

Money Doesn't Grow on Leaves: Cannabis Investing for Dummies (and Non-Dummies)

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When people learn that you are a cannabis attorney, there are a range of reactions. Nervous laughter bordering on incredulity may be most common. Another common reaction is the sentiment that investing in cannabis is a license to print money. Spoiler alert: This is not the case.

Consider this a public service announcement – one that applies both to cannabis operators looking to raise capital and to potential cannabis investors.

Hemp vs. Marijuana

The distinction between hemp and marijuana is enormously consequential and one that many new cannabis investors do not immediately appreciate. While the terms are often used interchangeably in common vernacular, one of the most common ways I begin conversations with potential cannabis clients is by determining whether the client is talking about hemp or marijuana.

This country's relationship with cannabis is a complicated one, and as is often the case in complicated matters, words matter. Marijuana and hemp are different strains of the *Cannabis sativa L* plant. So, "cannabis" is a scientific term, not a legal one.

Although the federal Controlled Substances Act historically made no distinction between marijuana and hemp, in 2018 the federal government defined "hemp" as any part of the *Cannabis sativa L* plant, including all derivatives and extracts such as cannabidiol (CBD), *provided that the plant contains less than 0.3% tetrahydrocannabinol (THC)*. Any *Cannabis sativa L* plant or derivative from such a plant with a higher THC level is considered "marijuana," which remains a Schedule I substance – the most stringently regulated category of narcotics – under the Controlled Substances Act. Because THC is the psychoactive ingredient in marijuana that produces the feeling of being "high," a critical difference between marijuana and hemp is that hemp will not produce a "high." In short and for relevant purposes below, hemp-derived CBD is legal to possess under federal law (and the law of most states), whereas marijuana is federally illegal.

And to add another wrinkle, the country is now dealing with cannabis derivatives that Congress

almost certainly never considered when it passed the Farm Bill in 2018 – specifically products such as Delta-8 THC, Delta-10 THC, and others. A number of these products can produce a “high” but they likely fall within a loophole in the law. That leads to a number of unintended consequences, including, just to name a couple, that consumers can now legally access products that will get them high but also those products – by virtue of being within a legal loophole – are essentially entirely unregulated at the federal level. Nevertheless, those products are largely responsible for the sustainability of the hemp industry as it exists today.

Raising Cannabis Money in a Nutshell: Lack of Access to Many Traditional Forms of Capital

It can be extremely difficult to access capital in the cannabis industry. This is a fundamental – if not *the* fundamental – obstacle to the development of the industry. Capital is oxygen for any business. In the cannabis world, capital means research, development, and expansion of product lines and therapies for patients. So what is the problem with accessing cash?

The legal distinction between marijuana and hemp raises important issues when raising capital. We’ll address both in turn.

Raising Marijuana Capital

Lending for marijuana operations is virtually a non-starter from traditional banks. In addition to the reasons described above, there is the separate concern that the collateral (e.g., the marijuana land, equipment, or proceeds) are subject to civil asset forfeitures under federal law. This means that the collateral securing the loan may essentially evaporate and render the loan unsecured. In the alternative, banks may be unwilling to foreclose on and take possession of property when the very possession of the property may run afoul of federal law.

There are private lenders specializing in the cannabis industry. Such lenders – who typically offer hard money loans – may be attractive absent other sources of capital, but the interest rates often make such loans unattractive or untenable for would-be cannabis operators.

So who can you get money from? For starters, it is always nice to have wealthy and supportive friends and family who are both willing and able to fund your business. That said, even your closest friends and family will likely expect something in return for their generosity. Most companies seeking to raise capital through investors provide one of two things in return: debt or equity. Debt financing, or debt raising, is when a company, typically by way of a bond or a promissory note, borrows money from an investor and agrees to pay it back at a later date with interest. Equity financing, on the other hand, is when a company generates capital through the sale of its ownership interests. Aside from the interest, the downside to debt financing is the high amount of risk – the principal and interest payments will become due regardless of actual business performance. With equity financing, the main downside is that the company is effectively selling off pieces of business ownership, causing dilution of pre-existing ownership.

Private companies seeking to raise capital through the issuance of debt or equity securities also have more traditional options – offering the securities to the public or through a private placement. An initial public offering, or an “IPO,” refers to the process of offering the shares of a private corporation to the public for the first time. While this option provides companies with an opportunity to offer equity through the primary market to millions of investors, it typically appeals only to larger, more

established private companies that are able to meet the requirements of stock exchanges and the United States Securities and Exchange Commission (SEC). And, at least as of the time of this writing, domestic exchanges are unavailable to most marijuana operators. Alternatively, a private placement is the sale of debt or equity to a limited number of qualified investors. Such investors may include friends and family, as well as professional investors such as private equity firms and venture capitalists. Compared to IPOs, private placements are subject to less stringent regulations and are more accessible for smaller, private companies and startups.

Of course, offering securities comes with legal obligations at both the federal and state level. The federal Securities Act of 1933 (Securities Act) requires that all offerings of securities be either registered with the SEC or exempt from such registration. IPOs are notably not exempt from registration or the SEC's ongoing company reporting requirements, both of which are known to be costly and arduous. Initial issuances to company founders and certain private placements, however, are exempt from registration. In addition to the Securities Act and the SEC's regulations thereunder, each state has its own set of securities laws and regulations. For example, companies making private placements may be required to make notice filings and/or pay a small fee in each state where securities are being issued.

Raising Hemp Capital

There shouldn't be a problem accessing capital for a hemp business. After all, hemp is federally legal and legal (in most formulations) in all states. Provided that you can find a lender that will provide financing to meet your needs, the law should not act as an impediment to obtaining those funds.

Unfortunately, however, not all financial institutions have dipped their toes into the cannabis sector. Some cite vague reputational concerns and others have not figured out how to price the extra compliance costs. And others are probably simply prisoners of inertia.

Cannabis-Specific Fundraising Considerations

So after all this, you still want to raise money for your cannabis business or invest in a cannabis business? Let's get into it, with the caveat that space prevents us from hitting on all of the considerations. Here are some of the most common issues in cannabis fundraising:

1. Marijuana Fundraising

Because all marijuana regimes are at present operated at the state level, raising funds for (or investing in) a marijuana business requires close adherence to the laws of the state(s) in which you are operating. Unfortunately, those laws are not uniform across the country. Here are a few examples of the types of important differences across states that you must seriously consider when raising capital or investing in a marijuana business.

All states that allow marijuana in some form or another require marijuana operators to be licensed. And most states have specific requirements for who can obtain a license. If you are attempting to raise money for a marijuana business, it is essential that you have all appropriate licenses. And if you are considering an investment in the marijuana business, your due diligence should include confirmation of the appropriate licenses.

One must also consider whether the state allows shares in a marijuana business to be transferred freely or if the transfer requires notice to and/or approval by regulators. Also consider whether the

investors must meet the licensing requirements themselves and what type of diligence is necessary to confirm that the investment is appropriate from that perspective. Finally, remember that most states require disclosures of all investors (or at least those with a substantial stake), and consider whether the company and the investors are comfortable making that information publicly-available.

2. Hemp Fundraising

There are fewer and less cumbersome considerations in hemp fundraising, but there are still traps for the unwary. Savvy banks and investors will require extensive due diligence to ensure that the hemp business is operating within the extensive and evolving hemp regulations at the federal and state level. In particular is the concern that hemp can turn into marijuana if the THC level becomes elevated (regardless of intention) above 0.3%. All of a sudden, then, an entirely legal investment or loan arguably begins to run afoul of federal law and can implicate money laundering concerns.

Takeaways

Will you make money investing in a cannabis? We don't know. Some people certainly do and others don't. What we do know is that you are far more likely to be successful as a fundraiser or an investor if you take the time to understand the ins and outs of the cannabis business and work with professional service providers with experience in the industry.

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