

CANNABIS

The recreational use of marijuana was legalized in Massachusetts in 2016, with some adjustments to the guidelines in 2017. That law and the issues surrounding it can be complex and can change depending on the town or municipality. Questions like location, to hiring to banking are just a few of the important topics. The Boston Business Journal talked with some local professionals who have first-hand insight into the ins and out of cannabis – both the opportunities and challenges in this new area of business.

BBJ Market President & Publisher Carolyn Jones talked with attorneys Andrew Myers of Davis Malm and Brian Falk of Mirick O'Connell as well as Mitzi Hollenbeck of CPA firm Citrin Cooperman and Gary Vierra, Chief Risk Officer of Baycoast Bank to get their experienced views of how to navigate this new and somewhat controversial business area.

BBJ: Let's begin with an overview from each of you as to the evolution of the cannabis industry.

ANDREW MYERS: It began with a lot of local entrepreneurs working within a heavy regulatory overlay. Very quickly it expanded to include several out of state players that supported these local entrepreneurs in providing financing and expertise for cultivation, production and retail. So it's become more corporate as the industry evolved and more recently expanded to include things like transportation and the need for distribution.

BRIAN FALK: From the local perspective I've been surprised how fast the evolution has gone from this industry being new and exciting and perhaps scary depending on your perspective to being a part of the business community. If you had told me in October of 2016 that in the spring of 2019 there would be a marijuana retailer open that got

a unanimous vote of the city council on a special permit I would have told you you were crazy. But that happened.

MITZI HOLLENBECK: I think that the biggest draw for a lot of municipalities was when Northampton – the first to open -- received their first check.

That I think alleviated some of the fears. They were concerned from a community perspective about what was going to happen when these businesses came into their cities and towns. But all the municipalities are starving for money. And I think when you look at the taxing scheme of candidates in Massachusetts you know there is some movement as to what's going to happen in the future. The fact that 17 percent goes to the state and only 3 percent of that goes to the municipality is causing some issues with the host community agreements. We're still in the infancy stages here in Massachusetts.

BBJ: Gary, from the banking perspective– what has been evolution as you see it?

GARY VIERRA: What's interesting from a banking perspective is that the regulation was set early on. We had the Cole Memo which set the enforcement

priorities for the Department of Justice. And a year later the second memorandum came out with guidance for banking marijuana companies. The problem we have on our end is just the lack of financial services that are available to these companies so everybody wants to get on board at once. We really have a measured approach to bringing businesses onboard.

BBJ: What do you see as the largest business challenges that cannabis companies are facing?

MITZI: The biggest challenge that these businesses tend to face relates to the taxing structure of these companies. If you are a licensed marijuana entity you are trafficking in a controlled substance. You're subject to the controlled substances act which dictates that you can't have any deductions or credits allowed for any ordinary and necessary business deductions. What does that mean for these companies? If you're a dispensary what happens is that the people that are ringing your register, your rent, your utilities, those are non-deductible expenses from a business perspective. In these mature markets, what happens is that this code section called 280E doesn't allow for any deductions (it allows for an adjustment to income which is cost of goods

sold). It allows for an adjustment to income which is cost of goods sold but what happens there is that these companies are going out of business because they're not able to pay their taxes. That's a huge issue for this industry. And certain states have decoupled from 280E -- like Massachusetts has a bill that's being debated right now in the legislature. Until something happens at the federal level we have a huge tax issue.

ANDREW: That also impacts the type of structure that a business should contemplate when they're entering into this industry. A lot of young businesses like to organize as an LLC taxed as a partnership which means it's a flow through entity. And people personally pay taxes based on their percentage of ownership. Many clients we advise choose to organize as a C corporation which is taxed as a separate entity and could isolate unanticipated tax. That is a question that operators need to consider.

ANDREW: But the other challenges are some of the challenges that any business might have but again they're condensed in time. They need to raise capital. They need to deal with the local permitting issues which are heavy in this business. People are getting into the industry because there's pent up demand and they see the opportunity but local permitting and state regulations, are burdensome on these operators. Unless entrepreneurs really understand the industry and become experts themselves it can be difficult to navigate all those challenges.

BBJ: It's a lot more complex than they might think. So Gary or Brian, thoughts on that?

BRIAN: Access to capital is also a huge issue especially for a smaller operator. In many cases, unless they want to work with a large operator and enter into some sort of management partnership agreement that takes away a lot of their independence and local control that's really their only option if they don't have their own means to fund the business.

GARY: The challenges on the financial services side are pretty obvious for the actual cannabis related businesses. They're dealing primarily in cash. They're paying their bills in cash. We've got people walking around with backpacks full of cash to pay their rent, their taxes and so forth. But what happens is there's a domino effect. So as these businesses pay other businesses that support them whether it be supplies or professional services, etc., those businesses have accounts and they're depositing their cash.

BBJ: What are the principal challenges for that local owner-

operator as opposed to the larger corporate entities that are coming in?

GARY: We talked about the local permitting issues. Finding the right place to start your business and getting community acceptance of that. The local issues are the first. The regulatory issues are the second, the Cannabis Control Commission is moving fairly slowly now. They have a lot on their plate. Plus they have enforcement. So they're doing a good job in a very challenging environment. I would say forming alliances, particularly for a business that is not vertically integrated. So if you have just a dispensary or just a processor or manufacturer of cannabis you need to form alliances with other businesses to sell your product and to distribute your product. And then you have to recruit good people, both experts and in particular areas such as cultivation but also you know just recruiting good personnel to work for you.

MITZI: There's a long term strategy that I think needs to be considered. An issue is that you can't sell across state lines. So the supply and demand need to match in Massachusetts. And once those challenges come to fruition, and the basic economics, like there is too much supply, or there's not enough demand, - the smaller operators are not necessarily able to withstand those. That's when you'll start to see more consolidation in the event that it's allowed under the regulatory environment. So there's an opportunity now. There's also a valuation issue in the industry. But we'll start to see that some of the smaller players just won't have the ability unless they really brand something whereby people are loyal to their brand. And we still have a black market issue. And we have, you know, the ability to grow at home. So there's additional opportunity here for the smaller operators to really be pushed out of the business.

BBJ: What are the primary issues at the municipal level?

BRIAN: Under the current statute, at the beginning the municipalities are in the driver's seat. You can't even apply for a CCC license without a host community agreement. And there's really not a whole lot operators can do if they're having trouble negotiating those community agreements.

ANDREW: As Brian mentioned the first issue is finding a site. This initially means finding a community that hasn't banned cannabis. Then within that community there are only certain districts or zoned areas that allow you to open up a marijuana establishment. And the third challenge is to find a piece of property within that district that you can buy or rent.



BRIAN R. FALK

Of Counsel, Mirick O'Connell

Brian is a municipal and land use attorney in Mirick O'Connell's Public and Municipal Law Group and Land Use and Environmental Law Group.

In his municipal practice, Brian counsels towns, cities, and districts in all areas of municipal law, including home rule, land use, real estate, elections, finance, taxation, procurement, public construction, and general governance. Brian advises local officials on compliance with the Open Meeting Law, Public

Records Law, and Conflict of Interest Law, and has extensive experience drafting town meeting warrants, bylaws, ordinances, and special legislation.

Brian also represents private clients in land use permitting matters and real estate transactions. He regularly appears before municipal boards seeking special permits, variances, licenses, and other local approvals.

In 2014, 2015, and 2016, Brian was named a Massachusetts "Rising Star" by Boston magazine and Law & Politics. Brian previously served on the Milford Zoning Board of Appeals.



MITZI HOLLENBECK, CPA, CFE

Partner, Cannabis Advisory Services Practice Leader

Mitzi Hollenbeck is a partner in the firm's Rhode Island office with over 15 years of experience providing accounting and audit services, tax planning, business consulting, and forensic services. Mitzi has a unique perspective on the cannabis business, being an elected official in the town of Lakeville, MA, where she is able to understand the local regulatory challenges facing this industry. Having established a network of cannabis advisors, Mitzi is able to translate her knowledge to the needs of this unique industry

as the industry evolves and provides industry experience from working with actual growers, distributors, and applicants who have already navigated these waters. She has experience working with cultivators, dispensaries, cannabis transportation companies, and cannabis-related businesses in both the United States and Canada.

Mitzi is a member of the American Institute of Certified Public Accountants (AICPA), Massachusetts Society of Certified Public Accountants (MSCPA), and Association of Certified Fraud Examiners (ACFE).

Mitzi holds a Bachelor of Science in Accounting from the University of Massachusetts, Dartmouth, and a Master's in Accounting from the University of Connecticut. She is a Certified Public Accountant in the Commonwealth of Massachusetts and a Certified Fraud Examiner.



ANDREW MYERS

Shareholder, Davis Malm

Andrew Myers is a shareholder in the Boston law firm of Davis Malm, practicing in the Business Law area. For over 25 years, he has represented emerging businesses in corporate, finance and securities matters, including mergers and acquisitions, public and private financings, venture capital transactions and joint ventures. His clients operate in a wide range of industries, including software, advanced materials, medical devices, manufacturing, computer peripherals, internet commerce, consumer products,

service industries, distribution, entertainment, and cannabis, among others. Andrew obtained his J.D. from Boston University School of Law, his M.B.A. from Boston University Graduate School of Management, and his B.A. from Colby College.



GARY J. VIERRA

Senior Vice President, Chief Risk Officer, BayCoast Bank

Vierra joined BayCoast Bank in September 2015 as Senior Vice President and Chief Risk Officer, assuming responsibility for risk management, compliance/BSA, audit, information security, and physical security for all business units and subsidiaries of the \$1.8 billion savings bank. As a member of the senior management team, he works closely with management, the Audit Committee, and Board of Directors in all matters related to risk management and compliance. Vierra is highly experienced in the fields of finance, operations,

information technology and risk management. He has been part of the senior management team at three financial institutions over his 38 year banking career. He held executive level positions at BankFive in Fall River, the former Slades Bank, now part of Rockland Trust, and the former First Federal Savings Bank of America, now part of Webster Bank. Vierra holds a Bachelor of Science in Business Administration with a concentration in Accounting and a Master's in Business Administration, both from Bryant University. Married with three children, Vierra resides in Cranston, Rhode Island where he is active in church and civic activities, most notably as a Founding Director and Treasurer for the Argosy Collegiate Charter School in Fall River, Massachusetts. He has also served in various leadership roles with the Boy Scouts of America for 16 years.



Mitzi Hollenbeck, CPA, CFE, Partner, Cannabis Advisory Services Practice Leader, Citrin Cooperman; Gary J. Vierra, Senior Vice President, Chief Risk Officer, BayCoast Bank; Andrew Myers, Shareholder, Davis Malm; Brian R. Falk, Of Counsel, Mirick O'Connell.

MITZI: In my town, Lakeville, we zoned all license types into the industrial zone and that happened through the Town Meetings. We went through all the public hearings, but then what happened is at the fall Town Meeting there was a citizen's petition to ban retail sales in the industrial zone. In the end the petition failed, but the point is the back and forth the business planning can experience.

BRIAN: You really need to understand where municipalities are coming

from. We have the Cannabis Control Commission that has a sole charge of fostering and regulating this industry. The 351 municipalities have a much different scope. They're there to govern a community, to provide local services and to find a way to fund those local services. Cannabis is one of 100 some odd things on municipal officials' plates on any given day.

I find that the applicants that move through quickly find a way to make themselves a priority but not a problem. And that can be a delicate

dance. But that comes from getting a sense of what the municipal officials' priorities are.

BBJ: Gary, your organization made that decision to bank for cannabis. How did that structure come about and what do you see as some of the challenges.

GARY: This actually was a board initiative. The board staying true to the bank's mission was that they felt that there was a sector of the communities that we serve that

were unbanked. Before we did move forward we looked at the various risks. Initial ones were legal and compliance. So once we got good intelligence we developed a program that we wanted to put in place. There's a heavy regulatory burden and compliance burden there. What we did is centralized the oversight both from a compliance and from a customer contact perspective. You needed to find people who had experience on the compliance side in dealing with compliance issues but also could talk to a customer. So it

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was a unique situation to be able to staff that department.

Many of the owners and managers have experience in growing and selling and manufacturing cannabis but they don't have a basic financial background. We are able to help them with that.

BBJ: What are the unique challenges and the risks that are associated with representing and advising cannabis industry clients?

BRIAN: So Mirick O'Connell is 103 years old and by nature relatively conservative. I led us into cannabis because of my municipal work. We had to do it anyway because we had to represent towns and cities who were doing it. But it led to other opportunities as well. First and foremost it's still illegal at the federal level. As lawyers we have to deal with the fact that we're advising clients on something that's illegal at the federal level. The Board of Bar Overseers has put out a policy that as long as attorneys are advising on compliance with state law and legal activities at the state level and also advising the clients about the federal level issues, we're not at risk.

MITZI: The Massachusetts Board of Public Accountancy came out and said that "we won't consider servicing the cannabis industry as

an Act Discreditable making the determination that you are not doing something that's unethical by servicing businesses that are in the cannabis space." So you know once we got kind of the green light to do that we were comfortable moving forward.

The issue is that these businesses really need our help. And they need good qualified accountants. And they need good qualified attorneys and professional services. Because otherwise if they're trying to navigate their way through this regulatory environment on their own they're going to run into things that they never expected.

GARY: We had to reach out to our insurance company service provider for data processing and so forth to get their buy in before we could move forward. We balance the level of customer service with the compliance requirements.

ANDREW: Individual clients in the cannabis space come to us with various levels of sophistication. And it is a very sophisticated practice area because clients need capital, and they must comply with state and local regulations. It's an education. Entrepreneurs must be prepared for the long road ahead and understand and have a proper appreciation for the overall business challenges that they'll face.

BBJ: How do each of you see the landscape of the industry changing in the next two to five years?

MITZI: I think what you'll start to see is the ancillary businesses, certainly the packaging companies, the construction companies, the insurance companies, the professional services companies -- they will always kind of have a steady stream of additional revenue that happens to be coming from the cannabis industry. Some of the local operators I think are going to start to fail. Probably by the time you get to year five. It depends on how quickly the licenses are issued. And where the regulations go in terms of consolidation and ownership limitations on numbers of licenses. We've seen a lot of the evolution of the industry already. Just as it moved from medical to adult use, the industry still has miles to go.

GARY: In addition to what Mitzi had said, the thing that we're seeing and that's actually impacting us already is we've had a consolidation of the industry even before the licenses are granted. So we have a number of businesses that we underwrote and before they even started selling or manufacturing or growing they had agreements to be purchased by national companies. And I think there's a struggle right now because the spirit of the law that was passed

is that there be a focus on women and minority owned businesses and also people who were in areas that were impacted negatively by past marijuana laws. The challenges for them is that they don't have the resources that the national companies do to really start up these businesses. So that creates a real problem and there's very limited lending opportunities for them to go to. They have to depend on personal or investment money.

ANDREW: There is going to be continued expansion both in the number of licensees and different market segments -- some of which we've touched upon. Maybe wholesaling, home delivery. There are platform technologies, software technologies that allow people to order at home that haven't started yet but will be coming into play.

BRIAN: The only thing I'd add is if and when social consumption becomes a reality I think that will have a big impact. I don't think it's going to change the industry so much but it will change the perception and the visibility of the industry.

The BBJ will have more Table of Experts programs on other topics and if you are interested in participating, please contact the BBJ advertising department at 617-316-3220.

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