

The Impact of COVID-19 On State-Legal Cannabis Companies

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Client Advisory

March 26, 2020 by Alexander G. Malyshev

The ongoing COVID-19 pandemic has many individuals and businesses, both small and large, coping with an uncertain future. State-legal cannabis companies in the United States must deal with the added complexity of continuing to operate in violation of federal law, and with everything that entails.[1] Because the response to the outbreak has mostly been financed by the federal government, where cannabis activities are illegal, but administered on a day to day basis by states that permit cannabis activities, state-legal cannabis operators must navigate uncharted waters in determining what assistance is available to them. The situation is quickly evolving, but we highlight some of the issues here.

A. Some States Have Deemed Medical Cannabis Operators As “Essential,” Allowing Them To Operate During The Outbreak

Several states, including hard hit New York, New Jersey, and California, have enacted some form of quarantine shutting down physical locations of all businesses deemed “non-essential” to promote social distancing. States have taken different approaches to administering these shut downs (for example, New Jersey focused on retail and entertainment, while others such as New York focused on the entire state economy).[2] Under either approach the retail operations of cannabis dispensaries are implicated.

New Jersey’s Executive Order 107 allows “alternative treatment centers” and medical marijuana dispensaries to remain open, subject to adherence to social distancing guidelines.[3] New York’s Department of Health provided guidance, prior to New York’s 100% workforce reduction, stating that “[i]n the event non-essential businesses are forced to shut-down due to COVID-19, Registered Organizations in the Medical Marijuana Program will be considered essential and allowed to remain open because they are considered medical providers” by New York.[4] New York also relaxed, to an extent, regulations about how medical cannabis is dispensed, allowing at the door (e.g. curbside) pick up, so long as other regulations are followed (including the requirement that dispensing be done on camera), and allowed home delivery (currently effective and through April 16, 2020) to promote social distancing.

The non-profit National Organization for the Reform of Marijuana Law (NORML) maintains a state-by-state summary of the impact of COVID-19 on cannabis operations (including whether states now allow curb-side or delivery options).[5]

B. Financial Lifelines May Not Be As Readily Available

For businesses, a major component of the response to the financial impact to the state imposed closures and social distancing requirements has been the expansion of the U.S. Small Business Administration’s Economic Injury Disaster Loan Program.[6] The Small Business Administration (SBA) will work directly with state governors to provide targeted, low-interest loans to small businesses and non-profits that have been severely impacted by the Coronavirus (COVID-19). The SBA’s Economic Injury Disaster Loan program provides small businesses with working capital loans of up to \$2 million, which can provide vital economic support to small businesses to help overcome the temporary loss of revenue they

are experiencing.[7] The program is set to be expanded by the Coronavirus Aid, Relief, and Economic Security (CARES) Act if it is signed by President Trump, by (among other things) relaxing its requirements.

Separately, the CARES Act is set to create a lending facility for small businesses (of up to 500 employees), in the form of forgivable loans of up to \$10 million to help them meet their payroll, rent, and utility obligations.[8]

Because cannabis remains illegal under federal law, it is unlikely that cannabis related businesses will be able to take advantage of these programs. Legislation was introduced, in June of 2019, to allow cannabis companies to access the SBA programs (including specifically the Disaster Loan program in Section 4).[9] It was referred to several committees in July, but has not advanced.

Cannabis related businesses should look to state specific programs that may provide capital independently of the SBA. For instance, New Jersey's Economic Development Authority (NJ EDA) set up a resource page to address COVID-19's impact on small businesses and non-profits, and has a number of existing loan programs available to small and mid-size businesses.[10] The state's resource page indicates that New Jersey is currently working on additional programs to address the economic impact of the outbreak.[11] In New York the Department of Financial Services has released guidance to regulated lenders encouraging them to work with all impacted businesses.[12]

At best, these state-level programs will provide temporary forbearance of obligations and, without the availability of federal assistance, businesses without sufficient capital reserves will not survive (despite the apparent uptick in business from the "stockpiling" of cannabis products provided at the outset of the outbreak). Dealing with the fallout will be all the more difficult because bankruptcy protection is largely unavailable for cannabis and cannabis related companies under the U.S. Trustee's current approach to objecting to any reorganization plans on the grounds of federal illegality.[13]

C. Legislation Meant To Help Workers During The Outbreak Will Disproportionately Harm Cannabis Businesses

The disproportionate impact of legislation meant to help workers stems from cannabis companies' inability to receive tax relief designed to partially offset additional costs to businesses. The Families First Coronavirus Response Act ("Families First Act"), mandates that all employers with fewer than 500 employees provide paid sick leave to employees who are unable to work (or telework) because of the following COVID-19 related conditions:

1. The employee is subject to a quarantine or isolation order by federal, state, or local government;
2. The employee has been advised by a health care provider to self-quarantine;
3. The employee is experiencing symptoms of COVID-19 and seeking a medical diagnosis;
4. The employee is caring for an individual who falls under category 1 or 2, above; or
5. The employee is caring for a son or daughter whose school has been closed (elementary or secondary only) or the child care provider is unavailable to provide care due to a governmental order.

Under the act, full-time employees are entitled to up to 80 hours of sick time, and part-time employees are entitled to sick time that equals the number of hours that such employee works, on average, over a 2-week period. The total amount that an employee may receive is capped at (i) \$511 per day or \$5,110 in total for an employee who takes leave due to categories 1-3 above, or (ii) \$200 per day or \$2,000 in total for an employee who takes leave due to categories 4-5 above.[14]

The added costs of mandatory federal paid sick leave during the outbreak is supposed to be offset (to an extent) by a corresponding refundable tax credit. However, Section 280E of the Internal Revenue Code ("IRC") provides that "[n]o deduction or credit shall be allowed for

any amount paid or incurred during the taxable year in carrying on any trade or business if such trade or business (or the activities which comprise such trade or business) consists of trafficking in controlled substances (within the meaning of schedule I and II of the Controlled Substances Act).” This would leave cannabis businesses having to cover the costs of the additional sick leave without the corresponding refundable tax credit. However, the owners of such businesses may want to discuss with their tax professional whether the business can claim this credit to the extent the business can show the credit to be a reimbursement of costs/expenses that are properly includible in “cost of goods sold” (which is not prohibited by IRC Section 280E).

Conclusion

The situation is quickly evolving, so this advisory should only serve as a starting point. New programs may be announced, in part based on how this situation evolves. However, once again, cannabis businesses are stuck between a rock and a hard place as a result of their federal illegality.

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For more information concerning the matters discussed in this publication, please contact the author **Alexander G. Malyshev** (212-238-8618, malyshev@clm.com), or your regular Carter Ledyard attorney.

[1] For a general overview of some of these unique challenges see our advisory titled “Despite the Trend Towards Legalization, Challenges Remain for Investors Considering Investment in State-Legal Cannabis Industries,” *available at* <https://www.clm.com/publication.cfm?ID=5647>. Additional, issue specific analysis, can be found on our practice page: <https://www.clm.com/practice/cannabis>.

[2] For our analysis of New York’s order, see “On-Site Workforce Restrictions for “Non-Essential” Businesses in New York State” *available at* <https://www.clm.com/publication.cfm?ID=5684>. For our analysis of New Jersey’s order, see “New Jersey Adopts COVID-19 Executive Orders as Part of Regional Responses” *available at* <https://www.clm.com/publication.cfm?ID=5688>. All of our analysis on the impact of COVID-19 legislation is available in our toolkit: <https://www.clm.com/practice/coronavirus>.

[3] See EO 107, ¶6(b). *Available at* <https://nj.gov/infobank/eo/056murphy/pdf/EO-107.pdf>. Executive Order 108 overrides all inconsistent municipal ordinances. See <https://nj.gov/infobank/eo/056murphy/pdf/EO-108.pdf>.

[4] See “Novel Coronavirus (COVID-19) Guidance for Registered Organizations,” *available at* <https://mjbizdaily.com/wp-content/uploads/2020/03/RO-Covid-19-Guidance.pdf>.

[5] See <https://blog.norml.org/2020/03/25/more-states-taking-action-to-ensure-uninterrupted-retail-access-to-medical-cannabis-during-covid-19-outbreak/>.

[6] See <https://www.sba.gov/page/coronavirus-covid-19-small-business-guidance-loan-resources>.

[7] These loans carry an interest rate of 3.75% for small businesses. Loan repayment terms vary by applicant, up to a maximum of 30 years. They may be used to cover accounts payable, debts, payroll and other bills COVID-19 has affected the ability to pay. While Economic Injury loans are available for amounts of up to \$2,000,000, the actual amount of each loan is limited to the economic injury determined by the SBA, less business interruption insurance and other recoveries up to the administrative lending limit.

[8] See "COVID-19: Federal, State and Local Resources Available to Small Businesses and Non-Profits Dealing With the COVID-19 Outbreak" (updated March 26, 2020), *available at* <https://www.clm.com/publication.cfm?ID=5690>.

[9] See "Ensuring Safe Capital Access for All Small Businesses Act of 2019," H.R. 3540 <https://www.congress.gov/bill/116th-congress/house-bill/3540>.

[10] See <https://www.njeda.com/about/Public-Information/Coronavirus-Information>.

[11] <https://faq.business.nj.gov/en/articles/3789888-what-programs-are-being-developed-by-the-state-to-support-businesses-that-are-financially-or-operationally-impacted-by-the-outbreak>.

[12] See "Guidance to New York State Regulated and Exempt Mortgage Servicers Regarding Support for Borrowers Impacted by the Novel Coronavirus (COVID-19)," (March 19, 2020) *available at* https://www.dfs.ny.gov/industry_guidance/industry_letters/il20200319_coronavirus_mortgage_relief; "Guidance to Department of Financial Services ("DFS") Regulated Insurance Entities Regarding Support for Consumers and Businesses Impacted by Novel Coronavirus (COVID-19)," Insurance Circular Letter No. 7 (March 19, 2020) *available at* https://www.dfs.ny.gov/industry_guidance/circular_letters/cl2020_07.

[13] See "Cannabis Businesses in Bankruptcy," *Client Advisory*, June 26, 2019. *Available at* <https://www.clm.com/publication.cfm?ID=5660>.

[14] See "Summary of Recent Federal and New York State Legislation Providing Paid Sick Leave in Response to the Coronavirus Pandemic," *Client Advisory* March 20, 2020. *Available at* <https://www.clm.com/publication.cfm?ID=5683>.

Carter Ledyard has created a COVID-19 Response Group to monitor the evolving legal landscape, address client questions and ensure client compliance with the laws and regulations issued in response to the COVID-19 pandemic. The Carter Ledyard COVID-19 Response Group consists of Jeffery S. Boxer (212-238-8626, boxer@clm.com), Judith A. Lockhart (212-238-8603, lockhart@clm.com), Bryan J. Hall (212-238-8894, hall@clm.com), Alexander G. Malyshev (212-238-8618, malyshev@clm.com), Melissa J. Erwin (212-238-8622, erwin@clm.com), and Leonardo Trivigno (212-238-8724, trivigno@clm.com). Clients should contact the attorneys listed above or their regular CLM attorney for any questions concerning legal obligations arising from the COVID-19 pandemic.

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