

THE BUSINESS OF CANNABIS

Cannabis in the Time of COVID: Where Things Stand and Where they are Going

By PRIYA SOPORI and STEVE STEIN

At the start of the year, the cannabis industry in California was facing growing pains. Licensed businesses were struggling with high tax rates and unfair competition from a rampant and largely unchecked black market.

Then the COVID-19 pandemic hit.

The crisis has placed increased pressure on a fledgling industry. Businesses in the cannabis space, like many others, are facing unprecedented challenges. But it is not all doom and gloom.

Here is our assessment of where things stand now, where they are going and how this crisis could create opportunities for strategic-thinking companies to thrive and grow:

THE GOOD

California Deems Cannabis Retailers “Essential”

It is a sign of how much things have changed that an industry that was illegal in California just a few years ago was one of the few services that California deemed to be “essential” during the COVID-19 crisis. “Because cannabis is an essential medicine for many residents,” the California Bureau of Cannabis Control authorized cannabis licensees to continue to operate, so long as they adopt social distancing measures, follow guidance from the Centers for Disease Control, and comply with local rules and regulations.

Demand for Cannabis is High

Although COVID-19 is inflicting widespread economic pain, it appears to be sparing cannabis retailers. Cannabis sales in California were up significantly in March and April 2020 compared to March and April 2019. Much like alcohol, cannabis seems to be recession-proof.

Restrictions on Cannabis-Related Businesses Appear to Be Loosening

Although cannabis is legal at the state level, most California localities do not allow cannabis-related businesses to operate. The economic downturn created by the COVID-19 pandemic appears to be causing that to change. It is increasingly likely that localities, desperate to make up lost tax revenue and jobs, will loosen restrictions on cannabis-related businesses out of fiscal necessity.

THE BAD

Cannabis Legislation is on Hold

California legislators are understandably focused on the COVID-19 pandemic. Consequently, bills that would help fix problems in the cannabis industry, such as high taxes, have been put on hold.

Deals and Valuations are Down

Although cannabis sales are up in California, deals in the cannabis space have plummeted in 2020 compared to the same time frame in 2019. Valuations also are down due in part to tight capital markets.

A Likelihood of Increased Litigation

Economic downturns often generate conflict and litigation.



With few exceptions, state courts in California are closed due to the crisis but, when they reopen, we expect a surge in cannabis-related litigation.

THE UGLY

Federal Relief is Unavailable to Most Cannabis Companies

Federal programs designed to help small businesses survive this crisis, such as the Paycheck Protection Program, are unavailable to most cannabis companies because marijuana remains federally illegal. California has stepped in, offering a reprieve from certain licensing requirements along with disaster relief. Even still, cannabis companies are on worse footing when it comes to government relief that their non-cannabis counterparts.

Bankruptcy Protection Also is Unavailable to Most Cannabis Companies

In Canada, cannabis companies have started filing for bankruptcy protection. In the United States, most cannabis companies do not have this option because marijuana remains federally illegal. But there is a potential exception: Hemp-related companies might be able to obtain bankruptcy protection because the 2018 Farm Bill legalized hemp-derived cannabidiol at the federal level. There are a few pending Chapter 11 filings by companies in the hemp space that we will be watching closely.

THE PATH FORWARD

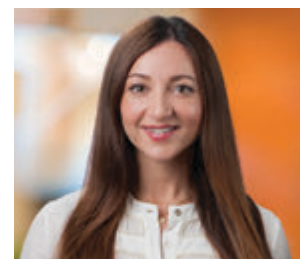
The COVID-19 pandemic is a stress test that we expect will result in consolidation of the cannabis industry. Com-

panies with significant liabilities—or ones that are not well funded—will be forced out of business or acquired. This creates opportunities for larger, better-funded companies to grow by strategically acquiring such companies and/or their assets at favorable prices.

We also expect that, once the dust settles, there will be pressure on California lawmakers to take steps to help the cannabis industry, including lowering tax burdens and increasing enforcement actions against black market operators.

As cannabis businesses navigate this uncertain terrain, they will need counsel who can advise them about the range of business issues implicated by this crisis, including changing COVID-19-related rules and regulations, employment-related issues, litigation, financing and restructuring. Please do not hesitate to contact us for guidance about these or other issues.

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