

Out-of-State, Non-Bank Financing Becomes Available for Washington State Licensed Marijuana Businesses

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Monday, June 20, 2016, was summer solstice. But in Washington, there were two other things to celebrate: a day to recover *after* the Fremont Solstice weekend, and, for legal marijuana businesses, the first day for the licensed marijuana industry to obtain funds from out-of-state financiers under the new rules from the Washington State Liquor and Cannabis Board (WSLCB).¹

This post describes the regulatory framework governing loans to Washington-licensed marijuana businesses and the penalties for noncompliance.

Who qualifies as a financier?

A financier includes anyone making a loan to a licensed marijuana business other than a banking institution.² Effective June 20, the WSLCB has eliminated the residency requirement for financiers, but the WSLCB increased the residency requirement to six months for owners, managers, and others designated as true-parties-of-interest in a marijuana business license that are expecting a percentage of the profits from a marijuana business.³ Simply put, the new rules permit out-of-state financing.

What should lenders designated “financiers” anticipate?

At a minimum:

- Financial and criminal background history investigation; and
- Continued disclosure of source of funds for funds invested in the marijuana business.⁴

In addition, financiers should expect the WSLCB vetting and approval process may take significant time.

When will the WSLCB approve funds?

The new regulations require a marijuana business to obtain WSLCB approval before accepting additional funds from a new or previously approved financier and to pay the WSLCB a \$75 fee for each approval.⁵ As stated above, the financier must continue to disclose to the WSLCB (and obtain approval) the source of funds for all funds it is to invest in licensed businesses.⁶ The new regulations raise several questions. First, how long will any approval process take in view of the WSLCB’s limited funding from the state? Second, will the WSLCB’s approval process be limited to only verifying the absence of criminal history and the source of the funds?⁷ Third, if the WSLCB has approved a financier’s revolving or other loan that may involve a series of loan advances, must the marijuana business obtain approval for each advance’s drawdown? The rule’s text requiring a financier “to continue to disclose the source of funds” demonstrates that if the WSLCB has approved a loan’s maximum loan amount, then that approval should provide approval for all of the loan’s individual advances.⁸ We shall see if the WSLCB construes the rule in this straightforward and reasonable manner.

¹ http://www.liq.wa.gov/publications/rules/Concise_Explanatory_Statement_2015_Marijuana_Legislation_Implementation.pdf.

² Washington Administrative Code (WAC) 314-55-010(10).

³ WAC 314-55-020(6)(b) and -20(10).

⁴ WAC 314-55-020(6)(b), -55-035(3), (5).

⁵ WAC 314-55-120(1).

⁶ WAC 314-55-035(5).

⁷ WAC 314-55-035(5).

⁸ WAC 314-55-035(5).

What are the penalties for violating the financier regulations?

Complying with both the letter and the spirit of the new rules is critical, because any marijuana business violating these regulations risks license cancellation, *even on the first violation*.⁹

A one-size-fits-all penalty seemingly serves deterrence purposes. But is it fair and reasonable? What is clear is one court recently showed little sympathy for a marijuana business violating the rules and later asking for forgiveness.

A Los Angeles medical marijuana business (Progressive Horizon) learned the lesson the hard way. The court granted an injunction barring operations after the business had failed to submit the name of its managers to the city under the limited immunity from enforcement granted in Proposition D.¹⁰ The business cured the violation and asked for forgiveness, but the trial court refused to dissolve the injunction. In May 2016, the appellate court saw it as a categorical decision: "The ordinance does not provide that immunity, once lost, may be restored."¹¹ But the court likely had the discretion to dissolve the injunction.

How will the cancellation penalty actually be applied?

Lawyers regularly warn clients about the Washington state "One-Strike-and-You're-Out" penalty. We hope that the regulators will be circumspect about imposing the cancellation penalties for the same fairness reasons that courts have developed equitable principles modulating various legal rules, including the material breach doctrine and the concept (in Latin) of *de minimis non curat lex* (the law does not concern itself with trifles). Yet, in the light of the *Progressive Horizon* case, merely relying upon fairness can be risky business.

What steps should financiers take when considering a loan to a marijuana business?

First, a new marijuana lender should strive for a positive first impression with regulators and take all steps to be viewed as an honest and careful participant in the legal marijuana business. Second, in view of the cancellation penalty for violating the financier and true-party rules, a financier should determine, as part of due diligence, if the prospective borrower has complied with the financier and true-party rules requiring disclosures and investigation of all of its owners, managers, and all others who are to receive a percentage of revenue from the business.

The second approach to minimizing the impact of section 280E is characterize as many costs as possible as COGS rather than operating expenses.

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⁹ WAC 314-55-530, Group 3 license violations.

¹⁰ *People v. Progressive Horizon, Inc.*, No. B263622, 2016 WL 3185769, at *1 (Cal. Ct. App. May 31, 2016) (construing the Medical Marijuana Regulation and Taxation Ordinance (Proposition D), L.A. Mun. Code, § 45.19.6).

¹¹ *Progressive Horizon* at *4.