The Business of Cannabis: Landlord – Tenant Considerations

By:

Jack Fersko[1]

[1] Copyright 2021, All rights reserved. Mr. Fersko is a partner at Greenbaum, Rowe, Smith & Davis, LLP where he Chairs the Real Estate Department, and Cannabis Law Group. This article is an updated version of an article published in conjunction with a program titled *Latest Developments in Cannabis Law*, presented by the New Jersey Institute for Continuing Legal Education in cooperation with the New Jersey State Bar Association Cannabis Law Special Committee. This article should not be used as, nor is it intended to give, legal advice. Any opinions set forth in this article are of the author only and not of the firm. Growing, processing, distributing and selling cannabis remains a federal crime and also violates the law in many states.

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Introduction

On December 17, 2020, the New Jersey legislature passed the New Jersey Cannabis Regulatory, Enforcement Assistance, and Marketplace Modernization Act (the "Act"), that was signed into law by Governor Phil Murphy on February 22, 2021.[2] On August 19, 2021, the New Jersey Cannabis Regulatory Commission (the "Commission") adopted its initial rules to implement the Act (the "Rules").[3] The Rules, which will be effective for a one-year period (expiring August 19, 2022) are lengthy and detailed in the oversight structure established for the regulated community (including owners and passive investors) and certain businesses, including financial investors (including debt and equity) and vendor-contractors (including landlords). There is a myriad of issues that an applicant for a cannabis business license must address, not the least of which are the real estate related implications presented by the Act and the Rules. This paper will focus on the considerations of each of a landlord and a tenant when considering a lease transaction for a cannabis business facility.

Forty-one states and the District of Colombia have legalized the sale of marijuana for either medical, recreational or CBD oil purposes and nineteen states and the District of Colombia have legalized the sale of marijuana for recreational use.[4] The United States spent $12 billion on legal cannabis products in the first half of 2021.[5] In 2020, sales topped $18 billion and are on pace to hit $25-$26 billion in 2021, making cannabis the fastest growing industry in the United States.[6] It is predicted that the field will grow to a $44.9 billion industry by 2025.[7] One of the motivating forces behind this anticipated growth and the favorable view of many state legislatures, is the revenues generated for state and local governments. As of May 2021, states reported $7.9 billion in tax revenue from legal marijuana sales.[8] Since 2014, Colorado's estimated state tax revenue from adult use cannabis was approximately $1.558 billion.[9] In Massachusetts, where 2021 sales are on a pace to reach $1.2 billion (a 70% increase over

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[2] N.J.S.A. 24:6I-31 *et seq*.
[3] N.J.A.C. 17:30-1 *et seq*.
[4] https://disa.com/map-of-marijuana-legality-by-state; Ganjapreneur Staff. *Here Are All The States That Have Legalized Weed (2021)*. https://www.ganjapreneur.com/. Sites last visited September 26, 2021.
[5] Bruce Barcott. *Americans are on a pace to spend twice as much on cannabis as on milk*. https://www.leafly.com/news/industry/americans-on-pace-to-spend-twice-as-much-on-weed-as-on-milk.
[6] *Id.*
[7] *Id.*
[8] https://www.mpp.org/issues/legalization/marijuana-tax-revenue-states-regulate-marijuana-adult-use/#:~:text=Estimated%20State%20Sales%20Tax%20Revenue%20from%20Adult-Use%20Cannabis,%20%20362%2C027%2C103%20%203%20more%20rows%20. Site last visited September 26, 2021.
[9] *Id.*

2020)[10], its estimated state tax revenues since November 2018 through April 2021 total approximately $261 million.[11]

The use of marijuana for medicinal purposes dates back to 2737 BC, when the Chinese Emperor Shen Neng reportedly prescribed marijuana infused tea to treat such ailments as gout, malaria, poor memory and rheumatism.[12] Its popularity is reported to have "spread throughout Asia and the Middle East and down the eastern coast of Africa."[13] By the late 1700s, hemp seeds and roots were a recommended treatment for a number of ailments in U.S. medical journals.[14] However, in 1906, Congress created the Food and Drug Administration to address a growing issue with opium and morphine, and in 1937, the Marihuana Tax Act was passed, making non-medical use of marijuana illegal.[15] Over the years, the federal government and the states have enacted laws outlawing growing, distribution and use of marijuana. The pendulum, however, clearly has shifted once again. While marijuana remains illegal in many states, and at the federal level, there is a growing national chorus for its legalization both medicinally and recreationally.

In August 2015, the National Conference of State Legislatures adopted a resolution providing that the federal laws should be amended to allow states to establish their own policies with respect to marijuana, stating expressly that the federal government should not undermine the policies of the states in this area.[16] And according to a Gallup poll released on October 25, 2017, 64% of those surveyed supported making marijuana legal in the United States.[17] On November 3, 2020, New Jersey voters approved a constitutional amendment allowing for adult-use marijuana.

The national lovefest with marijuana has produced a number of interesting social twists. In a May 28, 2017 article published in The New York Times, it was reported that in 2015 "women comprised about 36% of the executives in the legal-marijuana industry, compared with 22 percent in senior roles in other areas."[18] In a March 18, 2017 article in the New York Post, it was reported that marijuana has infused the social circles of many elites.[19] In California, entrepreneurs are sponsoring pairing dinners, matching wines and cannabis, and charging upwards of "$150 for a meal that experiments with everything from marijuana-leaf pesto sauce

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[10] Bruce Barcott. *Americans are on a pace to spend twice as much on cannabis as on milk*. https://www.leafly.com/news/industry/americans-on-pace-to-spend-twice-as-much-on-weed-as-on-milk.

[11] https://www.mpp.org/issues/legalization/marijuana-tax-revenue-states-regulate-marijuana-adult-use/#:~:text=Estimated%20State%20Sales%20Tax%20Revenue%20from%20Adult-Use%20Cannabis,%20%20362%2C027%2C103%20%203%20more%20rows%20. Site last visited September 26, 2021.

[12] Leonard I. Frieling. *Overview of Medical Marijuana in Colorado*. The Colorado Lawyer, Vol. 40, No. 4 April 2011, at 37.

[13] *Id.*

[14] *Id.*

[15] *Id.at 38.* The Marihuana Tax Act was declared unconstitutional in 1969. *Leary v. United States*, 395 U.S. 6 (1969).

[16] A copy of the resolution can be found at http://www.ncsl.org/documents/standcomm/sclaw/Marijuana_Policies_Federal_Interference.pdf.

[17] The poll may be located at https://www.mpp.org/news/press/new-gallup-poll-finds-record-support-making-marijuana-legal-u-s-64/.

[18] Abby Ellin. *Older Women and Cannabis: A Growth Industry.* The New York Times, May 28, 2017.

[19] Dana Schuster. *How pot is infiltrating New York's most elite social circles.* New York Post, March 18, 2017.

to sniffs of cannabis flowers paired with sips of crisp Russian River chardonnay."[20] The growth of the cannabis industry has not gone unnoticed by the alcohol industry at large.

Researchers have found that between 2006 and 2015, there has been a 15% drop in monthly alcohol sales in those states that have legalized medical marijuana.[21] In fact, in its February 14, 2018 10K filing, the Molson Coors Brewing Co., stated that the cannabis industry could have a material adverse effect on its business and financial results.[22] In addition, the maker of Samuel Adams, The Boston Beer Co., has warned in its 10-K filing that recreational marijuana use could adversely affect its sales, and Jack Daniel's maker, Brown-Forman identified recreational marijuana as a potentially negative impact on its business.[23] Perhaps recognizing the impact the cannabis industry may have long term on the alcohol industry, Constellation Brands, the world's leading international producer and marketer of spirits, wine and beer, purchased a 9.9% stake in Canada's largest licensed marijuana producer Canopy Growth for $245 million (CN).[24]

The cannabis industry has not only affected the social scene and caused the alcohol industry to take notice and affirmative action. The real estate industry as well has been, and all indications are, will continue to be, impacted greatly.[25] Two real estate investment trusts have been established to focus exclusively on the industry. Innovative Industrial Properties is a public entity traded on the New York Stock Exchange and Kalyx Development, Inc., is a private New York based REIT that has in excess of 500,000 square feet of industrial space.[26] Innovative Industrial Properties was the first publicly traded cannabis REIT. As of April 2021, it had a stock value of $183.93 per share and a market capitalization of $4.16 billion.[27] Kalyx Development is a private REIT with five properties in Arizona, Oregon and Washington state, where it serves as a landlord to eighteen established or emerging operators.[28] This is not an unexpected happening. It is not uncommon for marijuana dispensaries to pay a substantial premium for rental space, sometimes as much as "four times the going rental rate."[29] Michael McGuinness, the CEO of NAIOP New Jersey, has predicted that the legalization of marijuana in

[20] Thomas Fuller. *Pot to Pair With Wines? Sonoma Embraces Possibilities.* The New York Times, March 19, 2017.
[21] *Medical cannabis laws led to 15% drop in alcohol sales, study shows*. Marijuana Business Daily, January 24, 2018.
[22] Alicia Wallace. *Molson Coors calls legal marijuana a "risk factor" for its beer business*. The Cannabist, February 14, 2018.
[23] *Constellation's purchase of Canopy stake is 'transformative,' portends further investments*. Marijuana Business Daily, October 30, 2017.
[24] *Global cannabis market poised for 1,000%-plus growth to $140B, report predicts*. Marijuana Business Daily, January 23, 2018. *Constellation's purchase of Canopy stake is 'transformative,' portends further investments*. Marijuana Business Daily, October 30, 2017.
[25] *See generally* David Gelles. *A Real Estate Boom, Powered by Pot*. The New York Times, April 1, 2017.
[26] *See* Patricia Kirk. *Pot Warehouses Are Going Through a Boom*. National Real Estate Investor, April 7, 2017.
[27] Jonathan Grosser, April 2021. *Cannabis Real Estate Investment Trusts – A Multibillion Dollar Industry and Still Growing*. Royer Cooper Cohen Braunfeld LLC.
[28] http://kalyxdevelopment.com/. Site last visited September 26, 2021.
[29] Subrina Hudson. *Real Estate: High rents draw in landlords.* Los Angeles Business Journal, December 19, 2016 – January 1, 2017, Volume 38, Number 51.

New Jersey will be "transformational and will likely drive up rents for older industrial buildings in the 20,000- to 50,000- square-foot range with 15-foot or higher ceilings."[30]

The impact of the marijuana industry has also affected related industries. For example, the Institute of Real Estate Management has published a legislative white paper titled "Marijuana in Property Management" (updated November, 2016), that can be obtained on the IREM website. The paper addresses a number of issues property managers need to familiarize themselves with and consider in their day-to-day activities, including potential lease provisions, claims for reasonable accommodations,[31] rights of a tenant to grow or smoke marijuana on site, and security concerns. The paper also touches on unique issues that may affect different property types, including community association properties, multifamily properties, federally assisted properties, and traditional retail, office and industrial space.

Marijuana operations also pose unique insurance issues that stem from the high usage of water (presenting potential issues of mold), the highly flammable nature of certain processing techniques, and the increased need for security.[32] Some of the potential insurance products impacted include general liability policies, product liability policies, property policies, commercial automobile insurance policies,[33] workers' compensation policies[34], and more, including whether a failure of coverage triggers a claim against the agent or broker and whether their errors and omissions coverage will address the claim.

For attorneys, rendering advice on issues involving the use, growing, selling and dispensing of marijuana, as well as related real estate and financing issues, presents certain ethical concerns that require careful consideration.[35] The issue is beyond the scope of this article, but is covered thoroughly by Michael H. Rubin in an article titled *Smokin' Hot: New Jersey Lawyers, Marijuana Laws, And Legal Ethics*.[36] Similarly, attorneys practicing in the

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[30] Michael G. McGuiness. *Thinking green: The role of indoor farming in older industrial space*. Real Estate NJ, July 18, 2017.

[31] *See e.g., James v. City of Costa Mesa*, 700 F.3d 394 (9th Cir. 2012); *EEOC v. Pines of Clarkston*, 2015 U.S. Dist. LEXIS 55926 (E.D. Mich. 2015); *Carlson v. Charter Communications, LLC*, Slip Copy, 2017 WL 3473316 (D. Montana), *aff'd* 742 F. App'x 344 (9th Cir. 2018.

[32] *See Green Earth Wellness Center, LLC v. Atain Specialty Insurance Co.*, 163 F. Supp. 3d 821 (D. Colo. 2016) denying insurance carrier's motion for summary judgment to declare an insurance policy void on public policy grounds in light of the insured's claim concerning damage to its marijuana crop. By contrast, in *K.V.G. Properties, Inc. v. Westfield Insurance Company*, 296 F. Supp.3d 863 (E.D. Mich. 2017), the District Court granted the insurer summary judgment against a claim stemming from losses attributable to a tenants' cannabis operation at the property, based on a number of policy exclusions, including dishonest or criminal acts by someone to whom the landlord entrusts the property. It is important to note that in this case, the property owner/landlord did not learn of the unlawful use of its property until DEA agents executed a search warrant on the property. After learning of the illegal operations, the landlord filed eviction actions against the tenants.

[33] New Jersey's medical marijuana laws require that an alternative treatment center maintain a current automobile liability insurance policy of at least one million dollars per incident for each vehicle used to transport medical marijuana. N.J.A.C. §8:64-10.11(d).

[34] *See Hager v. M&K Construction*, 246 N.J. 1,33 (2021).

[35] Bruce E. Reinhart. *Dazed & Confused – Legal and Ethical Pitfalls in Marijuana Law*. Criminal Justice, Volume 31, Number 4, Winter 2017.

[36] Mr. Rubin's materials were prepared for, and were published in connection with, the New Jersey Institute for Continuing Legal Education program titled: *Commercial Leasing 2017: A Focus on Leasing, Insurance and Ethical Issues*, held December 6, 2017.

cannabis field need to confirm that their respective malpractice insurance carrier will cover claims arising out of cannabis industry related advice.

While excitement for the medical and recreational marijuana industries continues to grow nationally, there nevertheless remains a black cloud in the form of the federal government.[37] Marijuana remains a Schedule I drug under the Controlled Substances Act.[38] As discussed below, a series of Justice Department guidance documents were issued between October 2009 and February 2014 that provided the industry with a level of comfort to move forward with industry investment. On January 4, 2018, however, Attorney General Jeff Sessions, a long-time critic of legalized marijuana, issued a Memorandum for all United States Attorneys, rescinding these guidance documents.[39]

Federal Overview

United States Constitution

An analysis at the federal level, must begin with the fact that the Supremacy Clause of the United States Constitution provides that federal law preempts state law.[40] As such, notwithstanding the fact that a person may be licensed under state law to grow, produce or dispense for medicinal or recreational purposes, they remain subject to criminal and civil action under the full panoply of federal laws addressing growing, production and distribution of marijuana.

Controlled Substances Act

Marijuana is a Schedule I drug under Title II of the Controlled Substances Act. Pursuant to §822(a)(1), "[e]very person who manufactures or distributes any controlled substance or list I chemical, or who proposes to engage in the manufacture or distribution of any controlled substance or list I chemical, shall obtain annually a registration issued by the Attorney General in accordance with the rules and regulations promulgated by him." Pursuant to §822(a)(2), a similar registration requirement applies to those wishing to dispense a controlled substance. Under §822(d), there is authority for the Attorney General to "waive the requirement for registration of certain manufacturers, distributors, or dispensers if he finds it consistent with the public health and safety." In addition, §811(a)(2) authorizes the Attorney General to remove a drug or other substance from a schedule. In December 2009, a petition was filed by a Bryan

[37] *See generally* Avantika Chilkoti. *States Keep Saying Yes to Marijuana Use. Now Comes the Federal No.* The New York Times, July 15, 2017.

[38] 21 U.S.C. §801 *et seq.*

[39] It is interesting to note that, while a Republican administration oversaw the rescission of the Cole memoranda, the biggest beneficiaries of campaign donations are states' rights Congressional Republicans. *More Republicans are raking in money from cannabis industry*. Marijuana Business Daily, January 23, 2018.

[40] U.S. Const. Art. VI cl. 2. It should be noted that even the Supremacy Clause has its limitations. The Tenth Amendment provides: "The powers not delegated to the United States by the Constitution, nor prohibited by it to the states, are reserved to the states respectively, or to the people." U.S. Const. Amendment X. As such, the federal government cannot compel the states to either enact laws that are in the federal interest or to spend money enforcing federal laws.

Krumm to remove marijuana as a schedule I controlled substance. On July 19, 2016 the Drug Enforcement Administration of the Department of Justice denied the petition.[41]

Pursuant to §841 of the Controlled Substances Act, those violating the Act may be liable for a fine of upwards of $10,000,000 for an individual and $50,000,000 if a non-individual defendant, and for a repeat offender, a fine of upwards of $20,000,000 for an individual and $75,000,000 if a non-individual defendant, all depending on the quantity possessed, distributed, dispensed, or manufactured. In addition, the same section authorizes imprisonment of up to life, again depending on the quantity possessed, distributed, dispensed, or manufactured.

Potential liability under the Controlled Substances Act is not limited to those directly involved in the manufacture, distribution, dispensing or possessing of marijuana. Under §856(a)(1), liability also rests with those who "open, lease, rent, use, or maintain any place, whether permanently or temporarily, for the purpose of manufacturing, distributing, or using" marijuana. And pursuant to subsection (2), liability also extends to those who "manage or control any place, whether permanently or temporarily, either as an owner, lessee, agent, employee, occupant, or mortgagee, and knowingly and intentionally rent, lease, profit from, or make available for use, with or without compensation, the place for the purpose of unlawfully manufacturing, storing, distributing, or using" marijuana. Under §856(b), criminal penalties for such violations can include imprisonment of up to 20 years and a fine of no greater than $500,000 for an individual and $2,000,000 if a non-individual defendant. Pursuant to §856(d), violations can yield a civil penalty of the greater of $250,000 or two times the gross receipts derived from each violation.

Section 846 of the Controlled Substances Act makes the same fines and imprisonment penalties applicable to those who conspire with others to commit an offense otherwise governed by the act.

Fines and imprisonment are not the only risk presented at the federal level. Property forfeiture is also available to the federal government under 21 U.S.C. §853 (a person convicted of a violation of the act that is punishable by imprisonment for more than one year, also forfeits their real property used to commit the violation), §881(a)(7) (civil forfeiture and loss of property rights with respect to real estate and any leasehold interest therein, used in the commission of a violation of the act that is punishable by more than a year in prison). Forfeiture also may occur in the event of a violation of the Racketeer Influenced and Corrupt Organizations Act of 1970, 18 U.S.C. §1961 *et seq*.

Titles 18 and 21 are not the only tools in the federal government's toolkit. In addition, there is the Currency and Foreign Transactions Reporting Act of 1970 (better known as the Bank Secrecy Act) and the PATRIOT Act.[42]

With the background of Titles 18 and 21, the Bank Secrecy Act and the Patriot Act, one would expect there to be great reluctance to participate in the medical and recreational marijuana industry. A number of mechanisms exist, however, that enable the industry to continue - at least to a degree.

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[41] *See* Federal Register Vol. 81, No. 156, Friday, August 12, 2016.

[42] For an excellent discussion of the general federal statutory scheme and the related potential civil and criminal penalties, *See* J. Marcus Painter. *Rents, Refi's, and Reefer Madness*. Probate & Property, January/February 2015.

DAG Memoranda

On October 19, 2009, Deputy Attorney General David W. Ogden issued a memorandum (the "Ogden Memo"), with respect to investigations and prosecutions in states that authorize medical use of marijuana. The Ogden Memo was designed to provide guidance to federal prosecutors in states that had enacted laws authorizing the medical use of marijuana. Based on the Ogden Memo, the Justice Department determined that federal prosecutors should not focus federal resources on those "whose actions are in clear and unambiguous compliance with existing state laws providing for the medical use of marijuana." The Ogden Memo made clear, however, that it was not designed to "'legalize' marijuana or provide a legal defense to a violation of federal law" but rather, to provide "a guide to the exercise of investigative and prosecutorial discretion."

On June 29, 2011, Deputy Attorney General James M. Cole issued a memorandum (the "Cole I Memo"), which provided clarification of the Ogden Memo. The Cole I Memo acknowledged that a growing number of jurisdictions enacted, or were considering the enactment of legislation that would allow commercial cultivation and distribution of marijuana for medical purposes. The Cole I Memo underscored that the Ogden Memo focused on enforcement efforts with respect to "individuals with cancer or other serious illnesses who use marijuana as part of a recommended treatment regimen consistent with applicable state law, or their caregivers." In the Cole I Memo, the Department made it clear that a "caregiver" did not include "commercial operations cultivating, selling or distributing marijuana." Further, the Cole I Memo removed any comfort that the Ogden Memo afforded the medical marijuana industry, stating: "The Ogden Memorandum was never intended to shield such activities from federal enforcement action and prosecution, even where those activities purport to comply with state law."

On August 29, 2013, Deputy Attorney General James M. Cole issued a second memorandum (the "Cole II Memo"), which provided further clarification of both the Ogden Memo and the Cole I Memo. The Cole II Memo highlighted certain enforcement priorities of the Department (the "Cole Priorities"), including preventing (i) distribution of marijuana to minors, (ii) revenue from marijuana sales going to a criminal enterprise, (iii) diversion of marijuana from states in which it is legal to states in which it is not, (iv) use of state authorized activity as a cover for illegal activity, (v) the use of firearms in the cultivation and distribution of marijuana, (vi) driving while under the influence of marijuana, (vii) growing of marijuana on public lands, and (viii) possession or use of marijuana on federal property. The Cole II Memo made it clear that the foregoing list is a general, and not an exclusive, list of priorities. The Cole II Memo also underscored the historic relationship between the federal government and the states to allow and rely on the states "to address marijuana activity through enforcement of their own narcotics laws." Significantly, the Cole II Memo acknowledged the focus of the two prior memoranda on medical marijuana, and the patient and caregiver, as well as the carve-out for the commercial grower, distributor and seller, and concluded that those limitations were no longer applicable. So long as state laws established a regulatory scheme that contains strong and effective enforcement systems and will address the Cole Priorities, then "enforcement of state law by state and local law enforcement and regulatory bodies should remain the primary means of addressing marijuana related activity." Furthermore, the Cole II Memo went on to provide expressly that "prosecutors should not consider the size or commercial nature of a marijuana operation alone as a proxy for assessing whether marijuana trafficking implicates the Department's enforcement priorities listed above."

On February 14, 2014, Deputy Attorney General James M. Cole issued a third memorandum (the "Cole III Memo"), which provided further clarification of the Cole II Memo, and additional guidance. The Cole III Memo provided that, while "issued in response to recent marijuana legalization initiatives in certain states, it applies to all Department marijuana enforcement nationwide." Significantly, the Cole III Memo went further to address the impact of the Cole III Memo "on certain financial crimes for which marijuana-related conduct is a predicate."

The Cole III Memo raised the fact that "[f]inancial transactions involving proceeds generated by marijuana-related conduct can form the basis for prosecution under the money laundering statutes (18 U.S.C. §§1956 and 1957), the unlicensed money transmitter statute (18 U.S.C. §1960), and the [Bank Secrecy Act ("BSA")]." The memo also pointed out that "financial institutions that conduct transactions with money generated by marijuana-related conduct could face criminal liability under the BSA for, among other things, failing to identify or report financial transactions that involved the proceeds of marijuana-related violations of the [Controlled Substances Act ("CSA")]." Significantly, prosecution for these violations does not require an underlying conviction under state or federal law. The Cole III Memo provides that in determining whether to prosecute a financial institution or an individual for any of these violations, the prosecutor should focus on the Cole Priorities. The Cole III Memo also noted that the Department of the Treasury's Financial Crimes Enforcement Network was issuing concurrent guidance for financial institutions providing services to businesses involved in the marijuana related industry.

As set forth above, on January 4, 2018, Attorney General Sessions issued a memorandum for all United States Attorneys pertaining to marijuana enforcement. Although Sessions rescinded the series of guidance documents discussed above, he left actual prosecution to the individual federal prosecutors' determination, consistent with Chapter 9-27.000 of the U.S. Attorneys' Manual. The manual requires federal prosecutors to examine a number of factors in determining whether to bring a prosecution, including federal law enforcement priorities, the seriousness of a crime, the impact of a crime on the community and the deterrent effect of the prosecution. Subsequently, Attorney General William Barr "reversed course to some extent, stating that he was 'accepting the Cole Memorandum for now,' but that he had 'generally left it up to the U.S. Attorneys in each state to determine what the best approach is in that state.'"[43]

FinCEN Guidance

As set forth above, the Department of the Treasury's Financial Crimes Enforcement Network ("FinCEN"), issued "Guidance to clarify Bank Secrecy Act ("BSA") expectations for financial institutions seeking to provide services to marijuana-related businesses." The introductory language of the guidance is important since it provides that its intent is to clarify "how financial institutions can provide services to marijuana-related businesses consistent with their BSA obligations" and expects that the guidance will "enhance the availability of financial services for, and the financial transparency of, marijuana-related businesses." The guidance appears clear in its application to both medical and recreational marijuana-related businesses.

The FinCEN guidance sets out a protocol of due diligence that a financial institution should undertake of a customer in order to assess the risk of providing financial services to the

[43] *Hager v. M&K Construction*, 246 N.J. 1,33 (2021).

customer. The due diligence includes (i) verifying that the customer is licensed by and registered with the state, (ii) reviewing the state license application, (iii) requesting available information from the state licensing authority with respect to the customer, (iv) developing an understanding of the normal business activity of the customer and whether its business concerns medical or recreational marijuana, (v) on-going monitoring of available public resources, (vi) on-going monitoring for any suspicious activity, and (vii) regularly updating customer information. The due diligence is intended to enable consideration by the financial institution of whether the customer's business violates state law or implicates any of the Cole Priorities.

In addition, a financial institution providing services to a marijuana-related business must file suspicious activity reports "(SARs"), even though legal under state law, due to its illegality under federal law. The FinCEN guidance sets out three different SARs that may be filed, (i) a "Marijuana Limited" SAR Filing, (ii) a "Marijuana Priority" SAR Filing and (iii) a "Marijuana Termination" SAR Filing.[44] The FinCEN guidance noted that where the financial institution is providing services to a non-marijuana-related business that provides goods or services to a marijuana-related business (such as a landlord that leases property to a marijuana-related business), the financial institution will file SARs based on existing regulations without the foregoing three marijuana distinctions.

If, as a result of the financial institution's due diligence, the financial institution reasonably believes that none of the Cole Priorities are implicated or that state law is not violated, then a "Marijuana Limited" SAR should be filed. The FinCEN guidance sets out the details to be included in the "Marijuana Limited" SAR.

If, as a result of the financial institution's due diligence, the financial institution reasonably believes that there is a violation of state law or one of the Cole Priorities, then the institution is required to file a "Marijuana Priority" SAR. The FinCEN guidance sets out the details to be included in the "Marijuana Priority" SAR.

If, as a result of the financial institution's due diligence, the financial institution reasonably believes that it should terminate its customer relationship "in order to maintain an effective anti-money laundering compliance program, then it should file a "Marijuana Termination" SAR and if the financial institution becomes aware that the customer will move to a new financial institution, it should warn the new financial institution, as outlined in the FinCEN guidance. The guidance also sets forth the red flags indicating that the customer may be engaged in an activity violating the Cole Priorities.

Finally, financial institutions (and others) are required to report currency transactions in connection with marijuana-related businesses, just as in any other situation. The guidance makes it clear that such a business does not qualify as a "non-listed business under 31 C.F.R. §1020.315(e)(8). Thus, FinCEN Form 8300 must be filed.

Interestingly, notwithstanding the Sessions' memorandum, the FinCEN guidance has not been rescinded. Nevertheless, there are banking institutions that continue not to deal with cannabis facilities. Just this past October, Bank of America closed the account of Scottsdale Research Institute who was in the business of conducting FDA-approved trials to examine the

[44] There are Frequently Asked Questions Regarding the FinCEN Suspicious Activity Report available at http://fincen.gov/whatsnew/html/sar_faqs.html.

value of cannabis as a treatment for the terminally ill and military veterans.[45] This is not an isolated incident. For example, Wells Fargo called a loan of Steep Hill Alaska (a property owner leasing to a cannabis facility) in 2018 and PNC Bank closed the account of Marijuana Policy Project.[46]

Appropriation Bills

In addition to the Ogden and Cole memoranda and FinCEN guidance, there have been a number of appropriation bills enacted, beginning in December 2014, that bar the Department of Justice from utilizing appropriated funds to prosecute operators of medical marijuana facilities functioning in compliance with state medical marijuana statutes.[47] This legislation enabled a group of defendants, indicted under the Controlled Substances Act in connection with their marijuana-related businesses, to secure an injunction to prohibit the Justice Department from spending money to interfere with the particular state's medical marijuana laws.[48]

Case Law

Although the Ogden and Cole memoranda and FinCEN guidance give some degree of comfort, they do not override the fact that under federal law marijuana continues to be a Schedule I Controlled Substance, and thus, illegal in all circumstances under federal law. For example, in *The Fourth Corner Credit Union v. Federal Reserve Bank of Kansas City*,[49] the Court held that although the guidance documents seem to suggest that prosecutors and bank regulators can ignore federal law, a federal court cannot.[50] As such, a requested injunction to require the Federal Reserve Bank of Kansas City to grant the plaintiff credit union a "master account" to permit access to the Federal Reserve payments system in conjunction with its banking services to marijuana-related businesses, was denied. The Tenth Circuit vacated the district court decision, and remanded with instructions to dismiss the complaint without prejudice. The credit union then amended its complaint and took a position that it would not do business with marijuana facilities if such facilities' actions were contrary to law. Ultimately, the Federal Reserve Bank of Kansas City granted a limited master account subject to satisfaction of a number of conditions, including obtaining share deposit insurance from the National Credit Union Association ("NCUA"). Share deposit insurance is a standard requirement for any credit union chartered under Colorado law, but The Fourth Corner Credit Union was rejected by

[45] Melissa Schiller, *Bank of America Closes Cannabis Researcher's Accounts*, Cannabis Business Times, October 20, 2021 (https://www.cannabisbusinesstimes.com/article/bank-of-america-closes-account-cannabis-researcher-sue-sisley/)

[46] *Id.*

[47] Congress first passed the Consolidated and Further Continuing Appropriations Act, 2015, Pub. L. No. 113-235, 538 (2014). This law was extended until December 22, 2015. In December 2015, Congress enacted the Consolidated Appropriations Act, 2016, Pub. L. No. 114-113 (2015), that included in § 542 the same rider. This provision, initially known as the Rohrabacher-Farr Amendment, and now known as the Rohrabacher-Blumenauer Amendment, also was in the Consolidated Appropriations Act, 2017, Pub. L. No. 115-31, 537 (2017). The amendment was extended most recently on September 30, 2021 when President Biden signed H.R. 5305, the "Extending Government Funding and Delivering Emergency Assistance Act" extending the prohibition to December 3, 2021.

[48] *United States v. McIntosh*, 833 F.3d 1163 (9th Cir. 2016).

[49] 154 F. Supp. 3d 1185 (Dist. Ct. Colo. 2016), *vacated* 861 F.3d 1052 (10th Cir. 2017).

[50] *Id.*

NCUA. As a result, The Fourth Corner Credit Union brought suit against NCUA in federal district court to overturn that decision; however, the case ultimately was dismissed as moot.[51]

Filings by a marijuana-related business for protection under the federal Bankruptcy Code has also witnessed some interesting results. In *In re Rent-Rite Super Kegs W. Ltd.*,[52] the debtor leased part of a warehouse located in Denver, Colorado to tenants engaged in the business of growing marijuana. The matter came before the court on a motion to dismiss by a mortgage holder. The motion was predicated on the fact that the activities of the debtor were illegal under federal law and therefore, relying on the clean hands doctrine, the debtor should not be entitled to the equitable protection of the Bankruptcy Court. The court held that the debtor violated the clean hands doctrine, resulting in a dismissal of the case.

In *In re Arenas*[53] the debtors jointly owned a commercial building in Denver, Colorado, one unit of which was leased to a marijuana dispensary. In addition, one of the debtors was licensed to grow and dispense medical marijuana. The U.S. Trustee moved to dismiss the case for cause under 11 U.S.C. §707(a), relying in large part on the decision in *In re Rent-Rite Super Kegs W. Ltd.* In both cases the courts were persuaded that the trustee could not administer the assets without himself violating federal law. Somewhat in contrast, in *In re McGinnis*,[54] the court did not dismiss the case, but did determine that the debtor's Chapter 13 Plan for Reorganization could not be confirmed and required the filing of an amended plan. The determination relied on the fact that, in part, revenue to implement the plan would come from the debtor's own medical marijuana business and rent from the letting of space to medical marijuana growers, all illegal under federal law. Thus, while the case was not dismissed, the relief was denied for reasons similar to those expressed in each of *In re Arenas* and *In re Rent-Rite Super Kegs W. Ltd*. This conflict in approach (but effort to achieve a similar result) has been somewhat formalized by a letter from Clifford J. White III, Director, Executive Office for United States Trustees, U.S. Department of Justice, dated April 26, 2017, wherein Mr. White advises that the policy of the U.S. Trustee Program is for the U.S. Trustees to move to dismiss or object to all matters involving marijuana assets.

In a case of first impression before the Ninth Circuit, the Court examined whether a bankruptcy plan for reorganization is confirmable depends on a review of 11 U.S.C. §1129(a)(3) and whether this section "forbids confirmation of a plan that is proposed in an unlawful manner as opposed to a plan with substantive provisions that depend on illegality, … ."[55] *Garvin v. Cook Investments NW, SPNWY, LLC*, involved five real estate holding companies that sought Chapter 11 protection. One of the lease agreements involved a company in the cannabis business. While the plan provided for a rejection of this lease, the bankrupt estate did continue to receive rents from the tenant thus providing the Trustee with the argument that the rents provided indirect support for the plan. The court determined that so long as the plan was lawfully proposed, as distinguished from whether its provisions depend on illegality to succeed, the plan must be deemed in compliance with section 1129(a)(3). The

[51] *The Fourth Corner Credit Union v. National Credit Union Administration*, U.S. District Court, District of Colorado, Case No.: 1:15-CV-01634-RM-KMT, Order of Dismissal entered June 25, 2018.
[52] 484 B.R. 799 (Bankr. D. Colo. 2012).
[53] 514 B.R.887 (Bankr. D. Colo. 2014), *aff'd* 535 B.R. 845 (10th Cir. BAP 2015).
[54] 453 B.R. 770 (Bankr. D. Or. 2011).
[55] *Garvin v. Cook Investments NW, SPNWY, LLC*, 922 F.3d 1031, 1035 (Ninth Cir. 2019).

Garvin court's reading of section 1129(a)(3) was rejected however by the United States District Court for the District of Colorado.[56]

In a recent decision by the New Jersey Supreme Court, the Court determined, in in large measure on the series of appropriation bills enacted by Congress and restricting the United State Justice Department from using funds to interfere with state medical marijuana laws, that the Controlled Substances Act did not preempt New Jersey's Jake Honig Compassionate Use Medical Cannabis Act.[57] As such, the Court determined that an employer, through its workers compensation policy, must reimburse an employee for the cost of the employee's medical marijuana used in treatment of the employee's work related injury.

Tax Issues

Although the medical marijuana business is illegal under federal law, such businesses are still required to pay federal income taxes. Income for purposes of taxation includes income from illegal sources.[58] Most businesses are entitled to claim deductions against their gross income in order to arrive at their respective taxable net income. Tax deductions for a marijuana business, however, becomes a much more complicated problem due to the fact that, as previously mentioned, a marijuana-related business is illegal under federal law, notwithstanding its authorization and permissibility under state law.

The biggest problem for a marijuana business is §280E of the Internal Revenue Code of 1986, as amended (the "Code"). This section disallows deductions for expenses incurred in the business of producing or selling marijuana by providing that "[n]o deduction or credit shall be allowed for any amount paid or incurred during the taxable year in carrying on any trade or business if such trade or business (or the activities which comprise such trade or business) consists of trafficking in controlled substances (within the meaning of schedule I and II of the Controlled Substances Act) which is prohibited by Federal law or the law of any State in which such trade or business is conducted." Given marijuana's status as a Schedule 1 drug in the Controlled Substances Act, marijuana businesses are affected by the prohibition on deductions espoused by Code §280E. The prohibition extends to all of the businesses' deductions, even those that are not illegal per se such as rent, telephone, salaries, etc.[59]

While a marijuana business cannot currently take a deduction for its business expenses, the prohibition on deductions of § 280E does not extend to limit the ability of a marijuana business from offsetting its gross receipts by the costs of the goods it sells (i.e., the "costs of goods sold"). It is a well-established principle in tax law that the U.S Government cannot tax the return of capital and that the cost of the goods sold represents a return of the taxpayer's capital. Indeed, the Senate Report, being wary of the impropriety of disallowing the cost of goods sold and taxing the return of capital, in enacting §280E stated the following:

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[56] *In Re: Way to Grow, Inc.*, 610 B.R. 338 (D. Colorado 2019).

[57] *Hager v. M&K Construction*, 246 N.J. 1,33 (2021).

[58] *James v. United States*, 366 U.S. 213 (1961).

[59] *See Olive v. Commissioner of Internal Revenue*, 139 T.C. 19 (Aug. 2, 2012), *aff'd* 792 F.3d 1146 (9th Cir. 2015). *See also The Green Solution Retail, Inc. v. United States*, 855 F.3d 1111 (10th 2017), *cert. denied*, 138 S. Ct. 1281 (2018).

> All deductions and credit for amounts paid or incurred in illegal trafficking in drugs listed in the Controlled Substances Act are disallowed. To preclude possible challenges on constitutional grounds, the adjustment to gross receipts with respect to effective costs of goods sold is not affected by this provision of the bill.[60]

In fact, the Government, in a Tax Court case involving a medical marijuana business, has conceded that Code §280E does not prohibit the taxpayer from claiming costs of goods sold.[61] Also, in early 2015, an IRS Chief Counsel Advice Memorandum, CCA 201504011, clarified that although deductions may not be claimed, a marijuana business is allowed the cost of goods sold for production-related business expenses. Thus, until Code §280E is amended to allow for a current deduction of expenses, marijuana businesses can at least use costs of goods sold to offset their gross receipts in arriving at their taxable net income.[62]

Selected Lease Issues

Although marijuana-related businesses have been legal for medicinal or recreational purposes for some time now, the field remains in its infancy, and it is not yet clear the full panoply of issues that parties will need to address (and how) in commercial and industrial real estate transactions. One fact is clear, however, and that is in states where marijuana use for medical or recreational purposes is legal, there has been "a (1) 34 percent to 42 percent increase in demand for warehouses, (2) 18 to 19 percent increase in demand for storefronts, and (3) 16 percent to 21 percent increase in demand for vacant land."[63] Interestingly, there has been no reported "system-wide decreases in the value of land surrounding dispensaries or grow facilities."[64]

To begin, there are title insurance issues pertaining to cannabis-related businesses. On February 25, 2019, First American Title Insurance Company issued an Underwriting Communication advising its title issuing offices, title insurance agents and approved attorneys that the company will not offer title insurance or settlement/escrow services for marijuana related transactions. This includes any transaction involving a property that is or will be used for the production, sale, or distribution of marijuana, products containing marijuana or products derived therefrom, or a buyer, borrower or lender whose primary business is the production, sale, or distribution of marijuana, products containing marijuana or products derived therefrom. Similarly, Chicago Title Insurance Company will not insure transactions involving a cannabis related business. Based on a March 3, 2021 underwriting bulletin, Chicago Title Insurance Company requires that its agents include the following language in all title commitments:

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[60] S. Rep. No. 97-494 (Vol. I), at 309 (1982).
[61] *Californians Helping to Alleviate Medical Problems, Inc. v. Commissioner*, 128 T.C. 173 (2007).
[62] *See Jabari v. Commissioner of Internal Revenue*, T.C. Memo. 2017-238 (Docket No. 11331-14, November 28, 2017).
[63] Barak Cohen, Editor, *Cannabis Law – A Primer on Federal and State Law Regarding Marijuana, Hemp, and CBD*, 72 (American Bar Association 2021).
[64] *Id.*

NOTE: Owing to the conflict between federal and state laws concerning the cultivation, production, distribution, manufacture of cannabis (marijuana), neither the Company nor any of its policy issuing agents is able to act as settlement agent for, facilitate the closing of, or insure any transaction involving Land that is associated with these activities.

In addition to wrestling with title insurance coverage issues on an acquisition, leasing or financing of property, all parties to a transaction (purchaser, tenant and lender) must examine existing beneficial easements and Covenants, Conditions and Restrictions affecting a property to determine whether there are any terms that impact, or are impacted by, a cannabis operation at the property.

Depending on the particular processing operation of medicinal cannabis at a property, the business may be classified as an industrial establishment subject to the Industrial Site Recovery Act.[65] Pharmaceutical and medicine manufacturing has a NAICS number 32541, and wholesale distribution of drugs and druggist sundries has a NAICS number 424210. Both NAICS numbers are subject to the Industrial Site Recovery Act.

There also are a host of banking issues facing any cannabis related business. Traditional institutional lending has been problematic. Some within the traditional lending community are concerned by the potential of federal money laundering charges if they provide banking services to cannabis related businesses.[66] Many businesses lack a sufficient management track record, earnings history based on audited financial statements and, most importantly, viable collateral – a lender cannot take possession of growing plants and finished product and sell such collateral to satisfy the business debt. As such, the industry has, in part, turned to private debt and equity sources of capital, and credit unions.[67]

In addition, there are a host of issues a landlord and tenant must address when undertaking a lease transaction involving a cannabis related business. There are some themes that have developed.[68] Below is a very general discussion of a limited number of issues to evaluate in a lease transaction.

Due Diligence.

For a landlord, one of the first steps that should be taken when considering whether to lease property to a cannabis related business, is whether the lease will violate any existing loan covenants, including compliance with law covenants. If so, then a landlord either will need to

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[65] N.J.S.A. 13:1K-6 *et seq*.

[66] *See generally*, Robb Mandelbaum. *The Legal Marijuana Industry Has A Problem: Few Banks Will Touch Its Cash. But One Small Colorado Credit Union Is Daring To Try*. The New York Times Magazine, January 7, 2018.

[67] *Id.*

[68] For an excellent article addressing issues affecting lease transactions involving marijuana-related businesses *See* Glenn S. Demby, Esq. *Get 10 Protections When Leasing to a Marijuana Business*. Commercial Lease Law Insider, November 2014. Two additional articles on the topic include Mark S. Hennigh and Bret D. Kravitz *Real Estate and Marijuana: Financial Opportunity or Unmanageable Risk?* [a copy of this article was published in connection with the New Jersey Institute for Continuing Legal Education program titled: *Commercial Leasing 2017: A Focus on Leasing, Insurance and Ethical Issues*, held on December 6, 2017] and Tanya D. Marsh (Professor of Law, Wake Forest University School of Law), *What Real Estate Lawyers Need to Know in an Age of Legalization*, published in conjunction with the 2017 ABA RPTE Spring Symposia, Community Outreach Committee Program.

turn down the transaction, or seek alternative financing, in which latter event, the landlord may face a significant pre-payment penalty for the early payoff of its existing loan.[69] The ability to refinance the property, and the impact of any pre-payment fee must be factored into the landlord's evaluation of the economics of the deal with the cannabis related business in order to assess whether to move forward in the first instance, before even evaluating the additional issues that such a transaction presents. In addition, as with all lease transactions, a landlord needs to determine whether its loan covenants require lender approval of the lease transaction. Often, a breach of this covenant can result in a landlord-borrower violating a non-recourse loan provision and converting the loan to a recourse loan. If required, then a landlord should discuss the transaction with its lender early on in order to determine if the lender will approve the lease or not.

A similar evaluation also must be undertaken by a tenant, since it does not want to either believe it has secured real estate for its operation or make a substantial investment in a leasehold only to find that it must seek alternative space or is facing a loss of the leasehold due to a lender foreclosure action.

It is also advisable to confirm that the municipality will permit the use and whether any zoning restrictions may exist with respect to location, hours of operation and advertising, by way of example. In addition, a landlord should want to see that the municipality supports the tenant's license application. Evidence of municipal zoning and support is required to be included within the license application process.[70] It would be prudent for a landlord to require proof of the foregoing no later than the date of the tenant's submission of its application.[71] It also would be prudent for each of the landlord and the tenant to reserve a right to terminate the lease if municipal zoning and support cannot be obtained. An issue to address in this respect, is whether a landlord requires a termination fee for granting the right of termination to the tenant.

A tenant also needs to confirm in writing as a part of its initial due diligence, that the landlord will deliver a certification that the landlord is aware of the intended use of the premises for either a cannabis cultivator, manufacturer or retailer use, since such a certification is required by regulation.[72]

Permitted Use.

It is not against the law in New Jersey for a property owner that is at least 21 years old, to lease property to a cannabis business.[73] Should a landlord determine, however, that for financing

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[69] *See* Eric Sandy, *Steep Hill Alaska Suspending Testing Operations After Wells Fargo Calls Loan*, Cannabis Business Times, March 29, 2018 (https://www.cannabisbusinesstimes.com/article/steep-hill-alaska-wells-fargo/)

[70] *See* N.J.S.A. 24:6I-36, N.J.S.A. 17:30-7.6(d)2, 7.8(a) 4 and 5, 7.10(b) 8 and 9, 10.3(a) and 12.4(d). In *The Kind Compassionate v. City of Long Beach*, the court upheld the lower court's ruling that a municipal regulation and ban on medical marijuana dispensary operations did not discriminate against persons with disabilities, because the Compassionate Use Act ("CUA") and the Medical Marijuana Program ("MMP") did not grant any right to convenient access to patients for medical marijuana use. *See The Kind Compassionate v. City of Long Beach*, 2 Cal. App. 5th 116, 127 (2016). The court also held that the CUA and MMP do not expressly or impliedly preempt a municipality's zoning provisions regarding prohibition of a medical marijuana dispensary. *Id.* at 126. *See also City of Riverside v. Inland Empire Patients Health and Wellness Center, Inc.*, 56 Cal. 4th 729 (2013).

[71] It should be noted that a conditional license-holder has a 120-day period (subject to a possible 45-day extension) following issuance of a conditional license, to gain municipal approval. N.J.A.C. 17:30-7.6(d).

[72] N.J.A.C. 17:30-7.10(b)11.

[73] N.J.A.C. 17:30-2.1(d). *See* N.J.S.A. 2C:35-10b.

or other reasons it will not enter into a lease with a cannabis facility, or more generally speaking, want to prohibit or otherwise delineate the scope of any use by a cannabis facility, it is expressly authorized to do so by the Rules issued by the Commission.[74]

However, if a property owner is prepared to lease to a cannabis business, and has satisfied itself from a financing standpoint that there is no issue, the property owner must recognize that it will be considered a "vendor-contractor."[75] As such, a landlord may be subject to, and any cannabis business that enters into a lease needs to include a provision requiring that a landlord agree to submit to, a financial probity review.[76] The financial review varies depending on whether the landlord is an individual or an entity; however, assuming that the landlord is an entity (as most are), a landlord must be prepared for the Commission to review a litany of documentation and information, including:

- the entity's organizational chart and business formation documents
- pending and past litigation for the previous five (5) years
- documentation for any company in which the entity owns a 25% or more ownership interest
- tax returns
- minutes of meetings and resolutions passed by the entity's governing board during the previous two calendar years
- financial statements, bank statements, notes and loans payable and receivable
- any other information that the Commission deems relevant.

Information that is submitted to the Commission is not, however, considered a public record subject to an Open Public Records Act request and review.[77] As such, as landlord must enter such a transaction with its eyes wide open, and understand that its tenant is operating in a highly regulated industry. Accordingly, the lease and its terms will not necessarily be kept strictly confidential, and the leasehold property will be subject to inspection by the Commission.[78]

New Jersey permits both medicinal and recreational marijuana-related businesses, subject, however, to specific licensing requirements and limitations. Therefore, the use clause should delineate with some specificity the limitation on the use, and tie the use into the permits required for, and issued to, the cannabis business. A tenant, however, should consider reserving a right to expand into other licensed cannabis businesses in addition to what may initially be applied for or operated, as the regulations do contemplate multiple licensure after a period of some restriction.[79]

Also, each of the landlord and tenant should evaluate the title. Are there beneficial easements or covenants, conditions and restrictions that are necessary for the operation of the business (e.g., ingress and egress), but would be violated due to the operation's contravention of federal law.

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[74] N.J.A.C. 17:30-2.3(c).
[75] N.J.A.C. 17:30-6.8(s).
[76] N.J.A.C. 17:30-7.13(c)8, (d) and (e).
[77] N.J.A.C. 17:30-7.13(f).
[78] See N.J.A.C. 17:30-7.10(d)17 and 18; N.J.A.C. 17:30-9.1.
[79] N.J.A.C. 17:30-6.8.

Finally, consider odors that may be emitted, particularly if a multi-tenanted facility, and appropriate mitigation methods that should be required (such as air scrubbers), as well as certain processes that are highly flammable, and whether they should be permitted, even if licensed.[80]

Prohibited Use.

Just as there are certain permitted uses that need to be expressly addressed within a lease, so too are there certain prohibited uses, which depending on the license under which the cannabis business will operate, a landlord must be prepared to accept. For example, a cannabis retailer may not operate in a location in which there also operates "a grocery store, delicatessen, indoor food market, or other store engaging in retail sales of food; or …a store that engages in licensed retail sales of alcoholic beverages … ."[81]

Compliance with Law.

Operation of an alternative treatment center is illegal under federal law.[82] Consequently, there should be a carve-out from any federal law compliance obligation, limited to this finite situation. While it is illegal to operate a cannabis business under federal law, there are, however, a multitude of other, and unrelated, federal laws, with respect to which on-going compliance should be required, including, for example, the Americans with Disabilities Act.

In addition, similar to the permitted use clause discussed above, the obligation of the cannabis business to comply with all of the relevant provisions of the medical and adult use cannabis laws and the related regulations, should be delineated clearly and unambiguously. A tenant's obligation to comply with these laws and regulations must include any capital expenses required in connection with such compliance. This may arise from security and ventilation requirements, among others. Furthermore, notwithstanding the Sessions' memo, a landlord should require that the business comply with the Ogden and Cole memoranda. A landlord also should consider on-going evaluation of the tenant's operations consistent with the standards of the FinCEN guidance, and whether a banking institution doing business with the alternative treatment center would be able to file a "Marijuana Limited" SAR. The compliance with law obligation should also include future memoranda or guidance.

It is beyond the scope of this article to address the issues a landlord may face vis-à-vis its lender/mortgagee beyond what has been set forth above, by letting to a marijuana-related business, and vis-à-vis its own banking institution. Nevertheless, in line with the FinCEN guidance discussed above, a landlord should consider requiring a copy of the filings made by its tenant pursuant to the applicable medical or adult-use laws and the related regulations, as well as any other federal, state or banking related filings, in order to facilitate the landlord's bank's

[80] Although a cannabis business is required to "seek to prevent the escape of odors associated with cannabis over the boundary of the property" that is not protective of a landlord's interest in a multi-tenanted facility. N.J.A.C. 17:30-9.4(j). The New Jersey Department of Environmental Protection recently fined a cannabis grow facility for odors, alleging a violation of New Jersey's Air Pollution Control Act. *NJ fines marijuana grow facility in Hunterdon after odor complaints*. My Central Jersey August 25, 2021. https://www.mycentraljersey.com/story/news/local/hunterdon-county/2021/08/25/nj-marijuana-hunterdon-fined-odor-complaints/5587758001/.

[81] N.J.A.C. 17:30-7.10(c). *See* N.J.A.C. 17:30-12.1(a).

[82] *See Green Cross Medical, Inc. v.* Gally, 242 Ariz. 293, 395 P.3d 302 (Ariz. App. Div. 1 2017) and *Mann v. Gullickson*, 2016 WL 6473215 (N.D. Calif. 2016), wherein a landlord, in each case, was denied in its effort to have a lease declared *void ab initio* because the operation of a medical marijuana facility violated federal law.

customer due diligence (referred to in the FinCEN guidance discussed above) if and to the extent required of the landlord's bank.

Controlling Law/Jurisdiction.

The lease should spell out that all disputes will be governed by state law, not federal law, and that the state courts will have exclusive jurisdiction so that matters do not end up before a federal court that may well not recognized the legality of a state authorized cannabis operation.[83] Alternatively, the parties may want to provide for a specific dispute resolution provision.

Security, Maintenance, Repair and Replacement.

The medical or adult-use laws and the related regulations impose specific obligations of security and maintenance.[84] These obligations should also be included in the lease as a security and maintenance obligation of the tenant. Likewise, a tenant should reserve the right to undertake and implement such security procedures and maintenance alterations and improvements without landlord consent.

Because a tenant may make a number of improvements to the premises in conjunction with its operations, including modifications to HVAC systems, security measures, and piping associated with cultivation activities, a landlord should require that a tenant provide the landlord with all plans and specifications pertaining to such work. In addition, both parties would be well served to establish very clear restoration requirements, and from a landlord's perspective, determine any additional security for the tenant's performance.

Access.

Most landlords will reserve a right of access to inspect a premises from time to time, including to assess a tenant's compliance with the lease terms. As previously mentioned, a cannabis business is highly regulated. The regulations are such that a landlord simply cannot enter a cannabis premises without compliance with certain regulatory procedures and conditions.[85]

Utilities.

Marijuana-related businesses place a high demand on water and other utilities, including electric. If not separately metered, consider submetering at the tenant's expense, or provide for an estimate by the landlord, in its discretion.

Signage.

The medical or adult-use laws and the related regulations have specific signage limitations. While this should be covered by the compliance with law provisions, and permitted

[83] *See e.g., Ricatto v. M3 Innovations Unlimited, Inc.*, 2019 WL 6681558 (S.D.N.Y. 2019), at fn 4, wherein the court addresses the inability of the court to enforce a contract that would involve the court in advancing an otherwise illegal activity. There are cases where a court will enforce an illegal contract, for example to "avoid unjust enrichment to a defendant and a disproportionately harsh penalty upon the plaintiff." Mann v. Gullickson, 2016 WL 6473215 (N.D. Calif. 2016).

[84] *See* N.J.A.C. 17:30-9.10, 10.1(b), 10.3(c), and 15.5(h).

[85] *See* N.J.A.C. 17:30-9.4(l), 11.1(b), and 12.7.

use clause, it would be prudent to also expressly tie in signage rights of the tenant with the medical or adult-use laws and the related regulations.[86]

Common Areas.

While a landlord may control the common areas in a multi-tenanted facility, a landlord should avoid any liability for a failure of another tenant or any third party to abide by any restrictions that may be imposed upon the tenant under the medical or adult-use laws and the related regulations. For example, what if a third party engages in unlawful drug activity impacting the tenant's license? Similarly, a tenant needs to examine the use of common area and whether there is a need for some responsibility to be imposed on the landlord in order to protect the tenant's license. It is noteworthy that as defined by the Rules, "premises" includes all areas that a tenant has a right to occupy, which will likely include common areas.[87] A tenant should negotiate for a clause that will prevent the landlord from undertaking or permitting any activity that will cause the tenant to be in violation of any applicable laws or regulations. Query whether, in these times of the pandemic, a landlord allowing a restaurant to use portions of a parking lot resulting in the sale and consumption of alcohol places a license-holder in violation of regulations prohibiting the sale of food, beverages and alcohol on the "premises" of a cannabis business?[88]

Default and Termination.

A landlord should have a right to declare a default, or at least reserve a right of termination, in the event federal law enforcement priorities change, a federal enforcement action is commenced against the landlord or its property,[89] insurance requirements cannot be satisfied, or a necessary license is suspended or revoked. A tenant should have the same concerns and negotiate for similar termination rights. The parties will have to wrestle with whether notice and cure rights should apply to any of these situations, particularly a suspension or revocation of a license, and whether a legitimate appeal of such license suspension or revocation is in process.[90]

In addition, since a license-holder is required to go through an annual license renewal, each of a landlord and tenant should reserve a right of termination should a license not be renewed.[91] The issue that will be front and center in such situation will concern a termination fee should the tenant fail to receive a renewal license.

A landlord also should carefully consider its rights upon a default, since it may not want to re-enter by way of a warrant of removal, unless and until all of the marijuana product is removed.

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[86] *See* N.J.A.C. 17:30-14.1 and .2.

[87] N.J.A.C. 17:30-1.2.

[88] *See* N.J.A.C. 17:30-9.5(a) and (b).

[89] *See, United States v. 1840 Embarcadero*, 932 F. Supp. 2d 1064 (N.D. Calif. 2013), wherein a landlord sought to terminate a lease after a civil *in rem* forfeiture action was commenced by the federal government based on the medical marijuana facility operations conducted at the site. The landlord sought to terminate the lease due to the illegal activity, which effort was denied on unrelated grounds. Nevertheless, the case highlights the need for an express termination right in this circumstance.

[90] *See* N.J.A.C. 17:30-17.1 *et seq*.

[91] N.J.A.C. 17:30-7.16.

Indemnification.

Because of the continuing illegal nature of a marijuana-related business at the federal level, high security risks and potential criminal and civil forfeiture, a landlord's need for a broad and well-funded indemnity is important. In addition, opponents of marijuana-related businesses have used theories of common law nuisance and the federal RICO law, and are becoming increasingly more creative.[92] It may well be that a landlord is made a party to such litigation, potentially, materially and adversely affecting the landlord's own business investment. An indemnity that appropriately addresses such potential future issues is warranted and should be given careful consideration, along with meaningful collateral to backstop the indemnity.

Rent and Method of Payment.

A landlord should require that all rent obligations be paid by the tenant either by wire transfer or check, and should expressly prohibit the payment of rent in cash. A landlord may want to consider charging percentage rent as a part of the tenant's rental obligation. Charging a percentage of revenue or profits is expressly permitted by the Rules.[93]

Further Assurances.

The medical and adult use cannabis laws and regulations are often changing, and as a result, the requirements for a license-holder may require further assurance, certifications, disclosures, and assistance from a landlord. As such, it is wise for a tenant to require that a landlord agree to provide such further assurances as may be necessary in connection with a license-holder's renewal of its license, or obtaining an additional form of cannabis license.

On a similar level, a landlord should consider a requirement for a tenant to pay to a landlord any additional fees, taxes or related costs that may be incurred specific to the cannabis activity/business conducted on the property, including increased insurance and financing costs.

Insurance.

It is important that a landlord understand both the scope and quality of the insurance coverage that is available to its tenant operating as a cannabis business. Anecdotally, this author has been informed that coverages such as general liability, excess, property and automobile for cannabis businesses are limited, very few insurance companies are willing to accept the exposure and quality carriers will not offer coverage until federal law is changed. In addition, premiums being charged are high, and the general liability coverage is typically written on a claims made basis rather than the preferred occurrence form basis, which creates added risk for a landlord and business owner. There are some states that do offer specific policies for cannabis businesses,

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[92] *See e.g.*, *Safe Street v. Hickenlooper*, 859 F.3d 865 (10th Cir. 2017); *Crimson Galleria Limited Partnership v. Nathanson & Goldberg, P.C.*, U.S. District Court, District of Massachusetts, Case No.: 1:17-CV-11696. Lorelei Laird. *Noxious neighbors? To Colorado, marijuana is a business - to the federal government, it's a criminal conspiracy*. ABA Journal, November 2017. *See also*, Loren Picard, The Biggest Future Risk for Cannabis Operators: Lawsuits, Cannabis Business Times, November 4, 2021 (https://www.cannabisbusinesstimes.com/article/lawsuits-biggest-future-cannabis-risk-picard/)

[93] N.J.A.C. 17:30-6.8(u) provides that "[r]emuneration provided by a cannabis business license-holder to a … vendor-contractor [which includes a landlord] may include either a flat fee or a percent of revenue or profits."

such as California, Colorado and Nevada.[94] These policies do need to be reviewed carefully in order to understand fully the scope and quality of the coverage provided by the policies.

Conclusion

While the trend appears to favor the continued growth of the cannabis related industry, any number of events at the federal level could bring an end to both the recreational and medical sectors of the industry. Only time will tell whether the increasing body of research, revealing the medical benefits of marijuana, and the economic benefits that accrue at both the state and municipal levels, will prevail resulting in a legalization of cannabis at the federal level. In the meantime, both landlords and tenants need to be vigilant in protecting their respective interests in a lease transaction.

[94] Ashley E. Cowgill, Insurance Considerations for Cannabis Delivery Services, Policyholder Pulse, July 13, 2021 (https://www.policyholderspulse.com/insurance-cannabis-delivery-services/)