N.Y. 2010).

254. *See* Lorenzo, 139 S. Ct. at 1103–04.

255. *See* Superintendent of Ins. of N.Y. v. Bankers Life & Cas. Co., 404 U.S. 6, 12 (1971); SEC v. Softpoint, Inc., 958 F. Supp. 846, 862 (S.D.N.Y. 1997).

256. *See* United States v. O'Hagan, 521 U.S. 642, 643 (1997) (finding the "in connection with" element satisfied when the "transaction and the breach of duty coincide, even though the person or entity defrauded is not the other party to the trade").

257. SEC v. Zandford, 535 U.S. 813, 825 (2002).

258. *Bankers Life*, 404 U.S. at 13–14.

to reach investors."[259] Courts construing the "in connection with" element have not required the misstatement or omission to concern a security's value:

> [T]he fraud in question must relate to the nature of the securities, the risks associated with their purchase or sale, or some other factor with similar connection to the securities themselves. While the fraud in question need not relate to the investment value of the securities themselves, it must have more than some tangential relation to the securities transaction.[260]

Given the rather nebulous interpretations of the "in connection with" requirement,[261] a broad array of deception can potentially satisfy this element.

iii. Scienter

The third core element of a Rule 10b-5 claim is state of mind. In *Ernst & Ernst v. Hochfelder*, the Supreme Court held that a Rule 10b-5 plaintiff must prove "scienter"—"a mental state embracing intent to deceive, manipulate, or defraud."[262] The Court then also recognized that "[i]n certain areas of the law recklessness is considered to be a form of intentional conduct for purposes of imposing liability for some act" and reserved the question of whether recklessness would suffice for Rule 10b-5 liability.[263] The federal circuit courts have since accepted recklessness as sufficient for Rule 10b-5 scienter.[264] Since the passage of the Private Securities Litigation Reform

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259. Heminway, *supra* note 233, at 387 (first citing Semerenko v. Cendant Corp., 223 F.3d 165, 176 (3d Cir. 2000); then citing SEC v. Rana Research, Inc., 8 F.3d 1358, 1362 (9th Cir. 1993); then citing *In re* Ames Dep't Stores Inc. Stock Litig., 991 F.2d 953, 965 (2d Cir. 1993); and then citing *In re* Leslie Fay Co. Sec. Litig., 871 F. Supp. 686, 697 (S.D.N.Y. 1995)).

260. Ambassador Hotel Co. v. Wei-Chuan Inv., 189 F.3d 1017, 1026 (9th Cir. 1999); *see also Bankers Life*, 404 U.S. at 12; *Zandford*, 535 U.S. at 822.

261. *See* Thomas J. Molony, *Making a Solid Connection: A New Look at Rule 10b-5's Transactional Nexus Requirement*, 53 SANTA CLARA L. REV. 767, 768–69 (2013) (describing the difficulty in applying the "in connection with" element).

262. 425 U.S. 185, 193 n.12 (1976).

263. *Id.*

264. *See, e.g.*, Theoharous v. Fong, 256 F.3d 1219, 1224-25 (11th Cir. 2001); *In re* Phillips Petrol. Sec. Litig., 881 F.2d 1236, 1244 (3d Cir. 1989); Buell, *supra* note 194, at 549 ("[T]he federal appellate courts have uniformly held that recklessness *can* establish scienter under Rule 10b-5.").

Act of 1995 ("PSLRA"),[265] class action plaintiffs are required to plead "with particularity facts giving rise to a strong inference"[266] of scienter, one that a reasonable person would deem "cogent and at least as compelling as any opposing inference one could draw from the facts alleged."[267] And yet, this heightened pleading standard has not changed the substantive definition of scienter.[268] As a result, a private plaintiff may allege that defendants acted with intent to deceive, or

> may sue for merely reckless conduct of the super-negligence variety. That is, a plaintiff could seek damages under Rule 10b-5 on the ground that an actor issued a factually untrue material statement, was unaware of the untruth, and was unaware due to such extreme carelessness that she should have known that the representation was not true.[269]

The standards for scienter in actions brought by the SEC and DOJ are extremely murky.[270] The SEC's complaints frequently invoke both Rule 10b-5 and also Section 17, which uses a negligence standard in part,[271] and so it is unclear whether the SEC is alleging knowing, reckless, or even careless misrepresentations or omissions by the defendants.[272] There is even less guidance for criminal actions.[273] Though Section 24 of the Securities Act and Section 32 of the Exchange Act threaten fines and imprisonment for someone who "willfully" violates a provision of the Acts,[274] Section 32 of the Exchange Act further states that a defendant may not be imprisoned if

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265. Private Securities Litigation Reform Act (PSLRA) of 1995, Pub. L. No. 104-67, 109 Stat. 737 (codified as amended in scattered sections of 15 and 18 U.S.C.).

266. Securities Exchange Act of 1934 § 21D(b)(2)(A), 15 U.S.C. § 78u-4(b)(2)(A) (2018).

267. Tellabs, Inc. v. Makor Issues & Rights, Ltd., 551 U.S. 308, 324 (2007) (footnote omitted).

268. *See* Greebel v. FTP Software, Inc., 194 F.3d 185, 199–201 (1st Cir. 1999) ("[T]he PSLRA did not address the substantive definition of scienter.").

269. Buell, *supra* note 194, at 551 (footnote omitted).

270. *See id.* at 553–60.

271. *See* Aaron v. SEC, 446 U.S. 680, 697 (1980).

272. *See* Buell, *supra* note 194, at 554.

273. *See id.* at 555.

274. Securities Act of 1933 § 24, 15 U.S.C. § 77x (2018); Securities Exchange Act of 1934 § 32, 15 U.S.C. § 78ff (2018).

the defendant proves he did not have knowledge of the rule he is charged with having violated.[275] This statutory conflict has confused the federal courts.[276] The Supreme Court has not clarified the scienter standard for criminal prosecutions, and the federal courts have a wide variety of inconsistent standards.[277] Thus, the precise scienter standards in federal actions remain unclear.

iv. *In Pari Delicto* Defense

There are some defenses available to Rule 10b-5 defendants. Much like state law fiduciary duty claims, claims brought under Rule 10b-5 may be subject to the *in pari delicto* defense.[278] Courts have held that the *in pari delicto* defense may be asserted by defendants in private Rule 10b-5 actions.[279] However, the defense is a limited one. Courts have declined to permit the defense when it would contravene the enforcement purpose of the federal securities laws.[280] Indeed, the Supreme Court has limited the defense

> only [to] where (1) as a direct result of his own actions, the plaintiff bears at least substantially equal responsibility for the violations he seeks to redress, and (2) preclusion of suit would not significantly interfere with the effective enforcement of the securities laws and protection of the investing public.[281]

v. Bespeaks Caution Doctrine/Forward Looking Statement Defense

A second defense to a Rule 10b-5 claim is the common law bespeaks caution doctrine, which was incorporated in part into the PSLRA reforms. The bespeaks caution doctrine ren-

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275. 15 U.S.C. § 78ff.

276. *See* Buell, *supra* note 194, at 556.

277. *See id.* at 556–58 (collecting standards and citing cases).

278. *See supra* text accompanying notes 134–138 for a discussion of the *in pari delicto* defense.

279. *E.g.*, Kuehnert v. Texstar Corp., 412 F.2d 700, 704 (5th Cir. 1969); Hogan v. Teledyne, Inc., 328 F. Supp. 1043, 1047 (N.D. Ill. 1971).

280. *E.g.*, Bateman Eichler, Hill Richards, Inc. v. Berner, 472 U.S. 299, 310–11 (1985) (denying use of *in pari delicto* defense against plaintiff investors who were induced to purchase securities based upon fraudulent statements they believed to be valuable inside information).

281. *Id.* at 310–11.

ders "alleged misstatements or omissions . . . immaterial as a matter of law if accompanied by sufficient cautionary statements."[282] This doctrine applies to predictions, opinions, and other forms of soft, "forward-looking" statements contained in a company's communications:[283]

> [W]hen an offering document's forecasts, opinions or projections are accompanied by meaningful cautionary statements, the forward-looking statements will not form the basis for a securities fraud claim if those statements did not affect the "total mix" of information the document provided investors. In other words, cautionary language, if sufficient, renders the alleged omissions or misrepresentations immaterial as a matter of law.[284]

The doctrine recognizes the tension between investors' desire for corporate managers to share their forecasts and predictions about the companies' future operations and the understandable hesitation managers would have about doing so if they faced liability for guessing wrong. Notably, the bespeaks caution doctrine only applies to forward-looking statements; courts have held that it cannot shield misrepresentations of present or historical facts.[285]

The PSLRA added in Section 21E of the Exchange Act a safe harbor for covered persons, including directors,[286] in private fraud actions for written or oral forward-looking statements that are "identified as a forward-looking statement, and . . . [are] accompanied by meaningful cautionary statements identifying important factors that could cause actual results to differ materially from those in the forward looking statement[,] . . ." or if the plaintiff fails to prove that the statement

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282. Parnes v. Gateway 2000, Inc., 122 F.3d 539, 548 (8th Cir. 1997).

283. *In re* Donald J. Trump Casino Sec. Litig., 7 F.3d 357, 368 (3d Cir. 1993).

284. *Id.* at 371.

285. *See, e.g.*, EP Medsystems, Inc. v. EchoCath, Inc., 235 F.3d 865, 874 (3d Cir. 2000); P. Stolz Family P'ship L.P. v. Daum, 355 F.3d 92, 97 (2d Cir. 2004).

286. Covered persons include Exchange Act reporting issuers and persons acting on their behalf. Securities Exchange Act of 1934 § 21E(a)(1), (2), 15 U.S.C. § 78u–5(a)(1), (2) (1995). A "person acting on behalf of an issuer" includes "any officer, director, or employee of such issuer." § 15 U.S.C. § 78u–5(i)(4).

was made with actual knowledge that it was false or misleading.[287] A "forward-looking statement" is defined to include a variety of financial projections, plans for future operations, predictions of future economic performance, assumptions underlying these projections, plans, and predictions, and other similar statements.[288] Thus, there is no liability in private class actions for misstatements or omissions that constitute forward-looking statements and are accompanied by appropriate cautionary language. Regarding what constitutes appropriate cautionary language, "it is enough to point to the principal contingencies that could cause actual results to depart from the projection."[289]

The Section 21E safe harbor is limited. Likely the bespeaks caution doctrine, it applies only to forward-looking information, not to present or historical facts. Also, it does not apply to forward-looking statements made in connection with a tender offer or an initial public offering.[290] Protections in connection with the initial registration and sale of Retail Marijuana Corporations' securities might be the most important, since the retail marijuana industry is in its nascent stage, and the statutory safe harbor would not guard those.

b. Application to Directors of Retail Marijuana Corporations

There are at least two avenues that a plaintiff investor could pursue under Section 10(b) and Rule 10b-5 against a Retail Marijuana Corporation and its directors. The first has to do with the corporation's[291] legal existence. In offering its securities for sale, a Retail Marijuana Corporation represents that it is authorized to exist and to offer and issue those securi-

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287. Securities Exchange Act of 1934 § 21E(c)(A)(i), (B), 15 U.S.C. § 78u–5(c)(A)(i), (B) (1995). There is a complementary provision in Section 27A of the Securities Act. Securities Exchange Act of 1934 § 27A, 15 U.S.C. § 77z–2 (2018).

288. Securities Exchange Act of 1934 § 21E(i)(1), 15 U.S.C. § 78u–5(i)(1) (1995).

289. Asher v. Baxter Int'l Inc., 377 F.3d 727, 734 (7th Cir. 2004).

290. Securities Exchange Act of 1934 § 21E(b)(2)(C), (D), 15 U.S.C. § 78u–5(i)(1)(b)(2)(C), (D) (1995).

291. Throughout this discussion I use the term "corporation" and not "putative corporation," or "association," or any similar term that could prove distracting. Nonetheless, because of the illegal purpose doctrine, *see supra* Section I.D., the more distracting language is also more legally accurate.

ties. These representations may be explicit, such as those a corporation makes in a typical stock purchase agreement in which it represents its due authorization and authority to enter into the transaction.[292] They may also be implicit, as when a director tries to drum up investment interest by touting the corporation's financial vitality and long-term prospects in a meeting with prospective investors.

Tilray's public offer and sale of its securities entailed both explicit and implicit representations that Tilray is a validly existing corporation that was authorized to sell its securities. For instance, Tilray's prospectus states, "We are a corporation organized under the laws of the State of Delaware."[293] It reports having "authorized capital stock,"[294] including "two classes of authorized common stock,"[295] nine million shares of which were available for purchase in the initial public offering.[296] Tilray's amended and restated certificate of incorporation was attached as an exhibit to its registration statement.[297] Taken as a whole, Tilray's registration statement gives every impression that Tilray is a validly existing corporation under Delaware law and was selling authorized shares in compliance with the securities laws.

In fact, as discussed above, like any other Retail Marijuana Corporation, Tilray arguably does not exist, as the illegal purpose doctrine bars formation of a corporation formed for the illegal purpose of selling retail marijuana.[298] A corporation

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292. For example, a stock purchase agreement entered into by a corporation may contain language to the following effect: "Seller is a corporation duly organized, validly existing and in good standing under the Laws of the state of [STATE OF ORGANIZATION]. Seller has full corporate power and authority to enter into this Agreement . . . , to carry out its obligations hereunder . . . and to consummate the transactions contemplated hereby . . . ." ANDREW N. DAVIS & AARON D. LEVY, PRACTICAL LAW CORPORATE & SECURITIES, STOCK PURCHASE AGREEMENT (PRO-BUYER LONG FORM), Practical Law Standard Document 4-382-9882 (2019), Westlaw.

293. Tilray, Inc., Amendment No. 2 to Registration Statement (Form S-1) at 119 (July 16, 2018).

294. *Id.*

295. *Id.* at 8.

296. *Id.*

297. *Id.* at exhibit 3.3.

298. This is true even though Tilray has received a certificate of incorporation from the state of Delaware, and despite the fact that Tilray's stated purpose is "to engage in any lawful act or activity for which a corporation may be organized under the General Corporation Law of the State of Delaware." *Id.*

that does not exist is not authorized to sell its securities. To issue securities of a non-existent entity defrauds Tilray's investors, who have relied upon Tilray's representations that it is duly incorporated and has the capacity to issue securities.[299] In other words, Tilray's representations as to its existence and authority to issue securities are misrepresentations of fact, and therefore are potentially actionable under Section 10(b) and Rule 10b-5. Moreover, Tilray's engaging in the retail marijuana business—and soliciting investments in order to do so—falls squarely within the type of conduct that amounts to a "course of business which operates or would operate as a fraud or deceit upon any person"[300] and gives rise to potential scheme liability. As the Supreme Court has held, "using false representations to induce the purchase of securities would seem a paradigmatic example of securities fraud."[301]

See supra Section I.D. Though Delaware's corporation statute recognizes a corporation's legal existence upon filing, execution, and acknowledgment of the certificate of incorporation with the secretary of state, it also contemplates involuntary dissolution and forfeiture of a corporation's charter by court order. DEL. CODE ANN., tit. 8, §106 (2019); DEL. CODE ANN., tit. 8, § 285 (2019). The statute also preserves the right of the courts to inquire "into the regularity or validity of the organization of a corporation, or its lawful possession of any corporate power it may assert" when a corporation's existence is challenged. DEL. CODE ANN., tit. 8, § 329(b) (2019). Given the shifting state of marijuana law and the unintended consequences that state legalization has produced, it is possible that creative plaintiffs may successfully challenge such Retail Marijuana Corporations' legal existence in the future.

299. Though a discussion of common law fraud is beyond the scope of this Article, note that this representation could also give rise to liability for common law fraud. At common law, "[w]henever . . . an issuer or underwriter of securities offers them for sale to the public, he impliedly represents that the applicable provisions of law have been complied with. The falsity of that representation may give rise to an action either for breach of warranty or for fraud depending upon the culpability of the seller in the particular transaction. . . . The obligation of a warranty is absolute, and is imposed as a matter of law irrespective of whether the seller knew or should have known of the falsity of his representations. Fraud, on the other hand, involves the additional requirement that the seller knew, or, in the exercise of reasonable diligence should have known, that his representations were false." Mary Pickford Co. v. Bayly Bros., 86 P.2d 102, 111 (Cal. 1939).

300. 17 C.F.R. § 240.10b-5(c) (2019).

301. Lorenzo v. SEC, 139 S. Ct. 1094, 1097 (2019). The situation is analogous to the concept of "false pretenses," a term used in the federal Bankruptcy Code. Section 523(a)(2)(A) of the Bankruptcy Code creates a nondischargeable debt for money obtained through "false pretenses, a false rep-

A representation that Tilray exists and is authorized to issue securities is certainly also material for Rule 10b-5 purposes. Tilray's legal existence is clearly fundamental to an investor's legitimate investment expectations. If the State of Delaware later decides that Tilray does not exist and revokes its charter, Tilray's shareholders will see their investments evaporate. Thus, there is a substantial likelihood that a reasonable investor would consider the facts of Tilray's existence and authority to issue securities important in making investment decisions, and Tilray's lack of existence and authority would certainly alter the total mix of information about Tilray.

The second basis for Rule 10b-5 liability is the statements (or omissions) a Retail Marijuana Corporation makes about its compliance with the laws surrounding marijuana sales.[302] For example, the CSA Statement—"We believe that we are not subject to the CSA . . ."[303]—appears in the "Risk Factors" section of Tilray's registration statement. If a court later determines that Tilray is subject to the CSA, a Rule 10b-5 plaintiff might pounce upon the CSA Statement and claim that this was a material misrepresentation. While courts have held that "[g]eneral statements about honesty and integrity, including those about general compliance with the law" may be "immaterial puffery" and insufficiently specific to base a Rule 10b-5 claim upon,[304] a specific claim that Tilray is in compliance with (or not subject to) the CSA could still be material and

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resentation, or actual fraud[.]" 11 U.S.C. § 523(a)(2)(A) (2018). False pretenses refers to "a series of events, activities or communications which, when considered collectively, create a false and misleading set of circumstances, or false and misleading understanding of a transaction, in which a creditor is wrongfully induced by the debtor to transfer property or extend credit to the debtor." ColeMichael Invs. v. Burke, 405 B.R. 626, 645 (Bankr. N.D. Ill. 2009). Though this is a bankruptcy statute provision, not a securities statute provision, the import is similar: the Retail Marijuana Corporation is inducing the investor to invest under the false pretense that the corporation exists and is authorized to issue securities.

302. *See* 17 C.F.R. § 240.10b-5(b) (2019). Of course, any other misstatement or omission by a Retail Marijuana Corporation would be actionable as well. This analysis focuses on a specific statement made by Tilray because it exemplifies the type of statement that a Retail Marijuana Corporation is likely to make given the nature of its business.

303. Tilray, Inc., Registration Statement (Form S-1) at 24 (June 20, 2018).

304. *E.g.*, Fogel v. Vega, 759 F.App'x 18, 23-24 (2d Cir. 2018).

therefore actionable—though, as addressed later in this analysis, it is unlikely to be a successful claim.

Assuming a court finds at least one of these theories an actionable misrepresentation or deception, the question arises whether Tilray's directors are proper defendants. If the board of directors approves a contract or securities filing, then the board collectively has ultimate authority over the corporation's statement and, thus, "makes" the statement.[305] That said, individual directors cannot unilaterally effect board actions, so no individual Tilray director is necessarily the maker of Tilray's statements. Further, directors are not automatic control persons[306] so any finding that a Tilray director "controls" Tilray would have to be a fact-specific one. Another possibility, though again a fact-specific one, would be charging a Tilray board member who disseminates misinformation with liability under a scheme liability theory.[307] In any case, a plaintiff is more likely to successfully bring claims against Tilray directors who are also members of management, as they are more likely to exert control over the corporation and to be involved in touting the company's investment prospects.

Under either of the deception theories, satisfying the "in connection with" requirement will not be difficult. Encouraging investment is a paradigmatic example of conduct "in connection with" a securities transaction. Similarly, statements contained in a prospectus or registration statement are clearly within the scope of what Rule 10b-5 covers. A plaintiff should have no trouble establishing this element of a Rule 10b-5 case against Tilray's directors.

Scienter presents a thornier question. It would be difficult to establish that a Tilray director knew, or was reckless in not knowing, that Tilray does not legally exist—especially since Tilray has received a stamped copy of its certificate of incorporation from the Delaware secretary of state. It does not appear that anyone on Tilray's board is a lawyer.[308] Even a director

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305. *See* Securities Act Form S-1 (requiring that a majority of the board of directors sign the registration statement).

306. *See supra* text accompanying notes 224–28.

307. *See Lorenzo*, 139 S. Ct. at 1102–03 (holding an investment banker who disseminated false information via email with approval of his boss liable under Rule 10b-5 as a primary violator under a scheme liability theory).

308. *See Board of Directors*, TILRAY, INC., https://www.tilray.com/boardofdirectors (last visited Aug. 13, 2019).

with a legal degree probably would not be charged with knowledge that the illegal purpose doctrine renders Tilray (and all other Retail Marijuana Corporations) non-existent. The fact that Tilray is incorporated in a state in which retail marijuana has not been legalized makes the constructive knowledge argument somewhat stronger, but it is still likely that a court would not find the requisite scienter.

The same is likely true for the scienter surrounding the CSA Statement. Certainly, a Tilray director would be chargeable with knowledge that selling retail marijuana is illegal under the CSA. The more important question is whether it is appropriate to find that a director had the requisite intent to deceive when that director approved the language stating that Tilray does not believe it is subject to the CSA. Recall that, under the Supreme Court's jurisprudence, for an opinion to be actionable under Rule 10b-5, the plaintiff must prove that the opinion is about something that is objectively verifiable and the statement was knowingly false.[309] Whether Tilray is subject to the CSA is objectively verifiable, so a plaintiff can likely leap that hurdle. The much more difficult part would be proving that the CSA Statement was knowingly false. The plaintiff would have to show more than that a Tilray director privately held doubts about Tilray's being subject to the CSA; the director would have to know—or at least have a strong reason to believe—that Tilray actually is subject to the CSA. This might be possible if there were a "smoking gun" of board minutes recounting how Tilray's legal team explained to the board that Tilray is subject to the CSA. Records that reflect the opposite—e.g., minutes of a meeting in which Tilray's lawyers briefed the board on the CSA and advised the board that Tilray does not fall under it—would severely undermine the plaintiff's ability to establish scienter.

Even if a private Rule 10b-5 plaintiff can establish these "core" elements in a case against Tilray's directors, as well as reliance, economic loss, and loss causation, the directors can attempt to bring one of the available defenses. Because the bespeaks caution doctrine and forward-looking statement safe harbors are limited to forward-looking statements, the more relevant defense for purposes of this analysis is the *in pari delicto* defense. In short, a defendant director would need to

309. *See supra* text accompanying notes 247–249.

argue that a Tilray investor was equally at fault for seeking to invest in an enterprise that is unlawful under federal law, so the courts should not intervene.

This defense seems unlikely to prevail. If it is difficult to establish that a Retail Marijuana Corporation director had the requisite scienter to defraud investors regarding the state of the enterprise's legal existence, it is significantly more challenging to prove that a plaintiff-investor knew that the corporation did not exist and invested anyway. Except in the very unlikely case that a plaintiff has particular knowledge about business entity law and the interplay between it and marijuana legalization, it is extremely hard to believe that a court would invoke the *in pari delicto* defense against a retail marijuana investor on this theory. Similarly, a court would be highly unlikely to find that a plaintiff "knew" Tilray was subject to the CSA, and so should be barred from bringing an action on the basis of the CSA Statement. The *in pari delicto* is more limited defense than that, and is unlikely to be availing to directors of Retail Marijuana Corporations such as Tilray.[310]

1. *Section 11 Liability*

A second significant federal antifraud provision is Section 11(a) of the Securities Act. Section 11(a) provides, in relevant part, the following:

> In case any part of the registration statement, when such part became effective, contained an untrue statement of a material fact or omitted to state a material fact required to be stated therein or necessary to make the statements therein not misleading, any person acquiring such security (unless it is proved that at the time of such acquisition he knew of such untruth or omission) may, either at law or in equity, in any court of competent jurisdiction, sue—
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> . . . .
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> 2. every person who was a director of (or person performing similar functions) or partner in the issuer at

310. However, it is not an entirely toothless defense. A court could conceivably sustain the defense under different circumstances, such as if an investor sought to invest in a Retail Marijuana Corporation that planned to open retail stores in South Carolina, with full knowledge that South Carolina has not legalized retail marijuana sales.

> the time of the filing of the part of the registration statement with respect to which his liability is asserted[.][311]

In other words, this section imposes strict civil liability in suits brought by purchasers of registered securities upon issuers and their directors (and other statutory defendants) for fraud in the registration statement.

a. Cause of Action

The allure of Section 11 for purchaser-plaintiffs is that there are fewer elements to the cause of action than there are in suits under Section 10(b) and Rule 10b-5. Plaintiffs must prove there was a material misstatement or omission in the registration statement at the time that portion of the registration statement became effective. A registration statement will violate Section 11 "if it does not disclose 'material objective factual matters,' or buries those matters beneath other information, or treats them cavalierly."[312] The standard for materiality under Section 11 is the same as under Section 10(b).[313] Courts have also applied the bespeaks caution doctrine to Section 11 claims.[314]

To have standing, plaintiffs—even those who purchased on the secondary market—must also "trace" the specific shares they purchased to the public offering under the allegedly defective registration statement.[315] Unlike under Section 10(b), there is no need to prove scienter, reliance, or causation.[316]

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311. Securities Act of 1933, 15 U.S.C. § 77k(a)(2) (2019).

312. Olkey v. Hyperion 1999 Term Tr., Inc., 98 F.3d 2, 5 (2d Cir. 1996) (quoting I. Meyer Pincus & Assocs., P.C. v. Oppenheimer & Co., 936 F.2d 759, 762 (2d Cir. 1991)).

313. Rombach v. Chang, 355 F.3d 164, 178 n.11 (2d Cir. 2004).

314. *E.g.*, *id.* at 173 (applying the bespeaks caution doctrine and the PSLRA safe harbor in a Section 11 claim); *see supra* text accompanying notes 282–285 regarding the bespeaks caution doctrine.

315. *E.g.*, *In re* Century Aluminum Co. Sec. Litig., 729 F.3d 1104, 1106 (9th Cir. 2013) (citing Hertzberg v. Dignity Partners, Inc., 191 F.3d 1076, 1080 (9th Cir. 1999); Lee v. Ernst & Young, LLP, 294 F.3d 969, 978 (8th Cir. 2002)); Kirkwood v. Taylor, 590 F. Supp. 1375, 1377–78 (D. Minn. 1984), *judgment aff'd*, 760 F.2d 272 (8th Cir. 1985).

316. However, if the plaintiff acquires the security after the issuer publicly releases an earning statement that covers at least twelve months beginning after the registration statement's effective date, then the plaintiff must prove reliance upon the false statement in the registration statement or upon the

Statutory damages equal the difference between the plaintiff's purchase price (not exceeding the offering price) and the value of the shares at the time the suit was filed if the plaintiff still owns the shares, with derivations if the plaintiff sold the shares prior to filing suit or after filing but before judgment.[317] Outside directors face proportionate liability; they are liable for the portion of the judgment that corresponds to their share of the fault.[318]

There are several defenses to Section 11 liability. First, the defendant-director can prove that the purchaser-plaintiff had actual knowledge of the false statement or omitted fact.[319] This defense is not particularly useful, given that it is extremely difficult to prove what an individual plaintiff knew at the time of a securities purchase, especially since it is unlikely that a defendant-director had any personal connection to the plaintiff. Securities class actions only magnify the problem. This defense is largely useful after the fraud is publicly corrected so that the market (and therefore the individual plaintiff) "knows" the information.

The second line of defense protects defendants who reasonably and actually believed that the registration statement was not fraudulent. Non-expert defendants (i.e., defendants who did not prepare professional reports or valuations for inclusion in the registration statement) can avoid liability with respect to statements or omissions in a "non-expertised" portion of the registration statement (i.e., part of the registration statement not purportedly made by an expert) if they

> had, after reasonable investigation, reasonable ground to believe and did believe, at the time such part of the registration statement became effective, that the statements therein were true and that there was no omission to state a material fact required to be stated therein or necessary to make the statements therein not misleading[.] . . . (due diligence defense).[320]

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registration statement without knowledge of the omission. 15 U.S.C. § 77k(a).

317. 15 U.S.C. § 77k(e).

318. 15 U.S.C. § 77k(f)(2)(A); Securities Exchange Act of 1934, 15 U.S.C. § 78u-4(f)(2)(B)(i) (2019).

319. 15 U.S.C. § 77k(a).

320. 15 U.S.C. § 77k(b)(3)(A).

There is a slightly lower bar for non-experts' due diligence defense for statements in an "expertised" portion of the registration statement; in this case, non-expert defendants avoid liability if they

> had no reasonable ground to believe and did not believe, at the time such part of the registration statement became effective, that the statements therein were untrue or that there was an omission to state a material fact required to be stated therein or necessary to make the statements therein not misleading, or that such part of the registration statement did not fairly represent the statement of the expert or was not a fair copy of or extract from the report or valuation of the expert . . .[321]

Thus, non-experts must demonstrate reasonable investigation, reasonable grounds to believe, and actual belief that the non-expertised portion of the registration statement was truthful.[322] They must show only that they had no reasonable grounds to believe, and no actual belief, that the expertised portion of the registration statement was untruthful. The standard of reasonableness is "that required of a prudent man in the management of his own property."[323] This due diligence defense is rather onerous,[324] particularly for inside directors, who are generally chargeable with knowledge of all the rele-

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321. 15 U.S.C. § 77k(b)(3)(C).

322. Under Rule 176 of the Securities Act, factors that are relevant to determining whether the defendant conducted a reasonable investigation or had a reasonable ground for belief under Section 11(c) include, among others, the type of issuer, the defendant's relationship to the issuer, and "[r]easonable reliance on officers, employees, and others whose duties should have given them knowledge of the particular facts[.]" 17 C.F.R § 230.176 (2019).

323. 15 U.S.C. § 77k(c).

324. Courts have sustained the due diligence defense when outside directors have undertaken a careful review of the allegedly defective document and have reasonably relied upon representations by management and the corporation's independent investment and accounting firms. *E.g.*, Laven v. Flanagan, 695 F. Supp. 800, 810–11 (D.N.J. 1988). Outside directors have failed to establish due diligence when they were not sufficiently familiar with the corporation's affairs, when they relied upon management and failed to uncover errors that could have been detected through reasonable investigation, and when they were so familiar with a potential transaction that they could not have reasonable grounds to believe misstatements about that transaction were true. *E.g.*, Escott v. BarChris Constr. Corp., 283 F. Supp.

vant material facts of about the business and its operations.[325] Directors may rely on others only to the extent the reliance is reasonable. They cannot rely upon others when their own independent investigation would uncover the errors in question.[326]

The third line of defense is for whistleblower defendants who took measures to distance themselves from the fraudulent registration statement, including resigning from office and alerting the SEC that they would not be responsible for the fraudulent portion of the registration statement.[327] Obviously, the whistleblower defense is available only to a narrow class of defendants in narrow circumstances.

Finally, there is a "negative causation" defense—that is, defendants can prove that some or all of plaintiff's damages are attributable to something other than the false statement or omission in the registration statement.[328] The plaintiff's damages will be reduced to the extent that they are proved not to have been caused by the fraudulent registration statement.[329]

643, 687–90 (S.D.N.Y. 1968); Kitchens v. U.S. Shelter, 1988 WL 108598, at *37 (D.S.C. June 30, 1988).

325. *See, e.g.*, *BarChris*, 283 F. Supp. at 684–85 (finding the inside directors knew all the relevant information about the company's business and could not have believed that the registration statement was truthful); *Kitchens*, 1988 WL 108598, at *37 (similar). Inside directors have also failed to sustain their due diligence defense when they unreasonably relied upon preliminary estimates of a target company's financial information. Feit v. Leasco Data Processing Equip. Corp., 332 F. Supp. 544, 578–79 (E.D.N.Y. 1971); *see also id.* at 578 ("Inside directors with intimate knowledge of corporate affairs and of the particular transactions will be expected to make a more complete investigation and have more extensive knowledge of facts supporting or contradicting inclusions in the registration statements than outside directors.").

326. *See, e.g.*, *Laven*, 695 F. Supp. at 811 ("In pursuing such a[ ] [reasonable] investigation, a director may reasonably rely upon the representations of his subordinates."); *BarChris*, 283 F. Supp. at 690 ("To require an audit would obviously be unreasonable. On the other hand, to require a check of matters easily verifiable is not unreasonable.").

327. *See* 15 U.S.C. §§ 77k(b)(1)–(2).

328. 15 U.S.C. § 77k(e). This section provides "if the defendant proves that any portion or all of such damages represents other than the depreciation in value of such security resulting from such part of the registration statement, with respect to which his liability is asserted, not being true or omitting to state a material fact required to be stated therein or necessary to make the statements therein not misleading, such portion of or all such damages shall not be recoverable." *Id.*

329. *Id.*

Notably, the focus is not on whether the misstatement or omission induced the plaintiff to make the purchase; it is instead on whether the fraud caused the decline in the securities' value.[330] Defendants can demonstrate that the diminution in value was caused by other factors affecting the market as a whole, such as a broad decline in the stock market as a whole.[331]

b. Application to Directors of Retail Marijuana Corporations

Assuming the plaintiff has standing, Section 11 is a potential source of liability for directors of publicly traded Retail Marijuana Corporations like Tilray. As noted above, directors are statutory defendants under Section 11(a)(2). Thus, the crux of the plaintiff's case is proving that there was a material misstatement or omission in the registration statement. Though this will necessarily be a fact-intensive and company-specific analysis, Retail Marijuana Corporations are perhaps particularly susceptible to Section 11 claims because of the conflicted state of marijuana legalization. In other words, Retail Marijuana Corporations might prove attractive targets for aggrieved investors because marijuana's illegality under federal law leaves open potential avenues for suit. The following discussion describes how a Tilray investor might attempt to mount a Section 11 case on the basis of Tilray's Operations Statements and the CSA Statement.[332]

Examining the Operations Statements, Tilray assures potential investors that it does not produce or distribute marijuana in the United States.[333] It claims it "operate[s] only in countries where cannabis is legal[,]" in all the senses of the

330. Akerman v. Oryx Commc'ns, Inc., 609 F. Supp. 363, 368 (S.D.N.Y. 1984), *aff'd and remanded*, 810 F.2d 336 (2d Cir. 1987) ("[T]he statute recognizes that there may be cases in which a misstatement is material to an investor's decision although it has not in fact adversely affected the value of the stock.").

331. *See, e.g.*, Feit v. Leasco Data Processing Equip. Corp., 332 F. Supp. 544, 586 (E.D.N.Y. 1971) ("We cannot consider any damages caused, not by defendants' omissions, but by independent forces.").

332. *See supra* text accompanying notes 214-215 for the text of these statements.

333. Tilray, Inc., Registration Statement (Form S-1), at 24 (July 18, 2018).

word.[334] Therefore, although Tilray engages in accounting, legal, and creative services in the U.S.,[335] it takes the position that it does not "operate" there. The questions then become whether this is a misstatement, and if it is, whether it is a material one.

Arguably, a statement that Tilray only "operates" in countries where it is legal to do so is a misstatement. A court could certainly consider conducting "certain corporate and administrative services, including accounting, legal and creative services[,]"[336] to constitute "operations." If so, then Tilray does indeed operate in the United States, where it is not permitted under both state[337] and federal law to do so. Might a reasonable investor care about where a Retail Marijuana Corporation operates? Yes—it would certainly affect that investor's calculus of the legal risks the company (and potentially the investor) might face. For example, could the provision of these services in the U.S. constitute engaging in or affecting interstate or foreign commerce through a pattern of racketeering activity so as to create potential RICO liability?[338] Statements about where Tilray operates could potentially alter the total mix of information about Tilray available to the investor and, therefore, would be material.[339] Thus, the seemingly pedestrian Opera-

334. *Id.* at 76.

335. *Id.* at 24.

336. *Id.*

337. As mentioned above, Tilray is incorporated in Delaware and has offices in Seattle. Though Seattle has legalized both medical and recreational marijuana sales, Delaware has authorized only medical marijuana sales. *See State Marijuana Laws in 2019 Map*, *supra* note 39. Thus, to the extent Tilray is engaged in the retail marijuana business, it could be violating both state and federal law.

338. *See* Racketeer Influenced and Corrupt Organizations Act, 18 U.S.C. § 1962(c) (2018).

339. The argument that this is a material misstatement is, admittedly, a stretch. In examining a registration statement for Section 11 purposes, the "central inquiry" is "whether defendants' representations, taken together and in context, would have [misled] a reasonable investor about the nature of the investment." I. Meyer Pincus & Assocs., P.C. v. Oppenheimer & Co., 936 F.2d 759, 761 (2d Cir. 1991) (quotation omitted). Moreover, courts read the registration statement or prospectus "as a whole." Olkey v. Hyperion 1999 Term Tr., 98 F.3d 2, 5 (2d Cir. 1996). "The touchstone of the inquiry is not whether isolated statements within a document were true, but whether defendants' representations or omissions, considered together and in context, would affect the total mix of information and thereby mislead a reason-

tions Statements may not be of much interest to another type of corporation, but they take on increased significance for a Tilray investor because Tilray is a Retail Marijuana Corporation.

Tilray makes a variety of disclosures in its Risk Factors discussion that a Section 11 defendant could argue vitiates any claim on the basis of the Operations Statements. For example, Tilray cites the possibility of "significant fines, penalties, administrative sanctions, convictions or settlements arising from civil proceedings initiated by either the U.S. federal government or private citizens or criminal charges, including, but not limited to, disgorgement of profits, cessation of business activities or divestiture" as a result of violating any U.S. federal laws or regulations.[340] However, Section 11 plaintiffs must prove that the securities they purchased are traceable to the defective registration statement, not that they read and relied upon the defective registration statement. If a court found the statement in the "Business" section of Tilray's registration statement that Tilray only operates where marijuana-related activities are legal to be a material misstatement, it likely would not find that misstatement to have been overcome by language elsewhere that raises the risk of potential liability the company may face, as that statement of risk does not speak to, or alter, the specific statement that Tilray only operates where marijuana activities are legal.

It would be a different situation if, on one page, Tilray's registration statement stated, "We only operate where selling marijuana is legal," and on three other pages it stated, "We operate in many places—some in which selling marijuana is legal, and some in which it isn't." In that case, reading the registration statement as a whole, a court would likely find the lone "We only operate where selling marijuana is legal" to be immaterial given the "total mix" of information in the registration statement. But to say that "We only operate where selling marijuana is legal" is tempered by "We could be subject to a

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able investor regarding the nature of the securities offered." Halperin v. Ebanker USA.com., Inc., 295 F.3d 352, 357 (2d Cir. 2002). Then again, Tilray's prospectus as a whole gives the impression that Tilray does not operate in the United States, which is why it believes it is not subject to the CSA. It is therefore at least arguable that the Operations Statements are material.

340. Tilray, Inc., Registration Statement (Form S-1), at 24 (July 18, 2018). It also raises the specter of aiding and abetting liability for U.S. investors. *Id.*

variety of civil and criminal liability" is not the same—the caution does not correct or modify the misstatement.

The CSA Statement is a similarly appealing target for a Section 11 plaintiff, especially if a court later holds Tilray subject to the CSA. It is also the type of statement that other similarly situated Retail Marijuana Corporations might make in their registration statement. However, the CSA Statement actually presents a more difficult case for a Section 11 plaintiff. Even if a court ultimately decides that Tilray is subject to the CSA, an honestly held opinion is not a material misstatement of fact simply because it is later proven to be wrong; a statement of opinion is actionable under Section 11 only if the plaintiff can prove that it was not honestly held.[341] Moreover, an opinion on legal compliance does not become a materially misleading omission under Section 11 unless the "registration statement omits material facts about the issuer's inquiry into or knowledge concerning a statement of opinion, and if those facts conflict with what a reasonable investor would take from the statement itself . . . ."[342] Thus, a Section 11 plaintiff would have a difficult time attacking Tilray's CSA Statement unless the plaintiff could prove, for example, that Tilray had not consulted its lawyers regarding its potential exposure to the CSA, or that its lawyers had advised Tilray that it likely is subject to the CSA, or some similar fact that undermines Tilray's claim that it was an honest, if mistaken, belief.[343]

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341. *See* Omnicare, Inc. v. Laborers Dist. Council Const. Indus. Pension Fund, 135 S. Ct. 1318, 1327 (2015) ("[A] sincere statement of pure opinion is not an 'untrue statement of material fact,' regardless whether an investor can ultimately prove the belief wrong."). In *Omnicare*, the company's registration statement contained statements of opinion in which the company expressed the belief that it was not violating anti-kickback laws, accompanied by caveats that its interpretation of the law could prove incorrect. *Id.* at 1323–24. After the federal government brought suits against Omnicare for violation of those laws, investors brought a Section 11 suit, claiming that the company's statements about legal compliance were materially false. *Id.* at 1324. The Supreme Court declined to view the legal opinions contained in the company's registration statement as material misstatements because the plaintiffs did not challenge the sincerity of the company's belief. *Id.* at 1327. The Court remanded on the question of the alleged omission under the new standard the Court expressed. *Id.* at 1333.

342. *Id.* at 1329.

343. *See id.* at 1328–29.

If any of Tilray's statements or omissions were plausibly attacked in a Section 11 suit, the most likely line of defense for Tilray's directors would be the due diligence defense. Because the Operations Statements and the CSA Statement are in non-expertised portions of the registration statement (i.e., the Business and Risk Factors sections) the defendant directors would have to prove that they (1) conducted a reasonable investigation; (2) had reasonable ground to believe; and (3) actually did believe, at the time the registration statement became effective, that the statements made in the registration were true and complete. Under the circumstances, it would be challenging to mount this defense.

Regarding the Operations Statements, the directors would have to show that they conducted a reasonable investigation into where Tilray operates and reasonably and actually did believe that Tilray does not operate in the U.S. Given the fact that Tilray has offices in Seattle and acknowledges conducting certain business activities in the United States, this would be a difficult claim to make. In the unlikely event that Tilray's lawyers engaged the directors in a discussion of the term "operate" and provided a legal opinion that Tilray's various activities in the U.S. do not constitute operations, the directors might have a reasonable basis for believing the statement to be true. Otherwise, it would be hard for even an outside director to establish a reasonable belief about the Operations Statements.

The due diligence defense would be more likely successful in the context of the CSA Statement (assuming a court somehow found the CSA Statement actionable under the Supreme Court's standard). The defense would naturally be fact intensive, but the defendant directors could plausibly point to corporate records of meetings with lawyers in which they discussed Tilray's exposure to the CSA and the basis for the legal opinion that Tilray is not subject thereunder. Even finding that Tilray's lawyers disagreed about whether Tilray is subject to the CSA would not be fatal to the directors' defense so long as the directors could still show it was reasonable for them to

believe (and they actually did believe) that Tilray is not subject to the statute.[344]

The obligation to be entirely truthful in the registration statement is not unique to Retail Marijuana Corporations; every issuer of registered securities has the same obligation and the same potential Section 11 liability for misstatements or omissions. And yet, the unsettled state of the law makes it somewhat more likely that investors will seek redress from Retail Marijuana Corporations under the securities laws, especially if the federal government decides to enforce federal criminal laws against Retail Marijuana Corporations. This means that Retail Marijuana Corporations will need to be even more careful than other types of issuers because aspects of their business—such as where they have offices—will take on more significance than they would for issuers that do not regularly engage in conduct banned under federal law. Even if there is not a strong case under Section 11 against Tilray (or similar issuers) on the basis of these selected statements, Section 11 claims are easier to bring than Rule 10b-5 claims, and Retail Marijuana Corporations and those acting on their behalf are likely to be appealing targets. Accordingly, Retail Marijuana Corporations—more so than companies that operate more squarely in compliance with the law—must exercise great care to ensure that there are no statements or omissions that could potentially give rise to liability under Section 11 and the other antifraud provisions.

CONCLUSION

In light of the smorgasbord of possible liability sources for directors of Retail Marijuana Corporations, someone who chooses to accept a directorship in a Retail Marijuana Corporation must be either fearless by nature, particularly committed to the cause of legalizing retail marijuana, or downright foolhardy. Even if many of the theories of liability outlined in this Article are difficult to plead and prove, the costs of defending against them are high, both in terms of dollars and also in terms of managerial attention and opportunity costs. Rather than defend against shareholder litigation, many com-

344. *See id.* at 1329 (providing an example in which a single junior attorney disagrees with six of his more senior colleagues and concluding that the statement of opinion would not thereby be rendered misleading).

panies settle, even when their chances of prevailing at trial are relatively good.[345] With the greater prospect of defending against litigation and personal liability comes a greater challenge in finding qualified people willing to serve as directors.[346] This is problematic for the welfare of Retail Marijuana Corporations and particularly for their investors, who rely upon directors to safeguard their investments. There runs the risk that the best qualified, most experienced directors will stick to running more mainstream companies, while less experienced or less qualified directors take the helm of Retail Marijuana Corporations, potentially as "passion projects."

The situation becomes more tenuous the longer it continues. Some early investors in retail marijuana businesses are venture capitalists, accelerator companies, and other sophisticated investors.[347] Others are partakers in recreational mari-

345. *See* Amy M. Koopmann, Note, *A Necessary Gatekeeper: The Fiduciary Duties of the Lead Plaintiff in Shareholder Derivative Litigation*, 34 J. CORP. L. 895, 912 (2008-2009) ("Litigation is expensive, and settling a case, even a case that would not succeed on its merits, can be less expensive than the costs of getting the case dismissed, and certainly less expensive than going to trial.") (footnotes omitted); Ralph K. Winter, *Paying Lawyers, Empowering Prosecutors, and Protecting Managers: Raising the Cost of Capital in America*, 42 DUKE L.J. 945, 950 (Mar. 1993) ("[T]here is increasing evidence that settlement is inevitable where judgment on the pleadings or a quick summary judgment cannot be obtained, and that the amounts paid in settlement are in large part unrelated to the merits of the action."); Dionne Searcey & Ashby Jones, *First the Merger; then the Lawsuit*, WALL ST. J. (Jan. 10, 2011), http://online.wsj.com/article/SB10001424052748704482704576072050216781160.html (describing settlement of frivolous "strike" suits in connection with mergers and acquisitions).

346. *See* Martin J. Lipton, Keynote Address to the 25th Annual Institute on Federal Securities: Shareholder Activism and the "Eclipse of the Public Corporation" 6 (Feb. 7, 2007), https://corpgov.law.harvard.edu/wp-content/uploads/2007/02/20070210%20Lipton%20Address.pdf ("The growth of shareholder litigation against directors coupled with the media attention and reputational damage to the directors who are sued, and in part to all directors, affects the willingness of the most highly qualified people to serve as directors.").

347. *See* Melissa Pistilli, *Early Stage US Cannabis Companies Offering Opportunity for Accelerators*, CANNABIS INVESTING NEWS (Apr. 7, 2019), https://investingnews.com/daily/cannabis-investing/financing-early-stage-us-cannabis-companies/; Brett Relander, *Funding Platforms for Marijuana Startups*, INVESTOPEDIA, https://www.investopedia.com/articles/investing/030515/funding-platforms-emerging-marijuana-startups.asp (last updated Jun. 25, 2019).

juana use who believe in its legalization.[348] Still others may be entrepreneurs' friends and family members.[349] Some of these investors are well positioned to analyze investments and to take calculated risks, but others are unsophisticated (in investor terms) and more in need of reliance upon the safeguards afforded by competent and experienced directors.[350]

As investing in marijuana companies becomes more normalized, so too will exposure to Retail Marijuana Corporation's securities become more widespread. For example, mutual funds may begin to invest money in Retail Marijuana Corporations' securities, potentially without their fund investors' knowledge that they are now exposed to marijuana-related securities.[351] Or companies that had not been Retail Marijuana Corporations may start investing in marijuana businesses, like Constellation's investment in Canopy Growth.[352] If the winds change and the federal government begins enforcing the CSA against Retail Marijuana Corporations, investor losses could be substantial as Retail Marijuana Corporations go bankrupt or dissolve—whether voluntarily or involuntarily. This will likely open the litigation floodgates, not unlike the collateralized

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348. For example, rapper Snoop Dogg is a director of a venture capital fund that invests in marijuana-related start-ups. *See* Relander, *supra* note 347. Snoop Dogg is also a known marijuana user who favors its legalization. *See* Shirley Halperin, *Snoop Dogg on Teen Son's Pot Use: "He's Learning from the Master"*, HOLLYWOOD REP. (SEPT. 26, 2012, 12:19 P.M. PDT), https://www.hollywoodreporter.com/news/snoop-dogg-son-pot-obama-marijuana-374384.

349. *See* Frank Robinson, *Going Green: Legal Considerations for Marijuana Investors and Entrepreneurs*, 6 AM. U. BUS. L. REV. 57, 80 (2016) (surmising that "bootstrapping as well as friends and family are the largest source of funds" for Retail Marijuana Corporations).

350. *See* Nigam Arora, *How to Make, and Avoid Losing, Money with Marijuana Stocks*, MARKETWATCH (Jul. 24, 2018, 3:01 p.m. ET) ("[M]any unsophisticated investors are being drawn into cannabis stocks."); *Beware of the Next Big Investment*, WASH. STATE DEP'T FIN. INST. (Nov. 10, 2015), https://dfi.wa.gov/consumer/alerts/beware-next-big-investment ("Marijuana investment opportunities could be particularly susceptible to scams . . . ."). *But see* Caleb Silver, *Who's Interested in Marijuana Stocks?*, INVESTOPEDIA, https://www.investopedia.com/news/whos-interested-marijuana-stocks/ (last updated Jun. 25, 2019).

351. *See* Fein, *supra* note 205, at 22–38 (regarding trustees' and other fiduciaries' duties in connection with investments in marijuana-related securities).

352. *See supra* text accompanying notes 140–143 regarding Constellation's investment.

debt obligation backlash in the wake of the 2008 financial crisis.[353]

This situation begs for a legislative solution. While state courts can define their own state causes of action to exclude state-sanctioned retail marijuana activity and state legislatures can craft statutes that prevent unintended consequences from befalling Retail Marijuana Corporations,[354] states cannot redefine federal statutes to insulate Retail Marijuana Corporations from liability. In the current political climate, the cause of protecting directors of Retail Marijuana Corporations from personal liability is unlikely to inspire many Members of Congress to take legislative action, but the causes of clarifying the law, protecting investors, and resolving an "untenable" situation might.

353. *See* Jonathan Stempel, *Citigroup Settles Shareholder CDO Lawsuit for $590 Million*, REUTERS (Aug. 30, 2012), https://www.reuters.com/article/us-citigroup-settlement/citigroup-settles-shareholder-cdo-lawsuit-for-590-million-idUSBRE87S0UA20120830; *The Financial Crisis 10 Years Later: Lessons Learned*, PAUL, WEISS (Sept. 15, 2018), https://www.paulweiss.com/practices/litigation/financial-institutions/publications/the-financial-crisis-10-years-later-lessons-learned?id=27324.

354. *See* Newell, *supra* note 74, at 1392–93 (suggesting a state legislative solution to the illegal purpose doctrine); Scheuer, *supra* note 23, at 551–54 (proposing an exception to state business entity and related laws to prevent CSA violations from vitiating state business entity protections).