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**CARMEN A. TRUTANICH**  
City Attorney

June 20, 2012

Honorable City Council  
of the City of Los Angeles  
Room 395, City Hall  
200 North Spring Street  
Los Angeles, California 90012

Re: Proposed Ordinance Repealing and Replacing Article 5.1 of Chapter  
IV of the Los Angeles Municipal Code to Implement Recent Appellate  
Court Decisions Concerning Medical Marijuana

Council File Nos. 11-1737 and 11-1737-S1

Honorable Members:

Respectfully attached for your consideration, please find a copy of an article appearing in the Los Angeles Times on June 17, 2012, reporting that southern California marijuana businesses earn very substantial profits, notwithstanding their claims that they operate as nonprofit entities.

Very truly yours,

A handwritten signature in black ink, appearing to read "S. Blau".

STEVEN N. BLAU  
Deputy City Attorney

SNB:gl  
(Attachment as noted.)

latimes.com/news/local/la-me-0617-pot-retail-20120617,0,372401.story

**latimes.com**

## Some Southern California 'nonprofit' pot shops make big money

**Documents show a cash-infused retail world bearing little resemblance to the one pitched to voters for the 1996 Compassionate Use Act for 'seriously ill Californians.'**

By Joe Mozingo, Los Angeles Times

June 17, 2012

In the first raid, Orange County sheriff's detectives hit a Dana Point marijuana storefront, the San Clemente home of its director and a "stash house" he allegedly maintained nearby.

In the two homes, they found cash stuffed everywhere: in buckets in the garage and attic, in an Igloo cooler in a bedroom, under a mattress, on an ironing board, in a dresser. According to a search warrant affidavit filed in November, they recovered more than \$700,000.

At the shop, investigators found spreadsheets showing sales over 10 months totaled \$3.17 million, according to the affidavit, with \$2.47 million "cash on hand."

Paperwork indicated that a silent partner, a convicted drug dealer named John M. Walker, controlled the shop and six others in Orange and Los Angeles counties.

A subsequent raid of one of Walker's properties recovered a Beretta handgun, a shotgun, a Chinese AK-47 with a bayonet and grocery bags filled with four dozen rubber-banded bundles of cash; one of the bags contained a note with calculations totaling \$99,324.

The discoveries and many others like them across California are starkly at odds with the image presented by medical marijuana providers, who label themselves as "compassionate caregivers" and say they work on slim margins, give away cannabis to the poor and comply with the law.

Many medical marijuana dispensaries have been making huge sums of money even as they claim to be nonprofit, according to court and law enforcement records, industry insiders, police and federal agents. The Times found a cash-infused retail world unlike the one pitched to voters who passed the Compassionate Use Act for "seriously ill Californians" in 1996.

Few would suggest that everyone in the industry is making huge profits; many dispensaries do struggle

advertisement

**Sprint**

**TRADE UP & SAVE \$100**

For a limited time, bring us an iPhone from any carrier and get at least \$100 off an iPhone 4S.

**LEARN MORE**

Restrictions apply.

**iPhone**

The advertisement features the Sprint logo at the top left. Below it, the text 'TRADE UP & SAVE \$100' is prominently displayed in large, bold, black letters. Underneath, a smaller line of text reads: 'For a limited time, bring us an iPhone from any carrier and get at least \$100 off an iPhone 4S.' A black button with white text says 'LEARN MORE'. At the bottom left, it says 'Restrictions apply.' On the right side, there is an image of two iPhones, one white and one black, shown from the front. At the bottom right, the Apple logo and the word 'iPhone' are visible.

to stay afloat. Nor do the court cases capture the relief truly ill patients ascribe to high-quality marijuana they might have difficulty getting if these shops did not exist.

One reason for the vast disparities within the medical marijuana trade is that the regulations governing it are hazy. The 1996 initiative and a law the state Legislature approved in 2003 never made clear how patients were supposed to get marijuana, much less whether sales were legal. Attorney general guidelines issued in 2008 allow only for fees "that are reasonably calculated to cover overhead costs and operating expenses." Dispensaries decide to abide by that or not.

Records from a Granada Hills dispensary showed sales revenue topping \$10,000 on many days.

Spreadsheets from a Long Beach operation indicated the owners bought \$247,040 worth of marijuana and sold it in the next five months for \$776,589. A state Board of Equalization investigator testified that the pair sold a total of \$1,672,206 that year and reported only \$206,980 to the tax agency.

A Venice-area dispensary's bookkeeping revealed it did about \$5.1 million in sales in just over a year. One month's total was \$468,331 — with \$154,493 in "total profit." Another's profit was \$116,625, after a \$25,382 payment to the owner.

In North Hollywood, the two partners behind NoHo Caregivers emailed encrypted messages estimating they would each make \$194,000 a month in profit, according to a federal indictment.

The state Board of Equalization gives a very rough estimate that it collects up to \$105 million a year in sales tax from stores that are doing up to \$1.3 billion a year in sales.

There is no way to know what the average dispensary earns because they are unregulated, aside from those in a few cities, including Oakland, Berkeley and West Hollywood. That void has allowed operators to sell huge amounts of pot at giant mark-ups, seeding public mistrust of the industry and giving law enforcement ample incentive to crack down.

"Some people are abusing the system and raking in profits," said Don Duncan, operator of a West Hollywood dispensary and director of the California chapter of Americans for Safe Access. "That draws the credibility of the field of medical cannabis into doubt."

He and fellow leaders of the movement are pushing for a bill to better regulate the business. But the legal challenges to growers and dispensaries are mounting.

The federal government, which considers all marijuana use illegal and has signaled it will target any commercial operations, has launched a multi-pronged campaign to put this all back in the bottle. And local authorities throughout California, led by the Los Angeles Police Department and Los Angeles County Dist. Atty. Steve Cooley, are going after them too, based on the notion that nothing in the medical marijuana law permits sales or profits.

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On July 31, 2008, the DEA and Culver City police raided a dispensary called Organica, on the border of Venice and Culver City. After seizing about half a million dollars' worth of weed and \$16,379 in cash, the agents expected the shop to stay closed.

They were wrong. Organica's owner Jeffrey K. Joseph said he had an obligation to his "collective of patients."

The dispensary stayed open and continued to make money.

"Those patients still need their medicine," he said in a Web interview recorded after the raid, even though two other dispensaries were still operating within 1,000 feet of his.

On April 17, 2009, the California Highway Patrol stopped Joseph on his way to the Coachella music festival and found \$92,352 in his car. Federal and local agents executed a second search warrant on the shop four months later and seized about a million dollars' worth of weed and accounting records for seven months.

Those spreadsheets revealed how quickly business sprang back after the first raid. In December 2008, the dispensary made \$468,331 in revenue and \$154,493 in "total profit," they said. The next month's profit was \$129,620. Over the six months documented, the dispensary made \$610,301 in profit — in addition to \$82,066 in payments directly to Joseph.

And the marijuana vendors selling to Organica (growers or their brokers) were making even more. One of them, "Vendor S," made \$524,776 in two months.

With that much money flowing, the second raid failed to shut the shop down as well. In February, after a third raid, prosecutors charged Joseph with 24 felony counts of drug sales and money laundering — to which he would ultimately plead no contest to four counts and serve 41 days in jail — and the city attorney sought a preliminary injunction to close Organica.

Joseph fought the closure, arguing that Organica was a fully compliant, nonprofit collective, despite having repeatedly used the word "profits" in its own bookkeeping. Los Angeles County Superior Court Judge James Chalfant didn't buy it. "There is no evidence that Organica is a nonprofit entity," he wrote in granting the injunction, and he called it a "multimillion-dollar retail operation."

Joseph appealed that decision and lost again this April, when appellate judges ruled that the medical marijuana law "does not cover dispensing or selling marijuana."

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What California's medical marijuana law does allow is "qualified patients" and their "designated primary caregivers" to associate "collectively or cooperatively to cultivate marijuana for medical purposes."

What that means has been debated since it was written, spawning a side boom for attorneys and consulting firms.

In particular, prosecutors and defense attorneys spar over one section of the law that notes: "Nothing in this section shall authorize ... any individual or group to cultivate or distribute marijuana for profit." Prosecutors say that clearly bans any profit. Defense lawyers say the language is neutral, neither allowing nor prohibiting it.

Dispensaries largely call themselves "collectives" and "nonprofit" and label sales as "donations."

Many operators privately concede that the language isn't completely accurate. "There's people making lots of nonprofits," quipped the owner of several Orange County collectives, past and present. "It's the American way."

He asks why they can't make money when liquor, tobacco and pharmaceutical companies do.

In April, an entrepreneur looking to open a new marijuana store in downtown Los Angeles told The Times his plan was to buy from growers for about \$3,200 a pound, divvy it up and sell it over the counter for more than twice that. Because many shops sold a pound a day, he expected to make at least \$3,000 a day in gross profit.

The 32-year-old former mortgage broker had run a dispensary before, until the city shut it down, and knew the potential. With overhead, he still thought he could clear half a million dollars his first year, easy.

But he'd had to be creative with that money because his lawyer counseled him to take a salary of no more than \$50,000. So he planned to invest any excess proceeds into opening new shops, from which he could also draw salaries.

"I believe marijuana really helps people," he said. "But I'm not doing this for free."

William Panzer, who helped write the state's medical marijuana initiative, said there is no hard figure on how much someone in the business should make.

"What I tell my clients is this: I got a guy on the jury, 45 years old, busting his butt, moonlighting to pay his mortgage and put his kid through school. My client is a 23-year-old, running a dispensary and making \$200,000 a year. How do you think that's going to go?"

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LAPD Det. Robert Holcomb instructs smaller agencies with a simple message: "Sales are not authorized anywhere in the medical marijuana laws."

In the last three years, his team of detectives in the Devonshire Division got rid of all 38 dispensaries in their turf, whether they were barely getting by or brimming with cash.

He scoffs at the notion that they were collecting donations. He said he has found signs at dispensaries that read, "Do not haggle over the donation amounts" and "Sales tax will be added to all donations."

On March 26, 2009, police searched the luxury downtown loft of Marlene Miller, director of Caregivers Earth Ordinance in Granada Hills, and found \$16,410, mostly under a bed, according to court papers. They raided the store and took her pot.

Miller reopened within days, and they searched again, this time recovering \$20,686 from her car and \$9,000 from her office, according to police. They also found a spreadsheet on her computer that they contend listed daily sales from the previous September. The average daily sales on the sheet were \$9,533.

Miller reached a deal with prosecutors Wednesday that will allow her to plead no contest to a misdemeanor if she stays out of the pot business. Her attorney, Allison Margolin, would not comment except to say there was no evidence of "profit."

Many times, it's not clear who is getting the money. The Orange County Sheriff's Department launched the investigation of Dana Point Safe Harbor Collective when it got an anonymous letter saying John Walker, 56, silently controlled that shop, Belmont Shore Natural Care in Long Beach and others. He was not listed on any of the incorporation papers.

Walker, who lives in a sprawling Tuscan-style home on a hillside in San Clemente, had criminal convictions going back to 1976 for marijuana possession and sales, selling and transporting a controlled substance and carrying a loaded firearm in a public place. Paperwork seized at the Dana Point store suggested he was to get 60% of the profit from the shop.

In November, detectives raided the other storefronts and 16 connected properties. Inside a nearby Long Beach duplex owned by Walker, detectives found 14 flat-screen televisions, according to a report from the search. Inside the garage of another Long Beach house, they found the AK-47, other guns and bags of cash, along with Walker's wedding album.

The affidavit alleges that Walker used a prominent Long Beach attorney, Richard Brizendine, "to give the dispensaries the cover of legitimacy." Brizendine incorporated all seven shops. Records show that six days after the raid of Walker's home, the attorney was briefly granted trust deed to it as security for a loan.

The case is still open and no one has been charged. Brizendine would not discuss the allegations, citing attorney-client privilege. Walker could not be reached.

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Tax may be the biggest cudgel the feds have against medical pot. Increasingly, the IRS is applying an obscure provision of the tax code, 280E, which prohibits drug traffickers from claiming routine business deductions, for costs like wages and rent, when federal agents are trying to get back-taxes from them. Already dispensaries were in a quandary: Pay the IRS and literally document your federal crime to the federal government, or don't report it and risk going down for tax evasion. Now they face 280E, and potentially crippling tax bills.

At the same time, city authorities and the U.S. Justice Department are besieging pot shops with civil litigation and threats of asset forfeiture.

This is pushing the big money seekers underground. "They run sort of hit-and-run operations, make as much money as they can for six months and close down before they get caught," said Damian Nassiri of the Cannabis Law Group in Orange.

The founder of Avalon Wellness Center in Long Beach says she has tried to do the opposite. Valerie Crist, 56, was a Realtor when the housing market collapsed. Her husband's income in car sales was not enough, and they worried about their mortgage and their 10-year-old son's future college education. She and her sister decided to open a dispensary to make a modest income and do some good, Crist said. They paid a \$15,000 permit fee to the city.

They retrofitted a warehouse to grow on the premises to comply with a city guideline, borrowing and investing half a million dollars. The first crop failed because construction disturbed the atmosphere in the rooms. And when they opened seven months ago, they realized their industrial location was too remote. They had to offer deep discounts.

"We're struggling just to make payroll," she said.

Crist said she pays state and federal taxes, workers' compensation and liability insurance for employees, as well as attorney fees to keep her store open. She just draws a wage when she can, she said, not even the highest in the shop; that's the bookkeeper's, at \$20 an hour.

At her counter, a newcomer to the shop, a 23-year-old man nicknamed Junior, inhaled the aroma of various pot strains in jars. Between each, he sniffed a little shaker filled with coffee beans to cleanse his olfactory palate.

"How did you hear about us?" the bud tender asked him.

"Through a buddy at the hospital," he said.

He said he was on chemotherapy for non-Hodgkin's lymphoma, and the marijuana restored his sense of taste, tamped down the nausea and got him off the couch. He showed lesions on his tongue from the chemo. He said he'd come to the pot shop because he'd heard the prices were good. "I go all around, really," he said.

In downtown L.A., the former mortgage broker with the big plans began having doubts about starting a pot business. With the feds threatening to seize property, the few landlords who would lease to him demanded exorbitant rents.

At the end of May, he heard that the City Council was considering a ban. Did he really want to wade into this?

"I think I'll put this on hold," he said.

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