JS-6

UNITED STATES DISTRICT COURT
CENTRAL DISTRICT OF CALIFORNIA

CIVIL MINUTES - GENERAL

Case No.:	2:19-CV-05413-AB (FFMx)	Date:	October 29, 2020

Title: *Francine Shulman, et al. v. Todd Kaplan, et al.*

Present: The Honorable	**ANDRÉ BIROTTE JR., United States District Judge**
Carla Badirian Deputy Clerk	N/A Court Reporter
Attorney(s) Present for Plaintiff(s): None Appearing	Attorney(s) Present for Defendant(s): None Appearing

Proceedings: **[In Chambers] ORDER GRANTING DEFENDANT MIH'S MOTION TO DISMISS.**

I. INTRODUCTION

Before the Court is Defendants' Todd Kaplan, Medical Investor Holdings, LLC dba Vertical Companies, Vertical Wellness, Inc., Matt Kaplan, Drew Milburn, Courtney Dorne, Smoke Wallin, Robert Scott Kaplan aka Robert Scott, Elyse Kaplan, Jeff Silver, Iron Angel, II, LLC, and NCAMBA9, Inc. ("MIH Defendants") Motion to Dismiss Plaintiffs' Francine Shulman, Iron Angel, LLC, and 3F, Inc.'s Complaint. (Dkt. No. 66.) Also before the Court is Defendant Charles Houghton's Notice of Motion to Dismiss and of Joinder. (Dkt. No. 67.) Defendant Houghton's Motion seeks to dismiss Plaintiffs' Complaint and to join in MIH Defendants' Motion to Dismiss.

The Court deems this matter appropriate for decision without oral argument and **VACATES** the hearing set for October 30, 2020. *See* Fed. R. Civ. P. 78; Local Rule 7-15. For the reasons stated below, the Court hereby **GRANTS** MIH

Defendants' Motion to Dismiss, **DENIES AS MOOT** Defendant Houghton's Motion to Dismiss.

II. BACKGROUND

Plaintiffs and Defendants are involved in the production, marketing, and sale of cannabis. (*See generally,* Dkt. No. 1. ("Compl.").) In or around 2017, Plaintiff Shulman enlisted the help of several Defendants to grow and expend her cannabis business. (*Id.* at ¶¶ 9-10, 64-79.) At some point, the relationship between the Parties broke down and Defendants allegedly engaged in illegal conduct that wholly undermined and damaged Plaintiffs' cannabis business, including production and investment. (*Id.* at ¶¶ 11-18, 88-164.)

As a result, on June 20, 2019, Plaintiff brought this suit alleging twenty-five (25) causes of action. (Dkt. No. 1.) Four causes of action arise under federal law: Claims 1, 2, 14, and 15. The remaining 21 causes of action arise under California state law and are business and/or contract-related claims.

The Court granted Defendants' Motion to Compel Arbitration and the case was stayed pending arbitration. (Dkt. No. 58.) On July 13, 2020, the Court vacated the stay and ordered this case reopened. (Dkt. No. 63.) Defendants subsequently filed the instant motions to dismiss.

III. LEGAL STANDARD

Fed. R. Civ. P. ("Rule") 8 requires a plaintiff present a "short and plain statement of the claim showing that the pleader is entitled to relief." Fed. R. Civ. P. 8(a)(2). Under Rule 12(b)(6), a defendant may move to dismiss a pleading for "failure to state a claim upon which relief can be granted." Fed. R. Civ. P. 12(b)(6). A court may dismiss a complaint under Rule 12(b)(6) based on the lack of a cognizable legal theory or the absence of sufficient facts alleged under a cognizable legal theory. *Balistreri v. Pacifica Police Dep't*, 901 F.2d 696, 699 (9th Cir. 1988).

When ruling on a Rule 12(b)(6) motion, a judge must accept all factual allegations contained in the complaint as true. *Erickson v. Pardus*, 551 U.S. 89, 94 (2007). However, a court is "not bound to accept as true a legal conclusion couched as a factual allegation." *Ashcroft v. Iqbal*, 556 U.S. 662, 678 (2009). To defeat a 12(b)(6) motion to dismiss, the complaint must allege enough factual matter to "give the defendant fair notice of what the…claim is and the grounds

upon which it rests." *Bell Atl. Corp. v. Twombly*, 550 U.S. 544, 555 (2007). The complaint must also be "plausible on its face," allowing the court to "draw the reasonable inference that the defendant is liable for the misconduct alleged." *Iqbal*, 556 U.S. at 678. "The plausibility standard is not akin to a 'probability requirement,' but it asks for more than a sheer possibility that a defendant has acted unlawfully." *Id.* Labels, conclusions, and "a formulaic recitation of the elements of a cause of action will not do." *Twombly*, 550 U.S. at 555.

IV. DISCUSSION

A. Plaintiffs Cannot Allege Violations of 18 U.S.C. §§ 1962(c)-(d) and 1964(c) ("RICO") Because Any Remedy Would Violate Federal Law (Claims 1 and 2).

Defendants argue that Plaintiffs do not have a legally cognizable interest in their RICO claims because the alleged damages relate to a cannabis business which is illegal under the federal Controlled Substances Act, 21 U.S.C. § 801 et seq. ("CSA"). (Mot. at 10.) Plaintiffs counter that other courts have held that "just because [a party] is violating one federal law, does not give it license to violate another." *Siva Enterprises v. Ott*, No. 2:18-cv-06881-CAS-GJSx, 2018 WL 6844714, at *5 (C.D. Cal. Nov. 5, 2018) (citing *Greenwood v. Green Leaf Lab LLC*, No. 3:17-CV-00415-PK, 2017 WL 3391671, at *2–3 (D. Or. July 13, 2017)).

Plaintiffs seek damages for "injury to their business . . . including Defendants' scheme to take over Ms. Shulman's cannabis business . . . As a result, Plaintiffs lost control over their cannabis cultivation operation for a time at the Iron Angel Property, lost their opportunity to purchase and cultivate cannabis on the Wellsprings Property . . . . " (Compl. ¶ 177.) Plaintiffs damages under RICO are inextricably intertwined with their cannabis cultivation—any relief would remedy Plaintiffs' lost profits from the sale, production, and distribution of cannabis.

As such, the Court finds that any potential remedy in this case would contravene federal law under the CSA. A court order requiring monetary payment to Plaintiffs for the loss of profits or injury to a business that produces and markets cannabis would, in essence (1) provide a remedy for actions that are unequivocally illegal under federal law; and (2) necessitate that a federal court contravene a federal statute (the CSA) in order to provide relief under a federal statute (RICO). The Court finds this approach to be contrary to public policy.

The Court also notes that it seems implausible that RICO—a federal statute—was designed to provide redress for engaging in activities that are illegal under federal law. Plaintiffs' reliance on *Siva* is unhelpful because, in that case, Plaintiffs claims were premised upon misappropriation of confidential business information regarding cannabis sales and did "not involve the actual production or sale of cannabis." *Siva,* 2018 WL 6844714 at *5. Here, Plaintiffs' claims involve the actual production and sale of cannabis, thus increasing the likelihood that any remedy would contravene federal law.

The Court cannot remedy Plaintiffs' injuries because doing so would result in an illegal mandate; in short, Plaintiffs' injuries to their cannabis business are not redressable under RICO. *See Gonzales v. Gorsuch*, 688 F.2d 1263, 1267 ("The focus, however, is always upon the ability of the court to redress the injury suffered by the plaintiff; if the wrong parties are before the court, or if the requested relief would worsen the plaintiff's position, *or if the court is unable to grant the relief that relates to the harm*, the plaintiff lacks standing." (emphasis added) (citing *Gladstone, Realtors v. Village of Bellwood*, 441 U.S. 91, 100 (1979)). Plaintiffs lack standing to seek relief; accordingly, the Court dismisses the RICO causes of action (Claims 1 and 2).

B. The Lanham Act Does Not Protect Illegal Activities Such as Cannabis Cultivation (Claims 14 and 15).

As detailed above, cannabis is illegal under federal law. *In re Morgan Brown*, 119 U.S.P.Q. 2d 1350, at *3 ("marijuana . . . remain[s a] Schedule I controlled substance[ ] under federal law . . . . "). Thus, when a mark is used for cannabis products, the Lanham Act does not recognize the user's trademark priority or any derivative claims, regardless of any state laws that may contradict the federal statute. *See id.,* 119 U.S.P.Q. 2d 1350, at *5; *In re JJ206*, 120 U.S.P.Q. 2d 1568, at *2–*3; *CreAgri v. USANA Health Services Inc.*, 474 F.3d 626, 630 (9th Cir. 2007).

As the Ninth Circuit has stated, extending trademark protection for use on unlawful products would "put the government in the anomalous position of extending the benefits of trademark protection to a seller based upon actions the seller too in violation of that government's own laws." *CreAgri*, 474 F.3d at 630. As such, because any alleged use of the Iron Triangle trademark was on cannabis products which are illegal under federal law, Plaintiffs cannot state a claim for violation of the Lanham Act (Claim 14).

Because Plaintiffs' claim of false advertising under the Lanham Act is derivative of the Lanham Act claim, this cause of action fails as well. 119 U.S.P.Q. 2d 1350, at *5. Regardless, Plaintiffs must adequately allege statutory standing for a claim of false advertising. *See Lexmark Int'l, Inc. v. Static Control Components, Inc.*, 572 U.S. 118, 128, 134 n.6 (2014). Plaintiffs must show (1) that they are within the 'zone of interest' protected by the statute; and (2) proximate causation between his injury and the alleged statutory violation. *Id.* at 129-134.

As discussed above, the Lanham Act was created to protect trademarks that involve legal uses only. Where a mark is "being used in connection with sales of a specific substance (marijuana) . . . that is illegal under federal law . . . [it] encompasses a use that is unlawful." *In re Morgan Brown*, 119 U.S.P.Q. 2d, at *5. Because Plaintiffs claim for false advertising rests wholly on Defendants' use of its trademark to advertise marijuana products, it encompasses an unlawful use such that Plaintiffs are not within the "zone of interest" protected by the Lanham Act. Plaintiffs' claim for false advertising (Claim 15) fails.

C. Leave to Amend Is Not Warranted.

Neither the RICO causes of action nor Plaintiffs' claims under the Lanham Act could be cured by pleading additional facts because the illegality of marijuana cannot be pleaded around in a way that would confer standing. As such, the Court declines to grant leave to amend for these four causes of action. *See Lopez v. Smith*, 203 F.3d 1122, 1127 (9th Cir. 2000) (*en banc*) (leave to amend should not be granted if a pleading "could not possibly be cured by the allegation of other facts") (internal quotation marks and citations omitted).

D. The Remaining Causes of Action are State Law Claims and the Court Declines to Exercise Supplemental Jurisdiction Over Them.

District courts may decline to exercise jurisdiction over supplemental state law claims based on various factors, including "the circumstances of the particular case, the nature of the state law claims, the character of the governing state law, and the relationship between the state and federal claims." *City of Chicago v. Int'l Coll. of Surgeons*, 522 U.S. 156, 173 (1997). The Ninth Circuit does not require an "explanation for a district court's reasons [for declining supplemental jurisdiction] when the district court acts under" 28 U.S.C. §§ 1367(c)(1)–(3), *San Pedro Hotel Co. v. City of Los Angeles*, 159 F.3d 470, 478 (9th Cir. 1998), but does require a district court to "articulate why the circumstances of the case are exceptional in addition to inquiring whether the balance of the *Gibbs* values provide compelling

reasons for declining jurisdiction in such circumstances." *Exec. Software N. Am. Inc. v. U.S. Dist. Court for the Cent. Dist. of Cal.*, 24 F.3d 1545, 1558 (9th Cir. 1994), *overruled on other grounds by Cal. Dep't of Water Res. v. Powerex Corp.*, 533 F.3d 1087 (9th Cir. 2008). This "inquiry is not particularly burdensome." *Id.*

Because the remaining twenty-one (21) causes of action arise under California law, the Court finds that this case should be dismissed entirely as the state law causes of action "substantially predominate[]" over this matter. Moreover, the Court has dismissed all federal causes of action as discussed above and accordingly declines to consider the merits of the remaining causes of action which involve a business and contract dispute, the jurisdiction of which is more properly left with the state court.

V. CONCLUSION

For the reasons stated above, the Court **GRANTS** MIH Defendants' Motion to Dismiss **WITH PREJUDICE**. Defendant Houghton's Motion to Dismiss is **DENIED AS MOOT**.

IT IS SO ORDERED.