

Legal Corner

Let's be Blunt: Are dispensaries a little high maintenance?"

by Nicholas J. Klein, Esq.

Recreational marijuana has been legal in Nevada since 2016. However, the United States government still has marijuana on the books as an illegal substance under the Controlled Substances Act, identifying it as a Schedule 1 drug. Under federal law, this means marijuana has the high potential for abuse, no currently-acceptable medical use, and lacks an acceptable level of safety for use under medical supervision. This state-federal conflict has resulted in an abundance of questions concerning the risks and rewards of leasing property to a tenant operating a marijuana-related business.

Shortly after Nevada legalized recreational marijuana, a dispute arose in Arizona between a medical marijuana dispensary operator and a commercial landlord. The landlord leased the property to a medical marijuana dispensary. The lease included a provision for reduced rent until the tenant was able to secure a dispensary operating license from the state but did not specify any timeframe required to do so. Once the landlord sought to terminate the lease, the tenant filed a lawsuit. The lower court agreed with landlord's argument that the lease was invalid because it was an illegal contract under both federal and state law, indicating that at the time the landlord terminated the lease the tenant still had no state license to operate. The tenant appealed, and the Court of Appeals of Arizona analyzed both the state law requiring a license to operate a dispensary and the federal law illegalizing leasing a space for the purpose of distributing any controlled substance. Here are important points to glean from the Court's analysis:

Don't Overlook Other Enforceable Provisions: The lease permitted the tenant to sublease the property to a sub-tenant, a potentially profitable legal right irrespective of the tenant's own business. Landlord's unilateral attempt to terminate that right under the lease subjected the landlord to damages. In other words, the tenant had a legal right to lease the property to another tenant - potentially for a legal use. Because the landlord interfered with that right by terminating the lease, the landlord was subject to damages.

Plan for What Happens if a Condition is not Met: The lease in the Arizona case: (1) did not provide for a drop-dead deadline for tenant to obtain the license, and (2) did not state whether the lease would be void or voidable if the tenant failed to ever obtain a license or actually operate. Was the landlord going to wait for years for the tenant to meet the condition or terminate right away? The rent was at a reduced rate and likely could not be sustained for long. Interestingly, the Court upheld the finding that because the lease did not require the tenant to illegally operate the dispensary without a license the lease could be legally enforced.

Both Landlords and Tenants are often Accountable: The Court determined it important to consider the

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fault of each party in entering into the potentially unlawful contract and if invalidating the contract would result in unjust consequences. One party cannot play dumb and later claim that a lease for a marijuana business is unlawful because the party doesn't like the terms. The Court specifically said that the landlord was equally responsible for entering into the potentially unlawful contract.

The Federal law concerning medical marijuana is still in flux, and the Federal government has not really enforced the Controlled Substances Act. So, what should property owners do when a tenant with a marijuana business comes along? Here are a few things to consider in addition to the above points from the Arizona case: (a) whether the property is in the permissible locations in Nevada; (b) whether there is a loan on the property which would prohibit the lease; (c) whether the property is arranged and the building constructed in a way to protect the use; (d) whether it is a problem if the tenant wants to pay rent in cash; (e) there may be a lawsuit over enforceability; (f) most likely, cannabis operators are not subject to bankruptcy protections; and (g) federal tax trends may include future enforcement penalties against landlords who engage in profit-sharing of cannabis operations.

Careful consideration should be taken when considering leasing to a cannabis-related business, and legal counsel should be consulted regarding the nuances of the leases.



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