

**LEASING TO A MEDICAL MARIJUANA TENANT  
NOW IS IT A WISE NEW REAL ESTATE MOVE?  
June, 2010**

[This article updates the author's previous  
articles on this topic dated December 2009 and January 2010.]

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One of the most active aspects of an otherwise relatively moribund commercial real estate market in Colorado recently has been the demand for medical marijuana ("MM") facilities. Purchase-and-sale transactions are relatively simple: a willing buyer and a willing seller complete the sale, and the seller need not worry thereafter about what the buyer does with the property. Leases, however, generally create long-term relationships, and special care should be taken by both parties when entering into a lease for a MM facility.

There are many types of properties that are potential candidates for medical marijuana facilities, and except for land, given Colorado's climate, potential lease transactions exist in almost all property use categories:

- Industrial: indoor grow farms, labs
- Retail: storefront MM centers
- Office: MM centers, physicians, labs

Notwithstanding the heretofore common use of the word, "dispensary", note that use of the term "dispensary" is avoided in this paper, because not only is it not found in the constitutional amendment that led to the creation of the MM industry in Colorado, but it is not found in recently-enacted HB 10-1284 governing medical marijuana facilities in Colorado.

## **Background**

How did we get here, and what are the current legal issues that make leasing to MM facilities problematic?

### **Federal law and Department of Justice policy**

Marijuana is a "controlled substance", the possession, use and sale of which is illegal under a number of federal statutes, and there are also statutes allowing federal agents to confiscate real property used in the commission of a crime. About a year ago, however, U.S. Attorney General Eric Holder announced that the current U.S. Justice Department was adopting a policy of not enforcing federal drug laws related to marijuana, so long there was compliance with state law. This policy, of course, will not be binding upon future administrations, and it could even change during this administration. Moreover, Holder made it clear that the U.S.

Justice Department would continue to enforce federal laws against drug traffickers who "falsely masquerade" as legitimate medical dispensaries, and there will always be law enforcement officers who disagree with the policy will be looking for every opportunity to find that MM operators have acted in such a way that the policy does not apply.

### **Colorado law**

Marijuana is also a controlled substance under Colorado law.<sup>1</sup> Possession, use and sale of marijuana remain crimes except to the extent that one can bring oneself under the protection of the constitutional amendment and implementing statutes. Penalties for violating drug laws include incarceration, loss of driving privileges, and seizure of property used in connection with the crime. A constitutional amendment in 2000, discussed in more detail below, created for the benefit of qualifying patients and their "primary caregivers" an exemption and affirmative defense to prosecution for possession and use of marijuana for medical purposes. Following the U.S. Justice Department's policy announcement regarding easing of enforcement of federal drug laws against marijuana possession, distribution and use, the problem in Colorado was that while we had a constitutional amendment permitting the use of MM by certain patients, the implementing statutes had very little detail, and so it was pretty well impossible for a seller of MM to demonstrate compliance with state law.

### **Local law**

Local ordinances also govern the use of marijuana in additional ways, such as Denver's ordinance allowing seizure of real and personal property deemed to be a "public nuisance."<sup>2</sup> Following the Department of Justice's policy announcement, and the ensuing proliferation of MM facilities, Denver and a number of other jurisdictions, acting in the absence of definitive state law, enacted their MM ordinances or in some cases, moratoria.

### **The MM Constitutional Amendment and pre-HB 10-1284 confusion**

An amendment to the Colorado Constitution, passed pursuant to the initiative process in 2000, added Article XVIII, Section 14 to the Constitution. It creates an exception/affirmative defense to criminal prosecution under state law for certain medical patients with "debilitating conditions", their "primary care-givers" and physicians who recommend use of marijuana for treatment, so long as they comply with the requirements of the amendment and statutes and regulations enacted pursuant to it. Patients must apply to be listed in a state registry and be issued a registry card. There was no requirement for a registry of caregivers, and no mention of dispensaries. In 2001, as directed by the constitutional amendment, the state legislature enacted enabling legislation which is codified in C.R.S. 18-18-406.3 of the criminal statutes and C.R.S. 25-1.5-106 of the statutes which govern the Colorado State Department of Public Health and Environment ("CDPHE"). CDPHE, as required by the constitutional amendment and enabling

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<sup>1</sup> See, for example: 18-18-406, C.R.S., Offense relating to marihuana and marihuana concentrate; 18-18-410 and -411, C.R.S., Class 1 Public Nuisance; Keeping, maintaining, controlling, renting, or making available property for unlawful distribution or manufacture of controlled substances.

<sup>2</sup> See Article III of the Denver Municipal Code, Sections 37-70 through 37-87.

legislation, adopted regulations concerning its oversight of the medical marijuana registry program, at 5CCR 1006-2.

The CDPHE regulations included the definition of "primary care-giver" taken directly from the constitutional amendment: *'Primary care-giver' means a person, other than the patient and the patient's physician, who is eighteen years of age or older and has significant responsibility for managing the well-being of a patient who has a debilitating medical condition.* Neither the constitutional amendment nor the enabling statute, however, defined the phrase, "significant responsibility for managing the well-being of a patient who has a debilitating medical condition", so the CDPHE undertook to define that phrase in its regulations. It defined "significant responsibility for managing the well-being of a patient who has a debilitating medical condition" as, "assisting a patient with daily activities, including but not limited to transportation, housekeeping, meal preparation, shopping, making any necessary arrangement for access to medical care or services and *provision of medical marijuana.*" [Regulation 2, prior to amendment in 8/30/2009; emphasis added]

In the summer of 2009, the CDPHE held hearings on proposed amendments to its regulations. The most controversial of the proposed amendments would have provided that no person could be a primary care-giver for more than five patients at a time. The hearing concerning this proposed regulation was attended by hundreds of people, a large number of whom were passionate proponents of the use of medical marijuana. As the result of the hearing, the proposed five-patient limit was *not* adopted, and the list of examples of activities which constitute "significant responsibility for managing the well-being of a patient who has a debilitating condition" was amended to insert the word, "or" between each example. Thus, under the revised CDPHE regulations, *the provision of medical marijuana alone* met the definition of "significant responsibility for managing the well-being of a patient who has a debilitating medical condition". This action of the CDPHE, together with U.S. Attorney General Holder's announcement that the U.S. Department of Justice would not be enforcing federal laws against MM operators who comply with state law, ignited the explosion in the number of medical marijuana "dispensaries" in Colorado. However, note that the term "dispensary" is found nowhere in the constitutional amendment, the initial implementing statute or the CDPHE regulations. Those who sought to supply marijuana to patients entitled to receive it had to fit themselves within the definition of "primary care-giver". There was no permit or license requirement for, or registry of, primary caregivers.

On October 29, 2009, the Colorado Court of Appeals decided *People v. Clendenin*, Colo. Court of Appeals No. 08CA0624, finding the statute constitutional and dealing with the definition of "primary care-giver". The appellate court confirmed the lower court's conviction of Stacy Clendenin, who was found guilty of cultivation of marijuana, possession with intent to distribute marijuana, possession of marijuana concentrate, possession of marijuana – eight ounces or more, and possession of drug paraphernalia, after the police found in her home 44 marijuana plants, \$572 in cash and 67 medium sized zip lock bags (presumably containing marijuana). The Court of Appeals held that, in order to qualify as a "primary care-giver" under the constitutional amendment and enabling statute, a person must do more than merely supply marijuana to the patient, a decision that was directly at odds with the CDPHE regulations, under which simply providing marijuana to a qualified patient would bring a person within the

definition of "primary care-giver". [Because Ms. Clendenin was convicted prior to the enactment of the CDPHE regulations, the Court of Appeals said that it did not need to address the issue of whether the CDPHE regulations comport with the constitutional amendment.]

On November 3, 2009 the CDPHE, recognizing the fact that its regulations, which permitted someone to qualify as a primary care-giver on the sole basis of providing marijuana to a qualified patient, were in conflict with the *Clendenin* decision, revoked its definition of "significant responsibility for managing the well-being of a patient who has a debilitating medical condition". On the following Tuesday, November 10, Denver District Court Judge Larry Naves struck down CDPHE's action on procedural grounds. The negation of the CDPHE's withdrawal of its definition did not, however, resolve the problem, since the Court of Appeals decision still stands unless and until it should be overturned on appeal to the State Supreme Court, and it is hard to see how the CDPHE regulations would stand if the question were directly presented to the Court.

The concurring opinion by Judge Loeb in *Clendenin* pointed out that the major inadequacy with the constitutional amendment and initial implementing statutes was the fact that, "although qualifying patients and primary care-givers may be protected from criminal liability [for possessing, growing and using marijuana], nothing in the amendment protects their original *suppliers* from prosecution or conviction on drug-related charges." In other words, under state criminal law, certain people are exempt from liability for growing, possessing and using certain quantities of marijuana, but people who supply them are not. The only people who were registered were patients; care-givers were not registered or in any way regulated. Also, the constitutional amendment and initial implementing statute allowed patients and their primary care-givers to *grow* marijuana. Nothing allowed primary caregivers to buy it and re-sell it to patients.

In the absence of adequate state law, quite a few local jurisdictions enacted a patchwork of new licensing and zoning regulations and even moratoria on medical marijuana facilities. The monkey was on the back of state legislators to enact statewide law governing the cultivation, possession, distribution and use of marijuana for the uses contemplated by the constitutional amendment.

## **2010 legislation**

The Colorado legislature, after a great deal of contentious input from many sectors, finally enacted Senate Bill 10-1099 governing the patient-physician relationship and, in the waning days of the session, House Bill 10-1284, a comprehensive 60-page bill containing extensive licensing and regulation of MM facilities. Both bills were signed into law by Governor Ritter on June 7, 2010. HB 10-1284 and SB 10-1099 go beyond the Constitutional amendment to legitimize the MM supplier industry and create a system for licensing suppliers as separate and distinct from primary caregivers. Primary caregivers are required to actually be caregivers, do more than just supply MM, and they may have no more than 5 patients at a time. Primary caregivers will now be registered with the CDPHE. The bills contain detailed directives to local

and state licensing authorities, and require the Colorado Department of Revenue and CDPHE to further implement the law through rules.

Due to their length, HB 10-1284 and SB 10-1099 are not attached to this article. They can be found on the Colorado General Assembly's website, [www.leg.state.co.us](http://www.leg.state.co.us), and also on the author's website, [www.foxlegal.net](http://www.foxlegal.net), under "Marijuana Law". With not a little trepidation, the author here attempts to summarize the most important aspects of the bills, with emphasis on those provisions that will be of particular interest to real estate lawyers and commercial real estate brokers.

## **HB 10-1284**

Most of the provisions of HB 10-1284 will become new Article 43.3 of Title 12 of the Colorado Revised Statutes. The bill also amends Section 1.5 of Title 25 governing the CDPHE, and a number of other statutes found in Titles 16, 24, 25 and 39. With some small exceptions relating to financial aspects of the bill, the effective date of HB 1284 is July 1, 2010.

### **License types**

Under the statute, a MM operator must obtain one of three types of licenses from *both* the local licensing authority ("LLA") *and* the state licensing authority. The state licensing authority is the Executive Director or Deputy Director of the Colorado Department of Revenue ("DOR"). The LLA will, of course, vary from jurisdiction to jurisdiction. Local jurisdictions may altogether prohibit MM facilities by majority vote of either their electors or their governing bodies, and if not altogether prohibited, may impose restrictions that are more stringent than those found in HB 1284.

The only three types of licenses which the LLA and DOR may issue are:

- Medical marijuana center license
- Medical marijuana-infused products manufacturing facility license
- Optional premises cultivation license (must be adjunct to one of the other two types of licenses)

Additionally, the DOR may issue occupational licenses and registrations for owners, managers, operators, employees, contractors and support staff pursuant to to-be-enacted rules and regulations. Licenses are granted for 2 years.

### **Licensed premises and licensing**

Licenses for MM businesses are issued for *specific licensed premises*. One person may hold multiple licenses, but in considering whether to issue multiple licenses to one operator, the licensing authorities are directed to consider the possible restraint on competition. The application to the LLA must be made on a state-promulgated form plus any additional forms required by the LLA, and must be accompanied by plans and specifications for the interior of an existing building, or a plot plan, detailed sketch for the interior and architectural drawing of a to-

be-built building. The LLA *may* hold a public hearing, and if it does, notice requirements including posting the notice at the building or building site. Once an application is approved, it may not be issued until the to-be-licensed premises is ready for occupancy, fully fixtured, furnished and equipped, and the LLA has inspected it for compliance with the plans and specifications which were submitted with the application.

The LLA and DOR may not act upon an application until the right to possession of the proposed licensed premises is shown by a lease or ownership. Licensed premises may not be located in an area where such facilities are prohibited by local zoning ordinances, and they may not be located within 1,000 feet of a school, alcohol or drug treatment facility, principal campus of a college, university or seminary or residential child care facility [ed. – What does “*residential child care facility*” mean?], although LLAs may modify these distance requirements.

One controversial aspect of the bill is that the locations of optional premises cultivation licensed premises are exempt from the Colorado Open Records Act. This may be desirable from the point of view of landlords, tenants and law enforcement personnel, if not from the point of view of neighbors or potential neighbors who want to know where marijuana is being grown.

MM centers must comply with all provisions of Article 24 of Title 24, C.R.S., as such provisions relate to persons with disabilities.

There are provisions for a request for concurrent review of the local and state applications, but the state license will not be issued until the local application is issued. A \$5,000 corporate surety bond must be posted by the license holder to ensure payment of state sales and use taxes.

### **Rules required**

Although the bill has quite a bit of detail in its 60 pages, it requires the Department of Revenue to promulgate “rules” and “special rulings” as may be necessary for the regulation and control of the cultivation, manufacture, distribution and sale of MM, and for the enforcement of the statute. The statute has a fairly exhaustive list of specific matters that “may” be covered by such rules. Among these matters are:

- Procedures for licensing, fees, revocation, renewals
- Procedures for investigations, penalties
- Control of information, product displays
- Development of ID cards for owners, officers, managers, contractors, employees and other support staff involved with a licensed business, including a fingerprint-based criminal background check
- Security requirements for licensed premises, including at a minimum, lighting, physical security, video, alarm requirements and other internal controls
- Regulations of storage and transport of MM
- Sanitary requirements and labeling standards
- Records, tax reporting requirements

The previously-enacted sections of 25-1.5-106, C.R.S. were amended by HB 1284 to impose additional rule-making requirements on the CDPHE in connection with the MM program it administers, under which it already is registering patients entitled to use MM. Among other things, the CDPHE is directed to:

- Define what constitutes “significant responsibility for managing the well-being of a patient”, but the statute specifically provides that the act of supplying MM or MM paraphernalia, by itself, is insufficient to constitute such responsibility.
- Develop a process for a homebound patient to apply for a waiver to have his or her MM transported from a MM center to the patient by his or her caregiver. This waiver must be printed on the patient’s ID card and carried by the caregiver when transporting MM.
- Primary caregivers will now be registered, and the CDPHE must develop a form for application to be listed in the registry.
- Develop a form for use by physicians when making a MM recommendation for a patient.
- Because the statute specifically provides that a patient may have only one primary caregiver at a time, develop grounds and procedures for a patient to change his or her designated primary caregiver.

#### **Who may hold – or not hold -- licenses?**

Licensees must have been Colorado residents for 2 years, except for those who make an application by 12-15-10 and were Colorado residents on 12-15-09. Persons who may not hold MM licenses include persons of who are not of “good moral character” as demonstrated by information found in their criminal background checks [this includes individuals associated with corporations – in a presumed oversight, there is nothing about individuals associated with limited partnerships, limited liability companies or other entities], persons under 21, licensed physicians who make recommendations for the use of MM, nonresidents of Colorado; persons who have failed to pay child support, taxes or who have committed one of a host of other failures; law enforcement personnel, employees of an LLA or the DOR, persons who apply for a location that is a licensed retail food establishment or wholesale food registrant, and persons whose authority to be a primary caregiver has been revoked by the CDPHE.

#### **Financial matters relating to licensees**

Except for state or federally-regulated banks and other financial institutions, there must be complete disclosure of all persons having a direct or indirect financial interest in a licensed business, including the extent of such persons’ interests. Although the statute, no doubt inadvertently, says that a person shall not have an “unreported” financial interest unless such person has had a criminal background check, it is a fair bet that the rules will cure this wording glitch to say that no person shall have *any* financial interest without a criminal background check.

Query whether merely being the landlord of a MM facility is a “financial interest” within the meaning of the statute. Logically, one would assume that it is not, except that there is a good

argument that a landlord whose lease has a percentage rent clause has at an indirect financial interest that must be disclosed.

The statute specifically authorizes state-chartered banks and credit unions to loan money to licensed MM businesses. This, of course, does not solve the problem of the propriety of federally-chartered or regulated banks and other financial institutions doing business with MM licensees.

### **Other interesting aspects of the bill**

- The 70% rule: Licensed medical marijuana centers must grow at least 70% of their own MM in their own facilities pursuant to an optional premises cultivation license, and no MM licensee may sell more than 30% of its inventory to another licensee.
- Sale of MM-infused products are exempt from the 70% rule, and may be purchased for resale from a MM-infused product manufacturing licensee, but such products must be prepackaged and clearly labeled as specified in the statute
- Small amounts of MM may be distributed to state-licensed laboratories for testing
- All MM must be labeled and list all of the chemical additives, including nonorganic pesticides, herbicides and fertilizers.
- On-site consumption of MM or MM-infused products is prohibited
- A MM center may have no more than 6 plants and 2 ounces of MM per patient (or such greater amounts as a particular patient may be permitted to have) that is registered with it.
- Deliveries of MM to patients are not permitted except by primary caregivers to patients whose registrations with the CDPHE have a transport waiver.
- MM centers may not sell MM other than between 8 AM and 7 PM, seven days a week.
- It is illegal to pay, or for a physician to receive, anything of value for making a patient referral.
- The only persons who may cultivate MM are (1) a MM center with an optional premises cultivation license, (2) a MM-infused products manufacturing operation with an optional premises cultivation license, (3) a primary caregiver for his or her patients, or (4) a registered patient for his or her own use.
- The CDPHE will be maintaining a registry of primary caregivers. A primary caregiver may have no more than 5 registered patients at a time, except in exceptional circumstances.
- When a patient applies for registration, he or she must indicate whether he or she will be cultivating his or her own MM and/or obtain it from a primary caregiver or licensed MM center. If the patient will be using a MM center, he or she must register the primary MM center which he or she intends to use.
- MM patient registrations are good for one year.
- MM may not be consumed in public, and patients may not undertake tasks under its influence when doing so would constitute negligence or professional malpractice. It may not be consumed on the grounds of a school, in a school bus, in a correctional facility or in a vehicle, aircraft or motorboat, nor may a vehicle, aircraft or motorboat be operated by a person under its influence.
- Indigent persons are exempt from sales tax on MM, and the CDPHE is directed to promulgate rules for determining indigence and so marking registration cards.

## **SB 10-99**

SB 10-1099, which became effective upon signing, governs the physician-patient relationship, seeking to remedy the blatant advertising of quick, onsite physician recommendations for MM use that we have seen advertised by MM facilities. The bulk of the statute amends 25-1.5-106, which set up the MM program within the CDPHE. It defines a “bona fide physician-patient relationship”, including requirements that the physician conduct a full assessment of the patient’s medical history and “appropriate physical examination”, that the patient has previously consulted the physician before applying for a MM registration card, and that the physician be available for follow-up care and treatment. A physician who recommends the use of MM must be a graduate of an accredited medical school, have a valid and unrestricted Colorado license to practice medicine, and have a valid and unrestricted U.S. Department of Justice Drug Enforcement Administration controlled substance registration. The CDPHE is directed to develop standards for determining whether patients who seek registration cards for the use of MM are based upon recommendations by physicians with whom the patients have bona fide physician-patient relationships.

A physician must certify to the CDPHE that the patient has a debilitating medical condition and that the patient may benefit from the use of MM, on a form provided by the CDPHE. The debilitating medical condition and its cause, if known, must be specified. Physicians must maintain record-keeping systems identifying patients for whom they have made MM recommendations. Physicians shall not accept, solicit or offer any form of pecuniary remuneration from or to a primary caregiver, distributor or any other provider of MM; offer discounts or other things of value to a patient who agrees to use a particular caregiver or provider of MM; examine a patient at a location where MM is sold or distributed or hold an economic interest in a MM provider if they certify patients for the use of MM.

If the CDPHE has reasonable cause to believe that a physician has violated the statute or rules promulgated pursuant to the statute, it may refer the matter to the state board of medical examiners. Upon a finding of unprofessional conduct by that board, the CDPHE shall restrict, suspend or revoke the physician’s authority to recommend the use of MM. Under certain circumstances, it also may summarily suspend the physician’s authority pending action by the medial board. .

### **Leasing to MM businesses**

While the new legislation will likely weed out a lot of would-be MM operators, many others will be looking to buy or lease up space before the December 15, 2010 application date for persons who cannot meet the two-year residency requirement but who were Colorado residents on December 15, 2009. And while the Colorado legislation should bring some order to the Wild West of the MM industry in Colorado, many problems remain: previously-enacted local ordinances will have to be amended to coordinate with the state law, other localities will have to enact local ordinances, the rules required by the statute to be enacted by the DOR and CDPHE

will have to be promulgated (after hearings), and possession, distribution and use of marijuana remain illegal under federal law. Therefore, it would seem that the cautions and considerations for MM landlords and tenants remain much the same as before.

### **Three perspectives on a potential MM lease transaction.**

#### **The broker considering whether to represent a MM tenant**

Many of the considerations that will be germane to a broker in considering whether to represent a MM operator will also be germane to the landlord who is considering whether to lease space to a MM operator, so the broker's perspective will not be treated separately from the landlord's considerations, which follow.

#### **The landlord considering whether to lease to a MM tenant, and its broker**

The risks of having a MM operator in one's property are many. The primary risk is that the leased space and/or the building in which it is located may be seized under federal, state or local drug or public nuisance laws. Subsection 1(e) of the constitutional amendment says that "where property has been seized in connection with the claimed use of medical marijuana, it shall not be harmed, neglected, injured or destroyed while in possession of state or local law enforcement officials", and no property interests shall be forfeited under state law unless the owner has pleaded guilty of been convicted of a criminal offence. This does not help with respect to federal law if the Justice Department policy should be changed, and does not speak to seizure under local law (see, for example, Article III of the Denver Municipal Code, Sections 37-70 through 37-87). Moreover, seizure and forfeiture of property used in connection with the MM operation will still be real possibilities in the event that the MM operator goes afoul of existing or future state laws concerning MM, and especially if the landlord is deemed to have participated in or failed to correct a situation the landlord knew or should have known was in violation of law.

Other concerns for the landlord include safety and security issues, concerns of other tenants in a multi-tenant building or center (such as image, smoke, traffic, noise and security), the risk that one will be leasing to a front for illegal activity (or that an operator who starts out trying to be oh-so-legitimate will become not-so-legitimate over time), potential liability to persons harmed by persons under the influence who obtained their marijuana at the MM center of one's tenant (similar to "dram shop" liability); the risk that the operator will quickly go out of business due to new regulations with which it cannot comply, competition or lack of business experience; and the risk that the U.S. Justice Department will change its enforcement policy.

Prospective MM tenants are enticing landlords with percentage rent clauses and even offering them equity positions in their businesses. Landlords should remember that the new legislation requires disclosure of those holding direct or indirect financial interests in the MM business, and fingerprint-based criminal background checks of such persons. A landlord should therefore consider very carefully whether it wishes to enter into a lease with a percentage rent clause or consider accepting an equity position.

Intensive due diligence by the landlord and/or the landlord's broker is a must. In addition to the normal financial, credit status, business experience, and other investigation of a potential tenant that a landlord or its broker will do, the following are recommended:

- Even though one will be conducted pursuant to the licensing application a wise landlord will conduct its own criminal background check of the tenant and, if it is a corporation, LLC or other entity, its principals. This step is critical (a) to weed out bad tenants and (b) if the property owner is to have a prayer of defending a forfeiture action on the basis that it is an "innocent owner".
- Do not forget the regulations promulgated and administered by the Treasury Department's Office of Foreign Assets Control ("OFAC"), which prohibit U.S. persons from engaging in transactions with certain prohibited companies, individuals, nations and residents of certain countries, or persons acting on their behalf. There are very stiff penalties (monetary fines and imprisonment) for non-compliance. Landlords should be ascertaining that all potential tenants, and their officers, directors and major equity owners are not on OFAC's list of "Specially Designated Nationals and Blocked Persons ("SDN list").<sup>3</sup> Of course, this check should be done with *all* tenants; do not even consider entering into a lease with a tenant who shows up on the SDN list, or whose principals do.
- Require a detailed business plan with a detailed description of all activities contemplated. It may be advisable to make this operational description of all activities to be carried on an exhibit to the lease and to prohibit any activities that are not described in the exhibit. In many local jurisdictions, the operator will have to be preparing this anyway, to submit to the LLA. Continued compliance with the business plan should be a condition of continued occupancy.
- Developing a questionnaire about the operator's plans would be useful. Relevant questions would include asking where plants will be grown, what products will be sold (e.g., accessories? food products without marijuana? seeds? plants? seedlings? dried flowers?, MM-infused products?), whether the operator will run a walk-in or appointment-only facility, what activities will be allowed on-site (music? pool tables or other recreational use? lounging?), plans for security, and more. This questionnaire, completed and signed by the tenant, could become part of the business plan exhibit referenced above.
- Double-check any covenants that govern the building or center. Most covenant provide that businesses shall be operated in compliance with all local, state and federal laws, and these clauses have been used successfully to prohibit MM business from locating in buildings or centers governed by such covenants.
- Patients with debilitating conditions will be customers of dispensaries. Is the property sufficiently ADA-compliant to accommodate such persons?
- Double-check current zoning. Many local governments have, or are in the process of enacting new zoning ordinances regarding MM facilities.

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<sup>3</sup> The SDN list is updated frequently, and can be found at [www.treas.gov/offices/eotffc/ofac/sdn/index.html](http://www.treas.gov/offices/eotffc/ofac/sdn/index.html). OFAC also has a hotline, 1-800-540-6322. Experts recommend that due diligence include searching alternative spellings for names being searched, trade names and aliases, and checking for "false positives".

- Check with landlord's insurance broker: Can the MM tenant get the insurance required in landlord's current lease form? Are the requirements of landlord's lease sufficient for the operations of a MM tenant? Will landlord's insurance premiums be increased by the presence of a MM tenant? What effect will the presence of a MM tenant have on the insurance held by other tenants?
- Consider the effect of a MM tenant on other tenants, and review their leases. Landlords will not want to give other tenants grounds upon which they may claim the right to terminate their leases.
- Consider future plans for the building or center.
- Remember that most landlords' lenders have a right to approve or disapprove leases/tenants. While some lenders may have been lackadaisical about exercising this right, they may very well start paying more attention with respect to medical marijuana tenants.
- Also, check your deed of trust for requirements that all laws must be complied with, or other provisions that may prohibit leasing to a MM facility.
- Lenders that are federally-regulated should be especially reluctant to allow their debtors to lease to MM facilities. How appropriate is it, for instance, for a federally-regulated lender to be the assignee of all leases, when the leases include operators of businesses that operate in violation of federal law? Disgruntled neighboring tenants may call this to the attention of federal regulators.

### **The MM tenant looking at potential lease premises and landlords**

The potential MM center or MM-infused products manufacturing licensee seeking to lease space will also want to do its own due diligence after reviewing applicable local ordinances and the new state law, checking zoning, proximity of the premises to schools, other MM facilities, etc.; checking covenants affecting use of the building, the character and reputation of the landlord, building or center; security, ADA accessibility, other tenants and nearby neighbors who might complain and thus create operational hassles, and many of the other matters that will concern the landlord.

### **Negotiating and drafting the lease: Common clauses to look at again**

Many of the clauses that are commonly found in commercial leases should be looked at with a fresh eye in connection with the lease of space for use by a MM operator. Consider:

- Use clauses –
  - As mentioned above, from the landlord's point of view, the "permitted use" clause should be very tight, and using an exhibit which details permitted activities will be a good idea.
  - Do not forget "boilerplate" clauses that require the tenant to use the premises in compliance with all laws. MM facilities currently cannot be in compliance with federal laws, even if there is a moratorium on enforcement of those laws. Some "notwithstanding the foregoing..." language is going to be required.

- Note that the Colorado Attorney General has issued an opinion stating that medical marijuana facilities must obtain retail licenses and pay state and local sales taxes on all products sold, including food products, except seeds. A landlord may want the MM tenant to specifically acknowledge this responsibility, and not just rely on the "comply with all laws" boilerplate. Requiring production of the retail sales licenses and any other permits required in the local jurisdiction would be a good idea.
- Environmental clauses - Indoor growing, and even storage of marijuana, done inexpertly, can lead to serious mold problems. Consider pre- and post-occupancy environmental audits. Landlords will, of course, want tenants to bear the expense of the audits, while tenant will bargain for the opposite. Should a landlord beef up the right-to-inspect clause, with the right to insist upon an environmental audit or inspection during the term if it has a reason to believe that an environmental problem is developing? On the other hand, would that undermine any "innocent owner" defense that may exist to seizure and forfeiture of the real property under various federal, state and local seizure and forfeiture laws?
- Rent - As noted above, a percentage rent clause will likely trigger an obligation for the financial interest of the landlord in percentage rent to be disclosed, and require a criminal background check of the landlord. Also, while a landlord is already at risk of property seizure because a lease puts it in legal privity with its tenant, sharing in a MM tenant's profits further undermines any prayer of making use of an innocent owner defense.
- "No nuisance to other tenants" clauses - Consider the possibilities of smoke, odors, increased traffic, loitering by patients, and increased burglary risks as possibilities for violation of the "covenant of quiet enjoyment" or other clauses in the leases of other tenants, and require the tenant to address these concerns.
- Operating expense and utility usage clauses - Indoor grow farms use lots of electricity and water; MM centers may have a lot of traffic requiring increased security measures. In a multi-tenant property, a fair way of requiring a MM tenant to bear these additional expenses should be dealt with.
- Clauses that deal with security - Are existing security provisions sufficient? A landlord will want the right to make the MM tenant pay for additional security measures required by the state statute and local ordinances. Since security plans will have to be submitted with the license application, tenants should have no objection to preparing this for the landlord.
- Insurance clauses - As mentioned above, can the MM tenant get the insurance required in landlord's current lease form, or will modifications be necessary to accommodate the MM operator? Will such insurance be good enough? If landlord's insurance premiums are increased by the presence of a MM tenant, landlord will want tenant to pay for the increase.
- Signage - Depending upon where the MM tenant is located, other tenants in the building or project, and even neighboring properties, signage might be a very important subject during the lease negotiations. Local ordinances may have specific rules related to MM facilities.
- Rules and Regulations - Will the MM tenant's operations violate any rules and regulations for the building or center? Are the building's or center's operating hours appropriate for a MM tenant? If the landlord should modify the rules and regulations for

the MM tenant, it runs the risk of violating not-uncommon clauses in other tenants' leases that require the landlord to enforce rules and regulations in an even-handed manner.

- Lease term and options - Landlord may want short terms and heavy conditions on option terms.
- Early termination rights – This might be one of the most important lease clauses. Landlords may want the right to terminate a MM tenant for reasons additional to those which are already contained in their standard leases, such as if regulations are imposed upon the MM industry with which the tenant cannot comply, if security becomes a problem, if the federal government's enforcement policy changes, or if other tenants complain. Tenant may also want the right to terminate early if new regulations make it impossible or impractical to continue to operate, or it fails to qualify for a license under a future law.
- Unilateral right to amend – For MM centers that have sufficient other lines of business (e.g., health spa services, retail sales of cosmetics or clothing), or for MM-infused products manufacturing facilities that are capable of manufacturing non-MM products, an alternative to a right to terminate would be a unilateral right to amend the lease to prohibit sales of MM.
- Parking clauses – Does the lease's parking clause work for the MM tenant's operations? Does landlord have sufficient rights to control parking, require tenant to furnish license plate numbers of its employees, and other protections? On the other hand, the tenant will want to know that parking is going to be adequate, especially considering its medically-debilitated customers.
- Audit rights – The landlord may want to be sure that its rights to audit the MM tenant's books and records extends not only to its sales tax records, but also receipts and waivers its customers sign, and records it is required to keep pursuant to state and local MM laws and regulations.
- Assignment and subleasing clauses – Both sides of a leasing transaction will want to look at this clause closely. A landlord will want to be able to conduct criminal background checks on assignees or subtenants, for example.
- Tenant build-out – Note that the new law requires that detailed plans and specs for build-out, including security systems, be submitted with the license applications. Security cameras, special lock systems and other security provisions may require wall and roof penetrations and other considerations. Grow rooms have many special HVAC and utility requirements. Landlord and tenant should be clear about what is allowed, required and expected, both at the beginning and end of the lease term.
- Exclusive right clauses – MM tenants may ask for exclusive rights, just as any other specialized tenants, although proximity requirements in both the state law and local ordinances may make this issue not important.

In summary, leasing to a MM operator is anything but "business as usual". We are still in an interim period, operating under a new law not yet effective, with local ordinances needing to be enacted or amended, required rules not yet promulgated, and federal drug laws still on the books as to marijuana. The safest thing for a landlord or tenant to do for now (other than "just don't do it") is to wait until the law becomes effective, the rules are promulgated, and localities have had a chance to enact or amend their local ordinances. Nevertheless, the foregoing considerations are offered for those landlords and tenants who just cannot wait.