CLIENT ALERTS & INSIGHTS

Engaging in Activities that Violate Federal Law? DOJ Scrutiny of PPP Loan Recipients Turns to Ancillary Companies Supporting the Cannabis Industry

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Since its inception, the cannabis industry has always existed alongside significant regulatory and compliance challenges. These largely stem from the fact that the manufacture, distribution and possession of marijuana remains illegal under federal law, regardless of the outcome of recent efforts to move marijuana from Schedule I to Schedule III under the Controlled Substances Act, 21 U.S.C. § 841 et seq.

In recent months, the government's focus has turned to auditing and prosecuting not just companies directly involved in the cannabis industry but also those that support it-commercial landlords, suppliers and third-party service and goods providers are all excellent examples. Now more than ever, companies that service the cannabis industry must be diligent and proactive, particularly those that obtained "PPP loans" during the pandemic.

In Mar. 2020, the federal government enacted the Coronavirus Aid, Relief and Economic Security ("CARES") Act to provide emergency financial assistance to millions of Americans suffering the economic effects of the COVID-19 pandemic. In part, the CARES Act created the Paycheck Protection Program ("PPP"), which authorized billions of dollars in forgivable loans to small businesses.

The CARES Act requires small businesses to submit a PPP loan application before receiving any funds. Small businesses must certify that they are "not engaged in any illegal activity under federal, state or local law." This certification poses a significant risk for businesses affiliated with the cannabis industry.

The manufacture, distribution and sale of cannabis are legalized in Illinois. [1] In total, 24 states (plus the District of Columbia) legalized the recreational use of cannabis. [2] Another 14 allow for medicinal use of the drug. [3] Nevertheless, marijuana remains illegal under federal law. [4]

To that end, the Small Business Administration ("SBA") publicly stated that cannabis companies are ineligible for PPP funds because they are engaged in activity that violates federal law. [5] Specifically, both Direct Marijuana Businesses *and* Indirect Marijuana Businesses are ineligible to receive PPP funds. [6] In drawing this conclusion, the SBA relied on the following guidance:

Because federal law prohibits the distribution and sale of marijuana, financial transactions involving a marijuana-related business would generally involve funds derived from illegal activity. Therefore,

businesses that derive revenue from marijuana-related activities or that support the end-use of marijuana may be ineligible for SBA financial assistance. [7] The question of whether a particular business is eligible for assistance under an SBA program must be determined on an annual, case-by-case basis and depends upon the nature of the business' specific operations.

A Direct Marijuana Business is a business that grows, produces, processes, distributes or sells marijuana or marijuana products, edibles or derivatives, regardless of the amount of such activity. This applies to recreational and medical use even if the business is legal under local or state law where the applicant's business is or will be located.

An Indirect Marijuana Business is a firm that derived any of its gross revenue for the previous business year (or, if the firm is a start-up, projects to derive any of its gross revenue for the next business year) from sales to Direct Marijuana Businesses of products or services that could reasonably be determined to aid in the use, growth, distribution, enhancement or other development of marijuana. Examples of Indirect Marijuana Businesses include firms that sell smoking devices, pipes, bongs, inhalants or other products primarily designed, intended or marketed to facilitate marijuana consumption.

The DOJ is now investigating over 100 Direct and Indirect Marijuana Businesses for possible PPP violations. [8] Under the False Claims Act, private third parties can report PPP violations to the government. The third-party whistleblower will receive 15 to 30 percent of proceeds from any settlement business.

Though most Direct Marijuana Businesses are aware of their ineligibility status for PPP loans, the answer is far more unclear for those who may qualify as Indirect Marijuana Businesses. The SBA defines an Indirect Business as a: "firm that derived any of its gross revenue for the previous business year (or, if the firm is a start-up, projects to derive any of its gross revenue for the next business year) from sales to Direct Marijuana Businesses of products or services that could reasonably be determined to aid in the use, growth, distribution, enhancement or other development of marijuana."[9]

For example, a company that "sell[s] smoking devices…primarily designed, intended or marketed to facilitate marijuana consumption" is considered an Indirect Marijuana Business. [10] But what about a landlord who leases space to a marijuana company? Or a food company that primarily markets to those in the cannabis industry?

So far, the DOJ has released information on one case relating to PPP loan fraud by a small business associated with the cannabis industry. [11] Docklight Brands develops and sells hemp products. It also licenses trademarks for use in connection with cannabis products. Docklight certified that it was eligible for $494,719 in PPP funds. A third-party whistleblower later reported Docklight under the False Claims Act. The case settled for "double damages"-a common pretrial settlement proposal in these cases-that amounted to nearly a million dollars, with the whistleblower receiving $148,416.70 in settlement funds.

Though the SBA has clarified where the line falls, whether any possible "indirect marijuana business" actually fits that definition can be extremely fact-specific. It requires a review of revenue derived from sales to direct marijuana businesses, products and services offered, marketing materials and other business details.

Benesch anticipates that the DOJ will continue investigating companies that may qualify as Indirect Marijuana Businesses. If you or your business have concerns about a potential PPP loan investigation, please contact Benesch's White Collar or Cannabis Practice Groups. We stand ready to assist with experience and expertise in government investigations and the cannabis industry.

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[1] *See* 720 ILCS 550/1 *et seq*.

[2]*See, e.g.,* Pew Research Center, Most Americans now live in a legal marijuana state - and most have at least one dispensary in their county, available at https://tinyurl.com/3bswjcud (last accessed May 24, 2024).

[3] *Id*.

[4] See, e.g., 21 U.S.C. § 841, 844, 848; 18 U.S.C. §§ 371, 1956, 1957.

[5]*See, e.g.,* Marijuana Moment, Marijuana Businesses Are Ineligible For Coronavirus Disaster Relief, Federal Agency Confirms, *available at* https://tinyurl.com/2asweb4x (last accessed May 24, 2024).

[6] *Id*.

[7] SBA Notice Control No. Notice Control No. 6000-19005, Subject: Guidance on Grantees Providing Assistance to Marijuana-Related Businesses.

[8] *See,* e.g., Marijuana Moment, Justice Department Is Investigating Marijuana-Related Businesses Over COVID Relief Loans, Industry Sources Say, *available at* https://tinyurl.com/ke3878dy (last accessed May 24, 2024).

[9] SBA Notice Control No. Notice Control No. 6000-19005, Subject: Guidance on Grantees Providing Assistance to Marijuana-Related Businesses.

[10] *Id*.

[11]*See* United States Attorney's Office Western District of Washington, Company that improperly took COVID 19 PPP loan agrees to pay nearly $1 million to settle False Claims Act case, *available at* https://tinyurl.com/2tm9j7aw (last accessed May 24, 2024).