



---

**Portfolio Media. Inc.** | 111 West 19th Street, 5th floor | New York, NY 10011 | [www.law360.com](http://www.law360.com)  
Phone: +1 646 783 7100 | Fax: +1 646 783 7161 | [customerservice@law360.com](mailto:customerservice@law360.com)

---

## Why PE Is Wary Of Jumping Into The Cannabis Market

By **Darcy Reddan**

Law360 (July 5, 2018, 10:38 AM EDT) -- Investment opportunities abound as the cannabis industry begins to take shape in states across the U.S., but attorneys say a number of obstacles might prevent the private equity sector from making a full-fledged push into the burgeoning industry.

The cannabis industry will certainly call for an influx of cash in order to grow, but inconsistent regulation and intrusive disclosures will likely hurt the willingness of investors to commit capital to entities that are not slam-dunk investments compared to those with a longer life span and proven track record.

Partner Irán Hopkins and associate Claudia Fu of Akerman LLP are regulatory experts in the California cannabis industry and said they believe that some investment vehicles might not want any part of "plant-touching" investments depending on the type of fund that has been raised.

"Depending on how a fund is formed, there is a fork in the road," Hopkins told Law360 in an interview. "The incongruence between federal and state law has created chaos and confusion in the market, and a general fear of what might happen in terms of exposure to civil and criminal liability, seizure of property, and the ever present 'reputational risk.' Those with restricted funds, like third-party pension funds where your investors are managing other people's money, must be very, very cautious and probably want to steer away from plant-touching investments because of those risks and uncertainty, while individuals and accredited investors may be more willing to embrace that uncertainty as opportunity and assume some of those risks."

But investing in companies that are on the front line of cannabis cultivation isn't the only option for private equity investors.

Hopkins said ancillary service providers or pick-and-shovel businesses that provide equipment to the industry have been key targets for companies wishing to avoid investing in direct cultivators.

Hopkins and Fu both said one of the largest factors that causes hesitancy among investors is diligence, specifically, the general lack of documents.

Hopkins described it as "two worlds colliding," noting that investors are "usually accustomed to having a term sheet and a deck, maybe going through existing joint venture investment documents and other paper" that might be nonexistent for some cannabis-focused ventures.

This isn't the only obstacle in California's evolving industry, according to Hopkins and Fu, who

noted that new licensing requirements as a result of Proposition 64 are causing a need for reorganization of even the most established operators in the region.

"The new regulations totally changed the profits at the end of the day," Fu said. "The reporting costs and new costs of compliance now have to be calculated and considered, which is another way that the history of these companies doesn't necessarily reflect what the numbers might look like going forward."

In addition to the cost of compliance, businesses had to choose between an adult use license or a medical use license once Proposition 46, or the Adult Use of Marijuana Act, was approved by California voters.

The uncertainty of how this would affect the existing medical marijuana market created additional risk for companies when deciding which avenue to pursue.

While ensuring the investment is secure and profitable is the main concern of the funds, other risks can also be a cause for concern, according to Dennis Gutwald, of counsel at McDonald Carano LLP in the firm's gaming and administrative law group. Gutwald also spent seven years as a senior agent in the Investigations Division of the Nevada Gaming Control Board, which regulates the state's multibillion dollar gaming industry.

"Confidentiality of investors, to me, is by far the biggest [obstacle facing cannabis private equity investments]," Gutwald said, "followed very closely by the potential investigative requirements of the owners and principals of the organization" by regulatory bodies that are slowly taking shape in various states and will form in states that legalize the product.

According to Gutwald, one of the questions investors must ask is about the state's sunshine laws, which call for certain government proceedings to be open or available to the public. The potential that cannabis licenses will be susceptible to public records may have a chilling effect on investment.

Gutwald said in certain jurisdictions, the entire application for licensing is open to the public, which is a "deal killer" for a lot of private equity investors because some companies prefer to keep the names of investors private and also notes that the principals of these companies don't want the world to have personal information such as their address or phone number.

Hopkins referred to these same obstacles as reputational risks that investors are facing and said that the disclosures, or fear of them, can result in deals falling apart.

Hopkins and Fu said aside from reputational risk associated with investment, state licensing requires certain investors to report their entire criminal record, which in California includes traffic violations or tickets over \$300, and can result in the penalty of perjury if not disclosed properly.

"Just the way that regulators are phrasing all of this can be scary because it's so intense," Hopkins said. "I think that is a remnant as we are shifting from cannabis as a criminal enterprise to cannabis as a commercial agricultural commodity and science-based business. It's still not treated as any other business would be in terms of business licensing."

While private equity companies navigate the emerging industry, Gutwald said he believes the startup phase isn't best suited for private investment because companies are rushing open just to try and make some money.

"A lot of the business operations for these marijuana dispensaries are reminiscent of something

you'd see in the 1840s," Gutwald said. "I mean, you have people sitting around weighing stuff and putting it in a package and selling it. There is not mechanical packaging, there is a great lack of sophistication in the actual business operations themselves. Private equity would be superb at bringing that kind of sophistication to the business."

But Fu noted that the downside to waiting until it is federally descheduled or no longer prosecuted on a federal level is that by then banks will be willing to lend and it won't be as attractive an opportunity for the funds.

"As soon as we can do interstate business, the party's over," Hopkins said.

--Editing by Rebecca Flanagan.

---

All Content © 2003-2018, Portfolio Media, Inc.