NO. 756699-I

**COURT OF APPEALS, DIVISION I**
**OF THE STATE OF WASHINGTON**

LIBBY HAINES-MARCHEL ROCK ISLAND CHRONICS, LLC,

Appellant,

v.

WASHINGTON STATE LIQUOR AND CANNABIS BOARD, LICENSING DIVISION,

Respondent.

# RESPONDENT'S BRIEF

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## I. INTRODUCTION

Washington has a compelling state interest in separating the marijuana industry from criminals and criminal conduct. Until recently all marijuana transactions constituted criminal conduct under both state and federal law. This long history of criminality creates a powerful and compelling state interest in putting as much separation as possible between the marijuana trade and persons with recent, significant criminal histories. The inclusion of spouses as true parties of interest in marijuana licenses and the screening of both spouses for criminal conduct are legitimate and necessary means to accomplish this purpose.

Appellant, Rock Island Chronics, LLC (Chronics) asks this Court to invalidate two provisions of the Washington Administrative Code (WAC). The first, WAC 314-55-035, includes as a "true party of interest" the spouse of each individual associated with a marijuana license. The second, WAC 314-55-040, uses a point system to disqualify individuals with recent, significant criminal histories from participating in the marijuana industry. Invalidating these WAC provisions would give criminals access to Washington's marijuana industry by allowing someone with a disqualifying criminal history to conceal his or her involvement in the industry simply by submitting the license application in the name of the individual's qualifying spouse. The Court should reject this attempt to

require the Washington State Liquor and Cannabis Board (Board) to issue marijuana licenses without regard to a spouse's disqualifying criminal history, thus allowing the potential use of a "straw person" to mask the identity of a true party of interest in a marijuana business.

## II. COUNTER-STATEMENT OF ISSUES

1. Whether Chronics preserved a facial rules challenge to the enactment of WAC 314-55-035 and WAC 314-55-040 when it failed to raise a challenge until this appeal.

2. Whether Chronics' property rights were violated by the denial of its marijuana license application based on the true party of interest provisions in WAC 314-55-035 and the criminal history provisions in WAC 314-55-040 when Chronics had never been issued a license and had no property right to one.

3. Whether Chronics' right to contract was violated when Licensing refused to ignore the true party of interest provision in WAC 314-55-035 based on a community property agreement between two true parties of interest to the application.

4. Whether Chronics' right to marry was violated when Licensing applied the true party of interest provision of WAC 314-55-035 and the criminal history provision of WAC 314-55-040 in order to identify and investigate all persons associated with the license application, thereby

furthering the state's compelling interest in separating criminals and criminal enterprises from the marijuana industry and ensuring that all persons associated with the proposed business was qualified to hold a license.

5. Whether Chronics' right to work was infringed by the denial of its marijuana license application when a true party of interest to the application under WAC 314-55-035 could not satisfy the criminal history prerequisite for licensure under WAC 314-55-040.

6. Whether Chronics is entitled to an award of fees and costs as the prevailing party, or $3,000,000.00 in total damages when RCW 34.05.582(4) bars monetary payments unless expressly authorized by a provision of law other than the Administrative Procedures Act.

## III. STATEMENT OF THE CASE

WAC 314-55-035 mandates that "[a] marijuana license must be issued in the name(s) of the true party(ies) of interest," which includes the spouse of every person associated with the business. Each true party of interest must have fewer than eight criminal history points as calculated in accordance with the point system set forth in WAC 314-55-040. The Washington State Liquor and Cannabis Board, Licensing and Regulation Division (Licensing) denied the retail marijuana license application of

Rock Island Chronics, LLC, (Chronics)[1] after learning that Brock Marchel, the spouse of the LLC's registered agent, Libby Haines-Marchel, had a disqualifying criminal history stemming from his homicide conviction and ongoing 44-year incarceration. CP 158, 164-66. Chronics submitted a document signed by Mr. Marchel purporting to renounce his community property interest in the business and prospective license, but Licensing declined to give effect to the document. CP 168-70, 171-72. Chronics requested an administrative hearing to contest the denial of its application for a retail marijuana license. CP 154-55.

The parties agreed that the controversy involved no issues of material fact, and each filed a motion for summary judgment. CP 127, 214-21, 232-39. In the hearing before the Office of Administrative Hearings on the summary judgment motions, Chronics argued that the Washington State Liquor and Cannabis Board (Board) had violated Ms. Haines-Marchel's constitutional rights by disqualifying its application based on her husband's criminal history and refusing to reverse its denial of its license application after her husband renounced his community property interests in the business and prospective license. CP 121-26. Licensing argued that there was no statute or regulation that would change

[1] Rock Island Chronics, LLC, was the only party to the administrative appeal before the Office of Administrative Hearings. Ms. Haines-Marchel's name was added to the case caption during the judicial review proceedings.

or remove Mr. Marchel's status as a true party of interest or that rendered the true party of interest provision applicable only when a community property interest exists. CP 127-30. Following the motion hearing, the administrative law judge issued an Initial Order denying Chronics' motion for summary judgment and granting Licensing's cross motion for summary judgment. CP 265-72. In relevant part, the order stated that Mr. Marchel was a true party of interest to the license application under WAC 314-55-035; that Mr. Marchel had twelve criminal history points, which exceeded the limit under WAC 314-55-040; and that Licensing was correct to deny Chronics' marijuana license application based on the disqualifying criminal history. CP 270-71. Chronics petitioned for review of the Initial Order. CP 274-83. In a Final Order issued on November 10, 2015, the Board affirmed the grant of summary judgment and upheld Licensing's denial of Chronics' application for a retail marijuana license. CP 301-04.

Chronics petitioned for judicial review in King County Superior Court, arguing, in part, constitutional issues it had mentioned but not argued below. CP 435-46, 469. On July 29, 2016, the superior court affirmed the Board's Final Order. CP 497-502. The court held that the inclusion of spouses is warranted because a marital unit constitutes a special category of connection and functions together under the law and

that any potential infringement on an applicant's constitutional rights created by WAC 314-55-035 and -040 would even survive strict scrutiny, if applied, since the regulatory provisions provide narrowly tailored means to further compelling state interests in tightly controlling the marijuana industry, keeping the marijuana trade out of the hands of criminals, preventing revenue from the marijuana industry from being used to support criminal enterprises, stopping marijuana businesses from being used as a cover for illegal activities, preventing the use of a qualified spouse as a "straw person" to disguise a disqualified spouse's true interest in the business, and complying with the public safety expectations and interests of the federal government. CP 500. The court also determined that Mr. Marchel's renunciation of his community property interests did not change his status as a true party of interest under WAC 314-55-035 because such an agreement does not bind third parties, cannot be enforced by the Board, and can be ignored, changed, or eliminated at any time. CP 500-01. Chronics timely appealed the superior court's decision. CP 528.

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## IV. STANDARD OF REVIEW UNDER THE APA

The standard of review on appeal of a grant of summary judgment is de novo, which requires the appellate court to conduct the same inquiry as the trial court. *Mahoney v. Shinpoch*, 107 Wn.2d 679, 683, 732 P.2d 510 (1987). Appellate review is confined to the administrative record. *Clausing v. State*, 90 Wn. App. 863, 870, 955 P.2d 394 (1998). With the facts viewed in the light most favorable to the nonmoving party, summary judgment was appropriate if the undisputed facts entitled the moving party to judgment as a matter of law. *Lemire v. State, Dep't of Ecology, Pollution Control Hearings Bd.*, 178 Wn.2d 227, 232, 309 P.3d 395 (2013).

The Court conducts its de novo review of legal conclusions under an error of law standard. *Haley v. Medical Disciplinary Bd.*, 117 Wn.2d 720, 728, 818 P.2d 1062 (1991). Findings of fact are reviewed under the substantial evidence test, which requires evidence sufficient to persuade a fair-minded person of the truth of the declared premises. RCW 34.05.570(3)(e); *Darkenwald v. State, Employment Sec. Dep't*, 183 Wn.2d 237, 244, 350 P.3d 647 (2015). Constitutional challenges are subject to de novo review. *City of Redmond v. Moore*, 151 Wn.2d 664, 668, 91 P.3d 875 (2004). Statutes are presumed constitutional, and the challenger "must prove beyond a reasonable doubt that the statute is

unconstitutional." *In re A.W.*, 182 Wn.2d 689, 701, 344 P.3d 1186 (2015). Under RCW 34.05.570(1)(a), Chronics bears the burden of demonstrating the invalidity of the Board's order and is entitled to relief only if it demonstrates one or more of the grounds set forth in RCW 34.05.570(3)(a)-(i).

## V. ARGUMENT

### A. Chronics Has Waived Any Facial Rules Challenge

#### 1. Chronics Did Not Argue Below That The Enactment Of The WAC Regulations Exceeded Licensing's Statutory Authority And, Therefore, Has Waived The Issue

Chronics argues for the first time in this Court that Licensing improperly enacted WAC 314-55-035 because "statutory authority was [not] given to promulgate the spouse as the applicant" for a marijuana license. Appellant's Am. Br. at 11, 15. This argument raises a facial challenge to the validity of WAC 314-55-035 that was not raised below.

In order to preserve this issue for appellate review, Chronics was required to raise it in the administrative proceeding. *See Sourakli v. Kyriakos, Inc.*, 144 Wn. App. 501, 509, 182 P.3d 985 (2008) ("An argument neither pleaded nor argued to the trial court cannot be raised for the first time on appeal."); *see also* RAP 2.5(a) (the appellate court may refuse to review any claim of error which was not raised in the trial court); RAP 9.12 (in reviewing summary judgment order, appellate courts may

only consider issues called to trial court's attention); *Clark County Pub. Util. Dist. No. 1 v. State of Washington Dep't of Revenue*, 153 Wn. App. 737, 753, 222 P.3d 1232 (2009) (declining to review issues not raised in trial court). Because Chronics failed to raise a facial challenge to the validity of the regulations in the administrative proceeding below, any argument regarding the enactment of WAC 314-55-035 or -040 is waived and should be disregarded by this Court.

### 2. Chronics Did Not Raise Its Rule Challenge In A Declaratory Judgment Action, As The APA Requires

Even if Chronics had adequately raised its facial challenge in the administrative proceeding, it would fail. Under Washington's Administrative Procedures Act (APA), any challenge to an administrative rule must first be brought as a petition for declaratory judgment in Thurston County Superior Court. RCW 34.05.570(2)(b); *D.W. Close Co. v. Washington State Dep't of Labor & Indus.*, 143 Wn. App. 118, 133, 177 P.3d 143 (2008) (if rule challenge relates to agency's authority to promulgate a rule, declaratory judgment claim should be brought in Thurston County Superior Court). Chronics' failure to properly present a petition for declaratory judgment in Thurston County Superior Court

provides this Court with an additional reason to decline to review the facial validity of WAC 314-55-035.

Because Chronics cannot raise a facial challenge for the first time on appeal, its only remaining arguments are as-applied challenges to the provisions in WAC 314-55-035 and -040.

### B. As Applied, The Regulations Did Not Violate Any Of The License Applicant's Constitutional Rights

Chronics raises four as-applied arguments alleging violations of Chronics' constitutional rights and seeks fees, costs, and awards of $1,000,000 in actual damages, $2,000,000 in economic damages. Each of the four as-applied arguments is without merit, and the request for damages is improper. First, Chronics' property rights could not be violated by the denial of its license application because neither a license nor an application for a license is a property right. Second, Chronics' right to contract could not be violated by the license denial because the spouses' agreement did not bind Licensing. Moreover, the right to contract remained intact after the license denial. Third, the WAC regulations do not discriminate against married persons but merely impose reasonable and necessary regulations that include spouses as true parties of interest. Fourth, the license denial did not violate Chronics' right to work because the license application did not provide employment, and the inability to

qualify for a marijuana license did not hamper the applicant's right to pursue employment.

### 1. A License Application Is Not A Property Right

Washington courts have long held that a license is neither a property right nor a contract but, rather, is a temporary permit to engage in activity that would be unlawful without a license. *Rawson v. Department of Licenses*, 15 Wn.2d 364, 371, 130 P.2d 876 (1942) (holding that revocation of driver's license not deprivation of property rights); *see also Jow Sin Quan v. Washington State Liquor Control Bd.*, 69 Wn.2d 373, 382, 418 P.2d 424 (1966) (license to sell intoxicants "does not become a vested property right" but, instead, constitutes "a temporary permit, in the nature of a privilege, to engage in a business that would otherwise be unlawful"); *Showalter v. City of Cheney*, 118 Wn. App. 543, 548, 76 P.3d 782 (2003) (expending funds in reliance on duly-issued license does not create valuable, compensable property right). Chronics nonetheless claims that "[a] business license to sell marijuana is a property right" and argues that Licensing violated that right by ignoring Mr. Marchel's renunciation of his community property rights. Appellant's Am. Br. at 9. This argument is meritless.

Considering that courts have determined that even a duly issued license does not confer a property right on the licensee, it must necessarily

follow that the mere submission of an application for a license cannot confer a property right on the applicant. *See Showalter*, 118 Wn. App. at 548; *Jow Sin Quan*, 69 Wn.2d at 382; *Rawson*, 15 Wn.2d at 371. Chronics was never granted a license to sell marijuana, but even if it had been issued a license, the license would not have conferred a property right on Chronics or its members. *Id.* Thus, the denial of Chronics' license application could not have violated a property right that did not exist.

Chronics reasons, however, that its favorable selection in the state-run marijuana lottery system somehow conferred an entitlement to be issued a license at a later date, and Chronics interprets that alleged entitlement as a property right.[2] Appellant's Am. Br. at 9. There is no credible legal basis for such an interpretation, and appellant has cited no authority to support this reasoning.

While the state-run lottery system was in use, the lottery merely positioned eligible applicants in the order in which their license applications would be processed and evaluated. *See* former WAC 314-55-081(1) (modified in 2016). Regardless of the order in which applications were processed, however, each applicant was still required to go through the application process and meet all the qualifications set forth

[2] With the amendment of WAC 314-55-081, Washington ended its use of a lottery system to determine the order in which marijuana license applications are processed.

in the WAC regulations before a license could be granted. *See* WAC 314-55-020. Thus, even though Chronics believes that it drew a favorable lottery number, the applicant still had to satisfy all of the qualifications for a license. Because Chronics could not satisfy the criminal history requirement in WAC 314-55-040, Licensing did not err in refusing to grant the requested license.

In short, because neither the license application nor the lottery result gave Chronics a property right, the denial of Chronics' license application could not have violated a property right. This claim fails.

### 2. Chronics' Right To Contract Was Not Affected By The License Denial And Remains Intact

Contrary to Chronics' argument, the denial of its marijuana license application had no impact on Chronics' right to contract. Licensing was not a party to any contract with Chronics or either of its true parties of interest. According to Chronics, even though Mr. Marchel and Ms. Haines-Marchel were legally married when it applied for a license, Licensing should have excused Chronics from the true party of interest requirements of WAC 314-55-035 because Mr. Marchel signed a document entitled "Spousal Renunciation of Rights Affidavit" in which he purported to "knowingly and intelligently relinquish[] and convey[] all

interest in claiming any ownership to the business." Appellant's Am. Br. at 12. Chronics describes this renunciation as a "contract" between "husband and wife to change community property into separate" property and argues that Licensing's failure to give effect to this contract "infringed on [Ms. Haines-Marchel's] constitutional right to contract to own such property apart from [her] husband." *Id.*

Citing *Board of Regents of State Colleges v. Roth*, 408 U.S. 564, 572, 92 S. Ct. 2701, 33 L. Ed. 2d 548 (1972), Chronics reasons that because spouses have the right to enter a contract to change community property into separate property, Licensing was obligated to honor that agreement in order to safeguard Ms. Haines-Marchel's constitutional right to contract under the Fourteenth Amendment. There is no support for such a theory. Despite the spouses' private agreement aimed at altering Mr. Marchel's community property rights, Licensing was not a party to that agreement and was not bound by its terms.

It is true that the United States Supreme Court in *Roth* confirmed that Fourteenth Amendment guarantees include the rights "to contract, to engage in any of the common occupations of life, to acquire useful knowledge, to marry, establish a home and bring up children, to worship God according to the dictates of his own conscience, and generally to enjoy those privileges long recognized . . . as essential to the orderly

pursuit of happiness by free men." Licensing's decision, however, to disregard Mr. Marchel's renunciation did not interfere with or violate any of those Fourteenth Amendment guarantees. Nor did Licensing's decision alter in any way the private agreement between Mr. Marchel and Ms. Haines-Marchel. Their right to enter into that agreement or any other private contract was unaffected by Licensing's decision, which merely determined that Mr. Marchel continued to be a true party of interest under WAC 314-55-035 despite any private agreement purporting to convert his community property interest in the business and prospective license into Ms. Haines-Marchel's sole and separate property. Moreover, because Licensing was not a party to the agreement between the spouses, the agency was not bound by any contract obligations they had created. *See, e.g., Key Dev. Inv., LLC, v. Port of Tacoma*, 173 Wn. App. 1, 29, 292 P.3d 833 (2013) (no independent duty created even when contract directly benefits third party). In addition, Licensing had no power to enforce Mr. Marchel's renunciation. As the superior court's Order correctly noted, "the parties are free to choose to ignore, change or eliminate the agreement at any time without notice to or knowledge of the Board." Order at 5. Licensing had no obligation to base its licensing decision on such a document.

Chronics also contends that Licensing violated Washington's community property laws by failing to give effect to Mr. Marchel's renunciation. This contention lacks merit. The Washington Supreme Court discussed the basic principles of community property law in *In re Estate of Borghi*, 167 Wn.2d 480, 219 P.3d 932 (2009). There, the wife acquired real property that was subject to a real estate contract she had entered prior to her marriage. After her marriage, the real estate company executed a special warranty deed in both spouses' names, and the couple used the property a few years later to secure a mortgage on a home. When the wife died intestate, the husband sought a declaratory judgment that the real property had been his wife's separate property, not community property. In its analysis, the Supreme Court acknowledged that separate property "'maintains that character until some direct and positive evidence to the contrary is made to appear'" but also explained that separate property can be transformed into community property by conduct or evidence of intent. *Id.* at 484 (quoting *Guye v. Guye*, 63 Wash. 340, 352, 115 P. 731 (1911)).

Although Chronics contends that Mr. Marchel's affidavit had a permanent effect that should have been recognized by Licensing, the allegedly permanent nature of such a community property agreement is by no means certain. As seen in *Borghi*, separate property can be easily transformed into community property at a later date. Moreover, the

ultimate legal effect of Mr. Marchel's affidavit is unknown unless and until it is tested in a court of law. In the event a dispute might arise at some later date, evidence could be adduced to prove that the original affidavit was ineffective or had been void ab initio. Thus, even if the affidavit had been effective in transforming Mr. Marchel's community property into Ms. Haines-Marchel's separate property, Mr. Marchel could later challenge the separation of assets by showing that his wife's conduct after the date of the affidavit had changed the property into community property. *See Borghi*, 167 Wn.2d at 484. Moreover, nothing would prohibit him from revoking his renunciation at any time and reclaiming his interest in the marijuana business without providing any notice to the Board.

Another problem from a licensing standpoint is that there is nothing in the spousal agreement that would prevent Chronics from directing business profits to Mr. Marchel for his use and benefit or from involving him in Chronics' business operations and decision-making despite his renunciation of community property interest in the business. The contract between the spouses only affected them, could be revoked at any time, could be rescinded by conduct, could be altered at will, and could be ignored. Any or all of these actions could be taken without notice to the Liquor and Cannabis Board. Thus, any contract regarding the

spouses' community and separate property placed no burden on Licensing and could have no effect on its licensing decisions. Regardless of Licensing's actions, however, the rights of Mr. Marchel and Ms. Haines-Marchel to contract were, and continue to be, intact.

Under all these circumstances, Licensing did not violate a right to contract when it declined to allow Mr. Marchel's affidavit to serve as a basis for disregarding the true party of interest requirements in WAC 314-55-035 and the criminal history requirements of WAC 314-55-040. Instead, Licensing properly carried out its duty to enforce the regulations as written, and its decision should be upheld.

### 3. Simply Including Spouses As True Parties Of Interest In Marijuana License Applications Is A Reasonable Regulation That Does Not Infringe On The Right To Marry

Denying Chronics' marijuana license application based on Mr. Marchel's criminal history did not constitute marital discrimination, as Chronics contends. Appellant's Am. Br. at 24. As a preliminary matter, Chronics first mistakenly states that Licensing denied its marijuana license application "solely based on [Ms. Haines-Marchel's] marriage to Brock." Appellant's Am. Br. at 25. This is not correct. The application was not denied because of the parties' marital status but because a true party of interest, married to another true party of interest, was unable to qualify for

a license under the criminal history requirements of WAC 314-55-040. The requirement that spouses qualify in the same way that applicants must qualify is "not directed at the institution of marriage itself" or even closely related to the institution of marriage. *Cybyske v. Independent Sch. Dist. No. 196, Rosemount-Apple Valley*, 347 N.W.2d 256 (Minn. 1984) (marital discrimination not found in refusal to hire because of views held by applicant's spouse). Instead, the requirement of spousal qualification is a reasonable means to identify and scrutinize every person involved with a marijuana license application.

Licensing's decision to deny the application was only tangentially related to the parties' marital status. The process of vetting all persons associated with a marijuana license applies to everyone equally, whether married or not. When an applicant is married, however, spouses must be included in the vetting process because of the legal status of married persons. Licensing cannot simply ignore the disqualifying criminal history of a true party of interest merely because the disqualified party is married to someone who is more directly involved in the business. Moreover, the inclusion of spouses did not deny Chronics' members the right to marry or stay married, as alleged; it merely subjected the spouses to equal scrutiny as prospective licensees. This was not discriminatory and did not violate any constitutional principles.

A prima facie case of marital discrimination requires proof of discrimination based on marital status and proof that the discrimination was not justified or excused by business necessity. *Magula v. Benton Franklin Title Co.*, 131 Wn.2d 171, 930 P.2d 307 (1997). Courts will only grant relief from an agency order if it determines that "[t]he order, or the statute or rule on which the order is based, is in violation of constitutional provisions on its face or as applied." RCW 34.05.570(3)(a). Constitutional challenges are reviewed de novo. *City of Redmond*, 151 Wn.2d at 668. Chronics' mere submission of an application for a business license did not create any right or entitlement that could have been infringed by the mere denial of its license application. Nor did Licensing base its decisions on parties' marital status per se. Instead, Licensing simply fulfilled its obligation to thoroughly investigate and ensure the qualifications of all persons associated with the marijuana license application.

**a. Inclusion Of Spouses Withstands Rational Basis Review As It Applies Equally To All Applicants And Bears A Rational Relationship To A Legitimate State Purpose**

Even if this Court were to conclude that the spousal requirement in WAC 314-55-035 and the resulting denial of Chronics' application under WAC 314-55-040 requires rational basis review, the regulations would easily survive that level of scrutiny. A regulation will survive rational

basis review if it "applies alike to all within the designated class, there are reasonable grounds to distinguish between those within and those without the class, and the classification bears a rational relationship to a legitimate government purpose." *Campbell v. State, Dep't of Soc. & Health Servs.*, 150 Wn.2d 881, 900, 83 P.3d 999 (2004). "A classification must be upheld if there is any conceivable set of facts that could provide a rational basis for the classification." *Id.* The WAC regulations here meet all of these standards.

As set forth in the text of WAC 314-55-035, the inclusion of spouses as true parties of interest applies equally to everyone associated with the proposed business, including managers, partners, corporate officers, and financiers. The need for transparency alone provides reasonable grounds for including spouses as true parties of interest and bears a "rational relationship" to Washington's need to monitor the involvement of criminals in the marijuana industry. *Campbell*, 150 Wn.2d at 900. However, transparency is not the only reason to include spouses as true parties of interest. Until recently, all marijuana transactions constituted criminal conduct under both state and federal law. This fact heightens the state's interest in identifying everyone involved with each marijuana license in order to strictly regulate the incipient marijuana

industry. *See* Controlled Substances Act, 21 U.S.C. § 801, *et seq.*; RCW 69.50.101. This long history of criminality creates a powerful and compelling interest in putting as much separation as possible between the marijuana trade and persons with recent criminal histories. Put simply, the state has a compelling interest in creating a strong and impenetrable firewall between marijuana and its past history of criminality. The inclusion of spouses as true parties of interest in business licenses and screening both spouses for certain criminal conduct are legitimate and necessary means to accomplish this purpose. Both regulations bear more than a rational relationship to this purpose.

A memorandum issued by the United States Department of Justice (DOJ) on August 29, 2013, illustrates and reinforces the need to separate Washington's marijuana industry from all criminal influence. In the memorandum, Deputy Attorney General James M. Cole outlined the DOJ's position on state legalization in light of marijuana's continued status as a controlled substance under federal law and indicated that the DOJ will allow the cannabis trade to exist in Washington and other states only under certain conditions. CP 471-74.

Despite the DOJ's willingness to tolerate the marijuana trade in Washington for the time being, the Deputy Attorney General cautioned that marijuana is a dangerous drug that provides a significant source of

revenue to large-scale criminal enterprises, gangs, and cartels. He reiterated the DOJ's commitment to enforcing the Controlled Substances Act consistent with those concerns and clarified that the current tolerance of state-authorized marijuana does not alter the DOJ's authority to enforce federal laws, preclude investigation or prosecution, or provide a legal defense to charges of violating federal law. The memo enumerated eight essential law enforcement priorities that the DOJ uses to guide its enforcement of marijuana-related conduct in states that have enacted laws legalizing marijuana. For example, among those law enforcement priorities is ensuring that marijuana revenues do not end up making their way into criminal enterprises. Another priority is ensuring that state-authorized marijuana activity cannot be used as a cover for criminal involvement or pretext for any illegal activity.

An important component of the DOJ's willingness to allow the marijuana trade to exist at all in Washington and other states is the ability and willingness of states "to enforce their laws and regulations in a manner that ensures they do not undermine federal enforcement priorities" such as the two listed above. CP 471-74. In all cases, the primary question for the DOJ is whether the conduct at issue implicates one or more of its eight law enforcement priorities. In the DOJ's view, it is a state's enactment of a strong and effective state regulatory system and the state's

strict compliance with that system that can serve to allay the threat that marijuana operations pose to the DOJ's federal enforcement interests. *Id.* The DOJ's conditional tolerance of the marijuana trade has resulted in a nuanced and balanced relationship between federal law enforcement and the State of Washington which gives our state ample compelling reasons for ensuring that persons with recent significant criminal histories are screened from participation in the marijuana industry.

The true party of interest provision in WAC 314-55-035, which subjects spouses to scrutiny under WAC 314-55-040, is one way Washington has sought to ensure that the state is meeting DOJ's requirement to limit the involvement of criminal enterprises and other illegal activities in the marijuana trade. The true parties of interest provision ensure that every person who has a legal interest in or is closely associated with a marijuana business is known, clearly identified, and subject to criminal background checks and state supervision. The inclusion of spouses specifically ensures that a person with a disqualifying criminal history under WAC 314-55-040 cannot use his or her spouse as a "straw person" to gain ownership, influence, or control of a marijuana business that is otherwise impermissible. *See Dexter Horton Nat. Bank v. Seattle Homeseekers' Co.*, 82 Wash. 480, 481, 144 P. 691 (1914) (property deeded to "straw man" to disguise identity of real party of interest and

avoid personal liability). The provision also helps to ensure that a person with a proven history of involvement in recent criminal activity or who is currently under state supervision as the result of one or more criminal convictions cannot obtain a marijuana license and derive financial or other benefits for themselves or their fellow criminals.

All of this creates far more than just a "rational relationship" between the state's interest in distancing criminals from the marijuana industry and the regulation imposed by WAC 314-55-035. *Campbell*, 150 Wn.2d at 900. Therefore, if rational basis review is applied to the inclusion of spouses in WAC 314-55-035 for purposes of determining criminality under WAC 314-55-040, the regulations easily withstand such review and should be upheld.

**b. Even If Intermediate Or Strict Scrutiny Is Applied, The Inclusion Of Spouses Will Survive As Narrowly Tailored And Temporary Means Of Accomplishing Compelling State Interests**

If this Court determines that intermediate scrutiny, or even strict scrutiny, applies here, both the spousal inclusion provision in WAC 314-55-035 and the criminal history provision in WAC 314-55-040 survive both levels of scrutiny. "A law survives intermediate scrutiny if it is substantially related to an important government purpose." *State v. Jorgenson*, 179 Wn.2d 145, 162, 312 P.3d 960 (2013) (intermediate

scrutiny applies when rational basis is not appropriate but strict scrutiny is not necessary); *see also Silvester v. Harris*, No. 14-16840 (9th Cir. Dec. 14, 2016) (http://cdn.ca9.uscourts.gov/datastore/opinions/2016/12/14/14-16840.pdf) (applying intermediate scrutiny to firearm regulation).

Although the regulations here do not interfere with a fundamental constitutional right and, therefore, do not rise to the strict scrutiny standard, the regulations would still survive if subjected to strict scrutiny. Regulations are subject to strict scrutiny when they interfere with a fundamental constitutional right. *Amunrud v. Board of Appeals*, 158 Wn.2d 208, 220, 143 P.3d 571 (2006) (holding that interference with right to work based on revocation of driver's license due to child support nonpayment was not infringement of fundamental right). However, even regulations that interfere with a fundamental right will survive strict scrutiny if they are "narrowly tailored to serve a compelling state interest." *Id., citing Washington v. Glucksberg*, 521 U.S. 702, 721, 117 S. Ct. 2258, 138 L. Ed. 2d 772 (1997). The regulatory scheme in WAC 314-55-035 and -040 would survive such scrutiny, as it is narrowly tailored to serve compelling state interests.

The mere inclusion of spouses as true parties of interest is not discriminatory and does not interfere with a license applicant's

constitutional right to marry. The regulations as written are justified by the state's exceptionally compelling reasons for investigating all persons associated with a marijuana business in order to separate the marijuana industry from criminals and criminal conduct. In light of the crucial importance of this screening, Chronics cannot prevail in its assertion that including spouses as license applicants is "pretextual for marital discrimination and doesn't justify business necessity" because Licensing had no legitimate nondiscriminatory reason for denying Chronics' license application. Appellant's Am. Br. at 25. In reaching this conclusion, Chronics relies on two employment discrimination cases: *Magula*, 131 Wn.2d 171; and *Kastanis v. Education Employees Credit Union*, 122 Wn.2d 483, 492, 859 P.2d 26 (1993). Appellant's Am. Br. at 24-25. Because the instant case does not involve an allegation of employment discrimination, it is unclear that those cases are applicable here. Nonetheless, the need to screen out criminal influences from the marijuana industry is, alone, a necessary state justification for ensuring that spouses as well as applicants are fully investigated and determined to qualify for a license.

Chronics also mentions *Levinson v. Washington Horse Racing Comm'n*, 48 Wn. App. 822, 740 P.2d 898 (1987), to support its theory of marital discrimination. In *Levinson*, the Horse Racing Commission

granted a racehorse ownership license to a married woman who had bought a racehorse with her separate property. In her license application, Ms. Levinson had represented herself as unmarried. Later, however, the Commission suspended Ms. Levinson's owner's license after learning that she was married and that her husband had previously been convicted of a narcotics crime. Under WAC 260-12-160(2), anyone with a narcotics conviction was considered a disqualified person who could not be on race course property, and under WAC 260-12-160(3), no horse could be entered in a race if the owner or spouse was a disqualified person. The court acknowledged that the Horse Racing Commission had a compelling interest in maintaining the integrity of horse racing but concluded that the regulations as written were insufficiently tailored to meet the commission's legitimate aims. The court noted that "[r]egulations having an indirect effect on marriage universally require more than just a rational relationship between the state interest and the regulation imposed" and expressed concern that the regulations in question were "very sweeping," only marginally served the interest of maintaining integrity in the horse racing profession, and, by rendering the disqualification permanent, ran afoul of the strong public policy of rehabilitating convicted felons. *Levinson*, 48 Wn. App. at 825. Thus, the court concluded that the regulations unnecessarily infringed on Ms. Levinson's right to marry

while offering little protection to the integrity of the horse racing profession.

The circumstances in *Levinson* are readily distinguishable from the circumstances in this case in several respects. First, while the Horse Racing Commission had actually granted Ms. Levinson a license, Chronics has never held a license. Second, while the regulations in *Levinson* disqualified felons permanently, WAC 314-55-040 creates only temporary disqualifications for a certain number of years, depending on the seriousness of the conviction. Third, and most significantly, the long-established history of regulating the horse racing industry differs significantly and materially from the nascent regulation of the marijuana industry. In particular, the conversion of the marijuana trade from its long history of criminal conduct to the current state-sanctioned system of laws and regulations gives the state added incentive to enact particularly strict rules and requirements to screen out criminal elements and ensure the integrity of the industry. WAC 314-55-035 and -040 are narrowly tailored to accomplish the state's purpose while creating only a small and temporary impact on citizens' marital rights. *See Amunrud*, 158 Wn.2d at 220.

Under all of the circumstances discussed above, the strong need for separation between the marijuana industry and criminals creates a

compelling state interest that is entirely justified by the history and current status of this particular industry. Thus, the regulation that classifies all persons involved in a marijuana business and their spouses as true parties of interest is justified as a narrow and time-limited restriction. *Id.* By applying a reasonable regulation that is narrowly tailored to accomplish a compelling state purpose, the inclusion of spouses as true parties of interest in WAC 314-55-035 for purposes of determining criminality under WAC 314-55-040 survives strict scrutiny and should be upheld.

#### 4. Denial Of The License Application Did Not Violate Chronics' Right To Work

Licensing's decision to deny Chronics' license application could not be construed as a violation of the right to work since the denial did not alter the rights of its members to work. At no time was Ms. Haines-Marchel engaged in a marijuana business. Instead, she merely hoped to start such a business and was trying to show Licensing that she was qualified to hold the license she sought. Chronics' inability to qualify for the license did not deprive Ms. Haines-Marchel of her job or the right to pursue future employment, as she contends, since the submission of a license application was simply a request to engage in business activity that would have been illegal without the license. *See Jow Sin Quan*, 69 Wn.2d at 382. The application did not provide any entitlement to the work that

might ensue if the license were to be granted. Where neither work nor entitlement to work existed, there is no merit to Chronics' argument that the license denial interfered with Ms. Haines-Marchel's right to work by improperly tainting her application with her husband's criminality. Because Chronics was not entitled to receive a retail marijuana license, its members could not be entitled to work that might have existed if the license had been granted.

Nor did the denial of Chronics' license application deprive Ms. Haines-Marchel of her ability to follow her chosen profession as a retailer, as she suggests. The mere fact that she was unable to sell a single, strictly regulated product did not deprive her of the right to choose retail sales as a career path. She is still free to pursue a career selling any of a myriad of products.

Chronics mistakenly relies on *Greene v. McElroy*, 360 U.S. 474, 79 S. Ct. 1400, 3 L. Ed. 2d 1377 (1959), for the proposition that Ms. Haines-Marchel's fundamental constitutional right to employment was violated by Licensing's failure to "giv[e] her the opportunity to show qualifications for the employment, and a reasonable hearing regarding [her] fitness for the job." Appellant's Am. Br. at 20. In *Greene*, the plaintiff was employed as a government contractor and discharged after the Department of Defense revoked his security clearance without

providing a hearing with the proper due process safeguards. The Court held that the plaintiff could not be deprived of his job in a proceeding in which he was not afforded the safeguards of confrontation and cross-examination. *Id.* at 508. There, however, the interest at issue was already-established employment, and the deprivation was created by the failure to provide due process during a hearing on the matter, not by the mere discharge from his job.

In contrast, Ms. Haines-Marchel was not employed and, therefore, was not and could not be discharged. Nor was she deprived of due process, like the plaintiff in *Greene*. Instead, Ms. Haines-Marchel simply had a plan for a business that might be profitable and might afford her employment at some point in the future. She also was afforded a due process right to a hearing on the denial of her company's license application, which she exercised. Thus, Licensing's determination that Chronics could not satisfy the qualifications for the particular license it was seeking neither deprived Ms. Haines-Marchel of her job nor denied her due process of law.

Chronics similarly misplaces reliance on *Duranceau v. Tacoma*, 27 Wn. App. 777, 620 P.2d 533 (1980) for its assertion that the license denial violated the right to work because "work is fundamental and its

blockage is a violation of the due process clause." Appellant's Am. Br. at 21. The plaintiff in *Duranceau* had been hired to work at a logging operation that could only be reached by a single forest service road. The City of Tacoma controlled access to the road and barred access to any logging operations that employed residents of a certain town, so Mr. Duranceau lost his job when his employer learned that he was a resident of that town. The court held that Tacoma's restrictions were improper because they denied equal access to all citizens, directly interfered with plaintiff's fundamental right to employment, and were not the least intrusive means of achieving a compelling state interest. *Id.* at 780.

The circumstances in Chronics' case are clearly distinguishable from *Greene* and *Duranceau*. First, WAC 314-55-035 and -040 apply equally to all persons associated with a marijuana license application. Second, as explained above, Ms. Haines-Marchel was not employed and, therefore, was not deprived of a job, as were the plaintiffs in those cases. Third, the regulations are narrow, time-limited means of achieving the state's compelling interest in creating a firewall between criminality and the marijuana industry in Washington.

Licensing did not deprive Ms. Haines-Marchel of her right to work when it applied WAC 314-55-035 to include Mr. Marchel as a true party

of interest to Chronics' license application. Nor did Licensing deprive Ms. Haines-Marchel of her right to work when it applied WAC 314-55-040 and properly determined that Mr. Marchel had a disqualifying criminal history. In sum, Chronics' right-to-work argument fails.

### C. This Court Should Summarily Reject Chronics' Attempt To Obtain Fees And Costs, As Well As Damages That Are Not Available Under The APA

Chronics seeks $1,000,000 in actual damages, $2,000,000 in economic damages, and an unspecified award of attorney fees. Chronics is not entitled to monetary damages, costs, or attorney fees and this Court should reject Chronics' meritless attempt to obtain such awards.

Under RCW 4.56.250(1)(a), "[e]conomic damages" are "objectively verifiable monetary losses, including medical expenses, loss of earnings, burial costs, loss of use of property, cost of replacement or repair, cost of obtaining substitute domestic services, loss of employment, and loss of business or employment opportunities." Under this standard, the only basis for Chronics' claim appears to be the potential loss in business opportunities and profits caused by the denial of a marijuana business license. Under the APA, however, courts simply do not have the

power to award either economic or actual damages. RCW 34.05.570 and 34.05.574. In fact, no monetary payments are allowed unless expressly authorized by a provision of law other than the APA. RCW 34.05.582(4). Chronics has cited no such provision of law. For all of these reasons, this Court should summarily reject Chronics' attempt to obtain damages.

Chronics also believes that it is entitled to attorney fees and costs under RCW 4.84.010 and 4.84.170. Appellant's Am. Br. at 26. In Washington, the prevailing party in a judicial review of an agency action is entitled to attorney fees and costs unless the agency action was substantially justified or the circumstances make an award unjust. RCW 4.84.350; *Costanich v. Washington State Dep't of Soc. & Health Servs.*, 164 Wn.2d 925, 929, 194 P.3d 988 (2008). "Substantially justified" means justified to a degree that would satisfy a reasonable person. *Raven v. Department of Soc. & Health Servs.*, 177 Wn.2d 804, 832, 306 P.3d 920 (2013). An action is substantially justified when it has a reasonable basis in law and in fact. *Id.* The action need only be reasonable, not necessarily correct. *Pierce v. Underwood*, 487 U.S. 552, 566 n.2, 108 S. Ct. 2541, 101 L. Ed. 2d 490 (1988). Even if an award is warranted, an award of attorney fees is limited to $25,000.00. RCW 4.84.350(2).

Here, Licensing's denial of Chronics' license application was based on the regulatory standards set out in WAC 314-55-035 and -040.

As set forth above, Chronics' facial challenge to the regulations was waived when it failed to raise the issue in the trial court. On appeal, Chronics has neither argued nor shown that Licensing improperly applied the regulations or acted outside of the authority provided by the regulations. Instead, Chronics merely complains that the regulations, when applied as written, had a distressing impact on its marijuana license application. That impact, however, arose from the proper application of the regulations as written, not from any unfounded action on Licensing's part.

Under these circumstances, reasonable persons would conclude that Licensing's action in denying Chronics' retail marijuana application was substantially justified, particularly since the issues raised in this case are a matter of first impression. *See Costanich*, 164 Wn.2d at 928; *see also Alpine Lakes Prot. Soc'y v. Washington State Dep't of Nat. Res.*, 102 Wn. App. 1, 19, 979 P.2d 929 (1999) (defining "substantially justified" to mean justified in the main or in substance to a degree that would satisfy a reasonable person). A reasonable person would be satisfied that Licensing was justified in including spouses as true parties of interest to marijuana business licenses and in refusing to grant a marijuana retail business license to an applicant with a disqualifying criminal history, since that is exactly what was required by WAC 314-55-035 and -040.

To the extent Chronics has not prevailed in this appeal, it is not entitled to attorney fees and this Court should award none. If, however, the Court ultimately finds that Chronics is entitled to relief, Respondent respectfully requests an opportunity to present briefing on the sole issue of attorney fees.

## VI. CONCLUSION

Licensing properly denied Chronics' application for a retail marijuana license after discovering that a true party of interest to the application had a disqualifying criminal history. Licensing also correctly determined that there was no provision in WAC 314-55-035 that would remove a spouse as a true party of interest based on a document purporting to renounce the spouse's community property rights.

This Court should reject Chronics' attempt to raise facial challenges to the validity of the WACs for the first time in this appeal because Chronics did not raise the issue below or bring a proper declaratory judgment rule challenge as required by RCW 34.05.570(2)(b). The Court should also reject as meritless Chronics' four as-applied challenges based on alleged violations of constitutional rights to own property, to contract, to marry, and to work. Licensing's decision to deny Chronics a retail marijuana license under WAC 314-55-035 and -040 was a correct interpretation of the regulations and a proper exercise of its

authority. The Board's Final Order affirming the denial of Chronics' license application should be upheld.

RESPECTFULLY SUBMITTED this 22nd day of December, 2016.

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**COURT OF APPEALS, DIVISION I**
**OF THE STATE OF WASHINGTON**

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| LIBBY HAINES-MARCHEL ROCK ISLAND CHRONICS, LLC,<br><br>Appellant,<br><br>v.<br><br>WASHINGTON STATE LIQUOR AND CANNABIS BOARD, LICENSING DIVISION,<br><br>Respondent. | DECLARATION OF SERVICE |

I, Diane Graf, make the following declaration:

1. I am over the age of 18, a resident of Thurston County, and not a party to the above action.

2. On December 22, 2016, I deposited via U.S. mail, postage prepaid a copy of the Brief of Respondents to:

Robert H. Stevenson
Attorney for Appellant
11 W. Aloha St. #433
Seattle, WA 98119

3. On December 22, 2016, with permission and at the request of Robert H. Stevenson, I deposited via U.S. mail, postage prepaid a copy of the Brief of Respondents to:

Libby Haines-Marchel
3126 SW Raymond
Seattle, WA 98126

I declare under penalty of perjury under the laws of the State of Washington that the foregoing is true and correct.

DATED this day 22 of December, 2016.

DIANE GRAF
Legal Assistant