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## CONQUERING CANNABIS





# HIT THE BOOKS

Cannabis legalization smoking up professional services firms eager to advise entrepreneurs

By Andrew Tellijohn

**C**annabis-based products have been increasingly available in Minnesota over the last six years. The opportunities in that space became even more prominent last year when the state legislature voted to become the 23rd state to legalize adult recreational use of marijuana for Minnesotans over 21.

There are still a lot of questions related to what the industry will look like. The bill created the Office of Cannabis Management to license cannabis and hemp businesses and oversee the market and draft regulations related to 16 available licenses in the space are expected out later this year.

But with just 16 licenses and what is expected to be a highly regulated market developing, it's even more vital that entrepreneurs passionate about their products make sure they are on top of the business side of their ventures.

The first thing Jeff O'Brien, a partner with Chestnut Cambronne, does when potential business owners contact him about getting into the adult-use market is explain the law and its restrictions.

"Part of it is just educating them," he says. "There are 16 different licenses, 10 are adult use, there's four medical licenses and there's two for low-potency hemp."

That means that unlike, say, a liquor store license, which will generally be approved for anyone who meets qualifications, cannabis licenses in Minnesota will be significantly limited.

"It seems to be an inevitability that there is going to be a surplus of applicants for the licenses," O'Brien says, adding that the next step is explaining how they can put themselves in the best position to be selected. That includes considering a "social equity" addition to any application, he says. Twenty percent of the scoring system is based on

that, which means applicants will do better if they include someone who has been unfairly prosecuted for cannabis offenses in the past.

“One of the first questions we ask clients is, ‘Would you qualify? Would anybody in your ownership group qualify,’” he says. “Because theoretically that is going to put you in a more likely position to obtain one of those licenses.”

### Getting started now

In the meantime, professional service firms either built around cannabis or involved in the market indicate much of the preparation will be similar to that for any other type of business, save for the additional regulations that will come with being a cannabis business.

“Cannabis small businesses have to do all the things that you have to do as a normal small business or startup plus the overlay of cannabis regulation,” says Jen Randolph Reise, head of business and cannabis law at North Star Law. “I suggest people start with the fundamentals.”

Figure out what products and services you want to provide. Get a sense for the market. You know, she says, that there is a market, but there also are a lot of competitors starting up. Are you a low-cost provider? More expensive, but focused on higher quality? Retail or manufacturing only?

“As they think about where they fit into the market, they need to do so aware of the 16 different license categories,” Reise says, who adds that the Minnesota law creates opportunities for small businesses because it bans vertical integration for the larger licenses — you have to choose for those licenses if you are going to grow, manufacture or sell. “They want to have a lot of people have a little piece of the industry,” she says.

### Meet someone, build a team

So, as the state works through licensing and regulation details, don’t just sit around waiting. You should start learning about the existing marketplace and what is to come by meeting like-minded people by attending some networking events. Options include Minnesota Cannabis Growers Cooperative and Industry Council (run by Blunt Strategies) or the Minnesota Women’s Cannabusiness Network, says Laura Monn Ginsburg, partner and principal at Blunt Strategies.

Her firm ran the “MN is Ready” campaign pushing for legalization and helped write the bill. She also cautions against getting too swept up immediately in the exciting part of this like what is the brand, the color scheme, the look of the store — those are all important, but “the biggest mistake is overlooking the practicalities and understanding what is going on with the market,” she says.

With the hemp-derived THC market well underway and the adult-use market getting ready to heat up in the months

ahead, it’s never too early to start putting your team together. And, while small business advisers often preach having an experienced team, it’s even more important in the cannabis sector, with a number of still moving parts.

“There are a lot of similarities between the hemp-derived THC market we currently have in Minnesota and the adult use cannabis market,” says Jason Tarasek, an attorney with Vicente LLP, a national cannabis law firm. “There are enough distinctions that it wouldn’t hurt to include people on your team who have actually been through the battle in legal adult markets.”

### Raising capital and tax issues

Vicente helps with corporate formation, corporate structure, scoping potential properties and raising capital. Since federal regulations still classify cannabis as a Schedule I substance, normal banking relationships aren’t possible so, in most cases, at least before cannabis is legalized federally, a lot of that financing will come from friends, family and private equity, Tarasek says.

“This is a capital-intensive project and adult-use cannabis businesses don’t have access to traditional banking channels like other businesses do,” he says. “Most banks will not issue loans to cannabis businesses because it’s too risky. They can’t seize the collateral.”

“There are ways to raise money outside traditional banking channels, but it’s difficult to do on your own,” he adds.

Cannabis’ federal status also means issues with Section 280E of the federal tax code, which prohibits cannabis-based businesses from writing off business expenses on their taxes beyond the cost of the sale of the product.

“They don’t get to deduct their store employees, their store costs, they don’t get to deduct their G and A expenses and, a big component here, they don’t get to deduct their interest expense,” says Cory Parnell, CEO of the accounting firm BGM. “That is the number one problem within this industry ... which leads to a lot of companies going into this undercapitalized.”

### Spend cautiously

Professional service experts caution that business owners should take a slow approach to getting involved in real estate transactions or building leases, at least while there is still uncertainty around licensing.

Local governments can’t opt out of legalized cannabis, but they can, through land zoning, determine where such businesses can be located. Business owners also don’t want to sign a lease and then be stuck with years of payments — challenging, he adds, because landlords are equally reticent to sign leases with a bunch of contingencies.

It’s a delicate balance, industry observers say. Be ready to act quickly, but save your money wherever possible.

“Build your team, get your business plan together, un-



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**JEN RANDOLPH REISE**, NORTH STAR LAW

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derstand your financials and be ready to move,” says Jacob Irving, vice president of consulting services for Bridge West Consulting. “Don’t go rent a piece of property right now because we don’t know which properties are going to be zoned to do that.”

Or at least have a backup plan, O’Brien says. “What is the plan B,” O’Brien says. “If you go out and set up an entity and don’t get a lease space and you don’t get a license, what are you going to do? Are you going to try to go for low potency hemp [where licensing is less restricted]? I try to make it clear to folks there isn’t a guarantee you’re going to get a license so you have to have a fallback option.”

### **Banking exceptions**

While many banks have, at least for now, avoided taking on clients in the cannabis space, there are a couple of local exceptions. One is Bridgewater Bank, which has chosen to learn the business and work with companies in this space.

Damon Alm, assistant vice president treasurer management at Bridgewater, says the industry’s participants are largely small businesses who are in line with the entrepreneurs the bank was initially formed to work with.

“We knew this was something that was coming to Minnesota,” Alm says. “When the Farm Bill went through the first time in 2018, we really started talking to our board and exploring the space.”

It isn’t as straightforward a process as opening a restaurant or a traditional retail store, Alm acknowledges. Due diligence will take a little longer. The screening will be intense.

“We don’t want to cut any corners,” he says. “We want to make sure their business is compliant. We want to make sure that we’re doing business with customers that are in this for the right reasons.”

### **Don’t forget insurance**

While banking and legal issues typically are more top-of-mind, several professional service providers remind small business owners that when it comes to cannabis, insurance

also is vital.

Kimberly Perrine, an agent with the Perrine Agency, focuses on small businesses and fell into cannabis for personal reasons.

“I know that insurance is complicated on a good day,” she says. “You can look at three stores, three coffee shops on the same street and they’re all going to have different needs and they’re all going to have different policies.”

Throw in cannabis and the knowledge that most entrepreneurs in this space aren’t your typical business owners and it’s more so, she says.

“It’s not even on their radar,” she says. “They’re doing it because of their passion.”

But cannabis-based business owners need to consider everything from their label to their storefront to potential theft to accidents when it comes to insurance. Say, for example, you create a product to a retailer who sells it to a consumer. If something goes wrong, you’ll be brought into any legal action. They also need special coverage for their vehicles if out doing deliveries.

Such products are typically excluded from standard policies, Perrine adds. So, much like having a banker, an accountant and a lawyer, she suggests adding an insurance

agent to your team.

“It’s a necessary evil,” she says. “Everybody gets a piece of the pie when it comes to lawsuits and insurance claims.”

### Due diligence

While Blunt Strategies’ Monn Ginsburg agrees with getting a team together early, she also cautions that there are a lot of service firms getting into the business that were less involved in navigating the bill. So, caution is advised. Research their backgrounds, see how involved they have been with cannabis not just now but over the years. Check records and media archives.

“It is going to be useful to find somebody who specializes in cannabis law, cannabis accounting, cannabis business processes,” she says. “You should always do your homework because there are a lot popping up.”



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