

Getting Ready for the Cannabis “Green Rush” in Maine

By Edward J. Kelleher | September 2014

There is a strong prospect that, in 2016, Maine will follow Colorado and Washington state and legalize the sale, production and use of marijuana for “adult” or “recreational” purposes. The legalization of cannabis in Colorado and Washington has sparked a gold rush mentality as entrepreneurs rush to capitalize on the creation of a new market for a lucrative product. If Maine legalizes pot, there absolutely will be money to be made, but understanding the trends and currents of this emerging sector will go a long way toward sorting the winners from the also-rans.

Follow the action in Colorado and Washington.

If Maine legalizes marijuana for recreational use, it will need to develop a system for licensing growers and sellers, and for regulating the sale of products. Maine policy makers will surely look to the experiences of Colorado and Washington for guidance; those states took very different approaches to their legal marijuana regimes. Colorado built its recreational marijuana distribution system on the back of its medical marijuana system, which was well developed and highly regulated. Washington’s medical marijuana system was loosely regulated, and so Washington decided to construct a regulatory system for recreational pot from the ground up. The outcome in Washington was a long regulatory development process, which resulted in a long lag between legalization and the start of retail sales. Thus, marijuana entrepreneurs in Washington had a much longer wait before their proposed businesses could begin producing revenue. The Colorado system requires vertical integration of the distribution system (meaning that retailers need to grow and process the products they sell) whereas Washington prohibits vertical integration. There are many more subtle differences between the two states; these kinds of distinctions require different business planning responses. Regulatory subtleties like these will dictate how, where and when money can be made in a Maine cannabis market.

Keep a close eye on the Feds.

Marijuana is a completely illegal drug under federal law. It remains a Schedule 1 substance under the U.S. Controlled Substances Act, which means that in eyes of the federal government, marijuana is considered as dangerous as heroin. Every person growing

and selling marijuana in any state where it’s legalized, either medically or recreationally, is committing a federal felony. The Obama Administration has taken a cautiously hands-off stance toward the Colorado and Washington experiments, in essence telling local federal prosecutors to prioritize things like gang related marijuana trafficking, growing on public lands, prevention of violence in the cultivation of marijuana and distribution to minors, and to leave the rest to local government.

However, that stance is discretionary, and subject to reversal at any moment, or, importantly, by a future President hostile to legalization. It also leaves a lot of room for interpretation. Any pot retailer in Denver or Seattle can get raided by the feds at any moment, and state government couldn’t do much to stop it. The same would be true in Maine, unless the federal government re-classifies marijuana, or unless it acts to explicitly permit state level legalization. There have been some signs of motion on this issue, as public opinion turns more definitively in favor of legalization, such as bills which limit how federal law enforcement resources can be spent against medical marijuana producers. Some of these bills have attracted noticeable bi-partisan support. That being said, we are a long way from national de-criminalization, and thus, keeping an eye on the federal government’s attitude is critical.

There is a strong prospect that, in 2016, Maine will vote to permit recreational use of marijuana.

Don't be a "bad boy".

If you want to go into the cannabis business in Maine, you're going to need some form of a license from the state – getting that license is the whole ballgame. Without it, you're a spectator. Getting that license will almost certainly involve going through criminal background checks. Those background checks will apply to everyone in the ownership and management structure of a cannabis business, so you need to be thoughtful about with whom you partner. You're also going to be expected to strictly comply with the regulations and laws that govern your license, and so is everyone else involved with your business. The states which legalize pot are going to want to run tight ships, to avoid both federal scrutiny and a political backlash at home. A Colorado "edibles" producer recently lost its license because it had a major contractual relationship with another company, and that other company ran afoul of Colorado's licensing rules. So you're likely to be held accountable for everyone who has a role in your business, owners, managers, employees and even contractors.

And it's not just a licensing issue. Until full nationwide legalization the cannabis business will be operating in a legal gray zone. Investors, lenders, and other important players in this market want to minimize the risk that comes from working in that kind of arena, and thus, there will be a premium on transparency and scrupulous compliance with laws and regulations.

Understand the complicated financial issues.

Money earned from growing and selling marijuana is considered "dirty" money in the eyes of the federal government. This means it's hard to get a bank to accept the money a marijuana business makes for deposit. Banks are concerned that taking money from a marijuana business will cause them to violate various federal money laundering laws. Thus, most pot businesses in the U.S. operate on a cash basis. The drawbacks are obvious. Security is a huge concern when large amounts of cash; it creates accounting nightmares; in an on-line world, it's hard to pay bills without an account of some kind. There really is no good solution to this issue right now; the U.S. Treasury issued guidance in February 2014 allegedly

designed to help banks provide services to marijuana-related businesses, but the requirements the Treasury wants to impose were widely viewed as cumbersome and unworkable. Many cannabis businesses have to resort to things like money orders to pay bills.

Tax issues are difficult as well. Due to a 1970's war-on-drugs era tax code provision, cannabis producers are prohibited from deducting the expenses of their business operation from their taxable income. Thus, cannabis businesses essentially pay tax on their gross revenue, not just on their profit. There are ways to mitigate the effects of this rule, but courts have only recently begun to scrutinize these techniques so there is some uncertainty as to their viability.

Consider "ancillary" businesses.

There's a line about how in a gold rush, the best business is selling picks and shovels; it gets repeated ad nauseum in reporting about the marijuana business. The "picks and shovels" sector of the pot business is referred to as the "ancillary" business sector, and it includes things like testing labs, security companies, point-of-sale and inventory management software companies, hydroponic equipment and a wide variety of professional services. One web-based start-up, Leafly.com, a kind of Yelp for the medical marijuana market, has already been acquired by a cannabis-targeted hedge fund. Venture capital investors are much more willing to invest in these ancillary businesses since they are generally considered legally safer under federal law. A new industry like cannabis will require an extensive infrastructure to function successfully, so many of these ancillary businesses will thrive, and may be a good way to get a foot in the door to this new industry,

Lots of money will no doubt be made right here in Maine as we move into an era of marijuana legalization – but not everyone can be a winner in this new market. Watching the kind of trends I talked about here could be critical in positioning yourself for success.

This memorandum does not constitute legal advice. It is critical to consult with an attorney about the specifics of any proposed course of action relating to cannabis-related business activities. Importantly, marijuana possession, use, cultivation and sale are crimes under federal law, regardless of what any state law allows. Nothing in this memo can or should be construed to constitute a recommendation or advice that any person take actions that may violate federal law.

If you have any questions about any of the topics discussed in this advisory, please contact your Drummond Woodsum attorney.



Edward J. Kelleher

207.253.0587

tkelleher@dwmlaw.com

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