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LANDLORD TENANT LAW

Leasing to Cannabis Businesses


By **Warren A. Estis** And **Alexander Lycoyannis**

On March 31, 2021, Governor Andrew Cuomo signed into law the "Marihuana[1] Regulation and Taxation Act" (MRTA), which legalizes recreational marijuana use in New York State. Cannabis businesses could begin to open as soon as next year, as the new Office of Cannabis Management issues licenses and promulgates rules.

Of course, most or all of these new businesses will need to lease commercial space in order to operate—and undoubtedly, many real estate owners are eager to meet this new demand, especially in light of the toll the COVID pandemic and the shift to online shopping have taken on bricks-and-mortar retail assets. However, owners and prospective cannabis businesses have many legal issues and questions to consider before entering into lease agreements.

Notwithstanding the passage of MRTA, marijuana remains illegal under federal law pursuant to the Controlled Substances Act of 1970 (CSA). The CSA provides that it is unlawful to knowingly open, lease, rent or maintain any space for the purposes of manufacturing, distributing or using any controlled substances, including marijuana (CSA, 21 USC §856). The Supremacy Clause of the U.S. Constitution establishes that when state and federal law conflict, federal law—in this case, the CSA—controls (US Constitution, article VI, clause 2).

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Thus, a state's legalization of marijuana cannot prevent the federal government, if it so chooses, from enforcing CSA violations in that state (*see Gonzales v. Raich*, 545 US 1 [2005] [upholding application of CSA provisions criminalizing manufacture, distribution, or possession of marijuana to growers and users of marijuana for medical purposes in compliance with California's Compassionate Use Act, which authorized limited medicinal marijuana use]).

Accordingly, given that leases to cannabis retailers and the transactions occurring therein remain illegal under federal law, does that mean MRTA is illusory? Hardly. Notwithstanding such illegality, the federal government over several presidential administrations has refrained from aggressively enforcing the CSA with respect to cannabis-related transactions, resulting in the growth of the cannabis industry

WARREN A. ESTIS *is a founding member at Rosenberg & Estis.* ALEXANDER LYCOYANNIS *is a member at the firm.* PARKER ROTHMAN, *an associate with the firm, assisted in the preparation of this article.*

in states where it has been legalized.

Nevertheless, unless and until the CSA is amended or superseded, a level of legal uncertainty will always exist concerning leases to cannabis retailers in New York. Thus, forward-looking practitioners should plan for the possibility that federal enforcement priorities could change due to unforeseen circumstances or if 2024 brings a new presidential administration with a different philosophy on the subject.

A primary risk to both landlords and tenants of operating a cannabis business is the possibility of civil (or, less likely, criminal) forfeiture pursuant to 21 USC §881. The statutory scheme permits the federal seizure of, among other things, monies traceable to illegal drug activity and any real property used in conjunction therewith. Notably, civil forfeiture of real property does not require that the government prove the landowner is guilty of any crime. Rather, the federal government files an *in rem* complaint against the real property, and the initial warrant for the property merely requires the government to allege specific facts supporting a substantial connection between the property and the crime alleged (*see e.g. United States v. One Parcel of Prop. Located at 5 Reynolds Lane, Waterford, Conn.*, 895 F Supp 2d 305, 315 [D Conn 2012] [summary judgment granted to federal government on civil forfeiture claim where owners essentially conceded manufacture of marijuana on their property]). Notably, "*in rem* actions by the United States to forfeit real property used in a drug violation are commonplace and nation-wide" (895 F Supp 2d at 314).

However, federal law enforcement policy relating to marijuana began to change within the last decade. The "Cole Memorandum," issued in 2013 under the Obama administration, advised federal prosecutors to refrain from enforcing marijuana-related CSA violations in states that had legalized cannabis. [*See* Memorandum from James M. Cole, Deputy Att'y Gen., U.S. Dep't of Justice, on Guidance Regarding Marijuana Enforcement (Aug. 29, 2013), *available at* http://www.justice.gov/iso/opa/resources/305201382913275685746 7.pdf.]

Although the Trump administration nominally rescinded the Cole Memorandum, Attorney General William Barr stated that the U.S. Justice Department "operat[ed] under my general guidance that I'm accepting the Cole Memorandum for now" (*Original Investments, LLC v. Oklahoma*, CIV-20-820-F, 2021 WL 2295514, at *5 [WD Okla June 4, 2021]).

Under the Biden administration, Attorney General Merrick Garland has pointedly stated that "I do not think it the best use of the Department's limited resources to pursue prosecutions of those who are complying with the laws in states that have legalized and are effectively regulating marijuana" (Responses to Questions for the Record to Judge Merrick Garland, Nominee to be U.S. Attorney General, https://www.judiciary.senate.gov/imo/media/doc/QFR%20Responses%202-28.pdf [last accessed Jul. 30, 2021]).

Thus, while the permissive federal policy likely means that New York cannabis businesses can operate without fear of federal prosecution for the time being, careful practitioners should plan for the possibility that the CSA will once again be strictly enforced as written. Indeed, courts are "bound to follow the law as written and may not depart therefrom based on enforcement decisions made by the executive branch" (*In re Way To Grow, Inc.*, 597 BR 111, 133 [Bankr D Colo 2018], *affd* 610 BR 338 [D Colo 2019]).

An especially punitive feature of federal forfeiture law is that "in a forfeiture proceeding under section 881(a)(7), property in its entirety is forfeitable even if only a portion of it was used for illegal purposes" (*United States v. Land and Bldg. at 2 Burditt St., Everett, Mass.*, 924 F2d 383, 385 [1st Cir 1991]). Specifically, the federal government, on a proper showing, is authorized to seize

> [a]ll real property, including *any right, title, and interest (including any leasehold interest) in*

> *the whole of any lot or tract of land and any appurtenances or improvements*, which is used, or intended to be used, *in any manner or part*, to commit, or to facilitate the commission of, a violation of this subchapter punishable by more than one year's imprisonment.

(21 USCA § 881[a][7] [emphasis supplied].)

Thus, if a New York City building owner were to lease a ground floor commercial space to a cannabis retailer, the federal government could, conceivably, *seize the entire building*. One way that building owners could potentially be protected against this harsh consequence is to convert to condominium ownership and create a separate condominium unit to house the cannabis business. This possible solution flows from the decision in *United States v. One Parcel of Prop. Located at 133 Willington Hill Rd., Willington, Conn.* (855 F Supp 552 [D Conn 1994]).

In *133 Willington Hill Rd.*, the federal government sought forfeiture of the defendant real property due to the cultivation of marijuana thereon in violation of the CSA. However, prior to the alleged unlawful activity, the owner subdivided his property into three separate lots pursuant to local law, denominated lots one, two and three. There was no dispute that the alleged illegal activity occurred on lot two, and the government was therefore granted summary judgment as to such lot. The owner, however, sought to dismiss the claims as to lots one and three, since they were legally separate from lot two and no alleged illegal activity took place on those lots. The court agreed and dismissed the action as to those lots, insofar as they were "separate pieces of property, no different than if [the owner] purchased them separately as adjoining lots" (855 F Supp at 555).

The court further noted that the phrase "whole of any lot or tract of land" in the statute "must be determined from the duly recorded instruments and documents filed in the county offices where the defendant property is located" (*id.* at 554 [citation omitted]; *see also e.g. United States v. Certain Real Prop. and Premises Known as 38 Whalers Cove Dr., Babylon, N.Y.*, 954 F2d 29 [2d Cir 1992] [seizure of condominium unit]; *United States v. Prop. Identified as 410 11th St., N.E. Unit No. 23 Washington, D.C.*, 903 F Supp 158, 159 [D DC 1995] [same]).

Just as a subdivided tract of land creates separate and distinct tax lots, condominium units are independent parcels of real property each owned in fee simple absolute (*see* Real Property Law §§339-e[16], 339-g). Thus, analogizing to *133 Willington Hill Rd.*, if an owner owns three contiguous storefront retail condominium units and rents one of them to a cannabis business, the federal government can potentially only seize that one individual condominium unit under 21 USC § 881—as "determined from the duly recorded instruments and documents filed in the county offices where the defendant property is located"—and cannot seize adjacent units that are not part of the business.

While proposals to liberalize the CSA's treatment of marijuana and related transactions are currently being deliberated in Congress, it is anyone's guess as to whether these proposals will ever become law—especially in the current polarized political climate. In the meantime, parties considering leasing transactions for new cannabis businesses pursuant to MRTA should plan for the worst but hope that the current lax federal attitude towards marijuana continues.

1. So in original.