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Phone: +1 646 783 7100 | Fax: +1 646 783 7161 | customerservice@law360.com

Sanctions Will 'Fly' In Cannabis Bank Discovery Dispute

By Jonathan Capriel

Law360 (September 15, 2022, 7:37 PM EDT) -- A California federal judge is not happy with the way a cannabis industry banking firm has been behaving during discovery in a dispute accusing it of withholding funds from a client, and he has told Pacific Banking Corp. that "sanctions are going to fly."

U.S. District Judge James Donato of the Northern District of California tore into the banking company during a Sept. 8 hearing during which he was clear about his frustration at being back in front of the parties to discuss the dispute. Though at first, Judge Donato wasn't sure whom to blame, according to a **transcript** that was made public Wednesday.

"There's just something wrong here. I don't know whether it's you on the defense side or you on the plaintiff side or some regrettable combination of the two," Judge Donato said. "But I'm out of patience. This is a waste of judicial resources. I'm just done with it."

The judge vowed to "get to the bottom of it," adding: "That person will be punished."

The dispute landed before Judge Donato in March 2020, when Cann Distributors accused Pacific Banking of failing to make millions of dollars in tax payments to the state of California on its behalf, as well as failing to pay vendor invoices. The company also secured an order blocking Pacific from touching the roughly \$2.8 million Cann said it had deposited with the marijuana-friendly financial institution, a middleman of sorts between cannabis companies and traditional banks.

After a short back-and-forth at the hearing, Judge Donato's ire landed on Pacific Banking. The hearing was called because Cann Distributors said lawyers for Pacific Banking made outright denials — for example, regarding whether it had made certain payments — during the request-for-admissions process, but later during interrogatories said they didn't have enough information to answer the same questions.

An attorney for Pacific Banking, Stephen M. Lobbin of SML Avvocati PC, said: "Perhaps there was a collation error on my part."

"Don't say 'perhaps.' Own it. Own it. You didn't do the right thing," Judge Donato responded. "And we're here today, burning my time and my scarce judicial resources — I've got 400 other cases that are more deserving [of] attention than this, which is our fifth or sixth round of these discovery disputes, which are largely because you on the defense side are a rock in the gears of this court."

Judge Donato accused Pacific Banking of "outright gamesmanship" and told the company, "The hammer is going to drop all on you."

"This was a terrible and egregious abuse of the discovery process, and there are going to be consequences: professional conduct consequences, evidentiary consequences, monetary consequences," the judge said. "I don't know what I'm going to do yet."

He asked for a motion from Cann Distributors seeking relief because the banking firm hadn't responded to the requests for admissions appropriately and Cann hadn't given a specific number for how much the extra trouble had cost the company.

But representatives for Cann Distributors had another bone to pick. They told the court they had also discovered "a shell game" and asked to amend the complaint to include more parties because they had discovered Pacific Banking was a trade name for another company, which had been buying and stacking other entities inside each other, according to the transcript.

Pacific Banking CEO Justin Costello also incorporated businesses in the name of Cann Distributors in the state of Washington, the cannabis company said, which surprised and disturbed the judge.

Costello was present in court and confirmed that he had done so. He said it was necessary so he could bank as that entity inside the state. Pacific Banking serves in lieu of traditional banks for businesses that deal with marijuana because traditional banks generally won't deal with them, since cannabis is still illegal federally.

The parties disagreed over whether their service agreement had given Pacific Banking permission to do this, but Judge Donato called it the "weirdest thing I have ever heard."

"I have never heard of an agreement that said one party could create a fictitious business in another state using the other party's name," he said. "It's almost incomprehensible."

When he asked how Cann Distributors had managed to find what it had discovered so far, since discovery was closed, the attorneys said they had been doing their "own investigation." To get to the bottom of it, Judge Donato partially reopened discovery until November only for the purpose of examining corporate structure and ownership, according to an **order issued on Sept. 8**.

Finally, there was concern about the exact location of money that the court had ordered set aside for the length of the dispute. When asked whether Costello had moved money from that account, Steven M. Selna of Selna Partners LLC, a lawyer for Cann Distributors, said Costello had invoked the Fifth Amendment.

"Where is the money? I mothballed that money. Where is it?" Judge Donato asked. "It should be in an account to the dollar, to the cent. I did this. Where is it?"

Costello said he believed that the money was at a credit union in Washington state.

Judge Donato gave Costello a week to produce documentation showing exactly where the money was, down to the cent, under penalty of perjury.

"I will not accept any equivocations like 'we believe' or 'we think,'" the judge said. "I want a definitive statement of where that money is."

Cann is represented by Steven Michael Selna and Robert William Selna of Selna Partners LLP.

Pacific and the other defendants are represented by Stephen M. Lobbin of SML Avvocati PC.

The case is CCSAC Inc., et al. v. Pacific Banking Corp. et al., case number 3:20-cv-02102, in the U.S. District Court for the Northern District of California.

--Editing by Karin Roberts.