

Cannabis and Coronavirus: Issues for cannabis-related businesses to overcome

As the rest of the world reels from the effects of COVID-19 and “social distancing,” the legal cannabis industry is feeling the pain as demand declines and sales suffer. Despite this and the general aversion toward in-person sales, many states and localities, such as New York and San Francisco, declared medical cannabis dispensaries to be “essential” business (in a similar fashion to pharmacies) that may remain open, but only for delivery and pickup sales. Similarly on the recreational side, Nevada has allowed dispensaries to remain open so long as such dispensaries comply with “social distancing” measures, though Nevada strongly prefers that consumers utilize online ordering and delivery services.

That’s not the only thing that cannabis related businesses have to contend with in the COVID-19-era; in states where cannabis dispensaries are under a closure order, such businesses (and other cannabis-related businesses throughout the supply chain) may be at risk of default due to provisions in their supply contracts relating to force majeure, material adverse changes, unforeseen risks and acts of god, as well as in their leases and loan documents. Additionally, cannabis related businesses must also comply with state and federal employment laws and regulations, which in the times of COVID-19 are fluid and in constant flux.

Force majeure and Material Adverse Change

Many contracts, including supply contracts and license agreements, contain force majeure clauses or termination for convenience clauses that excuses one or both of the parties from performing under the contract. Often, these clauses are triggered by language such as “natural disasters,” “acts of war” and “acts of god.” While it remains to be seen (and litigated) whether the national emergency caused by the COVID-19 outbreak triggers these clauses, it is likely that many businesses that perceive that they have an unfavorable or unprofitable contract will attempt to utilize these clauses to escape performance. Moreover, many commercial loan documents contain “material adverse change” change clauses that place borrowers in default if there is a material adverse change in the borrower’s financial condition, operations, and business prospects.

The legal cannabis industry has already seen major declines in demand for in-person cannabis sales due and it is likely that the resulting financial hit that many cannabis businesses will take can be considered a “material adverse change” that can place a cannabis borrower in default. Cannabis borrowers should communicate early and often with their lenders to come to an arrangement to avoid being placed in default under “material adverse change” clauses.

Lease and loan covenants

It is a grim reality that businesses in nearly every industry are hurting financially as a result of “social distancing” policies and closure orders that sharply and suddenly decreased demand and limited the operations of many businesses. Reduced revenues are to be expected, and defaults in financial covenants contained in leases and commercial loans are likely to follow. That is not to say, however, that lenders and landlords are blind to the circumstances. To the extent that cannabis businesses have leases and loan documents that contain financial covenants, lenders and landlords may be open to discussing forbearances or other accommodations in order to retain the leasing or lending relationship, as the case may be.

Employment and Federal Sick Leave legislation

The effectiveness of pandemic mitigation policies is greatly reduced if employees who are sick are required to report for work because they have to make a choice between staying home sick or a day or more of wages. To address this, some employers are electing to give their employees two weeks of paid sick leave if they are infected with the coronavirus and a great deal of employers are allowing and encouraging their employees to work remotely. Both steps significantly reduce the amount of in-person contact that sick employees may have with the general public and their co-workers, reducing the risk of infection. These steps are critically important in the manufacture



and distribution of medical cannabis and cannabis-derived products whose end-users are often the most vulnerable members of the population, the elderly and the immunosuppressed.

These policies are also at the heart of [recent legislation passed by the federal government](#) with respect to employers that takes effect on April 2, 2020. As the COVID-19 crisis develops in the United States, we are likely to see additional workplace policy proposals; it is extremely important for cannabis-related businesses to stay current as policies shift.

Finally, even though cannabis-related businesses do not enjoy any deductions (other than for the cost of goods sold) under the Internal Revenue Code, these businesses may delay filing their 2019 federal tax return and payment of their 2019 federal income and self-employment taxes until July 15, according to Notice 2020-17 issued by the U.S. Treasury Department on March 18, 2020, and an announcement by the Internal Revenue Service on March 21, 2020. The return filing and payment delay may give some flexibility to cannabis-related businesses with respect to their cash flow.

We will continue to actively monitor developments in the COVID-19 situation and reactions in the legal community. If you have any questions, feel free to reach out to any Thompson Coburn attorney with whom you regularly communicate.

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