

Maine Cannabis Business State of the Industry

— Fall 2022 —

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A link to the slides from today's presentation will be sent to
all attendees following this event



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Presentation Agenda

Part 1

Evolution & Growth of the Industry

Real Estate & Commercial Contract Issues — *Sara Moppin*

Part 2

Best Practices in Workforce Management for Emerging

Cannabis Businesses — *Matt LaMourie*

Evolution & Growth of the Industry

Real Estate & Commercial Contract Issues

The National Shift in Public Opinion

- In 1995, the year before California became the first state to legalize medical cannabis, 25% of Americans polled in a Gallup survey favored nationwide legalization of cannabis.
- By comparison, in Gallup's 2021 survey, 68% of Americans polled favored legalization.

Maine Cannabis by the Numbers

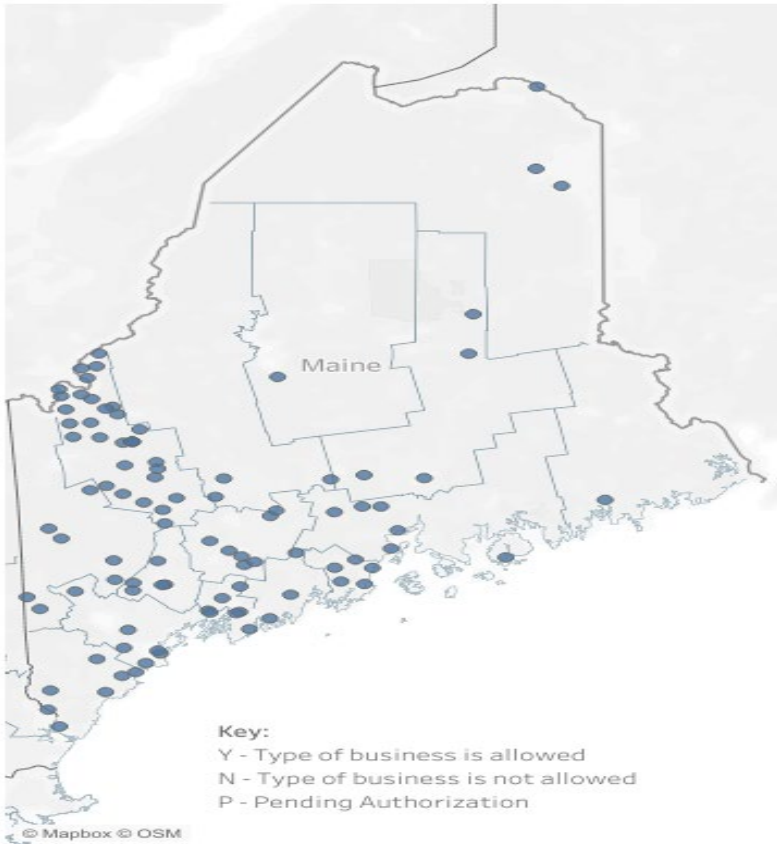
- OCP December 2021 Survey Results:
 - 64% of cannabis from regulated sources
 - 36% from black market
 - 54% of consumers who purchase from home-based caregivers do not have med cards
 - 33% of consumers who purchase from dispensaries or caregiver retail stores do not have med cards
 - For every \$1 in demand for adult use cannabis in Maine, there is about \$2 in supply

The Black Market Problem

- Illegal sellers and growers continue to thrive.
- Heavily regulated legal cannabis businesses are competing with a booming black market.
- The problem is not unique to Maine.
- Enforcement is virtually non-existent and until there is, there is very little concern of penalties.
- Without robust enforcement, it begs the question: are regulated cannabis businesses really set up for success?
- Why aren't illegal products being seized and offending shops being shuttered?
- Faced with high taxes, local municipal opposition, and competition from the black market, how to legal operators survive?

Cannabis as a Regulated Land Use

Adult Use Marijuana Opt-In by Municipality



Municipality	Retail	Growing	Manufacturing	Testing	
Alder Stream ..	N	Y	N	N	●
Anson	Y	Y	Y	Y	●
Auburn	Y	Y	Y	Y	●
Avon	Y	Y	Y	Y	●
Bangor	Y	Y	Y	Y	●
Bath	Y	Y	Y	Y	●
Beattie (No.2,..	N	Y	N	N	●
Berwick	Y	Y	Y	Y	●
Bethel	Y	Y	Y	Y	●
Biddeford	N	Y	Y	Y	●
Boothbay	Y	Y	Y	Y	●
Bowdoinham	Y	Y	Y	Y	●
Bridgton	Y	Y	Y	Y	●
Brownfield	N	Y	Y	Y	●
Brunswick	Y	Y	Y	Y	●
Byron	N	Y	N	N	●
Camden	N	Y	N	N	●
Chain of Pond..	N	Y	N	N	●
Chain of Pond..	N	Y	N	N	●
Chelsea	Y	Y	Y	Y	●
Coburn Gore	N	Y	N	N	●
Columbia	Y	Y	Y	Y	●
Damariscotta	Y	Y	Y	Y	●
Davis (No.3, R..	N	Y	N	N	●
Detroit	Y	Y	Y	Y	●
Eliot	Y	Y	Y	Y	●
Etna	N	Y	Y	Y	●
Eustis	Y	Y	Y	Y	●
Fairfield	Y	Y	Y	Y	●
Farmington	Y	Y	Y	Y	●
Freeman Twp	N	Y	N	N	●

What's Happening Now...

- From the perspective of a cannabis lawyer:
 - Lots of product available in the market / prices are dropping
 - Energy prices are going up
 - Partnership disputes
 - Importance of dispute resolution mechanisms in owner agreements
 - Importance of inventory tracking and membership interest forfeiture provisions in owner agreements
 - Uptick in mergers and acquisitions and consolidation
 - Uptick in failed cannabis businesses

Section 280E Problems

- Section 280E of the Internal Revenue Code prohibits cannabis companies from reducing taxable income by their business expenses (other than COGS), which results in a significantly higher effective tax rate as compared to other businesses.
- Maine allows deductions of 280E expenses for medical companies but not adult use. 36 M.R.S. § 5122(2)(PP).
- With the downturn in the market, it has become a significant problem in the industry creating huge federal income tax liabilities for some cannabis companies.
- “It also is perhaps the government’s most powerful tool in its war on drugs, where, today, it seems the IRS is the only federal agency still in the fight.” - Nicholas J. Richards @

Greenspoon Marder LLP

Maine's Residency Debacle

- In August of 2022, the First Circuit Court of Appeals struck down the Maine law that requires owners of medical cannabis businesses to be Maine residents, finding Maine's residency requirement to be unconstitutional.
- The First Circuit is the first federal appeals court to wrestle with cannabis and the dormant commerce clause, and it is unlikely to be the last.
- The panel relied on the Rohrabacher-Farr amendment, a spending bill rider that forbids the U.S. Department of Justice (DOJ) from using its funds to interfere in state-legal cannabis markets, as evidence that Congress has "acknowledged the existence of a market" in medical cannabis.
- Residency-based preferences in Detroit and Missouri were similarly struck down on DCC grounds last year. And Maine's adult use market is already open to non-residents.
- Many commentators hypothesize that this ruling puts many other state cannabis laws at risk, including state laws that bar interstate sales between states where cannabis is legal and social equity programs that reserve state licenses to in-staters.

Culture Clash

- Industry pioneers
 - Cowboy and/or “can’t we all just get along” personality types
 - Varying levels of sophistication
 - Varying levels of access to capital
- Business community
 - Sophisticated but little hands-on cannabis experience
 - Frustrated by industry pioneers
 - Greater access to capital

Important Contract Provisions

- **The federal illegality problem**
 - Some federal judges have refused to enforce state-law compliant cannabis contracts on the basis that cannabis is still illegal under federal law
- **Arbitration clauses**
 - Maine courts and judges may be reluctant to enforce contracts between cannabis businesses they consider illegal
 - Arbitration helps temper federal illegality defenses
 - Include provision that parties may mutually agree upon a cannabis friendly arbitrator
 - Include provision that parties agree not to raise any federal illegality defense

Important Lease Provisions

- Municipal licensing can be uncertain. Negotiate for a walk right if you are not successful in obtaining all necessary licenses and permits.
- Fixtures and equipment – make sure to get clarity on who will own the lights, irrigation systems, fans, etc. at end of lease term
- Live/work arrangements. Resident cultivators often reluctant to leave. Negotiate for a purchase option at end of lease term.
- Make sure to find out if the landlord has third party bank financing and REQUIRE landlord to obtain written consent from its lender to the cannabis use.
- Beware of leases that include hidden profit shares.
- Make sure landlord is aware and it is clearly spelled out in the lease the types of use the tenant will make of the property (adult use cultivation, caregiver retail store, medical manufacturing, etc.)

Don't Forget About Securities Law Compliance

- Cannabis business owners face a high monetary barrier to entry, forcing many to raise money through investors.
- Taking investment money without giving voting rights (i.e. passive investments) is a “security.”
- Must follow federal and state securities laws, which requires involvement of an experienced securities lawyer.

Don't Poach the IP of Established Brands

- Well-known candy companies are increasingly asserting IP rights against cannabis companies selling look-alike edibles and products that play on well-known brand names
- Last year, the maker of Skittles sued a California edibles company selling Zkittlez-branded cannabis products for trademark infringement. The case is still pending.

What Can Efficiency Maine Trust Do for You?

- In late 2020 Efficiency Maine Trust (EMT) voted to allow cannabis businesses to use their programs.
- EMT is a ratepayer-funded agency that oversees state programs designed to reduce costs associated with energy efficiency upgrades.
- EMT can provide energy-efficiency grant dollars for LED lighting, advanced HVAC systems, and standalone dehumidifiers.
- In 2021, EMT's annual report notes that it saw considerable interest and program participation from cannabis cultivation facilities.

Cannabis and Bankruptcy

- Bankruptcy can be an effective tool for struggling businesses to obtain “breathing room” from creditors, restructure debts, and escape certain litigation and collection efforts.
 - BUT cannabis businesses have historically not been able to use bankruptcy courts
 - Bankruptcy relief is unavailable to businesses whose activities are illegal under federal law
- State law receivership may be an option but it’s expensive
- Other options include:
 - out-of-court workout with individual creditors
 - Assignment for the benefit of creditors
 - Uniform Commercial Code foreclosure

Cannabis Banking

Why do cannabis businesses have so much trouble accessing banking services and payment systems?

- There is no safe harbor from federal prosecution concerning cannabis enforcement under the CSA.
- As a matter of policy and practice, prosecutors and regulators have focused attention on prosecutorial priorities outlined in Cole Memo, despite the Sessions Memo.
- But the policy and practice of no or limited federal enforcement could change at any time. And financial institutions are responsible to regulators who are independent from the DOJ and the executive branch.
- **Banking certainty won't come until a federal fix is adopted.**
- **Even with a federal fix, the compliance burden will be largely the same or even more highly regulated.**

Best Practices in Workforce Management for Emerging Cannabis Businesses

Effective Workforce Management



When do key compliance considerations kick in?

- **1 employee** – immigration, workers' compensation, anti-discrimination restrictions (ME), statutory overtime obligations, meal and rest break requirements, unemployment insurance liability
- **15 employees** – disability (ADA); discrimination (federal); family and medical leave (ME); sex harassment training (ME)
- **20 employees** – age discrimination (federal)
- **50 employees** – family and medical leave (federal)

Conditional Offer Letters

- Not the same as an employment agreement / not appropriate for equity grant situations
- Use for **EVERY SINGLE HIRE**
- Reserves the right to withdraw your offer in certain situations
- Imposes an obligation to disclose contractual obligations to prior employers

What Makes an Offer Conditional?

The new hire's start date/commencement is **dependent** upon satisfying specific conditions:

- Willingness to agree to restrictive covenants, where appropriate
- Background checks/credit history/driving record
- Occupational health exam
- Proof of eligibility to work in U.S.

“Acknowledged and agreed-to”

Employment Agreements with Restrictive Covenants

- Do **not** agree to a term of guaranteed employment / confirm at-will employment
- One size does not fit all
- Never agree to give equity (well, almost never...)
- Clarify confidentiality reqs., the businesses' ownership of IP, etc.
- Maine law imposes **very specific** limits on some forms of restrictive covenants (non-competes) – CONSULT LEGAL COUNSEL

Special Challenges for Emerging Cannabis Businesses

- Legal Compliance and HR Management “On the Fly”
- Secondary Employment (moonlighting) Issues
- Wage and Hour Compliance “Traps”
- Workplace Ergonomic and Safety Considerations

Q&A

Thank you!



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