

**City of Placerville
MEMORANDUM**

DATE: April 14, 2009
TO: City Council
FROM: George Nielsen, Chief of Police
SUBJECT: **Appeal Hearing – Medical Cannabis Dispensary
Michelle L. Smith / Mountain Meds**

This is an appeal to the City Council regarding the decision of the Chief of Police to deny renewal of the Medical Cannabis Dispensary permit previously issued to Michelle L. Smith / Mountain Meds.

BACKGROUND

The City of Placerville established the Medical Cannabis Dispensary (MCD) ordinance, Placerville City Code Title V, Chapter 25 effective June 24, 2006 as amended. The MCD ordinance was enacted by the Council to allow for MCD's within the City in the spirit of Proposition 215 and SB420, the California legislation allowing for medical marijuana.

July 10, 2007 Ms. Michelle L. Smith as an individual submitted an application to the Police Department under the City MCD ordinance to operate Mountain Meds, an MCD to be located at 645 Main Street. As part of the application documents, Ms. Smith was provided with a copy of the City MCD ordinance. August 20, 2007 Ms. Smith was granted approval of her permit application to operate the MCD. Incorporated within the permit approval document, Ms. Smith was reminded that per SB420 and the City MCD ordinance, the MCD permit holder may not sell medical marijuana for profit.

ANALYSIS

The MCD ordinance requires renewal of the permit each year. Included in the renewal process is an inspection of the premises, interview of the permit holder and an audit of the business records to insure compliance with the MCD ordinance, Proposition 215 and SB420.

Permit Renewal Processing / Site Inspection

August 20, 2008 at my direction Police Detective Rick Brown initiated the MCD permit renewal process for Michelle L. Smith / Mountain Meds. On this date Detective Brown conducted a site visit of Mountain Meds at 645 Main Street. Brown enlisted the

assistance of El Dorado County District Attorney's Office Forensic Accountant/Auditor Marilyn Meixner to assist in the audit of the business records. Detective Brown pre-announced and prearranged the site visit by making an appointment with Michelle Smith.

Detective Brown met with Michelle Smith at the premises to discuss the permit renewal and the operations of the MCD. Upon arrival Brown noted that no signs were displayed advising of an age limit to enter the premises (CC5-25-13-C). Brown specifically asked about employees of the MCD. Smith said that none of the employees get paid for working at the MCD, instead they are all volunteers. Smith stated that she, Michael Clark, Rick Hosford, Michael Hayhurst and Heidi Roberts are all volunteers and also the board members of the MCD. Smith said she was working on setting up pay scales for all of the employees but as of that date they were all just volunteers. Brown requested an employee roster and Smith was unable to provide one (CC5-25-12-D). Upon request, Smith was also unable to provide the names of independent contractors (CC5-25-6-A10). Smith reported that the hours of operation for the MCD are 10am to 6pm and they have approximately 300 registered clients.

Detective Brown questioned Smith about the business and financial record keeping for the MCD. Smith advised that a Mr. Pat Turner, a Certified Public Accountant and Attorney, keeps all the financial records for the MCD at his office located at 4970 Windplay Drive, El Dorado Hills. Smith reported that all bills and expenses are paid by the employees and the receipts go to Turner and are held at his office.

Detective Brown further questioned Smith about financial transactions within the MCD. Smith said that all of the bills and expenses are paid for with cash and the receipts are given to Pat Turner. Smith advised that she used to have a business bank account under Mountain Meds at Bank of America but recently the account had been closed and all the banking had been transferred to Rick Hosford's personal bank account. When questioned about the personal bank account, Smith advised Detective Brown that Hosford's account was set up under the MCD operation and she showed Brown a blank check from the account reportedly used for the MCD. The check appeared to be a personal check bearing only Hosford's name – nowhere on the check was there reference to Mountain Meds. Regarding deposits for the MCD, Smith advised that she sends all deposits to Pat Turner and after that she does not know where they go. Smith believed that the deposits go to Hosford's bank account but she was not sure.

Smith advised Detective Brown about how the business is conducted with the patrons. Smith said the person buying the marijuana is identified usually by a California identification card or driver's license at the front window. Once they are identified they are allowed to come into the office area through a secure door. A screening process is conducted where the patron completes and signs a form verifying the information and provides their recommendation from the doctor. The patron is also required to designate Mountain Meds as a "care provider" and sign a form confirming this designation. The information is entered in to a computer including the expiration date of the recommendation. Other care providers can also be listed on the forms. Once the screening and paperwork is completed the employee unlocks the security cage and

conducts the transaction with the patron. The amount sold is documented on an internal transaction form and the money is placed in a small safe.

Detective Brown noted two computers on the premises. One was reported by Smith to be the primary computer that holds the business records and patient information. The other was reported to be a personal computer brought in by one of the employees for playing video games. Upon an inspection of the computerized record keeping, Detective Brown noted that the client was logged by name, not by a user identification number for confidentiality (CC5-25-13-H).

Detective Brown reviewed files held in his office and discovered that two Mountain Meds employees were working on site who had not been cleared by the Police Department. Michael Hayhurst never completed the background process and Rick Hosford was denied because of his criminal history.

Written Notice, September 2, 2008

On September 2, 2008 Detective Brown provided Michelle Smith with a two page written notice dated August 28, 2008 advising of the violations noted above and advising that the permit renewal process was still active and on-going. Michelle Smith signed the forms acknowledging receipt of the documents.

Written Notice, September 4, 2008

On September 4, 2008 Detective Brown provided to Michelle Smith a formal written request for all business and financial records to be provided within 24 hours pursuant to City Code 5-25-13-I. The records requested were to be for all business from inception of the MCD August 20, 2007 through the end of August 2008. The form was signed by me and also by Michelle Smith acknowledging receipt of the document.

Permit Investigation, Pat Turner, September 4, 2008

As previously mentioned, Michelle Smith advised Detective Brown that Mr. Pat Turner was in charge of the financial business records pertaining to the Mountain Meds MCD. Smith advised Detective Brown at the on site inspection August 20, 2008 that the MCD had no financial records on site and that the records were all controlled and maintained by Mr. Turner's office.

Detective Brown contacted Mr. Pat Turner by telephone and was advised that Carol Ladd was one of Turner's employees and she had been assigned to conduct work for Mountain Meds. On September 4, 2008 Detective Brown and Marilyn Meixner from the District Attorney's Office met with Pat Turner and Carol Ladd at Turner's office in El Dorado Hills.

Turner reported that his office does the Board of Equalization "sales and use taxes" and the Employment Development Department "EDD" employment reports – that was it,

they perform no other accounting, record keeping or transactions for Mountain Meds. Turner and Ladd advised that in January 2008, Smith requested that Turner's office show her how to use "Quick Books" because Smith wanted to do her own record keeping for the MCD. Ms. Ladd showed Smith how to use the program and assisted her in entering a few items and how to track bills. The original documents that were entered in to Quick Books at that time were returned directly to Smith. Turner reported that they had not received any other information to do the books or conduct accounting services for Mountain Meds. Turner stated that they had no records in their possession for Mountain Meds.

Carol Ladd added that she also assisted Smith with the EDD employment reports and the BOE use and sales tax reports to assist in getting them caught up on those reports. Mountain Meds was reportedly behind with the taxes but Ladd had caught them up. Ladd stated that Mountain Meds claimed they have no payroll, so she assisted in completing the EDD report accordingly.

Carol Ladd further advised that she has not dealt with Smith since the initial help with Quick Books. Ladd advised that she either deals with Rick Hosford or a Kirt West. Ladd confirmed that the original plan was to just show them how to make the entries in to Quick Books and that Mountain Meds would maintain their own business records – they would only utilize Mr. Turner's business as a resource regarding accounting questions. Turner advised that there has been no follow through after the initial instructions on how to use Quick Books – the only time they have had contact with an employee from Mountain Meds was when they had questions. Turner stated that his office has not received any general ledgers or receipts from Mountain Meds. Ladd made it clear that they do not write out checks or keep track of the checks written from Mountain Meds and they have not received any other types of receipts. Ladd stated that she has not done any "book keeping" type work for Mountain Meds other than show Smith how to use Quick Books.

Pat Turner added that his company was in the process of assisting with the "non-profit" status for Mountain Meds. Turner stated that he was acting more as a paralegal than anything else in regards to the non-profit status. Turner said he helped prepare the forms but someone from Mountain Meds was to file the documents. Turner stated that to the best of his knowledge Mountain Meds was not a non-profit group at that point but were attempting to become non-profit. Turner believed that they were classified a "C" group corporation at that time and that the non-profit paperwork was pending. Turner advised that about 3-4 months prior he had begun the process for the non-profit status. Turner advised he did not believe that Mountain Meds had filed a corporate tax return, at least not through his company. Turner also stated that since Mountain Meds incorporated in August of 2007 they should have had a 2007 tax return at least for California.

Carol Ladd added that she believed Mountain Meds kept a daily log and an inventory sheet. Ladd advised that she showed Smith how to set up the inventory sheet but she does not know if it has been maintained regularly. According to Ladd, Kirt West was the last

person to bring her the inventory sheet to do the sales and use taxes and she had given the sheet back to West.

Permit Investigation, Michelle Smith, September 4, 2008

Later in the same day, September 4, 2008, Detective Brown met with Michelle Smith at the Police Department for a follow-up interview regarding the business and financial records for Mountain Meds.

Smith confirmed to Detective Brown that Mr. Turner's office had previously had all of the financial records and book keeping documents for Mountain Meds. Smith then said that she now keeps the financial records on site; however, unbeknownst to her at the time of the on-site inspection, the records were actually in the safe. On the day of the inspection, Smith did not have access to the safe. Smith stated that she did not know that Mr. Turner had ever returned the business records. Smith then said that Mountain Meds still does provide some receipts and financial records to Mr. Turner for tax purposes and that it was Rick Hosford's responsibility to provide the records to Turner.

When asked about Kirt West, Smith stated that she did not know who he was and she was unaware he had ever handled any records on her behalf. According to Police Department files there is no record of Kirt West ever being submitted for background check as an employee of Mountain Meds.

It should be noted here that this information from Smith about business records and book keeping is in direct contrast to the reports from Pat Turner and Carol Ladd.

Permit Investigation, Business/Financial Records

Smith provided to Detective Brown a package of paperwork that she stated was all of her financial information that was requested on September 4, 2008. Detective Brown submitted the records to Marilyn Meixner at the District Attorney's Office. Meixner reviewed the records and reported that the records were incomplete and insufficient as business records. She stated that not all of the bank statements had been provided and that there were discrepancies on the book keeping and tax returns. Most of the information contained within the records Smith provided was hand written. Smith did provide some type of printed receipt that appeared to be a transaction record; however, there was no account number or identifying information on it. The lower portion of the receipt had been cut off. Marilyn Meixner has submitted a written memorandum outlining various deficiencies of the business records.

On September 11, 2008 Detective Brown provided to Michelle Smith another formal written request for business and financial records including bank statements from the Mountain Meds Bank of America account, Rick Hosford's bank account and a new bank account with El Dorado Savings. Initially Smith responded that the bank account information was included in the original records provided. Detective Brown clarified with

Smith that the bank records were never provided and would be needed. Smith signed the form acknowledging receipt of the request for documents.

On September 12, 2008 Smith provided copies of the signature cards and some limited account information from Bank of America. The information pertained to Hosford's bank account and the original account that had been closed. The information was incomplete with various documents having portions eliminated and there were no actual bank statements from any of the banks. Smith included a letter stating that the records were ordered but it would take two weeks to obtain them.

The beginning of November 2008 Detective Brown talked with Smith and advised her that we still had not received sufficient business and financial records to complete an audit for the permit renewal process. Detective Brown reiterated that we still needed all records outlined in the previous written requests. To date we have received no further response from Michelle Smith regarding the requested documentation.

CONCLUSIONS

The initial site inspection revealed several technical violations of the MCD ordinance. These violations included failure to provide a list of names of employees, contractors and others who work at the facility (CC5-25-6A10), failure to disclose employee list upon demand (CC5-25-12-D), no age restriction signs posted outside (CC5-25-13-C), failure to record a user identification number for confidentiality of clients (CC5-25-13-H) and employees working on site who had not been cleared by the Police Department (CC5-25-12-A).

Regarding the employee background checks, the department acknowledges we were unable to verify that Smith was notified about problems with two of the employee background investigations, Hayhurst and Hosford. Regarding the background for Kirt West, he was never submitted or registered with the PD as an employee of Mountain Meds – this would be a clear violation and is unacceptable.

With respect to any follow-up to verify if the technical violations had been corrected, no inspection was conducted because we were never able to complete the audit of business records. The red flag was the inadequate financial documents and records which could indicate possible criminal activity. The technical violations are not necessarily related to possible criminal activity – they would be more procedural in nature and therefore secondary in the permit renewal process. Suffice to say the technical violations existed at the initial renewal inspection but we have not been able to complete the permit renewal process due to the lack of adequate business records.

Smith originally reported to Detective Brown that Mountain Meds serves approximately 300 clients and they are open for operations daily, 10am to 6pm. If each client used an average of about ½ oz product per month there might be use of a total of approximately 150 oz of product per month for the MCD. At a conservative rate of \$150 per oz, gross sales could be about \$22,500 per month and \$270,000 per year. We feel this is most

likely a conservative estimate of sales activity and the sales could actually be much higher. We have no way of confirming, verifying or knowing what the actual sales activity is due to the lack of business records.

Of note, the City Finance Department has Board of Equalization (BOE) sales tax figures reported by Mountain Meds. We are unable to determine how Mountain Meds has calculated the reported BOE figures as again, we have no way of verifying or knowing what the actual business activity has been due to the lack of business records.

The most significant and troubling issue with this MCD permit renewal is the lack of business and financial records and in particular conducting MCD financial transactions through someone's personal bank account.

Section 5-25-13-I of the MCD ordinance allows for access to the MCD's "books, records, accounts and any and all data relevant to its permitted activities for the purpose of conducting an audit or examination to determine compliance with this City Code and applicable law. Books, records, accounts and any and all relevant data will be produced no later than twenty four (24) hours after receipt of the Police Chief's written request(s)". The primary intent behind this section of the MCD ordinance is to insure that an MCD is operating appropriately as a not for profit entity serving patients in need of medical cannabis and not an illegal criminal enterprise engaged in funneling marijuana to illegal markets and obtaining substantial illicit profits.

Based on the lack of adequate business records and management oversight as outlined in this report we are unable to make any reasonable determination as to the actual purpose of Mountain Meds as a legitimate Medical Cannabis Dispensary. We are unable to determine the amount of product that has been sold, how much was originally paid for it, how much it was sold for, when and to where it was sold and the status of profit verses loss. All of this information would be needed to determine that the marijuana is not being sold for illicit profits, but rather just to cover reasonable costs of conducting the MCD operations per SB420 and City Code.

Throughout this MCD permit renewal process Michelle Smith as the permit holder has been unknowledgeable and somewhat confused about her business operations and she has seemed evasive and not forthcoming with the required information as outlined in the City Code. Smith has failed to keep accurate records for the business transactions and overall it is our opinion she has been irresponsible in conducting her business.

Smith told us that Mr. Pat Turner's office kept and maintained all of her financial records; however, in our investigation with Mr. Turner we learned that Turner's company has never conducted the accounting or book keeping functions for the business. This discrepancy is significant and displays a lack of knowledge and control over the MCD business operations.

It appears to us that Michelle Smith does not actually know what is going on within her own organization. It appears that others perhaps including but not limited to Rick

Hosford and Michael Hayhurst actually were in charge of and running the MCD operation even though Smith is the documented permit holder. For example Hosford was in control of the finances and Hayhurst has been in charge of obtaining the marijuana and other distribution functions. Smith appears to us as more of a “straw figure” to hold the permit while others actually operate the MCD at their own will and outside the direct knowledge and control of Smith. The fact that Smith did not even know the records were at her own office on the date of the inspection is a prime example of her lack of control over the operations. This to us is in violation of the spirit of the MCD ordinance and actually amounts to a defacto unapproved transfer of the permit to other un-permitted persons to operate the MCD.

On March 17, 2009 Michelle Smith was served with written notice of my decision to deny renewal of the MCD permit. The notice included Smith’s right to appeal this decision to the City Council.

March 19, 2009 the Office of the City Clerk received a letter of appeal and response from Michelle Smith.

Based on all the above, it is recommended that the Council deny the appeal from Michelle L. Smith / Mountain Meds and uphold the decision of the Chief of Police to deny the MCD permit renewal.

EXHIBITS TO BE PRESENTED

1. Placerville City Code, Title V, Chapter 25 – Medical Cannabis Dispensaries
2. MCD permit application and final permit issued to Michelle L. Smith
3. Written notice issued to Smith September 2, 2008
4. Written notice issued to Smith September 4, 2008
5. Copy of all business records submitted by Smith
6. Memo from Marilyn Meixner EDC DA regarding review of business records
7. Written notice issued to Smith September 11, 2008
8. Letter and attachment from Smith dated September 12, 2008
9. Written notice to Smith denying MCD permit renewal dated March 11, 2009 and served March 17, 2009
10. Appeal request and response from Smith received by City Clerk March 19, 2009

Submitted by:

Approved for Submittal to City Council:

George Nielsen
Chief of Police

John Driscoll
City Manager/City Attorney