

MEDICAL MARIJUANA

A BRAVE NEW WORLD FOR LANDLORDS AND TENANTS

BY LYNN FULSTONE, ESQ.

The passage of S.B. 374 in Nevada's 2013 legislative session not only paved the way for medical marijuana establishments (MMEs) to become licensed as the first commercial source of medicinal cannabis for patients in Nevada, but also spawned a frenzy of activity as applicants for the valuable MME licenses began to seek the real estate needed to satisfy the requirements of the application process. MME applicants rushed to be the first to find and lock up properties that met the separation and zoning requirements of state and local law, while still being suitable for their intended use for dispensing, cultivation or production of MMEs.

There are now 23 states, including Nevada, that have enacted laws legalizing some form of medical marijuana. Furthermore, the recreational use of marijuana is now legal in four jurisdictions. With the current trend of more and more states entering into the legalized medical marijuana industry, and the prospect of legalizing the recreational use of marijuana in the future, landlords and tenants (and the lawyers who advise them) need to be aware of certain issues in negotiating and leasing real estate on which MMEs will be operated.

Federal Law

Even though Nevada provides a lawful framework for the cultivation, manufacture and sale of medical marijuana, these activities are still crimes under the federal law known as the Controlled Substances Act (CSA).¹ Because the federal law prohibits the distribution and sale of marijuana, a landlord leasing to a tenant conducting these activities could face penalties under federal law even if the tenant is operating a MME in accordance with state and local law.

The current federal administration has adopted a somewhat relaxed approach to enforcing the CSA, as indicated in the August 29, 2013, U.S. Department of Justice, Office of the Deputy Attorney General, "Memorandum for All United States Attorneys" from James M. Cole (the Cole Memo), regarding enforcement of the CSA. The Cole Memo can be read to imply that the federal government does not intend to affect legitimate, state-run cannabis programs, but rather intends to use its limited investigative resources to focus on certain enforcement priorities.

However, there can be no assurance that subsequent administrations will continue the existing (non-)enforcement policies. Furthermore, in addition to possible criminal prosecution and imprisonment under federal law, other potential risks associated with the distribution and sale of marijuana include:

1. Seizure of assets or forfeiture of property related to the sale of medical marijuana;
2. Internal Revenue Service enforcement of special laws regarding taxing of profits from illegal enterprises; or
3. Loss of a privileged or federal license.²



ANA LEASING: ORDS



The Landlord Perspective

Although the risks to a landlord may be more attenuated than those for the tenant, the landlord and the landlord's property may still be subject to risks, including federal forfeiture, particularly if the tenant is not compliant with state or local law. It is important for a landlord to conduct adequate due diligence on any tenant proposing to operate a MME on the landlord's property. The level of risk to the landlord will be inextricably linked to the landlord's tenant. All leases should be triple net with no percentage rent, and the landlord should not otherwise take any ownership or profits interest in the MME. If the property is encumbered by a mortgage, landlords must review their loan documents to confirm that leasing to a MME tenant would not trigger a default or require lender approval.

The Tenant Perspective

Because the federal law prohibits the distribution and sale of marijuana, a landlord leasing to a tenant conducting these activities could face penalties under federal law even if the tenant is operating a MME in accordance with state and local law.

MME tenants should independently verify the applicable zoning and separation requirements, to assure they are not wasting time and money on unacceptable locations. MME tenants (or their counsel) should carefully review lease boilerplate (e.g. compliance with laws) to assure language is modified appropriately for the MME business.

The permitted MME use should be clearly stated in the lease. Tenants must be forthright with landlords about the proposed use of the premises and will need landlord involvement in the licensing process. Landlords will have to sign forms and, in some cases, will have to be fingerprinted or vetted, even if not taking an ownership

or profits interest. MME tenants must consider the pros and cons of entering into a short- or long-term lease in light of their prospects of successfully licensing and operating the MME business.

Lease Issues

Landlords and tenants should consider the following issues in negotiating the MME lease:

Insurance and Indemnity

Customary insurance required in leases for tenants may not be available for MME tenants in a particular jurisdiction. In addition, the landlord's loan documents may require certain insurance coverage for the landlord's property. Both landlords and tenants should investigate this up front. Typical lease indemnity provisions should be included in the lease customized for the MME tenant's use of the premises. MME tenants may want to try to make indemnification mutual.

Security Deposit and Guarantees

Landlords should consider a larger than normal security deposit (applicable to delinquent rent), and the possibility of personal guaranties that would be triggered in the case of "bad acts," such as loss of a license or commencement of a governmental action. MME tenants should be prepared to demonstrate their commitment to regulatory compliance and their financial wherewithal to mitigate these provisions.

Tenant Improvements

MMEs have unique tenant improvement (TI) requirements depending on the type of activity conducted on the premises. Cultivation and manufacturing facilities utilize specialized fixtures, equipment, lights, extraction materials and security equipment, which may not be useful for a subsequent tenant, or may be difficult to remove or unlawful for an unlicensed person to possess. Landlords leasing to MME tenants may want to

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impose the cost and/or obligation for TIs and their removal on the MME tenants. MME tenants may want to assure that all TIs, whether fixtures or trade fixtures, will remain the property of the MME tenant at the end of the lease.

Utilities and Waste Disposal

Depending on the activities and processes, MMEs can consume large quantities of water and electricity.

There are specialized requirements for the disposal of waste products and chemicals under state and local laws. These additional costs may affect the CAM or additional rent charged to the MME tenant. Landlords

should consider separate metering or excess use provisions. MME tenants should have information supporting their expected utility use with which to negotiate these provisions with landlords.

Access to Premises

Nevada law contains strict requirements regarding who has access to the premises where marijuana is cultivated, processed and dispensed.³ If authorized to enter the facility, the landlord or a representative must wear a badge and be escorted by a facility employee.

Other Tenants

If the property is a shopping center, or if adjacent tenants are involved, the other leases should be reviewed for approval rights and use restrictions, keeping in mind that under federal law MMEs remain unlawful. The landlord should consider the effect of the presence of an MME on existing and future tenants and be wary of potential

odors or other potential nuisance claims. When negotiating these provisions with landlords, MME tenants should have information supporting claims that their operations will not pose any odor or other similar problems.

Conditional Leases or Options

Nevada law requires MME license applicants to provide copies of all leases or executed option contracts showing that they possess or have the right to use the premises specified in the application

to properly carry on the activities sought.⁴ MME tenants may want a conditional lease or option agreement until all permits and licenses are received. Both parties should carefully consider any open-ended or multiple arrangements for the

same premises.

Lease Termination

Specific triggers allowing early termination for non-compliance with laws or loss of licensing should be included along with other default provisions. MME tenants should review the language of these provisions to eliminate overbreadth and assure consistency with applicable laws.

Environmental Compliance

Environmental problems, such as mold or air contamination from pesticides and fertilizers, could impact the interior of the premises as well as implicate state regulations.⁵ Lease provisions should require compliance with applicable regulations, while at the same time allowing for the MME tenant's use.

Use Restrictions

Both landlords and tenants should review applicable CCRs and loan documents affecting the property and

take appropriate steps to comply. As the standard prohibition against illegal activities could be interpreted to prohibit MMEs, it may very well be necessary to obtain a waiver or amendment of such language in addition to dealing with other potential restrictions.

Although the real estate frenzy has died down somewhat following Nevada's first MME licensing period in 2014, landlord-tenant leasing issues will continue to be important. New laws currently permit MMEs to change locations within their local jurisdictions; future MME applications periods may be opened by the state; and voters will have the opportunity to vote to legalize recreational marijuana in 2016. The brave new world of leasing to MME tenants has just begun. **NL**

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1. 21 U.S.C. § 801 *et. seq.* (2014).
2. Notice to Licensees from Terry Johnson, Esq., Bd. Member, Nev. Gaming Control Bd., to All Gaming Licensees & Applicants regarding Medical Marijuana Establishments (May 6, 2014) available at: <http://gaming.nv.gov/modules/showdocument.aspx?documentid=8874>.
3. See Nev. Rev. Stat. § 453A.352(4)(2015) (access to facilities only by or under supervision of authorized MME agents).
4. Nev. Rev. Stat. § 453A.322(3)(a)(2)(IV) (2015)(requiring written permission of the property owner to operate the proposed MME on that property).
5. See Nev. Admin. Code § 453A.658(2015) (required testing); Nev. Admin. Code § 453A.588(2015)(ventilation).

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