

Minimize Marijuana Risks With Special Lease Clauses

Description

The enactment of medicinal marijuana laws in 2013 and the recent enactment of laws permitting the cultivation and sale of recreational marijuana in Massachusetts commencing in July 2018 have created great opportunities for owners and developers of warehouse and industrial real estate in the commonwealth. However, these opportunities come with particular legal and business risks that must be taken into account by those who enter into leasing and other transactions with marijuana based operations. This article focuses on special issues related to leases between commercial landlords and marijuana cultivators or dispensaries.

There are currently 29 states that have laws or regulations recognizing legitimate medicinal uses for marijuana. Fewer states permit the cultivation and sale of recreational marijuana. Marijuana is still, however, a Schedule I controlled substance and is illegal under the federal Controlled Substances Act (CSA). Even in states such as Massachusetts, in which the use of marijuana for medicinal or recreational purposes has been legalized, anyone involved in cultivating, processing, distributing or selling marijuana for any purpose, as well as those who knowingly facilitate these activities, are subject to potential federal enforcement action, including criminal prosecution, civil actions, and seizure and forfeiture of property.

In addition, those who engage in transactions involving the proceeds of marijuana activities could be found to be in violation of federal money laundering statutes and other federal financial laws. All of these criminal and civil enforcement actions can occur even if the activities are in full compliance with state laws. In an effort to provide guidance to federal law enforcement, the [U.S. Department of Justice](#) issued guidance regarding marijuana enforcement to all United States attorneys in a memorandum from Deputy Attorney General David Ogden dated Oct. 19, 2009, and in memorandums from Deputy Attorney General James Cole dated June 29, 2011, and Aug. 29, 2013. Each memorandum provided that the DOJ is committed to the enforcement of the CSA, but indicated that the DOJ is also committed to using its limited investigative and prosecutorial resources to address the most significant threats in the most effective, consistent and rational way.

The Aug. 29, 2013, memorandum provided updated guidance to federal prosecutors concerning marijuana enforcement in light of state laws legalizing medicinal marijuana. The memorandum sets forth certain enforcement priorities that are important to the federal government:

- Preventing the distribution of marijuana to minors;
- Preventing revenue from the sale of marijuana from going to criminal enterprises, gangs and cartels;
- Preventing the diversion of marijuana from states where it is legal under state law in some form to other states;
- Preventing state-authorized marijuana activity from being used as a cover or pretext for the trafficking of other illegal drugs or other illegal activity;
- Preventing violence and the use of firearms in the cultivation and distribution of marijuana;
- Preventing drugged driving and the exacerbation of other adverse public health consequences associated with marijuana use;
- Preventing the growing of marijuana on public lands and the attendant public safety and environmental dangers posed by marijuana production on public lands; and Preventing marijuana possession or use of marijuana on federal property.

While the DOJ has historically relied primarily on state and local law enforcement to address marijuana activity, it has occasionally commenced criminal or civil actions against entities engaged in marijuana related activities. In addition, there is much uncertainty as to how President Donald Trump and Attorney General Jeff Sessions intend to treat medicinal and recreational marijuana laws, and whether the Trump administration might decide to increase enforcement or strictly enforce the CSA and other federal criminal and civil laws in all states,

including those that have approved medicinal marijuana.

In the event the DOJ begins strict enforcement of the CSA, there could be a direct and adverse impact on a tenant's or a landlord's business, revenue or property. If a tenant is forced to shut its operations, the property owner would likely need to replace the tenant with a nonmarijuana tenant, who would likely expect to pay lower rents. Additionally, property owners would likely suffer an economic loss on improvements made to the property that were specific to the marijuana industry.

In light of these various risks, the following are some of the more important protections, and sample lease provisions, that landlords should consider in connection with leasing to marijuana based tenants.

Early Lease Termination Rights.

Because of the risk of criminal prosecution, civil liability and forfeiture under federal law, and because of possible adverse actions by Massachusetts authorities in the event a tenant fails to be in compliance with applicable Massachusetts statutes or regulations, landlords should include provisions which grant them early lease termination rights. The following provisions are also meant to protect the landlord's business from actions by the tenant that could result in the landlord defaulting under agreements with third parties:

Early Termination. Landlord shall have the right upon Landlord's sole election, upon five (5) days prior written notice to Tenant or, if sooner, upon the effective date of any court order, to terminate this Lease in the event any of these causes ("Early Termination Causes") arise:

(a) The seizure by any governmental authority seeking forfeiture of the Premises, whether or not the court proceeding has actually commenced;

(b) The entry of judgment (whether final or not) that has the effect (whether by restraining order, injunction, declaration, or otherwise) of establishing the Tenant's use of the Premises constitutes a public or private nuisance;

(c) The commencement of an action under any federal, state, or local law (ordinance) or regulation seeking remediation of the Premises as a result of a violation by Tenant of any mandate pertaining to environmental sensitivity or commission of waste, irrespective of Tenant's intent and course of action following its commencement;

(d) A final, appealable judgment having the effect of establishing that Tenant's operation violates Landlord's contractual obligations (i) pursuant to any private covenants of record restricting the Premises, (ii) good faith and fair dealing to any third party, or (iii) pursuant to its obligations under its mortgage agreement with Landlord's Mortgagee;

(e) An event that (i) requires closure of the Building for more than 180 consecutive days for remediation of materially adverse circumstances created by Tenant's use of the Premises, or for more than 210 nonconsecutive calendar days within a 360 consecutive day period, or (ii) causes Landlord's insurance carrier to cancel casualty and/or liability coverage on the Building unless the Tenant procures coverage for the Building within five (5) calendar days thereafter, and commences and thereafter continues to pay any premium cost in excess of the premium (pre-cancellation) paid by Landlord without credit or offset against the Rent reserved under this Lease. This shall not include fire and other natural calamity events, unless the source of any such event is directly related to Tenant's operation, such as a heat lamp-related fire in any cannabis cultivation site.

Right to Inspect the Premises.

Landlords should include special provisions which give them the right to inspect the premises to ensure that the tenant remains in compliance with any applicable marijuana laws and regulations. A sample inspection clause follows:

Inspection of Premises. 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 employees).

Compliance by Tenant with Applicable Laws

The following clause is meant to have the parties acknowledge that the premises will be used for marijuana related activities, require that the tenant comply with all applicable laws and regulations and put the burden of compliance on the tenant:

Compliance with Laws. The parties acknowledge that myriad regulations and local, state, and federal laws and private persons shall govern the operation of Tenant's use and that Tenant alone will be responsible for compliance with all mandates and requirements of any nature. The parties also acknowledge that under federal law, the production, distribution and sale of cannabis remains a violation of the Controlled Substances Act and that, as between Landlord and Tenant, the risk of enforcement of such laws is on Tenant. Tenant's foregoing obligation shall encompass (i) all state and local laws and regulations from any governmental authority with jurisdiction over Tenant's use, including but not limited to [insert specific applicable 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 Permitted Use. 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.

Protections against Excess Service and Other Charges

Marijuana cultivation facilities often use extraordinary amounts of water and electricity and can put a strain on building services and facilities. A sample clause to protect a landlord against these extra costs follows:

Extraordinary Operating Expenses. Tenant shall reimburse Landlord for any extraordinary expense for Building or Premises operations resulting from Tenant's permitted use, including without limitation, the cost of evening security guards, supplementary janitorial services, water usage or HVAC system service and periodic maintenance.

Responsibilities upon Lease Termination

Landlords may desire to include a clause that requires a marijuana based tenant to remove its marijuana equipment at the termination of a lease and clean the premises of all marijuana-related product and residue:

Disposal and Removal of Alterations. 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. Tenant's covenant to comply with all applicable Mandates shall apply equally to dismantling Tenant's operations at the end of the Lease Term and surrender of the Premises. Landlord shall not return the Security Deposit to Tenant until an inspection of the Premises discloses that the above cleaning and disposal and removal of Alterations required by this Lease have been satisfactorily completed.

Special Indemnification Clauses

In addition to the standard indemnification clauses, leases should contain special indemnification clauses that are related to the particular risks of having a marijuana cultivator or dispensary as a tenant. These risks relate

to the various events that could cause damage to a landlord as a result of an event that leads to early termination of a lease, violations of federal drug laws or security risks:

Indemnity. In addition to the provisions of [general indemnification clause], Tenant agrees to indemnify and hold harmless Landlord from and against damages or losses Landlord incurs as a result of (a) any Early Termination Causes, (b) any violation of the Controlled Substance Act, and/or (c) damage done to the Building as a result of robberies, break-ins and burglaries.

While the enactment of laws in Massachusetts permitting the cultivation and sale of medicinal and recreational marijuana have created great demand and opportunities for owners and developers of industrial and warehouse space, those parties are still faced with substantial risk under federal law and special business risks particular to tenants engaged in the cultivation and sale of marijuana. While all of the risks cannot be eliminated, by including certain provisions in their leases, landlords can at least mitigate many of those risks.

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