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**Seminar 16**

**LEASING FOR CANNABIS RELATED USES**

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by:

**Robert M. DiPisa**  
Member/Co-Chair  
of Cannabis Law Group  
Cole Schotz P.C.  
25 Main Street  
Hackensack, NJ 07601  
rdipisa@coleschotz.com

**Douglas Praw**  
Partner/West Coast Real Estate Practice  
Group Leader  
Holland & Knight LLP  
400 S. Hope Street, 8<sup>th</sup> Floor  
Los Angeles, CA 90071  
doug.praw@hklaw.com

**I Federal**

- A. 1970 Controlled Substances Act (CSA)
  - i. Cannabis – Schedule 1 drug (heroin, meth)
    - a. Under the 1970 Controlled Substances Act (21 U.S.C. § 800 *et seq.*), cannabis is listed as a Schedule 1 drug. Schedule 1 drugs are considered the most dangerous. Its current federal status puts cannabis in the same category as heroin, cocaine and opium, in sharp contrast to its legality in the early 1900s. Of particular interest to commercial property owners is 21 U.S.T.C. § 856 (the “crack house statute”) which provides that using or allowing real property to be used for unlawfully manufacturing, storing, distribution, or using a controlled substance is a federal crime, the penalty for which may include forfeiture. It is the fear of breaking federal law and, potentially, losing their property that quite logically has made landlords reluctant to lease to cannabis businesses even in states where it is legal.
    - b. Schedule 1 drugs are considered the most dangerous.
    - c. Its current federal status puts cannabis in the same category as heroin, cocaine and opium, in sharp contrast to its legality in the early 1900s
  - ii. Crack House Statute (confiscation)
    - a. Of particular interest to commercial property owners is 21 U.S.T.C. § 856 (the “crack house statute”) which provides that using or allowing real property to be used for unlawfully manufacturing, storing, distribution, or using a controlled substance is a federal crime, the penalty for which may include forfeiture.



laws that authorize the use, distribution, possession or cultivation of medical cannabis.” The Department of Justice cannot use appropriated funds to enforce federal cannabis laws.

- c. The Rohrabacher Blumenauer Amendment language withholding appropriations to fund implementation and enforcement of federal cannabis laws in states where use is legal has given comfort to the cannabis wholesale and retail industry. It is against this backdrop of federal disinclination to enforce that the cannabis wholesale and retail industry has exploded in the United States.
- E. The MORE Act - House Judiciary Committee Chairman Jerry Nadler (D-NY) and Senator Kamala Harris (D-CA) introduced the Marijuana Opportunity Reinvestment and Expungement Act (MORE Act) on July 23, 2019. The MORE Act was reintroduced by Jerry Nadler (D-NY) on May 28, 2021. It is the most sweeping cannabis reform bill ever in Congress. What does the MORE Act do?
- F.
- a. De-schedules cannabis at the federal level to let states set their own policies without federal interference
  - b. Expunges prior cannabis convictions so we can start repairing the extensive damage done to communities of color from decades of biased law enforcement
  - c. Establishes a federal tax that would be used to assist the people and communities most harmed by cannabis prohibition with programs like job training, substance use treatment, and cannabis business licensing

## II Miscellaneous Other Federal Issues

- A. Taxes § 280 – With respect to business expenses and, more particularly, deduction of business expenses incurred by a cannabis retail operator, I.R.C. § 280(E) prohibits deduction of expenses from a trade or business on federal tax returns. The inability to deduct such expenses, including lease payments, obviously has a significant impact on profitability of retail cannabis outlets and effectively means cannabis stores pay higher taxes than other retailers.
- B. Dept. of Treasury-banks cannot facilitate criminal activity; therefore, banks cannot accept deposits from cannabis retailers
- i. Financial Crimes Enforcement Network (“FinCen”) requires \$10,000 cash deposits to be disclosed (suspicious activities reports (SARS))
  - ii. There are significant issues under federal law with respect to banking and cannabis retail facilities. As noted above, the volume of money changing hands in retail sales was estimated to be \$6.7 billion in 2016. Both Department of the Treasury regulations and case law (*Fourth Corner CU v. Federal Reserve Bank of Kansas City*, District Court Colorado 15-CB-01633) (2016) hold that banks cannot facilitate criminal activity; therefore, because possession and sale of cannabis is illegal, under federal law, banks cannot accept deposits from cannabis wholesalers and retailers. As a result, retail cannabis businesses are cash-only businesses. Because of the volume of money involved, the safety and security issues surrounding a retail cannabis business are significant. Because of the cash-intensive nature of the business, cannabis business owners are also subject to suspicious activities reports (SARs) under the Financial Crimes Enforcement Network (“FinCEN”) regulations, which provide that cash deposits in excess of \$10,000 must be disclosed to FinCEN.
  - iii. FinCEN has issued regulations with respect to cannabis-related businesses. A Department of the Treasury FinCEN Guidance was issued on February 14, 2014 regarding treatment of cannabis-related businesses. The basis of the Department of Treasury FinCEN Guidance is the Cole Memorandum. If the current

administration reverses the Cole Memorandum, the validity of the Department of Treasury FinCEN Guidance will come into question.

- iv. The following is a summary of the FinCEN Guidance due diligence requirements for banks wishing to open accounts with cannabis businesses: As a precondition to opening accounts and conducting business with a cannabis related business, banks are required to (a) verify with state authorities that the business is duly-licensed and registered; (b) review the license application related documentation; (c) request state licensing and enforcement authorities to provide information regarding the business; (d) develop an understanding of the activity of the business, including types of products sold and type of customers to be served; (e) on an ongoing basis, monitor publicly available sources for adverse information regarding the party; (f) conduct ongoing monitoring for suspicious activity; and (g) update due diligence materials on a regular basis. Part of the due diligence described requires determining whether the business violates the Cole Memorandum priorities.
- v. In the unlikely event that a financial institution agrees to undertake the above-described due diligence requirement, and open a bank account with a cannabis business, that institution will also be required to file suspicious activity reports (“SARs”) for its client’s deposits. Applicable federal regulations require SARs to be filed whenever a financial institution receives funds from a criminal activity. Because cannabis businesses are illegal, SARs must be filed with respect to all cannabis business deposits. Red flags described by the Treasury which require special SARs and, potentially, greater due diligence include, without limitation, (a) use of a state licensed cannabis-related business as a front for money laundering; (b) receipt by the business of substantially more revenue than may be reasonably expected; (c) the business receives more revenue than its competitors; (d) the business is depositing more cash than commensurate with revenue reported for tax purposes; (e) inability to document income is derived only from cannabis and not from sale of other drugs; (f) excessive deposits or withdrawals relative to competitors; (g) deposits believed to be structured to avoid currency transaction reports (“CTRs”); (h) rapid movement of funds, cash in and cash out; (i) third party deposits unrelated to the account holder; (j) commingling of funds with personal accounts; (k) transactions appearing to be on behalf of undisclosed third parties; (l) financial statements inconsistent with actual account activity; and (m) surges by third parties offering goods and services. Other areas which financial institutions are required to red flag include failure of the business to produce satisfactory documentation of licensing; efforts of cannabis-related businesses seeking to conceal or disguise their operation; due diligence revealing “negative information” such as criminal record, involving in illegal purchase of drugs, violence and other potential connections to illicit activity.

Given the Treasury regulations, it is no surprise that cannabis businesses are cash only and do not involve the use of customary banking arrangements.

- C. Trademark – not available - Trademarks are only permitted with respect to lawful commerce. As a result, registration of trademarks relating to sale of cannabis are not permitted.
- D. Bankruptcy – Gregory Garvin v. Cook Investments NW.
  - i. Relief under federal bankruptcy laws is not available to cannabis businesses which are insolvent (in re Arenas (Bankruptcy District Colorado (2014))). In addition, there is also a Department of Justice letter dated April 26, 2017 directed to bankruptcy trustees, stating “it is the policy of the U.S. that Trustees shall move to dismiss or object to all cases involving marijuana assets.”
- E. Representing Cannabis Companies
- F. Engagement Letter Policies

### III Hemp

- A. Legal Hemp v. illegal Hemp
  - i. 2018 Farm Bill
  - ii. Interstate commerce for hemp now allowed
- B. CBD
- C. Sales of CBD Seemingly Everywhere

### IV Legal Issues

- A. Civil Asset Forfeiture
  - i. The CSA classifies cannabis as a Schedule 1 substance. Penalties for violating the CSA include the forfeiture of any *real property* used to commit a violation of the CSA. [21 U.S.C. §853(a)]. Since 2014, the Appropriations Act contained a rider providing that the Department of Justice (DOJ) cannot use any federal funds to prosecute/enforce the CSA against state compliant *medicinal* cannabis facilities. However, as of June of 2021, the House approved a funding bill that goes further than the rider by including protections for banks.
- B. Financing Issues
  - i. Loan documents typically provide language stating that the loan may be accelerated in the event the real property is used in connection with illegal/unlawful activity. If there's financing on the property, Landlord should discuss the proposed cannabis related tenancy with its lender prior to committing to cannabis tenant.
- C. Permitted Use
  - i. "The Premises shall be used by Tenant to carry out a lawful cannabis business in accordance with [insert relevant state cannabis law and regulations] for the following uses that Landlord has initialed next to the listed item and for no other purposes. [List agreed upon permissible uses, including whether recreational sales are permitted]."
  - ii. "This is a nonsmoking premises. No smoking, including medical or recreational cannabis, inside or on the Premises is permitted. However, consuming medical cannabis with a vaporizer or in cannabis edibles, tonics, or concentrates is permitted."
  - iii. "No recreational or medical cannabis may be consumed on the Premises by the Tenant(s) or Tenant's guests and invitees without the prior written consent of the Landlord."
  - iv. "Unless otherwise consented to by Landlord, in writing, Tenant shall be prohibited from operating a recreational or adult use cannabis dispensary on the Premises, regardless of state law."
  - v. "Tenant shall at all times during the term of the Lease or any extensions thereof, have a copy of Tenant's state-issued cannabis license at the Premises and shall be available during working hours to present such license, which shall be in good standing with the applicable state governmental regulating authority. Upon each renewal of Tenant's state-issued cannabis license, Tenant shall provide a copy of such license to Landlord within twenty-four (24) hours of receipt."
- D. On-Site Cash
  - i. "Tenant shall use its best efforts to ensure that patients, customers, employees, agents, and owners of Tenant and Tenant's dispensary neither loiter, nor use, smoke, vape, dab, consume, in any form or fashion, any THC and/or CBD cannabis product in the Premises or Building, on the Property or in any adjacent properties. Tenant shall remove cash from the Premises at the end of each day,

so that at no time shall Tenant have in excess of \$[ ] on the Premises. Tenant shall provide Landlord with Tenant's daily cash transfer schedule and procedures and shall update such information to Landlord within twenty-four (24) hours of any changes to Tenant's cash transfer schedule and procedures."

E. Payment of Rent

- i. "Tenant shall pay all Rent, Additional Rent and any other amounts due to Landlord by check or wire transfer on the date set forth in this Lease. Unless otherwise agreed by Landlord, Tenant shall not be permitted to pay Rent, Additional Rent or any other amounts due Landlord in cash."

F. Issues with Percentage Rent

- i. If Landlord accepts percentage rent from a cannabis tenant, the landlord is deriving income directly from the sale of cannabis and cannabis related products -- exposing Landlord to liability for violating the CSA.

G. Utilities

- i. "Any excessive consumption of water or electricity shall be at Tenant's sole cost and expense. No utilities user sharing the meter for electricity or water, as the case may be, shall be obligated to pay a disproportionate share of utilities. If Landlord determines that the only reasonable means for proper allocation of electricity/gas/water usage costs is the installation of a separate meter, Tenant shall pay the expense of the meter and its installation within five business days of the date upon which Landlord informs Tenant of its election to install a separate meter."

H. Inspection of Premises

- i. "If approval from the [insert relevant state and local regulators] or any other governmental authorities is necessary in order for Landlord or any mortgagee to inspect the Premises, Tenant shall use its best efforts to support obtaining such approvals for inspection, time being of the essence. If Landlord's access to certain space in the Premises is conditioned on Landlord being accompanied by a member of Tenant's management team, Tenant shall provide such access to the Premises as soon as reasonably possible, after Landlord request."
- ii. "Landlord shall have the right, at any time any portion of the Premises is occupied by Tenant's principals, agents, or contractors, including at times when the Premises is not open for business to the public, to enter the Premises for the purposes of ensuring compliance with the covenants, warranties, and representations of Tenant under this Lease. In accordance with state licensing rules, Landlord must be accompanied by authorized Tenant personnel while inspecting limited access areas. Landlord may photograph or video-record in any medium the activities of Tenant, subject to privacy restrictions under HIPAA and state laws and so long as such visual records are not provided to anyone with an interest in possessing Tenant's trade secrets (other than government entities)."

I. Indemnification

- i. "Except to the extent caused by or resulting from Landlord's gross negligence or willful misconduct, Tenant shall save Landlord harmless, and will exonerate and indemnify and defend Landlord from and against any and all civil, criminal, or other claims, liabilities, or penalties, including attorney's fees, asserted by or on behalf of any person, firm, or public or governmental authority on account of or based upon Tenant's use of the Premises or any injury to a person, or loss of or damage to property, sustained or occurring within the Premises."

J. Signage/Marketing

- i. "At all times during this Lease, Tenant shall comply with all applicable statutes and regulations involving [insert facility type] advertising, signage and marketing of the [insert facility type] business."

K. Odors

- i. "Tenant shall undertake reasonable and diligent steps to mitigate any odor emanating from cannabis located on the Premises."

L. Tenant Improvements

- i. "The parties acknowledge that the Premises are not currently fit for the permitted use and that the alterations listed in Attachment A will have to be construed to render the Premises fit and that:
  - a. Tenant shall, at its sole expense, but with the good faith and reasonable cooperation of Landlord, secure all licenses, permits, and other approvals required to make such alterations;
  - b. Tenant shall not be entitled to reimbursement from Landlord for making any alterations or improvements that are unique to the operation of a Cannabis business and provide no residual value to a subsequent tenant; and
  - c. Tenant shall remove, at its sole expense, any and all alterations that Landlord designates for removal at the end of the Lease term."
- ii. "Tenant's covenant to comply with all applicable Mandates shall apply equally to dismantling Tenant's operations at the end of the term and surrender of the Premises."
- iii. "Tenant hereby covenants to dispose, according to Mandates, all unused inventory, refuse, and scrap materials and thereafter to clean to commercially acceptable standards (including sterilization of impermeable surfaces, wall to wall and ceiling to floor) all floors, walls, immovable fixtures, and air ducts serving the Premises."

M. Events of Default

- i. "...Tenant's failure to maintain the [insert facility type] license in good standing with the applicable governmental authorities,"
- ii. "...the initiation of any Federal enforcement investigation or action involving Tenant, Tenant's affiliates or Tenant's use of the Premises as a result of operating as a cannabis [insert facility type],"

N. Surrender at End of Term

- i. "Tenant shall remove, coordinate, and/or destroy, as permitted and directed by the applicable governmental authorities, all medical cannabis products remaining in the Premises upon expiration or earlier termination of this Lease."

O. Duty to Report

- i. "Tenant shall be required to report to Landlord within twenty-four (24) hours, including providing copies of any written notices, of any complaints received by Tenant, including but not limited to, patients, employees, agents, or owners, loitering, or using, smoking, vaping, dabbing, or consuming, in any form or fashion, any THC and/or CBD cannabis product in the Premises or Building, on the Property or on any adjacent properties. If Tenant receives any notices from the [insert relevant state and local regulators] or any other governmental authorities, regarding Tenant's [insert facility type] license or use of the Premises as a [insert facility type], Tenant shall submit such notices to Landlord within twenty-four (24) hours."

- P. Definition of Laws
- i. Tenant's obligation hereunder shall include (i) all state and local laws and regulations from any governmental authority with jurisdiction over Tenant's use, including but not limited to [relevant state law and regulations] and local zoning ordinances; and (ii) all federal laws to the extent those laws are not inconsistent with state and local laws allowing Tenant to use the Premises for the specified permitted uses. The covenant to comply encompasses all applicable laws that become effective before and during the Lease term, as may be extended (collectively, the "Mandates"), regardless of the cost of such compliance. Tenant's inability to comply with the Mandates shall be grounds for termination of this Lease.
- Q. Obtaining Insurance
- i. Insurance policies for cannabis tenants can be very expensive and typically contain many carve-outs regarding what is actually covered. Landlords will want to require tenants to obtain a robust insurance policy. However, landlords should be sensitive to what types of policies and coverages tenants can actually obtain.
- R. Security
- i. Landlords should be aware of the additional security concerns that come with leasing to cannabis tenants. Landlords should consider either requiring tenants to pay for additional security systems for the premises (which may include the hiring of a security guard) or building-in such costs to the lease. With regard to security guards, landlords should ensure a tenant hires an insured and reputable security company, or possibly require the hiring of off-duty policemen. Landlords also may want to specify whether security guards are permitted to be armed. (Note: This may be subject to state law specifics).
- S. Limitation of Liability/Personal Guarantees
- i. Landlords will not want to limit their recovery for any breach of the lease or damages from the tenant's activities to exclude recovery from any partner, shareholder, member, trustee, or beneficiary of the tenant. Landlords should consider lease guaranties.
- T. Landlord Early Termination Right
- i. Landlords should reserve the right to terminate the lease upon changes in laws related to the tenant's activities, including changes to applicable local, state, and federal laws, or upon revised official guidance concerning enforcement priorities from the Department of Justice (rescission of the Cole Memorandum).
- U. Governing Law
- i. Both landlords and tenants need to confirm applicability of laws governing the location of the cannabis activity and that counsel knowledgeable about the specific local requirements (such as zoning regulations) has reviewed the lease.
- V. Waiver of Defense
- i. Both landlords and tenants should waive any defense based on violation of federal laws and should stipulate that federal illegality based on the presence of cannabis is not a valid defense to a claim arising under the lease. Many states that allow cannabis cultivation require this term to be included in the lease, thus negating any federal "innocent owner defense" for a landlord.
- W. Warrant of Sustainability
- i. Landlords may want to remove warranties that the premises are suitable for a tenant's proposed use, since this may require significant alterations to the premises, such as building code and zoning alterations and inspections. Tenants should be responsible for all necessary permits, licenses, and approvals.

X. Environmental Concerns

- i. Both landlords and tenants should agree upon proper procedures for the disposal and storage of herbicides, pesticides, and fertilizers in addition to light and water use.