Hilary Bricken  00:06
Everybody, I'm going to give us a few seconds, maybe a minute or two for everybody to log in over 400 people registered for this webinar, which should tell you something. m&a is hot, hot, hot right now in the cannabis industry and has been for some time. 2021 basically broke some very interesting records around acquisitions, a lot of consolidation 2022 shows no signs of slowing down. And even more states are going to come online with medicalization and even don't use via their legislatures. And then, of course, November ballot initiatives. But today on this panel, the four of us I will moderate. This is Hilary Bricken, and I'm coming to you from our LA office. We're going to talk about corporate cannabis, relative to mergers and acquisitions. And instead of having individual canned presentations between our three speakers, it's really going to be more of a q&a dialogue based on the questions that you submitted beforehand, and really the questions that we have for each other based on experience and recent dealmaking across the country, to be honest, so I'll let each of our panelists introduce themselves in turn, and then we'll go ahead and get into the questions. I'd like to start with my colleague and partner in our Portland Oregon office, Vince Sliwoski

Vince Sliwoski  01:19
Hey, everybody, thanks for tuning in. My name is Vince, thanks for the intro. Hilary. I am here in Portland. I'm a business and real estate commercial real estate lawyer. I've been doing cannabis work almost my whole career. Since 2010, or 11. I think it's when we picked up our first medical cannabis clients here in Oregon. And we yeah, we've done a ton of m&a in the last, I'd say three to four years in Oregon. That's when the market really heated up. And I've worked on a lot of those transactions with with Nathalie, who's licensed here. And also Griffen is licensed in California. So look forward to it. And I'll let those guys self introduce as well.

Hilary Bricken  01:56
Yeah, Griffen, why don't we move to you for your intro?

Griffen Thorne  01:58
Hey, everyone, I'm Griffen. I'm the lawyer and Harris Bricken LA office. I started off my career litigating business and IP disputes moved into privacy law. And now do exclusively corporate work. We represent lots of cannabis companies. A large part of the corporate work I do is finance related, some real estate, and then m&a which is really those are the three areas I practice on most. I've worked a lot with Hilary events. And even Nathalie m&a transactions all over the West Coast, and specifically in California. So I’m here to answer any questions and just give everyone the rundown.
Hilary Bricken 02:40
Nathalie, why don't you submit your intro?

Nathalie Bougenies 02:43
Yeah, I am currently based on the East Coast, I really relocated here a few months ago, I was working out of the Portland office and been working with Vince for almost four years now on all of these transactions, and hopefully pretty soon my colleague Simone who was in New York, and I will get to work on these deals with clients who are on this side of the country.

Hilary Bricken 03:10
Fair enough. I'm going to go ahead and kick off our panel because we only have an hour today. And just as a reminder to everybody that's tuned in, please feel free to submit your questions during the webinar, I will see them I will ask them if there's time. And as long as they're relevant to the to the topic, you can rest assured I will do my best to get to them. I too, have done a ton of m&a in the space. In California in Washington. In 2020, our firm closed over a million dollars transactions, which was pretty outstanding for a firm of our size. That's how busy things are in the m&a department. So without further ado, we're basically going to take it from top to bottom with both business purchases and asset purchases and what we see in a variety of states because they're not all the same. And the first question that I have for the panel, and anybody feel free to take this. Do you need a letter of intent in place before you sell your licensed cannabis business?

Nathalie Bougenies 04:10
Yes, I'll take that one. I'd say depends if you're just selling a naked license where the terms are pretty straightforward, and it's just a matter of agreeing on the purchase price. And then the the payment methods. If you're using an escrow agent, for instance, then I generally don't see the need to incur legal expenses and wait, you know, to start drafting an asset purchase agreement. So that's typically what we'll advise clients who are just selling a license now if you're also selling equipment inventory or if there is real estate that's also involved, where the terms are a little bit more complex, and you have to agree on many more issues than I think a letter of intent can make sense. Also, if you're using binding provisions and LOI, that's a way to make sure that, you know, no one is looking elsewhere and that you're moving forward with this particular buyer. Until really, you draft the final agreements and then execute them. So yeah, in a nutshell, that's what I would recommend for otherwise.
Hilary Bricken 05:23
Very good. And then as far as the commonality of structures, we get this question a lot. A lot of folks in the cannabis industry have not actually engaged in m&a, pretty much ever. So they want to know off the bat, whether the buyer or the seller, what are the common structures that we're seeing in the marketplace, probably in the last few years for these m&a deals.

Griffen Thorne 05:45
I'll take that one. So it's sort of the rip off who wouldn't lose saying, we m&a encompasses both mergers on one hand, and acquisitions on the other mergers when two businesses combine and one of them survives with all the two combined businesses essentially, acquisitions when people are accompanied by another company, right. And so acquisitions and also the asset acquisitions in this space, depending on the state, so Nathalie was talking about buying a license can't do that in all states, you can't do that here in California. And so you typically, if you're doing purchase transactions, you're going to see either a membership interest purchase agreement, if it's an LLC or stock purchase agreement, if it's a corporation, other states like Oregon, you might see asset purchase agreements, I were there possible, I think asset purchase agreements are generally better because you're buying the assets of a company, which will be the license and the inventory and whatnot, and not the company itself, which may have all kinds of tax and other undisclosed liabilities. So the the risk for buyers is much. I'm oversimplifying this, but it's much less insane in a asset purchase deals and is in a in a stock or membership interest purchase deal, but again, largely dictated by state regulations. So that's where cannabis differs quite significantly from basically any other kind of business etc.

Hilary Bricken 07:08
Yeah, and I think sometimes that that's lost on the basic m&a practitioner, they don't realize that the regulatory invades the transaction, which is a nice segue into our next question, which is, do you have to buy the business structure or the license? Can you do a hybrid of both? Is it state dependent? Is it local dependent?

Vince Sliwoski 07:29
I could try to answer that I think sort of dovetailing off with Griffen said too, because the two questions are tied together in my mind, a lot of times it's really situational, right? Sometimes a seller will say this absolutely has to be a stock sale, because we're taxed at a lower capital gains rate. And if I sell assets, I'm going to get killed, right. Other times, you're able to get away with an asset sale, which people generally prefer they're simpler agreements are easier to negotiate. And they're almost sort of cultural,
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I would say to like the Oregon cannabis industry, for example, everybody's just always buying assets. And that's the way it works. You don't have to worry so much about liabilities, you may be assuming and disclosures, you kind of deal with all that and reps and warranties and disclosure schedules and stuff. Anyway, can you buy a license in these transactions? Technically short answer is no. In most states, you know, states tend to consider a cannabis business operating license in the way that they consider any other licensing issue may issue to you. So it's kind of like a driver's license, or awning license. It's personal to the person or entity that owns it. You can't say, Okay, I have a driver license, I'm going to go sell it to my friend over there. So he can drive a car, or I have a hunting license. So I'm going to sell it to this other guy so he can go on the hunt. Right? You can't do that. So what the state will do in some situations like in Oregon here, they will work with the buyer and the seller, they'll say, Okay, we understand that this business wants to sell to somebody else. What we're going to do is cancel the seller's license and issue a buyer's license concurrently. Right. So when we phrase that in the purchase agreement, asset or stock purchase agreement, we talk about somebody buying all rights title and interest in a successor license at the premises, that kind of thing. People often confuse the concepts but generally speaking, at least in Oregon, and in many states, you cannot straight up buy a license. That's something personal to you issued by the State.

Hilary Bricken 09:19
I was muted. I do want to correct something that I said earlier at the top of the hour, closing 1 million in transactions in 2020 really wouldn't make anybody bat an eyelash I want to check that was actually 100 million in transactions. So it's a much bigger number for us and Harris Bricken regarding our experience with m&a. And Vince, I appreciate you saying that because again, I think a lot of people when they talk about the transferability of licenses, and especially when they do letters of intent, the letter of intent may outline a license acquisition that is not even possible. Under the law, and therefore the contract is not enforceable, probably even illegal, and the regulators are going to shoot it down. So it's super important to know from the outset, what you can and cannot sell in these jurisdictions. And we have seen some very interesting behavior, where occasionally we'll come across a buyer, that's not so concerned about the regulatory impact, which, when that happens, we have to really contemplate what the dispute section is going to look like, in the contracts. Moving on, and this is a very important question that we get a lot and we even have a question about valuation in the chatbox. But how are buyers financing transactions these days, and kind of a dovetail of that? Probably, maybe four to five years ago in cannabis, the numbers, the valuation numbers were super pie in the sky, very frothy. Many of them were even pre revenue. From the substantiated record of doing business. They've come down considerably. But does a deal like the GW Pharma canopy, those deals in the country? Do they affect valuations universally? Or is it still more of a local game? Because we don't have interstate
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commerce. So it's really not some kind of comparable metric that we can measure all businesses against when those deals come to fruition?

Griffen Thorne 11:23
I didn't answer part of that question. And that is really on the valuation side, and specifically, the effect of that, that specific transits or transaction on the valuations of smaller deals, where again, se is what we see typically is, when you see the bigger companies, when they buy cannabis company, a lot of the time part of the purchase price is paid in stock in the Canadian parent company, as opposed to cash. And it's not, it's not the same thing as financing. But that's, that's how you say this, a lot of these deals get structured. In the smaller deals, a lot of there's a lot of debt financing, or even seller financing going on where let's say there's a million dollar purchase price, half of that paid up front, and the rest is carried over with a seller note that's paid over three, five years, with an interest rate, that's usually pretty significant, given the nature of the industry. So you know, unless you have a big buyer who's like got the cash on hand, or very small deal or something, there's usually some element of financing or paying in stock or something like that. Another thing we might see is earnout, post close earnouts. So that basically, rather than paying a high purchase price up front for a business, you know, we don't necessarily know it's going to be successful. We will promise the sellers if that if they stick around and help the business succeed, like in the capacity as a chief executive officer, something, they'll essentially get bonus, or now provision payments, you know, later down the road. And those make those benchmarks and the timing for all that is usually heavily negotiated. And there's no there's, there's really no such thing as like a one size fits all approach to this. So it's a lot of it's just business, business to business negotiations, and then legal come in and figure out how to make it work. Given cannabis regulations.

Vince Sliwoski 13:13
One thing I'd add to that, that I've actually seen people screw up a lot is when you have a seller carry transaction, and especially when you have an urn out, it's often the case that the seller still retains a quote unquote, financial interest or ownership interest in the business under the regulatory rules. And it's important that that's understood by the parties, It's understated, the buyer needs to understand that that could implicate down the line some risk to the license if the person misbehaves even if they're not active in the business. And it's important to understand they need to be disclosed, probably still, after they sell the business in the first place. And again, each state sort of a snowflake in terms of how strict they are in disclosure of owners and things like that, in some states have evolved over time, Oregon used to be a lot stricter than it is now. But if you fail to continue to list an owner or a financial
interest holder, as this case may be you could be in some regulatory hot water. So I always encourage people to think those things through too when they're talking about earnouts and seller financing.

Hilary Bricken 14:15
So we've talked about whether or not to have an LOI, the regulatory impact from the outset of the deal that you should understand considerations for buyer financing and seller to seller carry transactions. Now, the phase of the deal, depending on the parties typically moves into diligence. And diligence is a dirty word for lawyers and makes us very nervous for a variety of reasons. Because there can be lots of bodies buried around the sellers, the target assets, the business itself, and it really takes a skilled experienced attorney to know the questions to ask and this is not run of the mill m&a. There's going to be a robust probe on the regulatory compliance because you need to know that you're not buying buying a license or a business where the licensing is going to expire? What are some of the best ways to propound diligence target diligence at the sellers, and these companies, and especially when we're dealing maybe with legacy operators, that don't have a lot in writing, which we still do have in Washington, Oregon and California?

Nathalie Bougenies 15:27
Yeah, when it comes to due diligence, if it's just a license usually states, I mean, I can speak of Oregon, because that's where I practice and have the most experience, you can actually submit a formal request with the OLCC, which is a cannabis board in Oregon, in order to check on the status and the standing the good standing of a license that your client is about to purchase, the downside of going through that formal process is that it takes a very long time to get a response. So the way we've gone around that is to some to set a certain period of time for due diligence, but then include very solid representations, in their from seller, basically saying that if they breach the materially breach under the asset purchase agreement, that we would be able to terminate the agreement. And that would be a way to hold them accountable to keep the license in good standing until closing. So that's, you know, that's kind of the key issue there when you're dealing with a license. Now, if it's due diligence for other types of assets, like reviewing books and records for the company, that's just a different type of due diligence process, because we're not dealing with the regulatory agency that's more traditional, and similar to what you would be doing if you weren't dealing with cannabis. But yeah, I think I think the main due diligence piece when you're dealing with cannabis is to make sure that this license is in good standing until the very end of the deal.
I want to add to that, too, because someone's asking what is it important stuff, you want to ask for new deals? And basically, the answer is everything. You know, when we do these things, and we get pulled in to do a diligence transaction, we'll send the beginning of the relationship, a lengthy questionnaire, right with people are supposed to answer the questionnaire, at least in theory, if they do what they're supposed to do, and provide documents and provide information, then we look at it, and the accountants look at it. And like anybody else who needs any other professionals that need to look at it, look at it, to make sure that the sellers are actually saying the truth, right. Typically, it devolves into a long process where there's follow up questions and the follow ups and the follow up questions. And then we have to tell our clients, hey, maybe they're not being candid with you, or maybe this this one thing, there's a huge outstanding risk. But typically the things we look for, I mean, just at a very general level, we want to see all the corporate governance documents, we want to see material contracts or contracts that the business we're buying has with third parties. We want to know about litigation or threatened litigation or arbitration, we want to know about intellectual property registrations, if the business has tax issues, outstanding taxes, outstanding debt, probably the most, those two are probably the most important issues for any buyer, right? Because they want to, they don't who wants to buy a business that's trapped with debt? At least they don't know about right. And then I'm trying to think about some other stuff. Real estate matters, what property they own the property, the lease, that one's actually important. Because one of the most painful things to deal with in an m&a deal in my experience is a landlord. You know, when you come in and you're buying a business, all leases have provisions saying the landlord has to consent to new owners taking over and getting them to consent to that can be a pain, and they have absolutely zero incentive, in most cases to work with you and be friendly and things. So we, I mean, Vince, and I can tell you some stories about crazy stuff we've seen back in the day product to do here. But yeah, I mean, just it's really key to diligence stuff early and do it. Do it hard. And that way. I mean, the benefit of doing due diligence is that if something the sellers say turns out to be false, which began we've seen that happen multiple times. They've then committed fraud, you know, and they've omitted something and or intentionally misled you and you have way better claims against them than just breach of contract in my experience is you might not be able to get them on a fraud claim if you don't ask the right questions. So it's really key to get a lawyer who knows diligent stuff to really feel hard on it.

Diligence can be a good exercise too for knocking down the purchase price sometimes, I mean, you get into it and you find some undisclosed liability and all of a sudden Whoa, you know why? Why would We pay all that for your business. Look what we found. So I just think people buy these things.
Sometimes people get excited, and they plow through these deals, and they don't care about the diligence. And that happens more with real property than business assets, but happens with business assets, too. And we as lawyers are sometimes saying, Hold on, hold on, we don't want to throw a stick in this box, your transaction, but do some really basic diligence here, because it's like insurance, and then some. So I would encourage anybody here to really think through it. And I really like what Nathalie said, if there are public records out there, you can go to your regulators and you can get stuff like that get it. We had one situation where a buyer representative warranted that there were no enforcement actions against a company we get a week out from closing after this long protracted drawn out thing and all the sudden, the agency says, oh, we can't transfer that license, these people are under investigation, they might have their license cancelled. Well, you know, the sellers didn't disclose that, if the client had done that kind of diligence, they would have known that long ago and save themselves a lot of headaches. So good points all around.

Hilary Bricken  20:59
Yeah, and I will say, if you're getting pushback from the seller, on basic due diligence, it's a huge red flag, because when you're selling your business or assets or substantially all of the assets, you open the curtains, right to shed light on everything we've got, they should not be hiding the ball on liabilities. And really, I would say the two to three main areas are regulatory license, good standing history violations, verbal and written taxes, including to add, and local and state taxes. The to Ed liability is a death knell. If that's not taken care of, at least on a payment plan, or potentially in litigation, if you're comfortable with that. And then obviously, something comes up with diligence, we're going to talk about this, getting the right reps and warranties in place. We've had way too many people come to us after the fact after there's been closing, where even though they knew that there was a defect in diligence as the buyer, right, and even though the seller provided reps and warranties saying these are clean sheets, we have no problems. The buyer proceeded anyway, knowing that none of that was true. And that completely invalidates your ability to pursue the seller for corresponding damages. So don't be a Rube if you see something come up in diligence, say something. And if the sellers pushing back, that pretty much speaks volumes, and I don't think anybody on this webinar would disagree with that. We do have a question. And this is an important one. If the m&a is screwed up, right, you screw up the change of ownership. You transfer license when you can't. What have the penalties been including for things like failing to update who the new owners are getting approval of the new owners? It all works a little bit differently in every single state. Is it an administrator slap on the wrist? Are we talking complete forfeiture of the license?
Vince Sliwoski 22:54
I mean, I think you're right. And it depends answer and people hate that answer. And lawyers are famous for giving that answer. But it really is different state by state. We've seen some really big companies like curlies get fined. I think it was $100,000 they paid out in Massachusetts, we're doing exactly what Hilary just described. We've had clients here in Oregon who got Notice of Proposed license cancellations for stuff like that. Usually we're able to go to bat for them and get something worked out. But I mean, yeah, worst case scenario, you lose it all. It's just not something to trifle with. It's so easy to update disclosures just got to do a timely and do it right.

Hilary Bricken 23:31
Right. And definitely people need to know this on changes of ownership or license transfers. There can be deadlines, by which you have to report it's not an open ended option, at least in the state of California, formally with 10 to 14 days from the effective date of the change of ownership to tell regulators and start the approval process. Now I think what Griffen has to 14 days for all license types to get that change in from the date of the transaction, essentially, you miss the deadline, you're not going to have a lot of defenses around it unless truly something came up that viably prevented you from notification, we have a form for it and everything. So it can end up being a big deal to regulators. And if you don't have good defenses around why you failed to report, you're at least looking at some kind of a monetary fine and up to license cancellation in most states. Now, next question, and this may be a basic one, but this gets skipped a lot actually by both experienced purchasers and sellers. And the NACA experience when the panel think you should even bring in an attorney because we see people all the time negotiating their own loi as they get right up to closing and then they're calling a lawyer. So when ideally should people be giving us a rent?

Vince Sliwoski 24:51
Let one of you guys try that one. I mean, I've got thoughts on it, but go ahead. Maybe Nathalie could answer that one.

Nathalie Bougenies 25:00
Sure. Well, again, it depends, but I think the sooner the better, especially with the LOI, I think we see people coming to us to enter into LOI that only contained binding provisions, which I think is really dangerous. If you're doing that without an attorney who is providing guidance and counseling you throughout it, because you may agree to a purchase price that's way too high. Or you may agree to, you know, doing things that maybe are not in your interest, because you're not familiar with these regulations that apply to the purchase or sale of a license. And so, in my experience, the sooner the
better, so that you don't go to an attorney to then undo a mess, which ultimately is gonna cost you more money than if you had hired some firm like ours, from the get go. But if you're sophisticated seller or buyer that has done a few of these transactions, then it might be more appropriate for you to enter into an LOI without consulting with us first, because you already have a pretty good understanding of what can be done and not be done and then come to us to draft these documents. But since every deal is pretty unique, I think it's always a good idea to have these definitive agreements, the purchase agreement be drafted by an attorney, because again, these slight changes can have pretty significant impacts. And so don't just rely on past deals and repurpose agreements. But yeah, that's, those are my two cents.

Vince Sliwoski 26:43
It's good to you know, if you talk to a reasonable attorney, if somebody comes to me, and they want me to jump in and do all this stuff, sometimes they'll say, Well, I don't know if that makes sense. Yeah, like hold on your authority this and then come talk to me, right? Just because you tell your attorney, I feel maybe you know, on the way or something, something doesn't mean you're suddenly on the hook for $50,000, or some crazy thing, right. But the attorney is going to sort of talk with you work with you about when their role should really kick off what their role should be those kinds of things, and you get to authorize them doing anything, you get to authorize them drafting anything, you get to authorize them calling the other side's lawyers, whatever it is. So I think like Nathalie said the earlier the better, sort of a precautionary principle thing. And good lawyer will sort of guide you through it and step in when the time is right to step in.

Hilary Bricken 27:28
Yeah, and a solid m&a lawyer is also gonna tell you what's customary. If you've never done one of these deals before, you're gonna be in charge of a lot of business decisions, right? Like the consideration that's paid, what you're willing to commit to the timeline on the deal. Any other performance logistics, but really, the value add is for the lawyer to be able to say, I've done this before, this is what's normal and customary. This looks out of sorts. And then of course, you want somebody with that regulatory background. And we've helped lots of firms, including really big ones, even just do the regulatory part on m&a Because it's so overwhelmingly important to the life of the transaction. Now, another basic question that some of you may be surprised that we get, but you really shouldn't be because it is kind of dynamic. What is a closing, a lot of people are very confused about what a closing, actually is.
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Griffen Thorne 28:21
I didn’t take that one. So in regular deals, like not m&a deals, or finance or real estate deals, those just doing some sort of supply contract, you sign a contract and everybody gets to work, right? In a business purchase, you don't start typically speaking, sometimes, this is done differently for various reasons. But like, you'll sign a contract after some negotiations and some diligence, certain things will happen. Like for example, in a state like California, you'll go notify the local, city or county and start the local change of ownership process. And once those various things are done, you can get the landlord to sign off on it, which as I said earlier, is that nightmare a lot of the time, you know the business, the seller may be forced to clean up some books and records and taxes and debts and whatnot. Once all that stuff is done, which is all predetermined in the contract, then you close so to speak, and then simplify this essentially, they give you the keys to the business, you give them the dollars. And then that's it right. Some deals get structured with multiple closings like California, excuse me, California was common, is still common the structure that m&a deals where some part of the business is sold upfront. The rest is sold after you get final state approval. So you might see multiple closings, but generally speaking that's kind of how

Hilary Bricken 29:44
And you know, he mentioned having to notify the local government of what's going on before anybody pulls the trigger around a closing and just a footnote for our audience. The state in the locals do not always agree about how changes of ownership should proceed notification requirements, there could be local hearings around the change of ownership, some cities are extremely sensitive to new operators coming in more sensitive than maybe even the state. I digress though, because I mentioned the local government footnote, because it's typically a common closing conditions got to happen, take place be successful, before the money or whatever consideration changes hands for the business or the assets. So who wants to take the question about what are some of the common closing conditions that we see specifically for cannabis and then m&a in the context of cannabis generally.

Griffen Thorne 30:39
I can take this one just because I wrote a pretty lengthy article on our blog recently about this specific issue. And also was just talking about it. So number one, yes, city approval in California is absolutely key. The vast, vast majority of local jurisdictions require some kind of approval before you can change ownership. Whereas at the state level, which in my opinion, is incredibly stupid, you just notify them after. So if the state decides to deny your request, you'd have to go back and unwind the deal somehow, it’s really silly system. Another common one would be paying off debts. If you if you know the business as a debt, part of the conditions to closing they'd be paying that off and maybe even
means paying it off with some of the purchase price proceeds simultaneous with the closing, landlord approvals always going to be one that’s necessary, as long as the business has a lease, because like I said, every single lease will have a provision saying the landlord is entitled to consent to the owner of the business changing. We will see things like settlement of litigation potentially if there’s really active litigation, we want that to be settled. transfer ownership of intellectual property rights. You know, you name it, right. So there's just a whole host of things but we're talking cannabis and even to some extent CBD if you're in if you're in a jurisdiction where CBD has licensing involved. You know, they're very well, maybe changing ownerships, things that need to happen up front. So that's, that's really good. I mean, Hilary and I have been brought in on some deals to clean up where cannabis or non cannabis lawyers has done m&a deals. And like oftentimes, the change of ownership ship stuff is just not even considered like nothing, or it's 100% change of ownership that we see in this title out in California law, this at that time wasn't allowed. So just like the regulatory changes, ownership process can be one of the most daunting and that usually happen upfront.

Hilary Bricken 32:28
Okay. And then regarding things like undisclosed liabilities, because maybe no settlers perfect, maybe they don't even know, or they do know, and they seek to deceive. In the transactional documents, what are some of the best ways to protect against those, including common reps and warranties that we're seeing?

Vince Sliwoski 32:52
Reps and warranties is a big one holding back cash is a big one. I like doing that a lot. If I'm representing a buyer, I like to hold back as much as I can for as long as I can. So you know, to protect against something that comes out of the woodwork, it's kind of nice if $500,000 of the deal still sitting in escrow and I can claw it back. Those kinds of mechanisms and contracts are really, really big. From those people mess around with liquidated damages provisions and stuff that things like that. I think it just kind of ties back more or less to the concept of do as much diligence as you can and then have all of that standard contractual protection stuff baked in. And I realized, like for these businesses, some of the stuff is hard there cash businesses, record management's pretty poor, for the most part. But that's sort of not an excuse to write off the process and the protections. I mean, if they don't have standard p&l, and financials, at least getting to the point of sale system, do do something, do do whatever you can. And if you're willing to accept some risk, then yeah, in the contract, drafting hold back as much money as you can get the best reps and warranties you can, etc, etc. That's big picture how I think about it.
Anything else to add? Guys before we move on from that one? That's pretty big one.

**Griffen Thorne 34:11**

Yeah, I guess the only thing I'll add is that there's a knowledge standard. So when you representation warranty as a promise right to someone in the contract, and they say hi represents an orange that the company doesn't have any taxes that are outstanding, or it doesn't have any debts that are owed any third party. And all of that is going to be qualified typically with a knowledge standard saying like, if it's a company that's making this representation warranty within the representation is made by somebody at the company who has a specific level of knowledge. actual knowledge means it's something that that person actually knows at the time they're making this promise constructed knowledge as to what you always want to see as a buyer means not only things that they actively knew, but the things that they should have known with reasonable diligence. So if they get an envelopes from the IRS, that's that six inches thick, and they just don't open it right You know, prior to closing? Well, that's the end, it turns out they owed, you know, $100,000. Like, yeah, they just didn't have actual knowledge about something. But they should have known they should have opened it. Right. So this can be a huge point of contention and negotiations and deals. And if you're the buyer, you always want to be constructive, the looser you can get as the buyer, the broader that is, typically the better.

**Hilary Bricken 35:22**

Right. A third lever that I would add in there that we haven't mentioned yet is indemnification. Basically, to protect against third party claims that may crop up from how the business was previously run, I can guarantee you and cannabis, there's a lot of those that may not actually come out in diligence, because maybe the seller doesn't think it's relevant, or it's not possible or it's not going to happen. In California, we had big problems. Because previously before Prop 64, prior to 2016, most of most, if not all of our operators were nonprofits. And then once legalization hit, they all want to convert for profit entities. Well, there's a whole corporate process that goes in to that conversion that requires notification to essentially what our de facto shareholders are, they end up being the shareholders and the new entity. A lot of people skip over that particular step. And in m&a, you would rep and warrant for that and get indemnification for those claims. In the event, anybody came out of the woodwork saying, where's my piece of the purchase price. And again, that's very particular to cannabis. It's standard anyway, but because of the history of some of the operators here, indemnification is also really important. And that's also subject to negotiation with things like tipping baskets and the caps on what you're willing to spend and can't spend. And then a big one that Griffen and I always deal with is who's going to control the difference between the buyer and the seller. And of...
course, you know, as we were the buyer, we want the buyer to have a say in who's essentially defending them, and that they're competent enough even that comes up in negotiation. So another popular question that we get our servants good.

Vince Sliwoski 37:02
No, I was just confused. The interesting because it popping up in the feed right now somebody's asking a question about purchase price hold back. And escrow. Particularly we haven't quite talked about escrow and they're asking how do you do it at a bank and in my experience, it's not a good to like a bank won't handle your cannabis escrow. And especially not if it's cash. Typically, I think a lot of that stuff handled by third party law offices. Sometimes the sellers attorney will serve as the escrow with a conflict waiver and stuff. And typically what will happen there is you'll have your escrow agreement, and people will use things like title company calculators and things to figure out these that because it's kind of a it's not, it's just odd, and that it's not handled by banks or title companies and the way that would be in a non cannabis transaction. So just to answer that person's question, because it followed on what Hilary was talking about. I want to throw that out there.

Hilary Bricken 37:54
Another question that we got, and we get this quite often is how long it'll take. Right? How long does it take to get from an LOI to closing just slowly transitioning to new ownership, in our experience?

Vince Sliwoski 38:08
In Oregon, and can take I mean, so certain states are more transparent than others about where they're at with even processing these things. Oregon, they have stopped updating it online. But they told us I think this morning, when they're talking to him, they're about two months out, from assigning an application to an investigator. And then if things go well, it usually is another month. So in this state right now, is about three months. At certain points, it's been a lot longer. In some states, it is longer. That kind of brings up a separate issue of people wanting to get into these businesses faster, and signing up for management agreements, which I hate, I hate them so much. I'm going to write about them because they're abused, and they people make messes in these businesses before the sales close. And just sort of another topic, like have that on your radar. If somebody is approaching you and saying, Yeah, I'm going to buy your business. And I'm going to come in there tomorrow and actually start running it, you really better be careful with that for regulatory headaches and cash management issues. And just probably like red flags, right. And a lot of buyers bigger companies do that almost abusively, I would say to smaller companies, once you let somebody in, it's hard to unwind it. So anyway, timelines, the longer the timelines, the longer the regulatory timelines are, the more apt
people are to mess around and do stuff like that. But patience is key in these things and doing stuff upright, or doing the stuff in the correct sequence upfront. So there aren't the ways at the end when everybody's ready to close like a simple local regulatory approval or stuff or something like that can really save you some gray hairs.

**Nathalie Bougenies 39:39**
And just to add, quickly, because I'm dealing with that transaction right now, that's a little bit unusual in that that timeline can also be affected by local. Local government, for instance, like securing a lax can take a lot longer in certain counties than others and so that can Most of this timeline that Vince was talking about were typically within 30 days for the year submit unless in most counties in Oregon, you're going to get it, assuming you meet all the requirements, but then others are just have more stringent requirements. And it's a lot more difficult to gauge how long that process is going to take. And so that inevitably delays the rest of the process, including submitting your application with the cannabis board in whatever jurisdiction you're in.

**Vince Sliwoski 40:31**
Our goal is not in not in the know a lux is a land use compatibility, but it's a form of local approval in Oregon. One thing I'd also say, and it really ties into what Hilary and Griffen said, especially about non-cannabis lawyers drafting these deals is I've seen deals drafted, I've seen a bunch of asset and stock purchase agreements, where they're great, they're good contracts, they're built out on indemnities, and reps and all these things are talking about, but they don't have any sort of compulsion in them for the buyer to get in there. And start applying for the license on day one, right. And they don't have any mechanism for the seller to get in there and have oversight, like access to the actual person's license applications dashboard. And I've seen buyers, either willfully or more often just drop the ball type stuff, not dip your application and I thought somebody else was doing another three months goes by ready to close, nobody even applied for regulatory approval. Oh, my goodness. So I think that's really important stuff to draft into these contracts. Because you know, how long is it going to take, that's partially a function of where the dates out with these things. But it's also a function of how proactive the parties are.

**Griffen Thorne 41:36**
There's a real simple way to do this, too, I think, which is, it's a drop dead date, meaning if a closing doesn't happen by a fixed date, and continue to negotiate with a date is and neither party can walk, right. And so it keeps the buyers and seller, like motivated to get the job done. And oftentimes, when you have a drop dead date, it's like we get, you know, it's October 1, and it's September 25, everyone's
trying to get everything done, but he's an extra week, usually the parties are accommodating. But, you know, it's always good. Depending on who you are, what side of the deal you're on, to have a tight drop dead date that makes people act very fast and not drop the ball. But like in a state like California, where, you know, if you're in a certain city that I live in, and you drop a change of ownership box, request into the regulator, it could be like months before anything comes up. I mean, there's a time to do it, you could take a very, very long time, right? And so it's hard to the clients hate because we can never tell them, Oh, it's gonna take three weeks, just we just can't, you know, there's no way to do that.

**Hilary Bricken 42:40**
Now, and when government approvals explicitly involved in your m&a, it's a bit of a roller coaster and an unknown. So I'm I too am an advocate for the drop dead date to incentivize performance between the parties. But I pump the brakes when it comes to tying that date into what the government is going to do. Because nobody knows on either side of the aisle. And I doubt that anybody wants to bear the risk for what regulators and bureaucrats are going to do with the fate of their application, when they change rules constantly, or the interpretations are different from licensing analysts to licensing analysts. So just a word of caution on those drop dead dates. Now, earlier in the presentation, someone had asked about valuation and whether these really really big deals, which are probably mostly cash or stock consideration, probably more stock than anything, do they impact the valuation of other m&a transactions? Or is it really still localized where it only matters what's happening, you know, within the four corners of your state?

**Vince Sliwoski 43:45**
Sounds good question. I could talk about that. I don't know how much effect those really big deals in evaluations have on these like local closely held business sales between small operators? I think not a lot. And I think you know, you could certainly quibble with a lot of those valuations. I remember when the first Oregon cannabis unicorn was purchased for a billion dollars cash and stock Kira curaleaf transaction I wrote about, you know, that seems inflated to me. And I wrote about why and you can get into all that. I think it is important to understand what's market and what's customary in your jurisdiction with respect to valuations. I think it's not a traditional industry. You know, most industries, people still buy and sell things on multiples of EBITDA, right. EBIT as earnings before income taxation, depreciation, amortization, I think, just kind of like traditionally people used to buy stocks based on P E ratio, right? It's not really like that. In cannabis and certain industries have moved away from stuff. It's not really like that buying and selling tech businesses anymore, right? They're, they're buying and selling based on what they have for subscribers and market share, not so much earnings. Cannabis is
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weird. In Oregon, people Yeah, it's not EBITDA. It's not necessarily the market approach or the asset approach or the income approach or all these traditional valuation metrics, it's some percentage of sales usually. I mean, that's the most common metric people usually talk about. They say, what is what was your revenue last year? Last few years? Oh, really, your store did 1.5 million in sales? Well, 1.5 million sounds like a fair purchase price in the City of Portland. Maybe it's discounted in outlying areas. In certain buyers, like we represent, you know, bigger private equity buyers, they have more sophisticated metrics for looking at that stuff. And they kind of pencil it out and figure out ultimately whatever margins are to use a real estate term. But they'll when talking to sellers, they'll end up talking through basically 1x revenues or getting close to whatever percentage of revenues is because that's the lingua franca of work in m&a scene. So you've kind of got to know your way around what local customers and you should do some research before, you know agreeing on a price tie their brokers in every jurisdiction, there are other busier ways to get information as to other business sales. And it's kind of a fast moving space. But to circle all the way back around. I don't think these big like publicly held company deals have a lot of effect on the fast pace smaller m&a market transactions we're seeing in our various states.

Hilary Bricken 46:17
Yeah, I think that's right. Kind of stemming off of valuation a little bit? Not mostly not really. But see, she used to get these things done, and out the door between the brokers, the lawyers, other collateral fees, and as in the transaction, like diligence. What do you guys think the ballpark is, for your average buyer? Not some huge mega sale of multiple retail locations. But let's just say, acquisition of a single cannabis business. On the west coast. What kind of fees? Are we talking about? What should people expect?

Vince Sliwoski 46:57
Broker fees are different than attorney fees, brokers usually come in as a percentage of the deal, whereas attorneys are usually still hourly, and m&a. Although I've seen people agree to flat fee and percentage things there to brokers typically 2.5 to 5% of sale consideration. In my experience, attorneys, it depends on the deal if you're doing one of those little naked license deals like Nathalie was talking about, and it's $200,000. And that's literally all it is, is like no assets going over just one person replacing another as a licensee at a place. Maybe you can get away with paying five $7,000 to a lawyer in the best circumstance, if it's a bigger kind of more complex deal heavily negotiated, confusing diligence. Difficult attorneys to be honest on one side or the other difficult sellers on one side or the other. Those costs can go up pretty quick. Attorneys have a hard time estimating those things
sometimes at the outset. But what they can do is kind of talk to your face by face and say, well, now this happened, here’s what you can expect. That's the best way I can probably answer that question.

**Hilary Bricken 48:00**
Yeah, fair enough. And then as far as taxes go, and really successor liability, you know, what is the buyer assuming relative to taxes in both a business purchase? And then obviously, in Napa sales plus any?

**Griffen Thorne 48:17**
Although take this one, I mean, if it's a business purchase, the answer is everything right? All liabilities of the business still remain with business, and you're buying the business, so you're not walking into that potential mess. There are ways to make indemnification is probably the easiest thing you can do to make a seller continue to be on the hook. So if they didn't disclose something, for example, they indemnify you. So if the government comes knocking at your door and say, Hey, you owe us $100,000 For some kind of tax, and you just say hey, indemnify me, right? It's not perfect, because they would if they just disappear and say we're not you know, or just don't respond or something or fight you on it. And asset purchase, it's a lot different, right? Because you're not buying the business. The business is typically the the thing that owes the taxes, the business is the thing that owes the debt, as opposed if it turns out that the asset was collateralized in favor of some third party. So meaning if you were to buy a machine, right and then it turns out that the seller of it had done equipment financing and the finance companies still had some collateral interested in it will you be that'd be a problem because they become and potentially take that machine away? Right? So that's why diligence is key and you’re gonna want to get any contracts, you're also gonna want to make sure the agreement requires them to and you title to the goods free and clear of any encumbrance, so on and so forth. Right. But you know, I mean, that's m&a deals when it comes to either mergers or business acquisitions, just much more hairy in terms of the potential liabilities that can come over and even when someone says there's no liability, even when you do thorough diligence, like we see stuff coming up. So much post closing, and that's why we've been talking about the indemnification escrow rows and pull backs and things. It's just so key if you can get it through buyer.

**Hilary Bricken 50:08**
And we've got about 10 minutes left. And I do want to touch quickly on real estate because a lot of these transactions implicate a purchase of the real estate. A lot don't. And obviously, we've talked about having get landlord consent to assign the lease, etc. But when we do m&a That has a real estate
component, which it almost always does, obviously, because of the license. Should buyers also be diligent thing, the real estate impacted in the transaction?

**Vince Sliwoski 50:40**

I mean, yeah, whether or not you're buying the real estate, you need to do some real estate oriented due diligence. If you're buying the real estate, a lot of that can be sort of, I guess, shortcut in the sense that you get a title report, right? Hopefully, you're finding a title company that's willing to work with you. And hopefully, the real estate portion is even close to your title. But that that's sort of a formulaic standard diligence process, where you, you know, you get the title report, you read it, you say, Okay, what are they listing out as exceptions from title? What is it that they want to insure? Am I cool with that you want to fight them about some of those tried to change their minds? And then you also want to look at basic ordinance stuff like zoning? Is this what does the zoning code actually allow for this is, are there any possible changes coming up? Will I be grandfathered and all that sort of stuff. I've seen cannabis businesses cited in places where their zoning is actually non compliant. And it's just if you if you get that stuff wrong, it can be hairy to say the least, you want to know about easements, recorded unrecorded in conferences, you get lot book reports, things like that. So anyway, you want to go through your sort of standard real estate due diligence process when buying a piece of real estate, with respect to if you're just buying a business situated on land that you're not going to be buying, I think you still want to look into it, you want to obviously look at the landlord and the situation, as Griffen said, you want to see how much time do you have left on the lease? Do you have renewal rights? I mean, are you going to be able to even operate your business there for more than a little while? How much control do you have over that? It's helpful if you can even learn a little bit about how the what the landlord situation is, even if the lease is really good, is the landlord a very old person who, you know, somehow some trustee may take over this thing and not want to cannabis business there. All of a sudden, I've seen that happen. In theory, banks can always call the loan on a piece of real estate if they learn or know that cannabis businesses operating there. So and I've seen that happen, too, which was kind of shocking. I hadn't seen it happen for years. But I've seen it happen a couple of times recently, where a bank was sort of, I guess wise up and say, Hey, there's a loan on this property, we're carrying it and you're operating a federally illegal business here. And we're entitled to accelerate all the amounts due under the agreement. So I don't know if you can often get that far off. And a landlord's not going to want to tell you about their personal financial situation with respect to the property, but sometimes they do. And that's just good to know, it's good to have as much information as you can get. So yeah, you got to diligence, your real estate, whether or not you're buying the land, or just leasing it.
Griffen Thorne 53:18
Here’s one other example of why this can be so toxic. If you're buying a business that has a lease. Imagine the business has some undisclosed environmental, they dumped oil, it's something that at the end of the lease the landlord, alright, then you pay for this, right? So you walk into that you operate into that liability. And so you just got a you got to find that out. Yeah. Key.

Hilary Bricken 53:42
And just from a structuring perspective and a drafting perspective. I'd like to know your thoughts. If the real estate is implicated as part of the purchase price? Do you make that its own separate contract? Because it's such a different bundle of duties and rights? Or do you somehow incorporate it in the definitive m&a transaction itself without a separate agreement that we'd normally see if we were just purchasing the real estate?

Vince Sliwoski 54:09
Griffen you want to answer I saw you nodding or I could answer.

Griffen Thorne 54:12
Yeah, I think it's a very, I mean, I've seen people do it. I've seen people I've seen purchase agreements that bind multiple businesses. I mean, typically, that kind of stuff is really bad idea, because the reps and warranties and obligations are just so different when you're buying a business versus a piece of land. It's the preview of a purchase or even for real estate versus a purchase room for business are completely different looking. So trying to pack it all into one agreement. Some people might think Well, that'll save costs only have one agreement, right? But in fact, you just end up spending so much more time trying to massage the agreement to fit that it's just better to tell us the normal stuff, right, the normal purchase agreement, frankly, when you buy real estate, a lot of it's done on pre packaged forms anyway, as opposed to m&a which is usually just the form that a firm will have and tweak to the specific deal.

Vince Sliwoski 55:07
I think in most situations to you and think about I'm sorry, last point on this, you want to think about closings and whether you want their closings tied together. And in almost all cases, I think you do, I got brought in late on a deal, which is still going on, which is kind of drove me crazy, because the people all agreed to close on the real estate and even certain business assets ahead of the rest of the transaction closing. And that can be a mess, right? Because what if the real estate closes fine, but then something happens on the other side, there's no regulatory approvals. And then the buyer ends up in a position
where Oh, my God, all I bought is real estate, I didn't actually get the cannabis business that I wanted to have. And that's a recipe for disaster in fights. So I think you want to talk about, like, Mike Griffen said, having your two different agreements, three, four different whatever they are having the real estate purchase agreement separately on its standard form, probably, but having the closing conditions on closing of the asset purchase agreement and have them close, simultaneously and tying the agreements together in those in other ways. Because if you don't do that, you can end up in a strange situation. And it's hard to wriggle out of those.

Hilary Bricken 56:13
Yeah, have a couple more questions that I think are actually pretty good and timely, and maybe trending in m&a. One of them is, are we seeing more reps and warranties insurance in cannabis dealings? And I haven't actually seen anybody be able to pull the trigger yet. But I definitely have seen it negotiated and tossed around. What about you guys?

Vince Sliwoski 56:35
Haven't seen on a deal. I mean, we don't always know everything that's going on in background that was every deal with respect to things like that I personally haven't come across it or helped anybody acquire it. I don't see why you couldn't get it, though, in the sense that a lot of insurance companies are working with cannabis business to issue all kinds of policies. So why not that? I just think it's something I haven't seen yet. Maybe in a in a bigger deal. It would be more important, I would think.

Hilary Bricken 57:01
Yeah, I also think it depends on what the reps and warranties are maybe outside the standard if they're super customized. We've another good question. How are Aesop's being managed in m&a Has anybody dealt with an ESOP yet, which is obviously an employee stock ownership plan. And given that the valuations and share prices seem to be dropping across the board, at least in the MSOs, that we've all seen, do the employees really ever truly benefit in an m&a situation.

Vince Sliwoski 57:37
So it depends on how it's done. And Aesop's easier to move over in my experience in the context of a stock sale. Because then basically, what happens is, you know, the buyer just steps into the shoes of the seller and is now owning and running the ESOP. And all the grants, you know, are assigned the employer grants to the new company, or the new, or there's not even an assignment, there's just they just in New York, the new company, with an asset purchase, you have to be a little more thoughtful about it, and a buyer should diligence that ESOP and make sure that they understand it correctly, and
understand if they want to do a new one. But I think it's got to get closed out otherwise, because the shares with the seller company are going away. At least that's how I'd start thinking about it high level.

Hilary Bricken 58:19
And a question that we got beforehand, which I really like actually, given the nature and the character of the industry, can small businesses actually continue to survive and compete with MSOs? Buying up as many assets as it seems like they can in the secondary market? Do they have a chance here in the United States, or we just had some mass consolidation and a lot of exits and a few powerful operators in just a handful of years?

Vince Sliwoski 58:52
I think we got a shot. I mean, Hilary has written about this, actually, you know, each state, it's hard to move from state to state and cannabis right now, because the rules being so different in every state, and that's tricky for MSOs that gives the little guys more chance to stay and more chance to fight and more chance to get ahead. So I think, yeah, like, given the status of federal law, regional operators are still advantaged and will continue to be I think you might see a change one day when federal law changes, I think you'll see even more massive consolidation across state lines interstate and national consolidation. But I think for now, the little guys alive seen a lot of small businesses doing pretty well, despite what we call the Canadian invasion here in Oregon and all these MSOs coming in the last several years. It's not necessarily a market dominated by the big boys, at least not yet. My opinion.

Hilary Bricken 59:44
Yeah, California is pretty much the same way. We're big enough, everybody still has a place at the table. And m&a is not easy here. Despite the splashy headlines. Some of you may seen many of those deals are not remotely enforceable, at least in my opinion. Based on what I've seen, and what the regulations say. So I would say it's not all doomsday for the small operator. But many operators are looking to be acquired and to have NSX and to at least break even on what they initially invested. And it's been rough. It's been rough to get into the black for cannabis businesses for a multitude of reasons that I won't get into because we are at the one o'clock hour, which concludes our hour long panel. And thank our panelists for joining us today. Audience. Thanks for tuning in. If we didn't make it to your question, don't sweat it. We always do a blog post kind of summarizing these presentations after the fact. And we will try to get to your questions there in greater details we really appreciate you watching and definitely tune in for the next one. Thanks so much.