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Financial newsletter

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INSIDE THIS ISSUE

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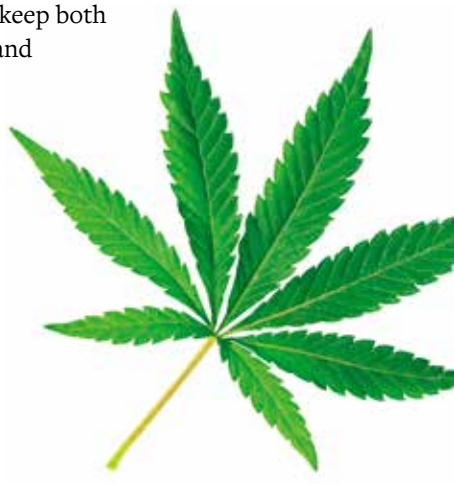
POTENTIAL OPPORTUNITIES IN LEGALIZATION: FINANCIAL SERVICES AND MINNESOTA'S LEGALIZATION OF CANNABIS

On May 30th, 2023, Governor Tim Walz signed into law a bill legalizing the recreational use of marijuana in the State of Minnesota. The bill is likely to create a new sector in Minnesota's retail business landscape; however, financial institutions' opportunities to work with those new businesses may not be as open and carefree as using the drug. Financial institutions should keep both feet on the ground and understand the rules and requirements before financing or otherwise providing banking services to any cannabis-related business.



Under the new Minnesota law, as of August 1, 2023, adults 21 and older will be able to possess up to two ounces of cannabis and may cultivate up to eight plants at home. However, state officials

continued on pg 2

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POTENTIAL OPPORTUNITIES IN LEGALIZATION: FINANCIAL SERVICES AND MINNESOTA'S LEGALIZATION OF CANNABIS

continued from pg 1

expect it to take 12-18 months before the Office of Cannabis Management is able to begin issuing licenses.[1]

Industry analysts forecast that total sales in the US legal cannabis industry will reach $29.6 billion by the end of 2023, further predicting that this figure could be as high as $45 billion by the end of 2027.[2] Despite these projected sales numbers, as of December 2022 there were only 773 depository institutions that provided banking services to cannabis-related businesses ("CRBs").[3] This discrepancy has been attributed to the legal risks and high compliance costs associated with providing financial and banking services to CRBs.[4] Since cannabis is still illegal at the federal level, financial regulators impose stringent reporting and monitoring requirements for financial institutions that serve CRBs.[5]

Current Federal Requirements

Under the current regulatory regime, in addition to other federal laws and regulations, financial institutions seeking to provide services to CRBs are subject to FinCEN's guidance regarding the Bank Secrecy Act.[6] Under FinCEN's current regulatory structure, a financial institution is required to file a suspicious activity report ("SAR") on any activity involving an CRB, regardless of state legalization.[7] In doing so, the financial institution must undertake significant investigation and analysis to properly categorize and draft an SAR.[8] These reporting obligations can create an extensive burden, potentially requiring a SAR covering every transaction taken by an CRB.[9] For example, a small credit union in Oregon filed around 13,500 SARs over a two year span for approximately 500 CRB clients.[10] The basis of the FinCEN reporting requirements is that under federal law, all transactions involving marijuana involve illegal activity and therefore require stricter reporting under the Bank Secrecy Act.[11] The effect of the reporting requirements is that the cost of providing financial or banking services to CRBs is higher than federally legal businesses and the financial institution providing those services faces more significant legal ramifications for the failure to comply with applicable regulations.[12] The American Bankers Association has stated that "any contact with money that can be traced back to state marijuana operations could be considered money laundering and expose a bank to significant legal, operational, and regulatory risk."[13]

Potential Future Legislation

Recognizing the incongruity between federal banking regulations and the growing number of states that have legalized marijuana, on April 27, 2023, a bipartisan group of congresspeople reintroduced the Secure and Fair Enforcement (SAFE) Banking Act in the House and Senate. As currently

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[1] Kyle Jaeger, *Minnesota Governor Signs Marijuana Legalization Bill Into Law,* MARIJUANA MOMENT (May 30, 2023), https://www.marijuanamoment.net/minnesota-governor-signs-marijuana-legalization-bill-into-law/; Shawna Mizelle and Sydney Kashiwagi, *Minnesota Becomes 23rd State to Legalize Recreational Marijuana,* CNN (May 30, 2023); https://www.cnn.com/2023/05/30/politics/minnesota-cannabis-legalization-recreational-marijuana/index.html.

[2] Press Release, BDS, BDSA Forecasts Legal U.S. Cannabis Market to Reach $45 Billion in 2027 (June 7, 2023), https://bdsa.com/press-release/bdsa-forecasts-legal-u-s-cannabis-market-to-reach-45-billion-in-2027/; Bryan McGovern, *Cannabis Weekly Round-Up: TerrAscend Closer to TSX Listing,* INVESTING NEWS NETWORK (June 23, 2023); https://investingnews.com/top-cannabis-news/.

[3] FinCEN, *Frequently Requested FOIA-Processed Records: Marijuana Banking Updates,* https://www.fincen.gov/frequently-requested-foia-processed-records

[4] Jeffery Miron and Nicholas Anthony, *Cannabis Banking: A Clash Between Federal and State Laws,* CATO INSTITUTE (May 27, 2022), https://www.cato.org/blog/cannabis-banking-clash-between-federal-state-laws

[5] FinCEN, *BSA Expectations Regarding Marijuana-Related Businesses,* FIN-2014-G001 (Feb. 14, 2014), https://www.fincen.gov/resources/statutes-regulations/guidance/bsa-expectations-regarding-marijuana-related-businesses

[6] *Id.*

[7] *Id.*

[8] *Id.*

[9] John Hudak and Aaron Klein, *Banks Don't Want to Work with Marijuana Companies. It's Time for that to Change,* BROOKINGS INSTITUTE (Mar. 28, 2019), https://www.brookings.edu/opinions/banks-dont-want-to-work-with-marijuana-companies-its-time-for-that-to-change/

[10] *Id.*

[11] FinCEN, *supra note* 5.

[12] Miron and Anthony, *supra note* 4.

[13] American Bankers Association, *Cannabis Banking: Bridging the Gap Between State and Federal Law*, https://www.aba.com/advocacy/our-issues/cannabis

drafted, the SAFE Banking Act would provide a safe-harbor to depository institutions, federal credit unions, and state credit unions who provide financial services to a state-sanctioned CRB.[14] Under the Act, federal regulators would be prohibited from: penalizing, prohibiting, or discouraging a bank from providing financial services to state legal cannabis businesses; ending or limiting a bank's federal deposit insurance if the bank provides those services; or recommending or incentivizing a bank to halt or limit the services provided to CRBs.[15] The SAFE Banking Act would also require that the SAR reporting requirements be amended such that the requirements are consistent with the purpose and intent of the SAFE Banking Act, likely meaning that SARs will no longer be required for transactions involving marijuana or marijuana products in states that have passed legalization legislation.[16] Those in the cannabis industry see the SAFE Banking Act as a springboard for financial institutions to meaningfully participate in the growing industry on a large scale for the first time.[17]

The SAFE Banking Act has enjoyed strong bipartisan support and has passed in the House seven times previously.[18] The SAFE Banking Act has not made it out of the Senate Banking Committee before, but Sherrod Brown, chairman of the committee, stated that he hopes that the Act will get a markup "sometime in the near future" but he could not give a specific timeline for markup and submission to the Senate floor.[19] Should the SAFE Banking Act pass, financial institutions will have an unprecedented opportunity to provide services to CRBs in states that have legalized marijuana.

What This Means for Financial Institutions in Minnesota

The confluence of Minnesota's legalization of cannabis and potential reform to federal banking regulations represents a unique opportunity for financial institutions in Minnesota to meaningfully participate in the growth and development of a new industry in Minnesota. Financial institutions should stay informed regarding the development of federal financial regulations as they apply to cannabis to fully take advantage of Minnesota's legalization as more customers and potential customers seek financial services for their upcoming CRBs.

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[14] SAFE Banking Act of 2023, H.R. 2891, 118th Cong. (2023).

[15] Stefan Sykes, *Lawmakers Reintroduce SAFE Banking Act, A Bill the Cannabis Industry Hails as a Lifeline,* CNBC (April 27, 2023); https://www.cnbc.com/2023/04/27/safe-banking-act-reintroduced-cannabis-industry-hails-bill.html.

[16] SAFE Banking Act of 2023, H.R. 2891, 118th Cong. (2023).

[17] Sykes, *supra* note 15.

[18] *Id.*

[19] Kyle Jaeger, *Key Senate Committee Chair Hopes to Hold Marijuana Banking Vote in "Next Two or Three Weeks' Following Negotiation with GOP,* MARIJUANA MOMENT (June 7, 2023); https://www.marijuanamoment.net/key-senate-committee-will-vote-on-marijuana-banking-bill-in-next-two-or-three-weeks-chairman-says/

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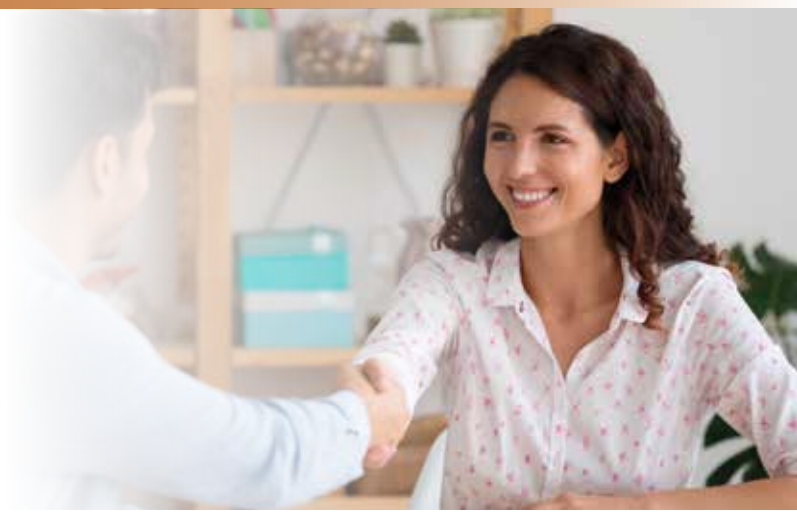

NON-COMPETE AGREEMENTS VOID IN EMPLOYMENT AGREEMENTS

The Minnesota Legislature recently passed a law rendering all covenants not to compete in employment agreements signed on or after July 1, 2023. The new law makes any covenant not to compete contained in an employment (or independent contractor) agreement/contract void and unenforceable if the agreement/contract was executed on or after July 1, 2023. This ban covers agreements between employee (including independent contractors) and employer that restricts the employee/independent contractor, after termination, from performing:

1) work for another employer for a specified period of time;
2) work in a specific geographical area; or
3) work for another employer that is similar to the employee's work for the previous employer.

The non-compete legislation does not, however, apply retroactively to void covenants not to compete in contracts or agreements executed before July 1, 2023. The new legislation also does not void an entire employment contract or agreement that contains a covenant not to compete, only the covenant itself. Additionally, the new law carves out a few instances when a covenant not to compete would still be valid and enforceable. These instances include:

1) when the covenant not to compete is agreed upon during the sale of a business; or
2) when the covenant not to compete is agreed upon in anticipation of the dissolution of a business.

In enacting this legislation, Minnesota joins Oklahoma, California, and North Dakota as states that have entirely banned covenants not to compete. Other states that have passed legislation restricting the validity or enforceability of non-compete clauses include an exclusion to the law for salary or income thresholds, allowing non-compete clauses for highly compensated employees. Minnesota's version of the law is more expansive because it does not include any income threshold. This broad application of a non-compete ban creates concerns regarding the new possibility that upper management and "C-suite" employees may easily and quickly become competitors at any time.

While the newly enacted legislation prohibits non-competes, certain restrictions in employment contracts remain applicable. The legislation does not apply to (or excluded) nondisclosure agreements, non-solicitation agreements, confidentiality agreements, agreements restricting the dissemination of trade secrets, or agreements restricting the ability to use client or contact lists, and agreements to protect trade secrets or other confidential information. All of these agreements remain enforceable in employment contracts or agreements executed after July 1, 2023. Nondisclosure, non-solicitation, confidentiality, trade secret, and client contract restrictions, which were once generally seen as accompaniments to a covenant not to compete, are now at the forefront of an employer's ability to protect sensitive information and customer relationships under Minnesota's new law. As a result, employers may need to revisit, reevaluate and strength the allowable restrictions in employment contracts–providing the most protection available within the context of the new legal landscape.

In addition to voiding covenants not to compete, the new law also addresses choice of law and choice of venue provisions in employment contracts. Under the new law, an employer is not allowed to require employees who reside and work in Minnesota, as a condition of their employment, to agree to a provision in their employment contract or agreement that would require the employee to: (i) adjudicate (litigate and arbitrate) in another state outside of Minnesota a claim arising in Minnesota; or (ii) deprive the employee of the substantive protection (i.e. prohibition of non-compete) of Minnesota law. As a remedy, an employee may receive injunctive relief and recover reasonable attorney fees.

Minnesota's new law will require some employers to reassess their employment contracts and agreements in order to ensure both compliance and protection under the newly enacted legislation. Employers may also need to evaluate their current practices regarding information security and employee access to sensitive information. While it is unclear what effect the new law will have on the labor market in Minnesota, employers should be aware that their old employment contract forms may be insufficient to protect their informational security or customers lists and may not comply with the new restrictions on choice of law and venue provisions for employees that are Minnesota residents.

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OBERG REVISITED: PROCEEDINGS TO DETERMINE THE PROPERTY STATUS OF GRAIN BINS

Previous readers of Gislason & Hunter's Financial Newsletter may recall discussion of a recent case decided by the Minnesota Court of Appeals regarding considerations to make in determining whether a grain bin is a fixture (and thus part of the real estate that can be pledged through a mortgage) or is personal property (and thus can be pledged through a security agreement). More specifically, the Court of Appeals established four factors that should be considered in making such a determination: (1) whether the grain bin can be removed without leaving the real property in a substantially worse condition than before; (2) whether the grain bin can be removed without breaking it into pieces and damaging the grain bin itself; (3) whether the grain bin has any independent value once removed from real property; and (4) the intent of the parties. This article addresses the first time that these factors were put to the test.

After the Court of Appeals' decision in the case, titled *Lighthouse Management, Inc. v. Oberg Family Farms et al.*, the matter was remanded to the District Court for further proceedings. In October of 2022, the District Court held an evidentiary hearing to determine whether the grain bins constituted real-estate fixtures or personal property. The parties retained experts who each testified regarding their opinions as to how the grain bins fit into the four factors established by the Court of Appeals. The experts agreed on some factual matters, including that (1) the grain bins were moveable and retained some independent value, (2) the grain bins were attached to concrete foundations only by nuts and anchor bolts, and could be moved by unscrewing those nuts from the anchor bolts, and (3) the grain bins required a concrete foundation and could not be placed directly on the ground. However, the experts diverged as to their opinions on other facts about the grain bins, including (1) the amount of work necessary to move the grain bins, (2) the condition and utility of the concrete pads following removal of the grain bins, and (3) the value of the gain bin components once moved.

After being presented with the evidence and expert opinions, the District Court noted that the Court of Appeals did not address whether the concrete foundations of the grain bins should be considered part of the structures for purposes of the four-factor analysis. The District Court ultimately determined that the concrete pads should be considered part of the structures, noting that "[t]here would be no reason to build a cement foundation of this nature, except for placing a grain bin on the foundation." With that in mind, the District Court weighed the four factors from the Court of Appeals as follows:

- Factor 1: Whether the grain bin can be removed without leaving the real property in a substantially worse condition than before. The District Court determined that this factor supported the grain bins being classified as real property because (a) the concrete foundations constituted part of the structures and (b) removal of the foundations would cause substantial damage to the real property.

- Factor 2: Whether the grain bin can be removed without breaking it into pieces and damaging the grain bin itself. The District Court determined that this factor supported the grain bins being classified as real property because (a) the concrete foundations constitute part of the structures, (b) the foundations cannot be removed without being broken into pieces, and (c) the grain bins therefore cannot be removed without damaging the structures.

- Factor 3: Whether the grain bin has any independent value once removed from real property. The District Court determined that this factor supported the grain bins being classified as personal property because they retain at least some independent value once removed from the real property.

- Factor 4: The intent of the parties. The District Court determined that insufficient evidence was provided to make a determination regarding the subjective intentions of the parties. Therefore, the District Court concluded that this factor favored none of the parties.

Based on this analysis, the District Court concluded that because two factors weighed in favor of the grain bins being categorized as real property and because only one factor weighed in favor of the grain bins being categorized as personal property, the grain bins constituted real property.

As of the date this article is written, it is yet to be seen whether another appeal will be taken from the District Court's latest decision. However, there are various takeaways to be drawn from the District Court's decision. First, expert testimony will likely be necessary as to each of the factors if a case including these questions goes to trial. Second, if a grain bin sits on a concrete structure, it is difficult to see how the Court of Appeals' first two factors would not weigh in favor of the grain bin being classified as real property. Third, it is likely an open question as to the types of facts a court will deem important in assessing the intent of the parties. Lastly, it is also likely an open question as to what a court should or will do if it determines that two factors weigh in favor of a real property classification and the other two factors weigh in favor of a personal property classification.

Ultimately, a lender is best off—and can likely avoid the need to ask these questions altogether—if it has a priority interest in both the real and personal property of a debtor. But in situations where this is not possible, there will be at least some uncertainty in most cases as to whether a grain bin is considered real or personal property.

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