AN ILLINOIS LAW FIRM

GETTING DOWN TO BUSINESS

HEYL ROYSTER
BUSINESS & COMMERCIAL LITIGATION NEWSLETTER

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WELCOME LETTER

Dear Friends,

Happy summer! Welcome to our latest edition of *Getting Down to Business*, the Heyl Royster Business and Commercial Litigation Newsletter. In this edition, we address a range of topics all relating to policies of the federal government that may affect your business here in the Midwest.

First, Gary Schwab provides insight into the U.S. Department of Justice's new focus on prosecuting corporate misconduct. Through issuance of its "Yates Memo" in September 2015, the DOJ signaled its intention to focus on individuals—rather than corporate entities—in its civil and criminal investigations of corporate wrongdoing. The Yates Memo represents a seismic policy shift that affects how corporations should react to inquiries by federal authorities. Next, Patrick Folley explores recent guidance from the Internal Revenue Service as to the tax treatment of workplace wellness programs. With the expansion of these programs in recent years, the business community has struggled to classify the benefits conferred by their plans. For example, should they be included in an employee's gross income? Patrick outlines guidance provided by a recent memorandum on the subject from the IRS Office of Chief Counsel. Finally, Monica Kim follows up on Nate Bach's recent article on the business implications of the Illinois Compassionate Use of Medical Cannabis Pilot Program Act (in our Winter 2016 edition) with the strange banking implications of this program. Because cannabis remains illegal under federal law, the transfer of proceeds from the sale of medical cannabis may cause banks to run afoul of money laundering statutes. Monica explores the DOJ and Department of Treasury's views on the subject and the banking industry's necessary emphasis on due diligence. She also suggests that small, local banks and credit unions may have an advantage in this expanding industry.

We look forward to continuing to provide news and free educational seminars on topics of interest to the business community. For over one hundred years, our firm has protected the rights of businesses. If you need assistance, whether business formation and governance, contract formation and enforcement, employment policy development and implementation, or litigation through trial, we look forward to speaking with you. If you have specific questions or suggestions for topics for future editions of *Getting Down to Business*, please just let us know.

John Heil

Vice Chair of the Business & Commercial Litigation Practice Group, Editor

THE YATES MEMO: THE U.S. DEPARTMENT OF JUSTICE GUIDE TO FIGHTING CORPORATE WRONGDOING

By: Gary Schwab, gschwab@heylroyster.com

The Yates Memo issued by the U.S. Department of Justice (DOJ) on September 9, 2015, sets forth six key steps for DOJ attorneys to take in both civil and criminal investigations of corporate misconduct. It focuses on individual accountability to combat corporate misconduct as that is seen as one of the most effective ways to deter future illegal activity, incentivize changes in corporate behavior, ensure that all proper parties are held responsible for their actions, and promote public confidence in the justice system. The six key steps are as

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follows:

1. To be eligible for any cooperation credit, corporations must provide all relevant facts about the individuals involved in corporate misconduct.

In order to receive any consideration for cooperation, the company must disclose all relevant facts about individual misconduct and cannot pick and choose what facts to disclose. If a company declines to learn of such facts or to provide the DOJ with complete factual information about individual wrongdoers, its cooperation will not be considered a mitigating factor at the time of sentencing. Once a company meets the threshold requirement of providing all relevant facts, the extent of the cooperation credit will depend upon traditionally applied factors in making that assessment such as timeliness of the cooperation, the diligence, thoroughness, and speed of the internal investigation, and the proactive nature of the cooperation. This condition of cooperation applies equally to corporations seeking to cooperate in civil matters such as in cases brought under the False Claims Act, 31 U.S.C. § 3729(a)(2). The "all or nothing" approach to cooperation credit has received the most attention of those commenting upon the Yates Memo.

2. Both criminal and civil corporate investigations should focus on individuals from the inception of the investigation.

DOJ attorneys are being instructed to focus on individual wrongdoing from the very beginning of any investigation of corporate misconduct with that being deemed the most effective way to force a disclosure of facts and the extent of any misconduct which might lead to civil or criminal charges not only against the corporation but also against culpable individuals.

3. DOJ's criminal and civil attorneys handling corporate investigations should be in routine communication with one another.

By having the DOJ's civil and criminal prosecutors, together with agency attorneys, all working together, the full range of the government's potential remedies can be considered and that will promote the most thorough and appropriate resolution in every case. Criminal prosecutors are instructed to notify civil attorneys as early as possible of any potential individual's civil liability. If a decision is made not to pursue a criminal action against an individual, the criminal prosecutors are instructed to confer with their civil counterparts regarding whether any civil action should be taken. Likewise, if civil prosecutors find an individual who they believe should be subject to criminal prosecution, they are instructed to refer that matter to the criminal prosecutors regardless of the current civil corporate investigation.

4. Absent extraordinary circumstances, no corporate resolution will provide protection from criminal or civil liability for any individuals.

The DOJ prosecutors are now instructed that they should not agree to a corporate resolution that includes an agreement to dismiss charges against, or provide immunity for, individual officers or employees. The same principal holds true in civil corporate matters. Any release of an individual from criminal or civil liability due to extraordinary circumstances must be personally approved in writing by the relevant Assistant Attorney General or United States Attorney.

5. Corporate cases should not be resolved without a clear plan to resolve related individual cases before the statute of limitations expires and declinations as to individuals in such cases must be memorialized.

So, if the investigation of individual misconduct has not concluded by the time that authorization is sought to resolve the civil or criminal case against the corporation, the prosecutors now must set forth a written plan including a discussion of the potentially liable individuals, a description of the status of the investigation regarding their conduct, what investigative work needs to be done, and a proposal on how to bring that matter to resolution before the end of any statute of limitations period. Because investigations of corporations can be lengthy and complex and take years to complete, it was previously not uncommon for individuals to wait until after the corporate case was resolved with the hope that, in the meantime, the statute of limitations' period would expire for them to be held individually liable. Now, that will be less likely as civil

and criminal prosecutors must develop a plan for holding the individual liable within the time frame allowed.

6. Civil attorneys should consistently focus on individuals as well as the company and evaluate whether to bring suit against an individual based on considerations beyond that individual's ability to pay.

Since civil enforcement efforts are designed not only to recoup government money but also to hold wrongdoers accountable, and to deter future wrongdoing, DOJ's attorneys are being instructed that just because an individual may not have sufficient assets or income to satisfy a significant judgment should not control the decision on whether a lawsuit should be brought against him. Civil prosecutors are being instructed to take into account whether the person's misconduct was serious and actionable and are also being advised to take into account the individual's past history and the circumstances leading to the commission of the misconduct, the needs of the communities being served and federal resources and priorities.

The DOJ's focus on individual accountability for corporate wrongdoing creates potential conflicts of interest and the following problems and issues for evaluation and consideration:

(a) Corporations seeking cooperation credits may not be inclined to give their employees the benefit of the doubt and report facts suggesting individual misconduct, thereby exposing their employees to criminal or civil liability where the facts are less than clear cut.

(b) On the other hand, if a corporation decides not to cooperate or fails to disclose all facts by picking and choosing what facts to disclose, it risks being subjected to penalties and not receiving any cooperation credit, if found guilty.

(c) While companies are only required to disclose facts, and not legal conclusions or opinions protected by the attorney-client or work product privileges, the process of making those disclosures without waiving those privileges may prove to be difficult.

(d) Knowing that the DOJ is keen on pursuing individual liability, employees may refuse to share information or disclose what they know in fear of being turned in by their employer to the DOJ for possible civil or criminal prosecution.

(e) Should a company agree to pay the attorneys' fees of its individual employees in an effort to show that it is concerned about their interests? If so, is there a way to recoup those fees if the individual is later found civilly or criminally liable for any wrongdoing.

(f) When interviewing employees, corporate counsel are required to give *Upjohn* warnings explaining to the employees that the company's attorneys are not representing them but rather the company, and make it clear that there is no attorney-client privilege between the company's attorneys and those individuals in the event that they make any admissions of wrongdoing. Since the Yates Memo encourages companies to turn over evidence implicating individual employees in corporate misconduct, the giving of *Upjohn* warnings to those employees becomes even more important.

(g) Corporations may want to think twice before deciding to have their counsel jointly represent the corporation and its employees in governmental investigations as counsel may be provided privileged information from an individual employee which will create a potentially unwaivable conflict of interest which will prevent the company from providing that information to the DOJ and risk the loss of cooperation credit.

(h) The company should consider whether to recommend separate counsel for individual employees facing potential criminal liability. Without separate counsel, individuals may not fully cooperate; however, if the individual is guilty, he may be advised by separate counsel to not cooperate, thereby inhibiting the company's ability to provide a full and final disclosure of all relevant facts.

(i) If individual employees retain separate counsel, the individual's attorneys may seek information and documentation from the corporation which the company may be reluctant to share out of a concern that by doing so,

it will receive less cooperation credit from the government, if subsequently found civilly or criminally liable.

Gary Schwab is a trial attorney who concentrates his practice in commercial litigation and the defense of civil litigation such as professional, municipal liability, and general negligence claims. In addition, he handles first party and third party insurance coverage claims for various insurance carriers. He appears in both state and federal courts and before governmental agencies.

TAX TREATMENT OF WELLNESS PROGRAM BENEFITS

By Patrick Folley, pfolley@heylroyster.com

The IRS Office of Chief Counsel recently released a memorandum providing guidance on the proper tax treatment of workplace wellness programs. Workplace wellness programs cover a range of plans and strategies adopted by employers to counter rising healthcare costs by promoting healthier lifestyles and providing employees with preventive care. These programs take many forms and can encompass everything from providing certain medical care regardless of enrollment in health coverage, to free gym passes for employees, to incentivized participation- based weight loss programs. Due to the wide variation in such plans the proper tax treatment can be complicated. However, the following points from the IRS memo can help business owners operating or considering a wellness program evaluate their tax treatment.

First, the memo confirmed that coverage in employer-provided wellness programs that provide medical care is generally not included in an employee's gross income under section 106(a), which specifically excludes employer-provided coverage under an accident or health plan from employee gross income. 26 USC § 213(d)(1)(A) defines medical care as amounts paid for "the diagnosis, cure, mitigation, treatment, or prevention of disease, or for the purpose of affecting any structure or function of the body," transportation for such care, qualified long term care services, and insurance (including amounts paid as premiums).

Second, it was made clear that any section 213(d) medical care provided by the program is excluded from the employee's gross income under section 105(b), which permits an employee to exclude amounts received through employer-provided accident or health insurance if it is paid to reimburse expenses incurred by the employee for medical care for personal injuries and sickness. The memo emphasized that 105(b) only applies to money paid specifically to reimburse the employee for expenses incurred by him for the prescribed medical care. This means that the exclusion in 105(b) does not apply to money that the employee would receive through a wellness program irrespective of any expenses he incurred for medical care. 26 CFR 1.105-2.

Third, any rewards, incentives or other benefits provided by the wellness program that are not medical care as defined by section 213(d) must be included in an employee's gross income. This means that cash prizes given to employees as incentives to participate in a wellness program are part of the employee's gross income and may not be excluded by the employer. However, non-money awards or incentives might be excludable if they qualify as de minimis fringe benefits (ones that are so small and infrequent that accounting for them is unreasonable or impracticable). 26 USC § 132(a)(4). The memo gives the example of a t-shirt provided as part of a wellness program as such an excludable fringe benefit, and notes that money is never a de minimis fringe benefit.

Fourth, payment of gym memberships or reimbursement of gym fees is a cash benefit, even when received through the wellness program, and must be included in gross income. This is because cash rewards paid as part of the wellness program do not qualify as reimbursements of medical care and cannot be a fringe benefit.

Fifth, where an employee chooses a salary reduction to pay premiums for healthcare coverage and the employer reimburses the employee for some or all of the premium amount under a wellness program, the reimbursement is gross income.

These points laid out in the IRS memo provide a solid foundation for understanding the tax treatment of workplace wellness programs and should be kept in mind by business owners deciding how to structure new wellness plans for their employees, or ensuring the tax compliance of existing plans.

Patrick Folley concentrates his practice in the area of commercial litigation, medical malpractice defense, and insurance coverage. While in law school, Patrick clerked for the Honorable James E. Shadid, Chief United States District Judge for the Central District of Illinois.

The Billion Dollar Industry in Need of a Bank

By: Monica Kim, mkim@heylroyster.com

As of March, 2016, cannabis is legally sold in 23 states and the District of Columbia, either for recreational or medical use. Illinois became one of these states in 2013, when the Compassionate Use of Medical Cannabis Pilot Program Act, 410 ILCS 130/1 *et seq*, (CUA) was signed into law. The CUA permits licensed cultivation centers to grow cannabis for sale to licensed dispensaries, which may then sell the product to registered qualifying patients. Currently, 18 cultivation centers and 33 dispensary locations are open or approved to be open in Illinois, with more set to open in the future. Illinois Department of Agriculture, Medical Cannabis Pilot Program (https://www.agr.state.il.us/medical-cannabis-pilot-program/) (last visited July 20, 2016), Illinois Department of Financial and Professional Regulation, Licensed Medical Cannabis Dispensaries (http://www.idfpr.com/Forms/MC/ListofLicensedDispensaries.pdf) (last visited July 20, 2016). There has been well over $2 million estimated in sales in Illinois since legal cannabis sales began on November 9, 2015. Nationally, cannabis sales exceeded $5.4 billion in 2015.

Despite the significant amount of cash flow, many cannabis businesses are unable to open and maintain bank accounts and deposit funds into an account due to current federal laws. Most notably, the product is still illegal under the federal Controlled Substances Act. Because of cannabis' federally illegal status, the transfer of funds from the sale of cannabis could be considered money laundering. The Bank Secrecy Act, 31 U.S.C. 5311 *et seq*, requires banks to undertake some due diligence in identifying and reporting potential money laundering activity. For example, a bank must file suspicious activity reports (SAR) if the bank knows, suspects, or has reason to suspect that a transaction involves funds derived from illegal activity. Due to the administrative burden and potential liability these laws impose on banks holding funds from cannabis businesses, among other considerations, banks are hesitant to accommodate the industry. U.S. Department of Treasury's Financial Crimes Enforcement Network (FinCEN) reported in 2015 that 266 of the 6,200 financial depositary institutions nationwide have open accounts with cannabis-related businesses.

Former U.S. Deputy Attorney General James Cole issued a memorandum (Cole Memorandum) on the federal priorities related to cannabis enforcement in 2013. The Cole Memorandum indicated cannabis businesses in states that have legalized cannabis are less likely to be a threat to the federal priorities under the Controlled Substances Act if these states have implemented effective regulatory and enforcement programs to manage cannabis distribution and the cannabis businesses were complying with such regulatory and enforcement programs.

Subsequently, FinCEN issued guidelines for financial institutions on cannabis businesses in 2014. FinCEN related that, since the sale of cannabis is prohibited under federal law, the SAR filing requirement applies to all cannabis business accounts. Additionally, banks must complete Currency Transaction Reports and Form 8300 (Report of Cash Payment over $10,000 Received in a Trade or Business) for cannabis business accounts without exception. FinCEN also emphasized the need for banks to conduct due diligence on cannabis

businesses requesting and maintaining a bank account. The take-away from the Cole Memorandum and FinCEN guidance: banks can serve cannabis businesses in legalized states as long as they follow these strict anti-money laundering procedures including due diligence.

In an effort to solve the cannabis industry's banking problem, some have explored creating their own financial institution specifically for the cannabis industry. A prime example of such a financial institution is the Fourth Corner Credit Union. When the Fourth Corner Credit Union was denied an account with the Federal Reserve System it filed suit against the Federal Reserve Bank of Kansas City. The Federal District Court of Colorado recently dismissed the suit, holding that, despite the Cole Memorandum and FinCEN guidance, the federal laws regarding the illegality of the product outweighed any directive on priorities in law enforcement.

This presents an interesting opportunity for smaller, regional financial institutions to take on these potentially lucrative accounts. For example, several state-chartered credit unions in Washington have elected to accept a number of cannabis business accounts. In Oregon, another state-chartered credit union was in the news for taking on about 50 cannabis business accounts. That credit union created requirements for its cannabis businesses to pass to maintain accounts with the credit union. All of these credit unions reported working closely with state and federal regulators to maintain transparency.

Financial institutions can enter into this industry. But is clear that compliance is of the utmost importance in creating and maintaining a successful relationship between cannabis business owners and financial institutions. Monitoring these accounts requires much attention and expense from these banks. At the same time, cannabis business owners are willing to comply with these extensive requirements because they need these accounts. Cannabis business owners must cooperate with their banks to ensure a long term successful relationship for both parties. The businesses must provide the banking institution with up to date documentation of their certification to open an account, and continue to notify the institution of any changes made with regard to their certification. Cannabis businesses must first and foremost ensure complete compliance with the CUA and its regulations. Financial institutions must identify due diligence standards and implement processes to ensure satisfaction of all reporting requirements. Due to the associated issues, cannabis businesses and financial institutions alike should confer with counsel as to what each side's compliance plan should look like.

Monica Kim concentrates her practice on commercial and business litigation. Monica has represented individual and business clients in litigation in state and federal courts in Illinois as well as in commercial arbitrations. Her focus on commercial disputes includes matters involving breach of contract, breach of fiduciary duty, fraud, and other business torts. Monica has experience in all aspects of pre-trial and post-trial activity, including motion practice, discovery, settlement negotiations and appeals.

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