RENTS, REFI'S AND REEFER MADNESS: MORE ON THE DISSONANCE IN COMMERCIAL REAL ESTATE CAUSED BY LEGALIZED MARIJUANA AT THE STATE LEVEL AND THE REGULATION OF FINANCE AT THE FEDERAL LEVEL

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I. INTRODUCTION

It came as no surprise. Just 12 short years after Colorado legalized *medical* marijuana, the State's voters approved legalized *recreational* marijuana as well. The State of Washington joined Colorado in 2012, and since then, the District of Columbia, Alaska and Oregon followed suit in allowing the legal use, sale and cultivation of recreational marijuana.

States see legalization as an opportunity to shift law enforcement resources to more important issues and as a way to enhance anemic state revenues through taxation of a popular drug. For real estate owners, legalization of medical marijuana was the *deus ex machina* that filled vacant industrial and retail space. And for lenders it was the panacea for poorly performing loans during the Great Recession. Everyone was happy – so happy that some were blind to the potentially adverse domino effects to their ownership, leasing and financing of commercial real estate.

The initially curious anomaly of legalized marijuana in a few states is now proving to have opened a complex Pandora's Box of problematic legal issues across much of the country for landlords and real estate lenders. The reason is simple. Marijuana – its use, cultivation, transport, sale, possession and all other related activities – remains unequivocally illegal under federal law. Legalization of marijuana at the state level does nothing to change that, creating instead a major dissonance in the real estate and finance markets where most transactions are unavoidably entangled with federal law.

Lenders are coming to realize that accepting deposits from marijuana operations, and loan payments from borrowers with marijuana-related tenants, creates the risk that they themselves are participating in prohibited money laundering or that the collateral they control is tainted. Some property owners are now recognizing that involvement with marijuana-related tenants creates risks against which state legalization provides little protection.

Federal efforts to defuse concerns by issuing limited, ambiguous and non-binding guidance from the White House, the Department of Justice and the Department of the Treasury have either created more uncertainty about how banks and property owners should move forward, or have lulled them into a false sense of immunity from some very real perils that such guidance fails to address.

With legalization proposals pending in more and more states for medical or recreational marijuana use, these issues will only become more pressing and widespread. And with no foreseeable change in federal law regarding marijuana's illegality, practitioners and their clients need to be aware of both the obvious and more obscure hazards of engaging in real estate and finance transactions where marijuana businesses are involved.

This paper examines some of those problems and perils in commercial real estate financing, ownership and leasing and discusses evolving methods of mitigating certain of those risks.

II. FEDERAL REGIME

Setting the stage for this state-federal conflict is a handful of federal laws, most a legacy of the early drug and culture wars of the 1970s, which continues to wield profound, widespread influence.

A. Controlled Substances Act (21 U.S.C. §§801-971).

The centerpiece of criminalization of marijuana at the federal level is the Controlled Substances Act ("CSA"). Enacted in 1970 during the Nixon administration, the CSA was part of the broader Comprehensive Drug Abuse and Prevention Act of 1970 and was introduced at a time of rising concern about the increasing prevalence of drug use in America. The CSA establishes five categories or classifications ("Schedules") of regulated drugs, based on the drugs' potential for abuse, their accepted medical use, and their treatment in international treaties. Marijuana is listed as a ***Schedule I Narcotic*** – the most dangerous of all categories of narcotics under federal law. In particular, Schedule I drugs are deemed by the federal government to have a high potential for abuse, no accepted medical use, and no recognized safe protocol for medical use. Examples of other Schedule I Narcotics include heroin, Ecstasy and LSD.

Manufacturing, distributing, or dispensing marijuana and other controlled substances is illegal under the CSA (21 U.S.C. §841-844), as is simple possession of marijuana. Attempting or conspiring to manufacture, distribute, or dispense controlled substances is also illegal (21 U.S.C. §846). Fines and imprisonment are established as penalties for violations of the CSA, ranging from fines of $1,000 to $2,000,000 and from less than a year in jail to sentences of ten years. In addition, the CSA provides that anyone who attempts or conspires to commit an offense under the CSA is subject to the same penalties as prescribed for the offense itself (21 U.S.C. §846).

Critically to landlords and to lenders, the CSA also very specifically addresses properties used for growing and selling marijuana at 21 U.S.C. §856:

> [I]t shall be unlawful to –
>
> (1) knowingly open, lease, rent, use or maintain any place, whether permanently or temporarily, for the purpose of manufacturing, distributing, or using any controlled substance;
>
> (2) manage or control any place, whether permanently or temporarily, either as an owner, lessee, agent, employee, occupant, or mortgagee, and knowingly and intentionally rent, lease, profit from or make available for use, with or without compensation, the place for the purpose of unlawfully manufacturing, storing, distributing, or using a controlled substance.

According to federal law, then, marijuana is illegal to possess, grow, or dispense, as is conspiring or aiding anyone else in doing so. Anyone in contravention of the law is subject to criminal prosecution and both criminal and civil forfeitures.

B. Bank Secrecy Act and SARs .

The Currency and Foreign Transactions Reporting Act of 1970 (commonly known as the Bank Secrecy Act or "BSA") is the primary federal anti-money laundering legislation. 31 U.S.C. §§ 5311-5330. The BSA requires financial institutions to support federal law enforcement actions against money-laundering by monitoring client activity, reporting suspicious transactions, filing reports of cash transactions over $10,000, and keeping records of cash purchases of negotiable instruments. Specifically, financial institutions are required to file lengthy Suspicious Activity Reports or "SARs" if the financial institution knows or suspects that a transaction appears to be an attempt to evade federal laws or reporting requirements, involves over $5,000 in the aggregate, and is not the type of transaction customary for the client, all of which may signify money laundering, tax evasion, or other criminal activities. The U.S. Treasury Department's Financial Crimes Enforcement Network, or "FinCEN", established under 31 U.S.C. §310, is charged with enforcing the BSA. Both criminal and civil forfeitures of property are authorized in 31 U.S.C §5317 for violations of the BSA.

C. USA PATRIOT Act.

The "Uniting and Strengthening America by Providing Appropriate Tools Required to Intercept and Obstruct Terrorism" (USA PATRIOT) Act of 2001 (PL 107-56) is chiefly intended to deter terrorist activities by, among other things, requiring financial institutions to report potential money laundering, giving special scrutiny to certain types of financial institutions, transactions, or accounts that are targets of criminal enterprise, such as private banking and correspondent accounts. The PATRIOT Act requires financial institutions to establish anti-money laundering programs, extends the SARs filing requirements under the BSA to more financial institutions (such as broker/dealers), and forbids those filing SARs from disclosing the filing to the subjects of the report[2].

D. Comprehensive Drug Abuse Prevention and Control Act.

Enacted in 1984 as part of the Comprehensive Crime Control Act of 1984, this Act provides for the civil forfeiture of property connected with illegal drug activity. 21 U.S.C. §881(a) (2013). The statute's broad provisions allow for federal seizure of all illegal drugs; equipment used in transporting, manufacturing, or in any way distributing drugs; any money traceable to illegal drug activity; any firearms connected to illegal drug activity; books and records; and importantly, any real property used in conjunction with felonious illicit drug trade:

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[2] The non-disclosure of SARs is serious business. During a deposition of a bank employee, the bank attorney failed to object to a question regarding the filing of a SAR. The improper disclosure prompted a written warning to all counsel for the bank nationally that subpoenas or other requests for information that would reveal the existence of a SAR must be declined and notice of the request must be provided to FinCEN. The letter went on to state: "the regulators and the bank view such improper disclosure as an offense subject to termination. I hate to speculate on what actions a terminated employee may take against the bank and the lawyer/law firm that was supposed to be representing them in a deposition or court …" and who failed to advise the employee to refuse to answer.

> *All 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 U.S.C. §881(a)(7).

E. Other Forfeiture Statutes and Criminal Forfeitures.

Forfeitures are also governed by 18 U.S.C. §981 (which provides for civil forfeitures related to a wider range of conduct than the Comprehensive Drug Abuse Prevention and Control Act, and establishes property disposition, processes, and the like), and the Civil Asset Forfeiture Reform Act of 2000 (CAFRA) (18 U.S.C. §983). CAFRA provides an "innocent owner" defense against forfeiture if the claimant (i.e., a landlord) proves beyond a preponderance of the evidence that it did not know of the illegal conduct, or took steps to terminate the illegal conduct upon its discovery (alerting law enforcement authorities, commencing eviction, etc.), or – if the property was acquired after the illegal conduct had commenced – that the claimant is a bona fide purchaser with no knowledge the property was subject to forfeiture. Criminal forfeitures are governed by 21 U.S.C. §853, which also details procedures governing seizure and forfeiture of property, including similar safeguards for third-party interests.

F. Racketeer Influenced and Corrupt Organizations Act of 1970 (RICO)

In addition to conspiracy provisions enacted within specific drug-related statues, such as the CSA's conspiracy provision in 21 U.S.C. §846, RICO (18 U.S.C. §1961-1968) gives the federal government extensive reach over those involved in criminal enterprises, by providing for more extensive civil and criminal penalties against those convicted under the statute. Among many other crimes and activities swept under its umbrella, RICO particularly covers those involved in illegal drug conduct under the CSA, as well as money laundering. RICO also introduced forfeitures of property involved in criminal conduct (21 U.S.C. §1963).

Until recently, the application of RICO in legal marijuana cases was mere conjecture. However, in February, 2015, Safe Streets Alliance[3], together with an adjacent land owner and a hotelier filed two federal lawsuits[4] in Colorado against licensed marijuana businesses, claiming that the "lawful" operation of the dispensaries under Colorado law were nevertheless criminal enterprises under RICO. In the complaints, the

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[3] Safe Streets Alliance is a Washington D.C. based advocacy group with a stated mission of safe and drug free neighborhoods, homes and schools, and is active in resistance to the legalization of marijuana, including through the filing of lawsuits. http://www.safestreetsalliance.org/

[4] *Safe Streets Alliance Phillis Windy Hope Reilly and Michael P. Reilly v. Alternative Holistic Healing, LLC, et al.*, U.S. District Court for the District of Colorado Civil Action No. 15-349; *Safe Streets Alliance and New Vision Hotels Two, LLC v. Medical Marijuana of the Rockies, LLC, et al.*, U.S. District Court for the District of Colorado Civil Action No. 15-350;

plaintiffs seek treble damages and injunctions against the two marijuana businesses, arguing that Colorado marijuana laws undermine the federal preemption principle. Interestingly, beyond the claims against the dispensaries and their owners, the complaints allege conspiracy participation by the accounting service for the business, the contractors building the dispensary structures, and the federal bank which was banking the business accounts of one of the dispensaries. The underlying damages to the plaintiffs in the cases are seen by some as insufficient to support the cases (loss of beautiful view in one case). However, if successful, the lawsuits could result in injunctive relief that others see as potentially dismantling the Colorado marijuana laws and marijuana industry. And whatever one thinks of the strength of the cases, the litigation had the effect of a major national bank closing the offending dispensary's accounts in return for a dismissal without prejudice from one of the lawsuits[5].

III. LEGALIZATION AT THE STATE LEVEL

Notwithstanding the CSA and its seemingly impervious resistance to change, in true "laboratory of democracy" style, since 1996 twenty-three states and the District of Columbia have approved legal use of marijuana, through either popular vote or legislation:

Alaska	Illinois	New Hampshire
Arizona	Maine	New Jersey
California	Maryland	New Mexico
Colorado	Massachusetts	New York
Connecticut	Michigan	Oregon
District of Columbia	Minnesota	Rhode Island
Delaware	Montana	Vermont
Hawaii	Nevada	Washington

See Exhibit A for more detail about each state's marijuana laws.

In addition, several states have attempted to implement medical marijuana legislation in 2015. Out of the 18 states that have introduced legislation this year to legalize medical marijuana, only Pennsylvania's legislation currently survives. On May 12, the bill to provide for medical marijuana in Pennsylvania passed the Senate with substantial support and moved on to the House. Five other states have passed legislation in 2015 to allow limited, non-plant marijuana use of oils with low levels of THC to registered patients. Louisiana and Ohio have similar measures in the works.[6]

And, as has been widely publicized, Colorado, Washington, the District of Columbia and now Alaska and Oregon have gone further and amended their state constitutions, statutes or regulations to legalize recreational use of marijuana, in addition

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[5] Colorado Federal Marijuana Lawsuit: Safe Streets Alliance Drops Bank Of The West From List Of Defendants By Philip Ross, International Business Times | February 27, 2015; http://www.ibtimes.com/colorado-federal-marijuana-lawsuit-safe-streets-alliance-drops-bank-west-list-1830568.

[6] Georgia, Oklahoma, Tennessee, Texas, and Virginia have all passed legislation in 2015 to allow low level THC oils. For more information on passed, pending, or failed marijuana legislation in 2015, visit http://medicalmarijuana.procon.org/view..php?resourceID=002481.

to allowing its medical use. Colorado's Amendment 64 ballot initiative passed in November 2012, as did Washington's Initiative 502[7]. In 2013, the District of Columbia's Initiative 71 (promulgated in D.C. Code § 48-904.01 -05), legalized recreational marijuana – a move that has yet to be approved by Congress. In 2014, Alaska passed Ballot Measure 2, and Oregon voters approved Measure 91. For the implementation of recreational marijuana regulations, Alaska and Oregon have tasked their Liquor Control Boards with breaking ground; Colorado and Washington, on the other hand, have promulgated elaborate statutory and regulatory regimes to control the implementation of legalized recreational marijuana use, which include: systems to track inventory from "seed to sale" to prevent diversion to the black market; extensive licensing requirements; rigorous health and sanitary standards; and strict limits on the number of licenses that can be granted[8]. Colorado requires that marijuana sold at the retail level only be supplied by Colorado-licensed grow houses (which grow operations must initially be vertically integrated in ownership with the retail establishment) and that ownership be limited to persons who have been residents of Colorado for at least two years and who pass criminal background tests[9].

Washington, on the other hand, bans home growing for recreational use, but because home growing is allowed for medical use, and because medical marijuana inventory is not tracked, the regulatory regimes are not in perfect complement. This may create an opportunity for diversion of medical marijuana into black market recreational sales, which Washington recognizes but to date has been unable to address legislatively.

All of the jurisdictions provide for significant taxation on the industry: Colorado levies a 15% tax on growers and a dedicated 10% sales tax, in addition to all other sales taxes, while Washington levies a 25% excise tax at each level of production, processing, and retailing. Oregon requires a $35 tax per ounce to be paid by the producer, while Alaska imposes a $50 per ounce excise tax on the initial sale of marijuana from a cultivation facility.

With (i) the growing momentum of medical marijuana nationwide, (ii) Colorado's, Washington's and now three other jurisdictions' bold forays into approving recreational use of pot, and (iii) the number of pending ballot or legislative measures to approve some form of marijuana use, it is clear the issue of marijuana usage no longer remains taboo or a re-election deal killer for many legislators. In fact, it appears increasingly evident that public sentiment is becoming more accepting of the use of marijuana, even in culturally conservative states such as Utah or Mississippi, at least when framed as an issue of compassion in medical treatment.

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[7] To avoid confusion, reference is largely confined to Colorado's and Washington's marijuana laws. The nascent legalization laws for the District of Columbia, Alaska and Oregon are not analyzed at this time.

[8] Colorado's regulatory scheme may be found at C.R.S. §§12-43.3-101 et seq. (Medical Marijuana) and C.R.S. §§12-43.4-101 et seq. (Recreational Marijuana) with regulations enforced by the Marijuana Enforcement Division within the Department of Revenue at 1CCR 212-1 (Medical Marijuana) and 1CCR 212-2 (Recreational Marijuana).See also, www.colorado.gov/cs/Satellite/Rev-MMJ/CBON/1251581331216 for the Marijuana Enforcement Division's website and access to the applicable statutes and regulations.

[9] See C.R.S. §§12-43.4-306(1)(k) and 402(1)(c)(I).

Well over half of the Union, then, has determined that marijuana, or some derivation thereof, has a valid, lawful use, and that possession and use of the drug for recognized purposes should not be criminalized. From a federal perspective, however, the public's increasing acceptance of and comfort with some form of legal use is jarringly out of step with the laws on the books. It is this conflict between what is legal and permissible at the state level, yet still prohibited at the federal level, that creates tremendous uncertainty and confusion among those who must walk a tightrope between the two.

IV. AN INCOMPLETE TRUCE: ATTEMPTS TO RECONCILE FEDERAL VS. STATE MARIJUANA LAWS

As momentum among the various states has grown to validate some form of marijuana use, so have efforts to bridge the chasm between the state and federal schemes governing the drug. These reconciliation efforts include attempts to pass new legislation, issuance of guidance by various oversight bodies, and pronouncements by the federal executive branch. As discussed below, these efforts unfortunately fall short of their intended mark of reassuring market participants caught in the crosshairs of state versus federal law.

A. Department of Justice Guidance.

Deputy Attorney General James Cole of the DOJ issued a guidance memorandum to all U.S. attorneys general on August 29, 2013 (the "Cole Memo") laying out the DOJ's priorities for enforcing marijuana-related violations of the CSA. The Cole Memo reiterates that distribution of marijuana remains illegal under federal law. Rather than outright suggesting it won't take enforcement action against state-legalized marijuana operations and conduct, however, the memo establishes eight *priorities* for enforcing violations of the CSA:

1. Preventing distribution of marijuana to minors;
2. Preventing proceeds from marijuana sales from benefitting drug cartels and gangs;
3. Preventing marijuana from being diverted from states where it is legal to states where it is not;
4. Preventing state-sanctioned marijuana operations from being used as a cover for trafficking in other illegal drugs;
5. Preventing violence and firearms from being used in marijuana growing and distribution;
6. Preventing driving under the influence of marijuana and the exacerbation of other "adverse public health consequences" of marijuana use;
7. Preventing marijuana from being grown on public lands; and
8. Preventing marijuana use or possession on federal property.

The Cole Memo also clarifies that the DOJ expects states and local governments that have authorized marijuana use to develop comprehensive regulatory and enforcement schemes, and that it will rely on its state and local law enforcement brethren to vigorously enforce those regulatory schemes. The Cole Memo warns that: "[i]f state enforcement

efforts are not sufficiently robust to protect against the harms set forth above, the federal government may seek to challenge the regulatory structure itself in addition to continuing to bring individual enforcement actions, including criminal prosecutions, focused on those harms." The Cole Memo also suggests U.S. Attorneys should consider the extent to which marijuana operations are in compliance with a state's regulatory framework in weighing potential enforcement action, rather than using the size or for-profit status of an operation alone as a proxy for whether it poses a risk under the eight areas of focus.

The Cole Memo was supplemented by a memo issued on February 14, 2014 (the "February 14 Memo"), in which the DOJ reiterated that financial institutions can still be prosecuted under money laundering statutes, and that they can be subject to criminal liability for marijuana-related financial *transactions* under these statutes, even in the absence of criminal prosecution for the underlying marijuana offense itself. Enforcement is more likely if a financial institution is implicated in one of the eight priority areas. For example if a bank looks the other way and fails to report when it knows a marijuana business client is diverting marijuana to another state. And the February 14 Memo warns that financial institutions may find themselves subject to federal law enforcement scrutiny if they operate in states where marijuana regulatory frameworks lack the robustness the DOJ expects, fail to follow FinCEN guidance (discussed below), or do not themselves adopt robust due diligence procedures for ensuring their marijuana clients are not violating the eight enforcement areas,.

B. FinCEN Guidance.

The Treasury Department's Financial Crimes Enforcement Network, or FinCEN, issued new guidance on February 14, 2014, in conjunction with the February 14 Memo issued by DOJ (the "FinCEN Memo"). The FinCEN Memo attempts to clarify how it expects to enforce the BSA in light of permissive state marijuana laws and to offer some comfort to the banking industry on how to fulfill its BSA obligations and not become enforcement targets should its members choose to accept marijuana-related businesses as clients.

When evaluating the risks of accepting such a client, the FinCEN Memo calls for financial institutions to conduct extensive due diligence regarding potential marijuana-related businesses. Elements of due diligence FinCEN expects banks to undertake include:

1. Verifying that the business is licensed by the state;
2. Reviewing the license application and related documents submitted by the business to the state to obtain its license;
3. Asking the state's regulatory bodies for any information they have about the business and parties related to the business;
4. "[D]eveloping an understanding of the normal and expected activity for the business, including the types of products to be sold and the type of customers to be served (e.g., medical versus recreational customers)";
5. Monitoring public sources for adverse information about the business;
6. Monitoring the business for suspicious activity; and

7. Refreshing information periodically.

FinCEN also expects banks to determine whether a marijuana banking client implicates one of the Cole Memo priority enforcement areas or violates state marijuana laws – in effect, making the banks arms of the regulatory and law enforcement bodies themselves. The banking industry views this as a "foisting" of policing duties upon them, which duties the banks are ill-equipped to handle at the granular level required by the FinCEN Memo. But as noted below, several financial institutions, with varying success, have viewed this extra set of duties as a market niche opportunity.

FinCEN reiterates that banks are required to complete SARs under the BSA for marijuana-related transactions, but establishes a new SAR filing protocol specific to the marijuana industry. Banks that serve marijuana clients, but whose clients do not implicate the Cole Memo enforcement priorities or violate state law, are required to file "Marijuana Limited" SARs. These filings identify the business and related parties and state that the SAR is being filed only because it is a marijuana-related business, and no additional suspicious activity has been identified.

A bank must file a "Marijuana Priority" SAR for clients it believes are implicated in violating either state law or a Cole Memo enforcement priority. If a bank decides to terminate a marijuana client to remain compliant with anti-money laundering laws, it files a "Marijuana Termination" SAR, and may alert a subsequent financial institution about suspected illegal activity.

FinCEN identifies numerous "red flags" to help banks determine whether a client's activity warrants reporting, including:

1. Using a marijuana business as a front for other illegal activity. Signs may include a business that takes in significantly more revenue than expected, or than its local competition, or than demographics would suggest, or the business is depositing more cash than it reports for state and federal tax purposes.
2. Lack of state licensing.
3. Inability to demonstrate the legitimacy of outside investments.
4. Concealing marijuana business activity, such as using a non-marijuana-related trade name.
5. Negative information, such as a criminal record, regarding the business owner.
6. A prior record of enforcement action against the business.
7. Engagement in international or interstate activity.
8. An out-of-state owner.
9. A marijuana business operating on federal land.
10. Proximity to a school.
11. A "non-profit" operation that seems to be operating more as a for-profit.

Given that some states explicitly do not establish licensing regimes (Washington's medical marijuana program, for example), it is unclear if lack of licensing alone is sufficient to trigger a red flag. In Colorado, the risk is that an existing marijuana-related business suddenly does not qualify for a renewal or modification of its license, or its license is terminated for failure to comply with the complex licensure rules – potentially triggering a FinCEN issue if the bank knows or should know of the lack of licensure.

There is no doubt, however, that the level of scrutiny required of marijuana-related businesses goes far beyond the due diligence required of virtually any other client a bank might take on. It is also unclear whether bank personnel would even have the expertise to evaluate the information they would need to collect under this guidance – most bank personnel are unlikely to know whether revenues are in line with what should be expected, for example, particularly given the newness of the industry as a legal enterprise. Unless a bank attaches substantial fees to marijuana transactions for the massive regulatory compliance load, it seems likely that the level of effort required to conduct the expected level of due diligence, combined with the risks of getting it wrong, would strongly militate against taking on marijuana clients. As discussed later, some banks and credit unions have arrived at several creative, if not occasionally "questionable", solutions to engaging with marijuana customers.

C. Legislation.

In recent years, various legislative attempts have been made to decriminalize marijuana at the federal level. Colorado Congressman Jared Polis (D-Boulder) introduced H.R. 499 in 2013, for example, which would require the Attorney General to remove marijuana from Schedule I under the CSA, while in 2011 former Congressmen Barney Frank and Ron Paul introduced H.R. 2366, which would have done the same thing. Such bills never seem to sustain life in the form of a hearing before being sentenced to legislative death.

More narrowly targeted legislative efforts have not gained significantly more traction. Colorado Congressman Ed Perlmutter (D-Denver) has introduced HR 2652, the Marijuana Businesses Access to Banking Act of 2013, which would prohibit federal regulators from limiting or terminating a bank's deposit insurance simply for serving marijuana-related business clientele, or from attempting to discourage a financial institution from accepting business from marijuana-related clients; or from "taking any action on a loan" made by a lender to a marijuana-related business. The bill would also grant immunity from federal criminal prosecution or investigation into a financial institution solely because of its providing services to marijuana-related businesses, and would essentially eliminate the "Marijuana Limited" SAR filing requirement. Congressman Perlmutter's bill has yet to receive a hearing and predictions are that such a hearing may be some years away.

On May 30, 2014, HR 4660, an appropriations bill for Commerce, Justice, Science and Related Agencies passed the House. Section 558 of the bill prohibits the DOJ from using funds appropriated through the legislation to prevent states from implementing their own state laws that "authorize the use, distribution, possession, or cultivation of *medical*

marijuana." This particular section is reportedly unlikely to be adopted in the Senate's spending bill, however.

HR 2240, the Small Business Tax Equity Act of 2013, introduced by Oregon Congressman Earl Blumenauer (D-Portland) and supported by an odd bedfellow, Grover Norquist of Americans for Tax Reform, would amend the Internal Revenue Code §280(E) by allowing state-legal marijuana-related businesses to deduct their ordinary and necessary business expenses by exempting marijuana businesses from the prohibitions of I.R.C. §280E (discussed in more detail below). Although proponents argue tax reporting compliance would rise with passage of such a bill, legislative sources indicate there is virtually no chance of its passing.

In an effort to nudge the federal government into permitting easier banking of legalized marijuana businesses, Colorado's Governor John Hickenlooper signed into law House Bill 14-1398 that authorizes formation of "marijuana financial services cooperatives" to provide banking services to marijuana-related businesses *after* providing evidence to the State Commissioner of Financial Services of approval from the Federal Reserve to access the banking system. The Federal Reserve received its first application for recognition and access through issuance of a master account from Fourth Corner Credit Union in November of 2014, but the Federal Reserve has yet to grant it such recognition and access.

But could the apparent log-jam be loosening? In a surprising move from the Republican-controlled U.S. House of Representatives, in early June 2015, the U.S. House passed by a bi-partisan vote of 219-189 an appropriation measure for the Drug Enforcement Administration which specifically prohibits use of DEA funds to prevent any State from implementing their own laws in furtherance of legalized "medical" marijuana.[10] The passage of this amendment is far from the end of the story, however. The Senate is considering its own DEA appropriations measure, and the House floor debate was lively with strong opinions against the measure voiced, including reference to the DEA's 2014 Release on the dangers of medical marijuana.[11]

D. Lobbying by the Banking Industry.

With anemic efforts to generate a legislative solution, and stop-gap regulatory letters that arguably create even more problems for lenders, one must wonder where the banking industry is in pushing for a solution to the federal-state conflict in marijuana laws. The answer appears to be that the banking industry has bigger issues to deal with, including reforms to Dodd Frank, and that the expenditure of political capital isn't viewed as a wise investment at this time. The American Banking Association ("ABA") is not particularly keen to tackle this issue, as its FAQs on the marijuana industry note, because the market opportunities remain relatively small and continue to be outweighed by the risks: "For

[10] Amendment to H.R. 2578.

[11] See *The Dangers and Consequences of Marijuana Abuse*, U.S. Department of Justice Drug Enforcement Administration, May 2014; see also, House Blocks DEA From Targeting Medical Marijuana, Huffington Post, June 3, 2015. http://www.huffingtonpost.com/2015/06/03/congress-medical-marijuana_n_7505066.html

some banks, particularly those in states where usage is legalized for medical or recreational purpose, this may be seen as a legitimate small business with growth potential just like any other small business. However, the industry has not taken a position on the issue and under current federal laws; bankers see too much risk to get involved in this business."[12]

In addition, riling influential senators who oppose marijuana's reclassification may be seen as imprudent: some chairs of critical senate committees are not friendly to the marijuana industry. For example, after publication of the FinCEN Memo, Senators Dianne Feinstein (D-CA) and Chuck Grassley (R- Iowa) wrote FinCEN an extremely pointed letter essentially demanding that FinCEN back off its suggestion in the guidance that lenders might be able to serve the marijuana industry without risking prosecution if they followed FinCEN and DOJ guidance. Collectively, these senators hold extremely powerful positions on finance, judiciary, taxation, and other committees, and the ABA is unlikely to want to expend political capital to serve what is now a fringe market, potentially losing goodwill with these and other influential senators.

Simply put, many banks consider legal pot businesses to be too small, too diffuse, and too difficult to deal with to justify spending much good will on Capitol Hill to solve the supremacy problem. But at least with medical marijuana, the tide on Capitol Hill may be starting to turn, with some wondering whether banking solutions can be too far behind.

V. IMPLICATIONS FOR THE COMMERCIAL BANKING INDUSTRY

The proverbial camel's nose of medical marijuana is well inside the political and public opinion tent, and the camel may ultimately run completely loose before too many more years pass. But make no mistake: the "legality" of all medical and recreational marijuana businesses is a fiction that exists currently only by the good graces of the Obama Administration's directives to the Department of Justice, Treasury and others to partially stand down on criminal or regulatory enforcement against marijuana businesses or individual users acting within the laws of their state. The Obama Administration has made clear it has no intention of pushing for marijuana legalization at the federal level, and the new U.S. Attorney General, Loretta Lynch, made it clear in her confirmation hearings that she viewed marijuana as a more dangerous "drug" than alcohol and tobacco. If the political winds shift in the 2016 presidential election, some or all the leniency shown by the current administration may be rolled back, as to recreational marijuana, medical marijuana, or both. As a result, one simply cannot know how strictly laws against marijuana operations or possession will be enforced until at least January 2017, when a new administration occupies the White House.

Until predictability is created by removing marijuana as a Schedule I drug, either legislatively or by Department of Justice action at the behest of a new administration, the risk of changes in policy, and the risk that some marijuana operator's conduct might cross the boundaries of the limited enforcement directives discussed above, loom large for

[12] *Frequently Asked Questions: Marijuana and Banking*, American Banking Association, February 2014. http://www.aba.com/Tools/Comm-Tools/Documents/ABAMarijuanaAndBankingFAQFeb2014.pdf

lenders. Some of the foreseeable criminal, regulatory and civil implications for the banking industry in the marijuana arena follow:

A. Seizures.

As discussed in Section II (E) above, both civil and criminal forfeitures are available to the government in enforcing violations of the CSA. At the time of writing, no Colorado seizures of marijuana-related real property were known to have occurred without the involvement of other suspected criminal conduct. Nevertheless, the ever-present and heightened risk of such criminal activity, coupled with raids and other enforcement actions that have occurred, put a bank's collateral and an owner's property at significant risk.

The exposure of bank collateral and owner assets to the long arm of federal seizure rights is frightening. Federal law not only permits the seizure of the marijuana-related real estate assets by the federal enforcement agency, but also the stripping of otherwise legitimate lien rights of lenders. *U.S. v. One Parcel of Property Located at 5 Reynolds Lane, Waterford, Conn.*, 909 F.Supp.2d 131 (D.Conn. 2012) (mortgage interest in seized property held inferior to the government's forfeiture right in seizing property used to grow medicinal marijuana).

More specifically, 12 U.S.C. §881(a)(7) provides for the forfeiture to the federal government of real property "which is used, or intended to be *used, in any manner* or part, to commit, or *to facilitate the commission of*" a violation of federal drug laws (emphasis added). The federal government must merely prove that the real property was used to "facilitate" the commission of a violation of federal drug laws. See *Com. v. Real Property and Improvements Known as 2314 Tasker Street Philadelphia, PA 19145, 67 A.3d 202* (Pa.Cmwlth., 2013). "Facilitation" is in the eye of the judicial beholder, but can be found if the real property was used in any way related to the narcotics violation. See *U.S. v. Real Property In Section 9, Town 29 North, Range 1 West, Tp. of Charlton, Otsego County, Mich.*, 308 F.Supp.2d 791 (E.D.Mich. 2004). Once a property is deemed to have been involved in facilitating a criminal enterprise, the burden shifts to the lender or the owner to prove it is entitled to the innocent lender or innocent owner defenses.

The bank's and the owner's ability to fight off the seizure and retain their collateral and ownership position is further limited by the need to prove innocence once the government establishes a nexus between the property and the illegal conduct. See, for example, *Com. v. Real Property and Improvements Known as 2314 Tasker Street Philadelphia, PA 19145*, 67 A.3d 202 (Pa.Cmwlth, 2013). While Sections 983(d) and 853(n)(b)(6) provide "innocent lender/owner defenses", they apply ***only if*** the lender or owner truly neither (i) consented to, nor (ii) had knowledge of the criminal conduct, and (iii) once either of them became aware of the conduct, they did all that could reasonably be expected to prevent or terminate the illegal conduct. Given there is nothing particularly "hidden" about medical marijuana dispensaries and grow operations operating openly, lenders and owners will have a difficult time meeting any, let alone all, requirements of the innocent owner or innocent lender defense.

While more recent DEA raids appear to be limited to violations of DOJ enforcement priorities in the Cole and FinCEN memos,[13] the potential for real estate seizures still gravely impacts the parties involved. In a recent Colorado Chapter 11 bankruptcy, the debtor, who derived roughly 25% of revenues from leasing warehouse space to tenants who were marijuana growers, was found to have grossly mismanaged the assets of the estate by subjecting the creditor's collateral to the risk of forfeiture due to CSA violations.[14] Although the court acknowledged that the actual risk of DEA forfeiture indictments was minuscule, the court could not require that the creditor "bear even a highly improbably risk of total loss of its collateral in support of the debtor's ongoing violation."[15]

While a great deal of case law has developed regarding disproportionality of seizures, constitutional violations and the like, the courts – including the U.S. Supreme Court – have tended to side heavily with the federal government. Greater criminal conduct opportunities and other issues surrounding legal marijuana operations increase the risk of federal drug enforcement involvement and the possibility of such seizures.

Practice Pointer: When the only defense to seizure is lack of knowledge, lack of consent, and effectively constant vigilance to prevent the federally illegal conduct, the only truly safe approach for lenders and owners is to prohibit such conduct and undertake regular audits of their properties/collateral to assure that none of the space is being used to "facilitate" a federal drug felony.

B. Anti-Money Laundering.

While many bankers initially looked to the marijuana industry as a potential source of new banking revenues, Colorado's temporary requirement of vertical integration of grow operations with retail dispensaries, and limits on the size of those respective operations, has removed a bit of the business bloom on the rose. To many bankers, the business opportunity is becoming only marginally more attractive than other one-off successful family-owned businesses, such as the corner bar or strip mall pizza shop.

Add to that the additional regulatory burdens of the FinCEN Memo and filing various levels of SARs with respect to these customers just to avoid sanctions for money laundering and criminal conspiracy[16], and most banks have lost their appetite for

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[13] For full story, *see* Matt Ferner, *DEA, Denver Police Raid Multiple Marijuana Grow Operations (Update)*, THE HUFFINGTON POST, (Oct. 29, 2014), http://www.huffingtonpost.com/2014/10/28/denver-marijuana-raid_n_6063066.html.

[14] *In re Rent-Rite Super Kegs W. Ltd.*, 484 B.R. 799 (Bankr. D. Colo. 2012). See also, *Federal Bankruptcy Courts No Safe Haven for Marijuana Producers or Their Landlords*, David T. Brennan, Esq., Lexology, May 31, 2015, http://www.lexology.com/library/detail.aspx?g=37014f46-8e05-4968-8cdc-3ac9e76bcc3c

[15] *Id*. at 806. The parties later stipulated to relief from stay to allow the lender to foreclose on the warehouse.

[16] Violations of BSA requirements include potential civil and criminal sanctions for banks and individual bankers, including:

- Civil penalties of $1000 per each day of noncompliance;
- $500 penalty per violation of BSA documentation requirements;
- Civil penalties for willful violations equal to the greater of the amount of the transaction or $25,000;
- $10,000-per-day civil penalty for failure to file a CTR within the required 15 days;
- "Cease & Desist" order from the FDIC for continued noncompliance;

attempting to work with these businesses at all. However, the lucrative business prospects of working with the nascent marijuana industry still remain quite attractive. Banks that have decided to accept marijuana industry clients appear to operate in either (i) overt, publicized conformity with FinCEN requirements or (ii) cryptic, selective acceptance of marijuana customers.

A few banks have initially accepted the risks and tried to move forward with admitting marijuana industry customers, operating in strict conformity with FinCEN requirements. MBank out of Oregon and First Security Bank from Nevada attempted to capitalize on the new market by publicly advertising their new, marijuana-friendly banking procedures.[17] However, after a few months of post-holing through the morass of federal regulatory requirements under the guidance memos, both banks retreated from the marijuana industry and eventually closed all marijuana-related accounts. While commentators initially suspected the move derived from fear-mongering federal regulators, both banks continued to underscore the compliance difficulties in maintaining marijuana customers.[18]

Other banks actively sought to keep themselves and their marijuana customers under the radar. Believing that regulatory scrutiny is the mark of death, these banks maintain a discrete relationship with marijuana customers. In fact, the foundation for continued relations appears to be dependent on the undisclosed nature of the relationship, with some banks requiring a nondisclosure agreement before accepting marijuana customers.[19] Because disclosure equates to the loss of the highly-prized banking relationship, dispensaries have avoided discussing the name of their banks, even to other dispensaries because of the fear that the competitor will publicize the information.

At least one prospective bank, which asked to remain anonymous, has taken significant strides to follow FinCEN guidance without losing income to the heavy cost of regulatory compliance. In its business model, the Bank will hire compliance personnel to perform the necessary extra due diligence, but it will pass through the additional fees to marijuana customers. The Bank effectively has accepted the implicit directive under the federal banking memos to consider itself a partner in the enforcement of the FinCEN guidance, andwill charge the high cost of compliance to the marijuana customers.

- $250,000 fine and/or imprisonment for up to five (5) years for any individual willfully violating anti-structuring money laundering laws.
- $500,000 fine or imprisonment for up to ten (10) years for any individual willfully violating the structuring provisions while violating another federal law.
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[17] David Migoya, *MBank Pulls Out of Colorado a Week After Taking on Cannabis Accounts*, The Denver Post, (Jan. 26, 2015, 4:57 PM), http://www.denverpost.com/business/ci_27398018/mbank-pulls-out-colorado-week-after-taking-cannabis.

[18] Chris Sieroty, *First Security Bank Of Nevada Pulls Out Of Cannabis Banking*, Nevada Public Radio, (May 14, 2015), http://knpr.org/knpr/2015-05/first-security-bank-nevada-pulls-out-cannabis-banking.

[19] David Migoya, *Colorado Pot Credit Union Surveying Industry, Acquires Location*, The Denver Post, (Jan. 13, 2015, 6:32 PM), http://www.denverpost.com/business/ci_27314182/colorado-pot-credit-union-surveying-industry-acquires-location .

While this model would provide the marijuana industry with an adequate banking outlet, the potential success of this cost pass-thru method remains unclear. The banking issue has been a long-lasting and resounding complaint within the marijuana industry; however, dispensaries and growers are learning to adapt to operating without banking. The significant costs to the customers, along with the marijuana industry's general distrust of the amorphous and ever-changing banking regulations, could prove detrimental to new banks seeking to pass the cost of compliance along. Unless enough clients are willing to fully invest in this new style of banking, and at a sufficient customer volume level with a specific bank to create the economies of scale necessary for the bank to hire the requisite regulatory compliance expertise, the extra measures needed for structuring FinCEN compliance could still prove to be too great a weight for the banking industry.

In addition to deposits falling within the sights of these anti-money laundering requirements and anti-structuring (or "structured transaction") requirements[20], banks must fear the same with respect to payments from their commercial real estate borrowers. Banking lawyers are finding a growing workload in the area of default notices such as that attached as Exhibit B, threatening acceleration and foreclosure if a marijuana-related operation is not removed from the collateralized real property. If a marijuana dispensary's income is a problematic deposit for a bank, so too is a loan payment derived from rents from that dispensary. Banks and bankers are even required to go so far as to file SARs in which their borrowers/landlords (not the offending tenant) are the subject of the report, lest the government charge the bank and the banker individually with failing to report the rent paid by a marijuana business as laundered funds. And as noted earlier, the bank is not permitted under the PATRIOT Act to alert the landlord/borrower of the SAR filing.

But before banks dispense such default notices, banks and their counsel need to review the extent of the protections in their loan documentation and the extent of the information in their files regarding the tenants. Most loan documents contain a series of standard "illegality" provisions such as the following:

> *Compliance with Laws. The Project and the Property shall comply with all applicable laws, ordinances, rules and regulations of federal, state, county or municipal governments or agencies now in force or which may be enacted hereafter, during the term of this Loan and any extensions thereof.*

But is the general clause good enough to support the default notice? We suggest it is not for the following reasons:

- If the bank has made the loan with knowledge or reason to know that a tenant is operating a marijuana-related business, arguments may be made that the bank is estopped to place the loan in default on the basis that such a lease violates applicable law;

[20] "Structuring" is the act of breaking down large monetary transactions to many smaller transactions to avoid reporting requirements or to hide a large and illegal transaction from detection – e.g., payment through a large number of smaller value money orders).

- Banks may have required estoppel certificates or Subordination, Non-Disturbance and Attornment Agreements ("SNDAs") from tenants and thereby be on notice of the operation, or even worse, be in contract with that tenant not to disturb their tenancy; and

- Even if the offending tenant is a new occupant of the collateralized property, if the bank subsequently received rent rolls disclosing the marijuana operation, or could have inspected the property and seen the operation and yet did nothing about the situation, the same estoppel arguments may be made.

Even if the bank has avoided these estoppel risks, the simple "compliance with law" clause may leave the less sophisticated borrower (or even lender) thinking that state legalization of marijuana is a safe harbor – a belief still held by many proponents of the marijuana industry, marijuana business operators, landlords desperate to fill space, and even loan officers anxious to make their quarterly quotas. Such unchecked wishful thinking (or in many cases, willful ignorance) leads to very open operations of marijuana-related businesses at the collateralized real property. And unless the lender can show it had good reason not to inspect the collateral, any innocent lender/innocent owner defense in a seizure action or other BSA violation may be gone.

This knowledge by the bank can have profound effects. In a case of great note, an Arizona lender loaned a Colorado dispensary $500,000. After the dispensary failed to make payments, the lender commenced an action in the Arizona U.S. District Court to collect repayment. [21] Despite both Arizona and Colorado recognizing legalized marijuana, the trial court granted the defendant's motion to dismiss because the contract was void for illegality and against public policy. After quoting from the loan agreement which stated "Borrowers shall use the loan proceeds for a retail medical marijuana sales and grow center", the court held:

> *The explicitly stated purpose of these loan agreements was to finance the sale and distribution of marijuana. This was in clear violation of the laws of the United States. As such this contract is void and unenforceable.* [22]

The court acknowledged the draconian nature of its ruling, but then noted that even equitable relief, such as unjust enrichment or restitution, was unavailable. "Equitable relief is not available when recovery at law is forbidden because the contract is void as against public policy." If a creditor can be estopped from even collecting money indisputably loaned to a marijuana operator because the loan agreement recites an illegal purpose, the estoppel effect of other documents in the lender's file must be considered carefully as well.

Practice Pointer. In lieu of the simple compliance with law provision typical in loan agreements, banks in states where medical or recreational marijuana is legal should

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[21] *Hammer v. Today's Health Care II*, CV2011-051310 (Ariz. Sup. Ct. Apr. 17, 2012), available at http://www.keytlaw.com/Cases/hammer.pdf; *see also Haeberle v. Lowden,* 2012 WL 7149098 (Colo. Dist. Ct.) (holding a contract between a marijuana grower and retailer was void as it was against public policy)

[22] *Hammer*, supra at p.4.

consider (i) making sure no loan documents reference a condoned marijuana activity, and (ii) employing a much more comprehensive clause, such as the one set out at Exhibit C. While such a clause still does not necessarily provide full protection or a safe harbor from federal enforcement agencies, it certainly reduces the risks of being barred from invoking the right to demand termination of the offending lease or invoking loan acceleration. And under all circumstances, it is incumbent upon lenders (i) to regularly physically audit their collateral to comply with the BSA, and (ii) to report newly identified cash flow related to marijuana businesses using a SAR, all in order to maximize defenses against claimed violations of any applicable criminal and banking laws.

C. Guaranties, Non-Recourse Loans and Bad Boy Guaranties.

1. **Guaranties in General**: For landlords, guarantors of marijuana businesses are coming in a variety of flavors – some being wealthy investors seeking the opportunities in this new economy, and some being simply unsophisticated, first time business people with an "affinity" for all things marijuana. The risk that a marijuana operation may lose its state license, or may fall into issues with law enforcement creates a much greater potential for abandonment and default. The guaranty either becomes very important, or landlords must recognize the risk that the lease guaranty will be essentially worthless. Query, however, what will the impact of "illegality" be on the enforceability of a guaranty where the illegal purpose is known?

Similarly, lenders must recognize that leases that support collateral, income ratio covenants, and the like in their loan documents may be at risk where a borrower's tenants are in the legalized marijuana business. This risk is not at all abstract. According to some Colorado bankers, regulators conducting loan reviews have fully excluded income from marijuana-related businesses from cash flow calculations, effectively throwing a loan into immediate covenant default. Plus, with federal criminal and civil seizure laws' ability to strip the collateral of the bank's security interest, guarantors' wherewithal becomes all the more critical.

2. **Non-Recourse Loans**: The competitive market in banking for garnering the next good loan has brought back non-recourse structures in a big way. "Bad Boy" carve-out guaranties are still the norm, and they continue to address historic areas of risk of significant impairment to the lender's collateral. Seizure, business shut down, and the many other risks of marijuana businesses involved in the bank's collateral should be seen as such a risk as well.

Practice Pointer. Banks are well-advised to consider adding to

Bad Boy guaranties compliance with covenants against marijuana operations (such as those included in Exhibit C), or at least a covenant that if the collateral is impaired or lost for any reason as a result of any law enforcement action related directly or indirectly to a marijuana violation, the guaranty will apply or spring into place.

D. Other Regulatory Risks for Banks.

Since the Great Recession of 2008, regulatory scrutiny of the banking industry has increased several orders of magnitude, including the attention given by regulators to the nature of a bank's collateral. Downgrading collateral adversely affects a bank's reserve requirements and ability to lend generally or lend in that specific economic sector (i.e., the commercial real estate lending department of the bank). Collateral involving a marijuana operation not only creates the risk of such a downgrade, but also the potential for the bank being subject to takeover or additional supervision by the Office of the Comptroller of the Currency ("OCC") or other federal banking regulatory agency. Marijuana collateral also presents the risk of the bank violating the FinCEN Memo requirements and the conspiracy provisions of the federal criminal statutes related to Schedule I narcotics. Legal and practical opportunities for banks to mitigate these risks by somehow finding a way to "make it work" are still very elusive. Rather, as discussed below, for the time being, unless the bank is well-versed in, and well-staffed for, meeting FinCEN regulatory requirements, lenders may want to consider focusing on ways to maintain the bank's flexibility to protect its collateral from the presence of a marijuana operation.

1. **Eroding Collateral Value Risks for Banks**.

Banks are increasingly recognizing marijuana-related real estate collateral as having heightened risks of on-site criminal conduct, break-ins, environmental and general property devaluation risks. Appraisals of marijuana-related collateral may be affected by the existence of such operations, but thus far no official position or guidelines from the appraisal industry have been published. However, deterioration of the physical condition of the collateralized property upon the removal of special utility, ventilation and other infrastructure to support a cultivation or dispensary operation can be significant and destructive. With such deterioration can come the downgrading of an asset and impacts on the bank's regulatory requirements, or re-balancing requirements for owner/borrowers to meet loan-to-value covenants.

Practice Pointer. Assuming a bank even underwrites a loan knowing the collateral contains a marijuana operation, care should be taken in evaluating impacts on marketability and resale price, as well as establishing higher than usual capital replacement and turnover reserves for such a tenancy.

2. **Foreclosures**.

As an axiom of the above concerns, banks need to be aware of the trip wires in a foreclosure proceeding. Properties leased in whole or in part to marijuana operations may already be financially troubled. A bank foreclosing on such a property potentially faces the same issues with receipt of tainted funds from tenants. Foreclosed landlords are known to sometimes simply surrender the keys to the lender, presenting a dilemma for the lender in working with or accepting rents from the marijuana tenant. And on the flip-side of foreclosure considerations, given the *Today's Health Care* illegality ruling in Arizona Federal Court, mentioned above, one may need to consider issues with the sale of post

foreclosure bank OREO property to marijuana operators: are the proceeds tainted; is the contract enforceable; has the bank somehow conspired in a money laundering scheme?

Practice Pointer. Given the draconian regulatory and criminal remedies for handling or collecting funds derived from marijuana-related operations, a bank may be well advised to appoint a receiver to hold and use such rental monies for operation of the collateral as opposed to loan repayment, or simply refuse to collect/receive monies from that tenant. And given the problematic rulings on "contracts" with known marijuana operations, a bank may be well advised not to enter into a contract for sale of property to such an operator.

VI. IMPLICATIONS FOR LANDLORDS/BORROWERS

As discussed above, the high rents of the burgeoning legalized marijuana economy have been their own form of narcotic to landlords – especially those who until recently had high vacancy rates. Payments in multiple small-dollar money orders, gold coins, and cash are not uncommon, but have not stopped landlords from forging ahead with such leases – even at the risk of participating in a "structured" money laundering scheme.

But their perceived good fortune has finally begun to give way to the realization that subtle and not-so-subtle costs lurk behind these otherwise profitable transactions. Before the federal backpedaling in 2013, the DEA made it explicitly clear that state laws have no impact on its ability to subject landlords to criminal prosecution, imprisonment, and forfeiture of real property.[23] While the DEA has not acted against anyone in compliance with the DOJ memos, and perhaps federal legislation may soon limit seizures through the budgeting process, the fact that the government can still legally strip a landlord of property has created uncertainty in the courts. Indeed, in several bankruptcy cases, the courts ruled that a marijuana tenant operating in violation of the CSA provided cause for dismissal of Chapter 11 bankruptcy reorganization filings due to the potential of forfeiture of the collateral or bankruptcy estate assets and the openly illegal nature of the tenant's activity.[24] The *Rent-Rite* case sets the stage for the landlord's dilemma in leasing to marijuana tenants with its 2014 ruling that a landlord's operation of a warehouse which was partially rented to a state licensed marijuana operation was a violation of the CSA *by the landlord*. The *Arenas* case goes on to warn that landlords' efforts to then enforce rights, or seek federal protections may fall on deaf ears, especially in the federal court system.

> *Under our federal system of government, a state is perfectly free to … "continue to look the other way when their citizens defy federal law." By the same token, the states have no power to require any branch of the federal government to do the same. A state citizen that chooses to defy one federal law puts himself in an awkward position when he seeks relief under another federal statute – especially*

[23] *Marin Alliance For Med. Marijuana v. Holder*, 866 F. Supp. 2d 1142, 1151 (N.D. Cal. 2011).

[24] *See In re Arenas,* 514 B.R. 887, 895 (Bankr. D. Colo. 2014); *In re Rent–Rite Super Kegs W. Ltd.*, 484 B.R. at 802–803.

when granting that relief directly involves a federal court in administering the fruits and instrumentalities of federal criminal activity.[25]

A. Potential Acceleration, Eviction Concerns and Lease Defaults.

Unless a commercial property is owned free and clear, or financed privately, the default letter attached as Exhibit B is likely to be delivered to the owner eventually – *especially after this paper is read*. Between removing the tenant or acceleration, the choice should seem obvious. But it is not. First, in the vein of the cure being worse than the disease, if a marijuana-related lease is for most of a building and the loan is non-recourse, the borrower may want to consider letting the bank take over the property (depending, of course, on the extent of equity, the ability to remove and replace the tenant, etc.).

Second, and potentially of more concern given the implications of some of the previously-cited cases, such as *Hammer and Rent-Rite*, is if the lease's stated use is the precise marijuana operation creating the default or illegality issue. While banking law is generally federal, landlord-tenant law is not. A tenant being evicted on the basis of a federal law violation may well argue successfully to a state court judge that federal banking issues are the landlord's problem. The court may then rule that the landlord is estopped from seeking eviction because not only is the tenant's operation lawful under state law, but the landlord knew of and consented to the marijuana-related use when the parties entered into the lease. At that point, unless the landlord can use the lender's acquiescence to the marijuana-related lease as a potential defense to the acceleration, the buy-out of the tenant may become the very expensive and only way of avoiding foreclosure.

Practice Pointer. Lawful marijuana tenants are a new area of the law, so proposed solutions are untested. However, a landlord may want to include in any lease a clause similar to the prohibition on marijuana-related operations set out in Exhibit D. At a minimum, landlords should include a termination provision similar to the sample also set out in Exhibit D, allowing termination of the lease, regardless of any knowledge or acquiescence of the landlord, in the event a lender or governmental agency notifies the landlord of a loan default or criminal violation[26]. Landlords should also consider creating flexibility for marketing the property by allowing termination of a marijuana-related lease upon or prior to a property sale; while some landlords may be willing to take the risks, other commercial property buyers may have federal licenses or other issues precluding them from having any ownership interest in a property with a marijuana-related lease in place.

Further, with the issues that tend to accompany grow operations and dispensaries, expanded default provisions should be included in the lease to broaden the landlord's right to terminate the lease. Such issues include general nuisance, odor, illegal smoking or other consumption, criminal conduct, loitering, interference with other tenants, fire hazards, cancellation or increases in costs of insurance, violations of other tenants' rights, increased

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[25] *Arenas, infra*.

[26] Landlords should also consider negotiating with a lender, if appropriate, a cure right permitting the Borrower/Landlord the time necessary to commence remedial action through tenant notice and eviction.

utility costs, damage from operations and more. (See discussion on property deterioration, below.)

B. Abandonment Concerns.

In the new legalized marijuana economy, barriers to entry may be low in terms of business experience, but complications with licensing, supply regulation and the like are not insignificant for many who are not adept business people. Hence, the instability of marijuana-related tenancies can be an issue for landlords as well. Whether due to a midnight move-out or an eviction, landlords are occasionally encountering abandoned marijuana-related products left behind in their properties.

Practice Pointer. Strong abandonment and destruction clauses in leases are potentially more critical in the marijuana situation because (notwithstanding entreaties or "advice" of family and friends as to creative "solutions" in lieu of disposal) it is not yet clear what landlords should do with abandoned marijuana products. Indeed, even in an eviction situation, query whether public policy would favor removal of such inventory to the curb[27]. Absent clarity from state statute or regulations, the best practice for now is likely notification to the authorities to take possession of abandoned marijuana products.

Also, the midnight move-out can sometimes be hours ahead of a state enforcement action and some form of distraint or other notice. (See attached Exhibit E). We are aware of one landlord who received notice from the State of Colorado the day after a tenant moved out, requiring that all marijuana products be secured and kept on the leased premises – a true problem for the landlord, had the tenant not taken all the inventory with them the previous day. It is not yet clear how this issue is to be resolved if such a notice is received by an evicting landlord while the tenant still occupies the premises or has indeed abandoned marijuana inventory.

C. Physical Impact on Premises.

Anecdotal evidence is mounting with both grow and dispensary operations that the physical presence of marijuana plants, products, and processes can create significant impacts on the demised premises and beyond. Such impacts can include[28]:

- **Electrical**: unsafe wiring, oversized fusing, damaged fixtures;

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[27] *Christensen v. Hoover*, 643 P.2d 525 (Colo. 1982) clarified that if a landlord voluntarily took control of a tenant's property after an eviction, even if just to store it for the tenant's benefit, a bailment was created and the landlord could be liable for damages to the property. In 2004, C.R.S. §13-40-122 was revised to address the *Christensen* case and give landlords immunity for storage of a tenant's property so long as the eviction and dispossession of the property occurred through a proper execution of a Writ of Restitution (i.e., the Sheriff oversaw the eviction). Presumably a Sheriff overseeing such an eviction would also take possession of the marijuana inventory, but it is not legally required that the Sheriff do so.

[28] Courtesy of an unfortunate and victimized client, the Colorado Association of REALTORS (www.coloradorealtors.com/will-recreational-marijuana-affect-real-estate/) and Colorado Inspection Services (www.inspection-perfection.com/marijuana-grow-room-dangers.html)

- **Structural**: holes for ventilation and electrical access, wood rot, rusted hollow columns;

- **Ventilation**: damaged vents from water heater and furnace, rusted gas burning appliances like furnaces, mold from venting to interior, attic or crawlspace, deterioration of chimney mortar from venting to fireplace;

- **Environmental**: pollution from hydroponics wastes, groundwater, wastewater, improper use of insecticides, health of occupants and other tenants, CO2 Devices, mold, insecticide, fertilizer.

- **Catastrophic Hazards**: explosions and fires from the rendering process to extract THC from marijuana for hash oil, or other concentrated oils. Such processes, while now arguably legal, are nevertheless very dangerous, creating large and destructive explosions in residential and commercial property. Such explosions are increasing in frequency, with 32 such blasts in Colorado in 2014[29]. While fire departments and the courts contend with the legal nuances, landlords need to be mindful of the financial, safety and insurance implications of operations where such oils are being distilled.

These types of impacts, and others, from marijuana operations can create large re-tenanting expenses, which can, in turn, impact replacement reserves, capital calls, and income covenants. They also can result in lower appraisals and loan curtailment payments to rebalance loan ratio covenants.

Practice Pointer. As a result of the above concerns, a trend is emerging that requires tenants to make larger security deposits, and even more expensively, build a space within the demised premises – essentially creating a sealed box within the rented core and shell to protect the premises and adjoining tenants from the externalities of a marijuana operation. Expanded indemnities and detailed removal provisions are also becoming more common for such leases.

D. Licensing.

Practice Pointer. In Colorado, the licensing of marijuana operations is similar to the process for liquor licenses, including application processes, hearings, criminal background checks, density limitations, setbacks from schools, etc. Both landlords and tenants should be prepared for the contingency that a license will not be granted for a variety of reasons. And landlords need to be mindful that, depending on the basis for the decision, a license denial may bar another application at that same location or within a thousand feet for a period of two years. Accordingly, just as with liquor licenses, a landlord may want to require the use of qualified counsel to assist with the application to avoid such

[29] See, New York Times, Odd Byproduct of Legal Marijuana: Homes That Blow Up, Jack Healy, January 17, 2015. http://www.nytimes.com/2015/01/18/us/odd-byproduct-of-legal-marijuana-homes-blow-up.html?hp&action=click&pgtype=Homepage&module=second-column-region®ion=top-news&WT.nav=top-news&_r=0

a stigma for the property[30]. Consideration should be given as well to lease provisions, continuing liability for rent, and the like in the event an existing tenant loses its license.

VII. INSURANCE COVERAGE RISKS FOR BANKS AND OWNER/BORROWERS

Insurance is its own quagmire in the legalized marijuana arena. Insurance companies are springing up seemingly daily to provide protection to marijuana businesses. The industry is already providing coverage to marijuana businesses for theft of plants, workers' compensation, professional liability for prescribing doctors and even product liability insurance. But for lenders and commercial property landlords the issue is more problematic.

The typical insurance policy employed by a landlord (and therefore lenders as additional insureds) for commercial property is the Insurance Services Office ("ISO") Form CP 00-10 with a CP 10-30 Cause of Loss Form, or some manuscripted or other variant of these forms. To date these policies make no specific mention of marijuana or marijuana-related activities as covered or excluded from coverage. However, the ISO CP 00-10 states that "Contraband or property in the course of illegal transportation or trade" is excluded. And the CP 10-30 Cause of Loss forms that accompany the commercial policy exclude:

> ***Dishonest or criminal act by you****, any of your partners, members, officers, managers, employees (including leased employees), directors, trustees, authorized representatives* ***or anyone to whom you entrust the property for any purpose****:*
>
> 1. *Acting alone or in collusion with others; or*
> 2. *Whether or not occurring during the hours of employment.*

More broadly, insurers have successfully denied claims arising from illegal activities on the basis that coverage would violate public policy, and until marijuana is declassified as a Schedule I Narcotic, these cases may continue to go the insurance companies' way.[31]. Therefore, to the extent a casualty to commercial real estate is the result of conduct related to a marijuana dispensary or grow operation, both the owners and lenders run a significant risk that adequate coverage for the event will not be available. And the opportunities for large casualty claims arising from a marijuana business are legion: fire from excessive electrical requirements, water damage and mold from humidification, illness from evacuated production air into other tenant or common areas, and explosions from cannabis oil distillation systems are but a few.[32]

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[30] See, e.g., C.R.S. §12-43.3-308 and §12-43.4-307.

[31] For a more detailed discussion of related insurance issues, see ***Marijuana Legalization: Implications for Property/Casualty Insurance***, Brenda Wells PhD, AAI, Journal of Insurance Issues, 2014, 37 (1); 77-92.

[32] In one casualty claim sounding like an episode from Showtime's *Weeds*, the authors uncovered an insurance claim denial for an explosion and fire resulting from a tenant drying marijuana in a clothes drier. The possibilities are endless.

VIII. TAX IMPLICATIONS

Lurking behind the perceived profitability of marijuana operations is the cold, hard business reality that marijuana businesses, as opposed to other federally illegal businesses, are not permitted to deduct their ordinary and necessary business expenses[33]. Rather, because marijuana is a Schedule I narcotic, marijuana businesses essentially pay tax on gross income[34]:

> *No deduction or credit shall be allowed for any amount paid or incurred during the taxable year in carrying on any trade or business if such trade or business (or the activities which comprise such trade or business) consists of trafficking in controlled substances (within the meaning of schedule I and II of the Controlled Substances Act) which is prohibited by Federal law or the law of any State in which such trade or business is conducted. I.R.C. Section 280E*[35]

In assessing a tenant's wherewithal to comply with a lease's financial terms over the long term, it may be advisable to first examine the tenant's business plan and pro forma income statements. To the extent the business is actually paying taxes, a material number of new entrants to the marijuana trade may not be aware that their already high level of taxation is against gross income, not net income[36].

Of potential concern also is Section 280E's effect on landlords. Between the federal definition of "trafficking," the provisions of Section 280E, and concepts of conspiracy, an argument can be made that a landlord expressly leasing to a marijuana-related tenant is sufficiently participating in the criminal enterprise to also be subject to the deduction prohibitions of Section 280E. This would appear to be a stretch, but it may also be a matter of degree – dependent on factors such as: whether the tenant is a single building user or just one of many tenants, whether the tenant is in good faith complying with state law, or whether the landlord is actively permitting the tenant to engage in more egregious illegal conduct under state or federal law. Case law has only remotely touched this area through some arguably inconsistent cases dealing with the separateness of (and therefore deductibility of expenses for) other businesses operated in conjunction with or by the same

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[33] In *Commissioner v. Tellier*, 383 U.S. 687 (1966)(quoting *United States v. Sullivan*, 274 U.S. 259 (1927), the Supreme Court stated "We start with the proposition that the federal income tax is a tax on net income, not a sanction against wrongdoing … the statute does not concern itself with the lawfulness of the income that it taxes." *Id*. at 263.

[34] The one exception to Section 280E's prohibition is the allowance of the deductibility for the cost of goods sold (over-generalized, inventory costs) because Reg. §1.61-3(a) defines gross income as total sales, "less the cost of goods sold."

[35] Under the federal sentencing guidelines, a "drug trafficking offense" is "an offense under federal, state, or local law that prohibits the manufacture, import, export, distribution, or dispensing of a controlled substance (or a counterfeit substance) or the possession of a controlled substance (or a counterfeit substance) with intent to manufacture, import, export, distribute, or dispense." U.S.S.G. § 2L1.2(b)(1)(iv).

[36] Anecdotally, the marijuana industry lobby has suggested the low rate of tax compliance in the industry is the result of the disallowance of usual deductions. In other words, the lack of the industry's filing of tax returns, or its filing of false tax returns, could be reversed and even more revenues generated if the prohibitions of Section 280E were lifted for "legalized" marijuana.

owner as the marijuana business.[37] Where the landlord is seeking a marijuana user for a single tenant building, or where a shopping center is largely devoted to marijuana-related businesses, or where the landlord advertises the marijuana-related business as part of a tenant association obligation, the issue may not be entirely free from doubt.[38]

Practice Pointer. Talk to your accountant or tax lawyer before becoming too collaborative with your marijuana-based tenant.

IX. COMMON-INTEREST COMMUNITIES AND MULTI-FAMILY PROPERTIES

A detailed discussion of the interplay between legalized marijuana and specific common interest community developments is both beyond the scope of this paper and has been the subject of much writing and extensive programs already. However, a brief nod to intersecting areas with other developer topics in this paper is in order.

A. Single Family Developments.

The adage that what goes on inside one's own home is one's own business is certainly easier to follow in the single family home situation than in condos and apartments. The impact on neighbors is simply less, and therefore so too is the incentive to regulate marijuana activity. Nevertheless, in establishing covenants for a neighborhood, developers may wish to limit types of businesses and in certain circumstances limit home growing operations or use (though enforcement of such in-home limitations may be difficult). Limiting owners' ability to smoke or otherwise use marijuana-related products outside, but on their own property, in a way that negatively impacts neighbors is a possibility, though in some ways it is no different than attempting to limit the ability of one's neighbor to smoke in his backyard.[39]

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[37] *See, e.g., Californians Helping to Alleviate Medical Problems, Inc. v. Commissioner*, 128 T.C. 173 (2007) (holding that a non-profit medical dispensary associated with a broader care giving business did not defeat the deductibility of expenses related to the care giving business); but see, *Rupp v. Commissioner*, 103 T.C.M.(CCH) 1594, (2012) (holding too close a nexus in a somewhat similar situation, but delineating a list of considerations including: common location, ***whether business was part of an effort to generate revenue from the owner's land***, whether businesses were formed as separate entities***, whether one business benefitted from the other, common advertising***, degree of shared management, degree of oversight by the caregiver over both businesses, use of the same accountant, and the degree of shared books and records.

[38] For an excellent and thorough discussion on Section 280E and medical marijuana and related issues, *see*, Roche, Edward J., *Federal Income Taxation of Medical Marijuana Businesses* (August 12, 2013); Tax Lawyer, Vol. 66, No. 2, 2013; U Denver Legal Studies Research Paper No. 13-38. See also, Benjamin Moses Leff, Tax Planning for Marijuana Dealers, 99 Iowa L. Rev. 523 (2014) (suggesting an argument for avoidance of Section 280E's prohibitions by establishing marijuana-related businesses as a Section 501(c)(4) social welfare organization – an approach taken to task by other authors).

[39] Colorado law permits the growing of six plants but also the possession of an unlimited amount of marijuana grown from those plants for personal use. The right, the desire, and even the need, for HOA's to prohibit such growth at all. or use in or on one's property, has not been tested but could potentially rest on protection of the community from attracting criminal activity, such as break-ins and the like, or could rest on protection of the community or neighbors from odors or nuisances. It may also be taken care of locally through zoning

B. Condos and Mixed Use Developments.

Prohibitions on smoking inside individual residential units are more justified in the condominium setting where shared ventilation and common hallways or other physical attributes of the building make second hand "partaking" of a neighbor's pot smoke unavoidable. But again, the same arguments can be made for tobacco smoke, and most developers are disinclined to limit the marketability of their real estate product thusly. But inclusion of the right of the Owners Association's Board to enact prohibitions, such as the following, in a condominium declaration's general legal compliance clause is not uncommon:

> *Inasmuch as the use, sale or possession of marijuana is prohibited under Federal Law, the Association may adopt Rules and Regulations or other prohibitions on use, possession or distribution of recreational or medical marijuana within the Units, the Limited Common Elements or the General Common Elements.*

Such regulations may then run the spectrum from an outright prohibition, to something tailored to allow the consumption of edibles but no smoking, with substantial progressive financial penalties for repeated violations, including loss of voting privileges and injunctive remedies. For example:

> *No Unit Owner, or Unit Owner's family members, guests, invitees, tenants, employees, customers, contractors, or agents may display, transfer, distribute, sell, transport, or grow marijuana on or in the interior or exterior of the Limited and General Common Elements of the Project. Marijuana and marijuana products must be kept in an enclosed, locked place when a Unit is unattended by the Unit Owner or the Unit Owner's family members, guests, invitees, tenants, employees, customers, contractors, or agents. Marijuana and marijuana products must be disposed of off of the Project grounds. Consumption of edible marijuana products is not prohibited. However, smoking or other consumption of marijuana which results in marijuana smoke, vapors or odors by any Unit Owner, or Unit Owner's family members, guests, invitees, tenants, employees, customers, contractors, or agents within a Unit or the interior or exterior of the Project's Limited or General Common Elements, is strictly prohibited. Any violation of the foregoing shall result in a fine of the Owner by the Association of $1,000 for the first offense, $2,000 for the second offense, and $3,000 for any subsequent offense, together with loss of voting privileges of the Unit Owner for a period of one year. Nothing herein shall be deemed to preclude the Association at any time from obtaining injunctive relief and damages for any violation of the foregoing restrictions.*

Because the law is in flux, it is easier to create the right in the project's declarations to regulate through rules and regulations, than to include the prohibitions directly in the declarations. Such rules may include restrictions on smoking or use of marijuana products on limited or general common elements, and restrictions on growing plants in a unit due to

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– the City of Denver considered an ordinance prohibiting smoking in a way where odors could be detected by neighbors, but that proposal was not adopted.

the oils and odors generated.[40] And outright prohibitions on commercial dispensary, baking/cooking, and other operations due to their conflict with residential uses, their potential for nuisance, odor and crime, and other concerns may be appropriate. Further, the impact of commercial units being owned by a marijuana operation on the loans of other residential or commercial unit owners is untested but not free from concern. For mixed-use condominiums coming on line, the same concerns are present as with existing mixed-use owner associations. (See notice to a commercial unit owner denying right to lease to an edibles bakery at Exhibit F).

C. Multi-Family Properties.

Common HVAC systems, common hallways, and other common elements all present the problem of inflicting one occupant's marijuana use on other occupants. The issues are not dissimilar to those with condominium regimes, but Amendment 64 makes clear that landlords may prohibit growing and use, which many have done in part out of fear of issues with lenders.[41] (See Exhibit G Notice To Tenants of Dominion Tower in Denver). It should also be noted that HUD projects are prohibited from permitting marijuana use or growing. Indeed, per the attached directive from HUD, medical marijuana users are not permitted to occupy HUD properties through the low income voucher or other programs. See Exhibit H. Thus far, however, HUD has not required tenant evictions in Colorado, and as always seems to be the case with HUD regulations, "new HUD policies on the subject may be forthcoming soon."

X. OTHER CONSIDERATIONS

Banks, owner/landlords, tenants, developers, condominium associations, sellers and buyers face slightly different risks from many of the same issues, and in the end, few alternatives exist to eliminate those risks without eliminating the marijuana operation from the real estate altogether, or until marijuana is legalized at the federal level. Such other risks, impacts and areas of consideration beyond the scope of extensive analysis in this paper, but worthy of the practitioner's contemplation, include:

A. Buying and Selling Property.

1. Seller disclosures regarding existing or prior marijuana operations on or near the property;

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[40] The Colorado Clean Indoor Air Act effectively prohibits smoking marijuana in any location where tobacco smoking is prohibited. See C.R.S. §§25-14-201 et seq.

[41] Anecdotally, one lender recently was reluctant to place a covenant in a multi-family loan agreement regarding prohibitions on marijuana use – the property is a student apartment complex and the lender's site inspection revealed that there were more bongs than PlayStations in the units. The lender feared inclusion of the anti-marijuana covenant would put the borrower in technical default upon execution of the loan documents. This situation where rents, and therefore loan payments, are the product of the student's parents, and not the product of a marijuana-related business, may create a sufficient defense for the lender in a federal regulatory or other action. This is not a new situation for student housing.

2. Termination of unwanted marijuana-related leases limiting marketability to buyers or to other more favorable tenants;

3. Interference with federal licensing of new owners or other tenants (e.g., security clearance contracts or defense contracting businesses);

4. Medical office issues (e.g., many doctors, hospitals and medical practices can neither prescribe medical marijuana nor have any interest in the operation of medical marijuana businesses through real estate ownership or otherwise due to their federal licenses or federal funding).

B. Federal Buildings, Federal Lands and Licenses to Operate on Federal Land.

Within the federal buildings in Colorado, employees have been advised that possession and use will be governed by federal, not state, law and therefore no marijuana is allowed. Licenses to operate on federal land, such as ski areas, also carry the same concern, hence the proliferation of pot prohibition signs on the slopes. And use in the national parks, national forests, etc., is also forbidden.

C. Federal Water Projects.

As another unforeseen consequence, or another contradiction to the Obama Administration's "hands off" position on legalized marijuana, the Federal Bureau of Reclamation, whose reservoirs supply water to local water districts and municipalities, has indicated that federal project water supplies cannot be used for the growing of marijuana.[42] Specifically, the Bureau's water is not to be used in the cultivation of marijuana, and any discovery of application of such water to marijuana cultivation is to be reported to the Department of Justice.[43] The Bureau's written policy interestingly points out that while the Bureau is required not to approve the application of federal project water to marijuana cultivation, the Bureau is also not in the business of enforcing the federal drug laws (presumably intending for its watch-dog role to be fulfilled upon reporting an issue to the DOJ). The scope of sorting out commingled water rights and other issues with improper application of water is beyond the scope of this paper, but property owners should be cognizant of the possibility that water delivery for a large real estate project may be adversely affected by the improper consumption of just one tenant.

D. Securities Issues.

Curiously, it is not illegal to raise investment funds for an illegal purpose. However, in raising funds for a new real estate partnership where occupancy may involve marijuana-based businesses, attorneys and developers need to be careful to draft an entirely new set of "Risk Factors" covering a wide range of potential impacts – from insurance

[42] See Next City, *Feds to Pot Growers: Don't Water Your Plants with Our H2O*, Sarah Goodyear, May 27, 2014. http://nextcity.org/daily/entry/watering-pot-plants-legalized-marijuana-states
[43] See Bureau of Reclamation Policy Manual Temporary Release PEC TRMR-63, Expires 5.16.2016. http://www.usbr.gov/recman/temporary_releases/pectrmr-63.pdf

issues to possible seizure. More importantly, out-of-state investors are prohibited from any ownership in marijuana establishments in Colorado.[44]

E. Ethics Issues and Criminal Risk.

In adopting the modification to Rule 1.2 of the Rules of Professional Conduct earlier this year, the Colorado Supreme Court solved the ethical dilemma for Colorado attorneys working with legalized marijuana businesses in Colorado[45]. And it is unlikely based on the review of existing case law that a lawyer would be prosecuted for conspiring or aiding and abetting a federal crime simply for advising a marijuana-related client on matters clearly legal under Colorado law. But if that same client drifts into illegal territory in its conduct, licensing, lending practices or otherwise, by definition it will be difficult for the lawyer to claim he or she did not know that the marijuana dispensary or cultivation operation was illegal, or that he or she did not in some way knowingly help the business. This is the kind of limb a client can saw off behind the lawyer easily, and the lawyer is well advised to seek counsel quickly and determine whether withdrawal or other "distancing" is appropriate. [46]

And on that note …

XI. CONCLUSION

Whether the mix of metaphors includes a camel's nose, trains leaving stations, or water and bridges, it is clear that the momentum in the United States for the ultimate legalization of medical and potentially recreational marijuana is widespread and growing. Public sentiment is building for broader legalization and acceptance. In 2013, the Pew Foundation conducted a study that showed an overwhelming 72% of Americans found the costs of marijuana enforcement exceeded the benefit to society, 52% favored legalization, and 60% thought the federal government should not enforce federal criminal laws against marijuana in states where it is legal.[47]

Additionally, Congress is beginning to catch up to the sweeping social reform supporting marijuana. On June 3, 2015, the GOP-controlled House of Representatives approved a bill that would prohibit the DEA from interfering with state laws that permit the use of medical marijuana. While an amendment to prevent the DOJ from interfering with state recreational marijuana laws marginally failed, Congress appears to be showing more interest in marijuana issues.

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[44]See C.R.S. §12-43.4-306(1)(k).

[45] See Colorado Rule of Professional Conduct 1.2(14), adopted March 14, 2014.

[46] Lawyers in jurisdictions where marijuana is now legal should also beware that their Federal Rules of Professional Conduct may not be as accommodating to a marijuana practice as the State Rules of Professional Conduct. On December 1, 2014, the Colorado Federal Court refused to adopt Colorado's modifications to Rule 1.2, thereby leaving unethical in the Federal Bar the counseling of clients on marijuana matters that are illegal under federal law, regardless of their legality under Colorado law.

[47] Pew Research Center, *Majority Now Supports Legalizing Marijuana*, 2-3 (2013).

But the forward push for the marijuana industry is not without major impediments. In December, 2014, the States of Oklahoma and Nebraska filed a complaint with the Supreme Court, arguing that Colorado's legalization of marijuana caused an increase in drug crimes in their states.[48] The complaint alleges that the Colorado-sourced marijuana has caused significant cost due to increased law enforcement, judicial proceedings, and incarceration levels. In response, Colorado has asked the high Court to throw out the case, with Oregon and Washington filing a brief in support of Colorado's legalization. Currently, the Supreme Court has asked the Solicitor General, a request awkwardly falling on President Obama's new Attorney General – Loretta Lynch - to file a brief to express the government's view on the lawsuit. At this time, it is unclear whether the Court will hear the case and weigh in on the current state of marijuana legalization, but the very inquiry of the Supreme Court of the DOJ has caused many to rethink their initial reaction that the Supreme Court has no interest in the supremacy and other issues surrounding the legalization of marijuana state-by-state.

It is not this paper's intent to quibble with that national trend and suggest the sky is falling. It isn't. It is all a process – a process that played out with Prohibition and other controversial mores over our country's history. But, as with most fundamental changes in a given legal area, when one peels back the onion's layers, the change has many nuanced, complicated, far-reaching and unanticipated effects.

Marijuana legalization is complicated by the interplay and dissonance of state law, federal law, concepts of supremacy, and an informal and easily reversible "hands-off" policy announced in the waning years of the Obama Administration. A change in residents at the White House could reverse that stance and collapse the house of cards on which "legal" marijuana operations are currently built with just a phone call to the U.S. Attorney General. In the absence of a very unlikely quick legislative declassification of marijuana as a Schedule I Narcotic, conflict and uncertainty will continue.

In a down market, lenders and owners watching a property or a loan go under may be willing to take greater risks with marijuana-related tenants, thinking that "Halitosis Is Better Than No Breath At All." And in a hot market with a hot new industry begging for more space, lenders and owners may be attracted to the potential financial gains. But in so doing, those lenders, owners and their attorneys need to be aware of, and take into account, the many criminal, civil and financial risks arising from the criminal treatment of marijuana at the federal level, banks' resulting reporting requirements, and risks of loss of an owner's loans, leases and land.

[48] See *States of Nebraska and Oklahoma v. State of Colorado*, Motion for Leave to File Bill of Complaint in Original Action, U.S. Supreme Court Original Action Case No. 22O144. Original cases are typically heard by an appointed special master, not tried before the U.S. Supreme Court. It is anticipated that such a process would be followed in this original action if accepted by the Supreme Court.

EXHIBIT A

STATES WITH LEGALIZED MARIJUANA

State	Year Passed	Details
Alaska **Alaska Stat. Ann. §§17.37.010-080 (West 2012)**	1998 (ballot) (medical)	Mandatory patient registry w/ID cards for approved medical conditions; allows 1 oz. and up to 6 plants
Ballot Measure 2	2014 (ballot) (recreational)	If over 21, can buy up to an ounce (smokable) at a licensed retail store; can home-grow up to 6 plants
Arizona **Ariz. Rev. Stat. Ann. §§36-2801 to -2819 (West 2012)**	2010 (ballot)	Mandatory patient registry w/ID cards for approved medical conditions; must be bought from registered non-profit dispensary; allows 2.5 oz.; up to 12 plants
California **Cal. Health and Safety Code §11362.5 (West 2012)**	1996 (ballot)	Voluntary patient registry; home growing permitted for 8 oz.; up to 12 plants
Colorado **C.R.S. 18-18-406.3**	2000 (ballot) (medical)	Mandatory patient registry w/ID cards for approved medical conditions; allows 2 oz.; up to 6 plants
C.R.S. 12-43.4-101 et. seq.	2012 (ballot) (recreational)	If over 21, can buy up to an ounce (smokable) at a licensed retail store; can home-grow up to 6 plants
Connecticut **Conn. Gen. Stat. Ann. §21a-253 (West 2012)**	2012 (legislative)	Mandatory patient registry w/ID cards for approved medical conditions; limit of 10 producers, limited licensed dispensaries; 1 mo. supply allowed
District of Columbia **C.C. Code §§7-1671.01 to .13 (Lexis 2012)**	2010 (legislative) (medical)	Mandatory patient registry w/ID cards for approved medical conditions; no home grow, must be purchased from licensed dispensary; 2 oz. allowed
D.C. Code Ann. §48-904.01 -.05	2014 (ballot) (recreational)	If over 21, can buy up to two ounces (smokable) at a licensed retail store; can home-grow up to 6 plants
Delaware **Del. Code. Ann. tit. 16, §§4901-A-26A (West 2012)**	2011 (legislative)	Mandatory patient registry w/ID cards for approved medical conditions; no home grow, must be dispensed by licensed non-profit; 6 oz. allowed
Hawaii	2000 (legislative)	Mandatory patient registry w/ID cards for approved medical conditions; allows 3 oz., up to 7 plants

State	Year Passed	Details
Haw. Rev. Stat. Ann. §§329-121 to -128 (West 2012)		
Illinois **410 ILCS 130 (2013)**	2013 (legislative)	Mandatory patient registry w/ID cards for approved medical conditions; no home grow; allows 2.5 oz. w/in 14 days
Maine **Me. Rev. Stat. Ann. tit. 22, §§2421 to 2430-B (West 2012)**	1999 (ballot)	Voluntary patient registry; licensed dispensaries; home grow permitted; 2.5 oz.; up to 6 plants
Maryland **Md. Ann. Code §§13-3304-3316**	2014 (legislative)	Mandatory patient registry w/ID cards for approved medical conditions; limited licensed dispensaries; 30-day supply allowed
Massachusetts **MGL c. 94C, §32L-32N (20140**	2012 (ballot)	Mandatory patient registry w/ID cards for approved medical conditions; up to 35 non-profit dispensaries; 60-day supply
Michigan **Mich. Comp. Laws §§333.265421-30 (West 2012)**	2008 (ballot)	Mandatory patient registry w/ID cards for approved medical conditions; must home grow or obtain from designated caregiver limited to 5 patients; allows 2.5 oz., up to 12 plants
Minnesota **Minn. Stat. §152.22-37 (2014)**	2014 (legislative)	Mandatory patient registry w/ID cards for approved medical conditions; two state-authorized manufacturers, 4 distribution facilities; 30-day supply, non-smokable only
Montana **Mont. Code Ann. §§50-46-301 to -323 (2012)**	2004 (ballot)	Mandatory patient registry w/ID cards for approved medical conditions; provided by non-profit caregiver for no remuneration to 3 patients max; allows 1 oz., 4 plants
Nevada **Nev. Rev. Stat. Ann. §§453A.010-.810 (West 2012)**	2000 (ballot)	Patient registry w/IDs for approved medical conditions; state-authorized growers and dispensaries; allows 1 oz.; 7 plants
New Hampshire **N.H. Stat. §126-X:1-11 (2014)**	2013 (legislative)	Mandatory patient registry w/ID cards for approved medical conditions; provided by 4 alternative treatment centers; allows 2 oz. during 10-day period
New Jersey **N.J. Stat. Ann. §§24:61-1 to -16 (West 2012)**	2010 (legislative)	Mandatory patient registry w/ID cards for approved medical conditions resistant to conventional medical treatment; provided by 6 centers in 3 regions, first 2 centers required to be non-profit; allows 2 oz.
New Mexico	2007 (legislative)	Mandatory patient registry w/ID cards for approved medical conditions; provided by

State	Year Passed	Details
N.M. Stat. Ann. §§26-2B-1 to -7 (West 2012)		licensed non-profit growers caring for max of 4 patients; home-growing by license; permits 6 oz., 16 plants
New York N.Y. Pub. Health Law §§ 3360-3369E	2014 (legislative)	Mandatory patient registry w/ID cards for approved medical conditions; 30-day supply, non-smokable only
Oregon Or. Rev. Stat. Ann. §§475.300-.346 (West 2012)	1998 (ballot) (medical)	Mandatory patient registry w/ID cards for approved medical conditions; allows home growing; state-licensed dispensaries; allows 24 oz., 24 plants
Measure 91	2014 (ballot) (recreational)	If over 21, can buy up to an ounce (smokable) at a licensed retail store; can home-grow up to 4 plants
Rhode Island R.I. Gen. Laws Ann. §§21-28.6-1 to -13 (West 2012)	2006 (legislative)	Mandatory patient registry w/ID cards for approved medical conditions; state-authorized non-profit producers/dispensers; permits home growing; allows 2.5 oz., 12 plants
Vermont Vt. Stat. Ann. tit. 18, §§4472-74L (West 2012)	2004 (legislative)	Mandatory patient registry w/ID cards for approved medical conditions; 4 non-profit dispensaries authorized; allows 2 oz., 9 plants
Washington Wash. Rev. Code Ann. §§69.51A.005-.903 (West 2012)	1998 (ballot) (medical)	No registry; no dispensaries; home grown or provided by caregiver, or purchased from recreational licensed retailer; allows 24 oz., 15 plants
Initiative 502	2012 (ballot) (recreational)	If over 21, can buy up to an ounce (smokeable), 16 oz. infused in solid, or 72 oz. infused in liquid at a licensed retail store; no home-growing

STATES WITH LEGALIZED MARIJUANA LIMITED TO CANNIBIDIOL

State	Year Passed	Details
Alabama **S. 174**	2014	Calls for the University of Alabama to conduct research into cannibidiol's efficacy in treating neurological conditions.
Florida **H.R. 843**	2014	Permits "four regional organizations around the state" to grow and dispense cannibidiol for seizures, Parkinson's, Alzheimer's, and PTSD.
Georgia **H.R. 1**	2015	Permits cannibidiol for eight neurological conditions, including seizures, cancer, MS, and ALS.
Iowa **S. 1243**	2014	Limited to patients with epilepsy or other seizure disorders, allows possession of six-month supply. Calls for a University of Iowa study of cannabidiol.
Kentucky **S. 124**	2014	Permits state medical schools to conduct research into cannabidiol oil.
Mississippi **H.R. 1231**	2014	Permits cannibidiol for the treatment of sever epileptic conditions.
Missouri **H.R. 2238**	2014	Establishes a system for non-profit applicants to produce the oil under guidelines.
North Carolina **H.R. 1220**	2014	Permits a trial study of cannibidiol by four state universities.
Oklahoma **H.R. 2154**	2015	Establishes a medical pilot program using cannabidiol.
South Carolina **H.R. 4803**	2014	Permits clinical trials by the University of South Carolina.
Tennessee **H.R. 197**	2015	Directs the Tennessee Tech University to study the efficacy of cannabidiol use to prevent seizures.
Texas **H.R. 892**	2015	Allows cannabidiol to treat epilepsy in children.
Utah **H.R. 105**	2014	Instructs the Department of Agriculture to grow low-THC hemp for to produce cannabis oil. Allows Utah residents to acquire the medicine in Colorado and bring it back to Utah.
Virginia **S. 1235**	2015	Prevents the prosecution of patients who use cannabis oil for seizure-related conditions.
Wisconsin **Assemb. 726**	2014	Allows cannabidiol use for seizures in children.

STATES WITH LEGALIZED MARIJUANA LIMITED TO HEMP[49]

State	Year Passed	Details
Indiana **S. 357**	2014	Authorizes industrial hemp subject to federal approval.
Nebraska **Leg. 1001**	2014	Charges the Department of Agriculture to research the plant and its uses.
North Dakota **H.R. 1436**	2015	Legalizes industrial hemp containing no greater than three percent of THC.
West Virginia **S. 237**	2015	Legalizes industrial hemp containing no greater than one percent of THC.

[50]

[49] Visit http://www.celebstoner.com/news/marijuana-news/2014/03/13/four-states-on-verge-of-passing-cbd-only-laws/ for more information.

[50] Visit http://www.ncsl.org/research/agriculture-and-rural-development/state-industrial-hemp-statutes.aspx for more information.

EXHIBIT B

SAMPLE DEFAULT NOTICE

RE: Notice of Default for Violation of Applicable Law
Loan No: ____________________ (the "Loan")
Borrower: _______________________ ("You" or "Borrower")

Dear _____________:

This letter is to notify you of the determination by ___________ ("Lender") that your leasing of space to a marijuana dispensary in real property pledged by you as collateral for the Loan constitutes an Event of Default under the Loan. In particular, it has come to our attention that certain space (the "Leased Premises") located at _____[address] _______ (the "Pledged Property") is leased by you to a marijuana dispensary and that proceeds of that operation may be paid to you as rent or other remuneration.

The operation of a marijuana dispensary in the Leased Premises located in _________, Colorado, violates the Federal laws of the United States of America, notwithstanding the State of Colorado making such operations legal under state law. Congress has determined that marijuana is a controlled substance under the Controlled Substances Act, 21 U.S.C. 801 et seq., and as such, growing, distributing, and possessing marijuana in any capacity other than as part of a federally authorized research program, is a violation of Federal law regardless of state laws permitting such activities. Further, in the case of *United States v. Oakland Cannabis Buyers' Cooperative,* 532 U.S. 483 (2001), the United States Supreme Court held that there is no medical necessity exception to the prohibitions on manufacture and distribution of marijuana established by the Federal Controlled Substances Act.

The Loan Agreement governing the Loan, including but not limited to Section ____ thereof, and the Deed of Trust for the Pledged Property, including but not limited to Section _____ thereof, provide that Borrower shall comply with all laws, ordinances, regulations, and standards that affect the Pledged Property. The operation of a marijuana dispensary within any portion of the Pledged Property is a breach of the terms of the Loan Agreement and Deed of Trust by virtue of its violation of federal law.

The Federal Drug Enforcement Administration and the United States Attorney's Office have relied upon the above referenced federal court decision to bring legal actions to close marijuana dispensaries in spite of the state laws permitting same. In bringing these actions the U.S. Attorney's Office has used the government's forfeiture powers under 21 U.S. Code § 881 and 18 U.S. Code § 981 to seek forfeiture of the real property where the marijuana dispensary is operated, including forfeiture of any security interests held in the real property by lenders. Consequently, the operation of a marijuana dispensary on the Pledged Property creates a risk that Lender may lose its security for the Loan in the event of a

forfeiture proceeding by the U.S. Attorney's office. This is not a risk that Lender can reasonably accept.

The Loan Agreement and Deed of Trust each provide that the waiver by, or failure of, Lender to enforce any provision at a particular time does not waive the right of Lender to enforce such provision at a later date. Therefore, we request that you cause the termination of the Lease and the full vacation of the illegal activity from the Leased Premises on or before June 30, 2013 pursuant to Section _______________ of the Loan Agreement and Section _____ of the Deed of Trust. If you do intend to take action to terminate the Lease or the operation of the marijuana dispensary on the Property, it is imperative that you inform me in writing, and no later than ten days after the date of this letter, as to what steps you are taking to cure this Default and terminate the operations of the dispensary. If satisfactory steps are not being taken, then Lender will take such action as it deems necessary to protect its security interest in the Pledged Property .

To the extent Borrower has failed to comply with certain other provisions of the Loan Agreement, Deed of Trust, or any other Loan Document as defined in the Loan Agreement, Lender does not waive such defaults and expressly reserves its right to enforce the same.

EXHIBIT C

SAMPLE LOAN COVENANT

Compliance with Controlled Substances Laws.

1. Borrower shall not enter into, consent to or permit any lease, sublease, license or other agreement relating to, or otherwise permit the use or occupancy of, the Property for a Controlled Substances Use or in any manner that violates or could violate any Controlled Substances Laws, including, without limitation, any business, communications, financial transactions or other activities related to Controlled Substances or a Controlled Substances Use that violate or could violate any Controlled Substances Laws (collectively, "Drug-Related Activities").

2. Borrower [and its Affiliates] shall not engage in any Drug-Related Activities.

3. Borrower shall not make any payments to Lender from funds derived from Drug-Related Activities.

4. Borrower shall provide to Lender, from time to time, within (_) ___ days after Lender's request therefor, any information that Lender reasonably requests, relating to compliance with this Section.

5. Borrower shall include in all leases and other agreements for use and occupancy of the Property, provisions that (i) prohibit any Controlled Substances Use or Drug-Related Activities on the Property and (ii) permit the Lender to make physical inspections of the Property upon the request of the Lender.

6. Lender shall be permitted to make physical inspections of the Property to assure compliance with the provisions of this Section from time to time [upon __ days' prior written notice to Borrower].

7. For purposes of this Section, (i) "Controlled Substances Laws" means the Federal Controlled Substances Act (21 U.S.C. §801 et seq.) or any other similar or related federal, state or local law, ordinance, code, rule, regulation or order; (ii) "Controlled Substances" means marijuana, cannabis or other controlled substances as defined in the Federal Controlled Substances Act or that otherwise are illegal or regulated under any Controlled Substances Laws; and (iii) "Controlled Substances Use" means any cultivation, growth, creation, production, manufacture, sale, distribution, storage, handling, possession or other use of a Controlled Substance.

8. **The provisions of this Section shall apply notwithstanding any state or local law permitting the Controlled Substances Use or Drug-Related Activities.**

9. Notwithstanding any provision in any Loan Document to the contrary, no direct or indirect disclosure by Borrower to Lender or any person affiliated with Lender, and no knowledge of the Lender or any person affiliated with the Lender, of the existence of any Drug Related Activities or Controlled Substance Use on, in or about the Property shall estop Lender or waive any right of Lender to invoke any remedy under the Loan Documents for violation of any provision hereof related to the prohibition of any Drug Related Activities or Controlled Substances Use on, in or about the Property. The foregoing shall apply notwithstanding the receipt or execution of an Estoppel Certificate or a Subordination, Non-Disturbance or Attornment Agreement or other document from or with any tenant of Borrower engaged in such prohibited activity.

EXHIBIT D

SAMPLE LEASE COVENANTS

PROHIBITION CLAUSE:

Compliance with Controlled Substances Laws.

1. Notwithstanding any provision in this Lease to the contrary, any course of conduct between the parties or any acquiescence by Landlord or its agents, Tenant shall not directly use or occupy the Premises in any manner for a Controlled Substances Use or in any manner that violates or could violate any Controlled Substances Laws, including, without limitation, any business, communications, financial transactions or other activities related to Controlled Substances or a Controlled Substances Use that violate or could violate any Controlled Substances Laws (collectively, "Drug-Related Activities").

2. Tenant shall not engage in any Drug-Related Activities.

3. Tenant shall not make any payments to Landlord from funds derived from Drug-Related Activities.

4. Tenant shall provide to Landlord and Landlord's lender, from time to time, within (_) ___ days after Landlord's or Landlord's lender's request therefor, any information that they may reasonably request, relating to compliance with this Section.

5. Tenant shall permit the Landlord and the Landlord's lender to make physical inspections of the Property upon the request of the Landlord or the Landlord's lender to assure compliance with the provisions of this Section from time to time [upon __ days' prior written notice to Tenant/at any time during Tenant's business hours].

6. For purposes of this Section, (i) "Controlled Substances Laws" means the Federal Controlled Substances Act (21 U.S.C. §801 et seq.) or any other similar or related federal, state or local law, ordinance, code, rule, regulation or order; (ii) "Controlled Substances" means marijuana, cannabis or other controlled substances as defined in the Federal Controlled Substances Act or that otherwise are illegal or regulated under any Controlled Substances Laws; and (iii) "Controlled Substances Use" means any cultivation, growth, creation, production, manufacture, sale, distribution, storage, handling, possession or other use of a Controlled Substance.

7. The provisions of this Section shall apply notwithstanding any state or local law permitting the Controlled Substances Use or Drug-Related Activities.

8. Notwithstanding any provision in this Lease or any other document or communication related thereto, to the contrary, no direct or indirect disclosure by Tenant to Landlord or any person affiliated with Landlord, and no knowledge of the Landlord's lender or any person affiliated with the Landlord, of the existence of any Drug Related Activities or Controlled Substance Uses on, in or about the Premises shall preclude or estop

Landlord or be deemed to constitute a waiver of any right of Landlord to invoke any remedy under this Lease for violation of any provision hereof related to the prohibition of any Drug Related Activities or Controlled Substance Use on, in or about the Premises. The foregoing shall apply notwithstanding the receipt or execution by Tenant, Landlord, and/or Landlord's lender of an Estoppel Certificate or a Subordination, Non-Disturbance or Attornment Agreement or other document.

TERMINATION CLAUSE:

Notwithstanding any provision in this Lease to the contrary, Landlord shall have the right in Landlord's sole discretion, upon thirty (30) days' notice, to terminate this Lease with no further liability to Tenant in the event of:

(i) Tenant or any occupant of the Premises is engaged in Drug Related Activities on or about the Premises,

(ii) any federal, state or local criminal, administrative, or other enforcement action, or

(ii) any demand for compliance, notice of default or acceleration, or similar action by Landlord's lender,

related to Tenant's business or the Premises arising from the operation of the Premises for the cultivation, growth, creation, production, manufacture, sale, distribution, storage, handling, possession or other use of any marijuana- or cannabis-related product or service or other conduct or other use of the Premises in any manner for a Controlled Substances Use or in any manner that violates or could violate any Controlled Substances Laws, including, without limitation, any business, communications, financial transactions or other activities related to Controlled Substances or a Controlled Substances Use that violate or could violate any Controlled Substances Laws (collectively, "Drug-Related Activities"). For purposes of this Paragraph, (i) "Controlled Substances Laws" means the Federal Controlled Substances Act (21 U.S.C. §801 et seq.) or any other similar or related federal, state or local law, ordinance, code, rule, regulation or order; (ii) "Controlled Substances" means marijuana, cannabis or other controlled substances as defined in the Federal Controlled Substances Act or that otherwise are illegal or regulated under any Controlled Substances Laws; and (iii) "Controlled Substances Use" means any cultivation, growth, creation, production, manufacture, sale, distribution, storage, handling, possession or other use of a Controlled Substance. **The provisions of this Paragraph shall apply notwithstanding any state or local law permitting the Controlled Substances Use or Drug-Related Activities.**

EXHIBIT E

DESTRAINT NOTICE

BEFORE THE EXECUTIVE DIRECTOR, DEPARTMENT OF REVENUE
STATE LICENSING AUTHORITY
STATE OF COLORADO

NOTICE OF ADMINISTRATIVE HOLD PURSUANT TO RULE M 1202(B)

IN THE MATTER OF:

JMMP Enterprises, Inc.
d/b/a Grateful Meds
110 Snyder Street
Nederland, Colorado 80466
Medical Marijuana Center License Application No. 402-00496

JMMP Enterprises, Inc.
d/b/a Grateful Meds
2640 East 43rd Avenue
Denver, Colorado 80216
Optional Premises Cultivation Facility License Application No. 403-00733

Applicant.

PLEASE TAKE NOTICE THAT following the inspection of the business known as JMMP Enterprises, Inc., d/b/a Grateful Meds ("Applicant"), with a medical marijuana center (application number 402-00496) located at 110 Snyder Street, Nederland, Colorado and optional premises cultivation facility (application number 403-00733) located at 2640 East 43rd Avenue, Denver, Colorado, the Department of Revenue, State Licensing Authority, Marijuana Enforcement Division ("Division") has developed reasonable grounds to believe that Applicant possesses certain marijuana or marijuana-infused products that constitute evidence of acts in violation of the Colorado Medical Marijuana Code, article 43.3 of title 12, and rules promulgated pursuant to it, or otherwise constitute a threat to the public safety.

THEREFORE, to prevent the destruction of evidence, diversion, or other threats to the public safety, the Division hereby issues this Notice of Administrative Hold ("Administrative Hold") pursuant to Rule 1202(B), 1 CCR 212-1 (2013). The Administrative Hold is effective immediately and shall remain in effect until administratively lifted by the Division or modified by Final Agency Order.

INVENTORY SUBJECT TO THE ADMINISTRATIVE HOLD

The attached Exhibit A sets forth the marijuana and marijuana-infused products subject to this Administrative Hold (the "Subject Inventory").

TERMS AND CONDITIONS OF ADMINISTRATIVE HOLD:

Applicant is hereby ORDERED and required to adhere to the following terms and conditions of this Administrative Hold.

1. This Administrative Hold is effective immediately upon receipt of this Administrative Hold by Applicant.
2. Applicant shall retain the Subject Inventory during the pendency of this Administrative Hold.
3. Applicant must comply with the inventory tracking requirements pursuant to the Division's rules and regulations during the period of this Administrative Hold.
4. Applicant shall completely and physically segregate the Subject Inventory in a limited access area of the premises where it shall be safeguarded by Applicant.
5. This Administrative Hold shall not prevent Applicant from continued cultivation or harvesting of the Subject Inventory.
6. If applicable, the Subject Inventory shall be put into separate Harvest Batches.
7. Applicant during the pendency of this Administrative Hold is prohibited from selling, giving away, transferring, transporting, or destroying the Subject Inventory.
8. Nothing herein shall prevent Applicant from entering into a mutual agreement with the Division to voluntarily surrender the Subject Inventory, upon a full and knowing waiver of rights. Such voluntary surrender may require destruction of the Subject Inventory in the presence of a Division investigator or surrender of possession of the Subject Inventory to a Division investigator for future destruction.

CERTIFICATION BY THE DIVISION

I, Henry J. Hasler, Investigator for the Division certify the following:

1. An Investigation was conducted of the marijuana business(es) identified in the attached Exhibit A.
2. A description of the Subject Inventory is set forth in Exhibit A.
3. Reasonable grounds exist to believe that the Subject Inventory constitutes evidence of acts in violation of the Colorado Medical Marijuana Code and rules promulgated pursuant to it, or otherwise constitute a threat to the public safety.

4. A copy of the Administrative Hold was issued with a Notice of Denial sent to the marijuana business(es) identified in Exhibit A.

APPROVED and ORDERED this 1st day of April, 2014. Investigator for the Division: By: [signature]	

DEPARTMENT OF REVENUE
STATE LICENSING AUTHORITY
MARIJUANA ENFORCEMENT DIVISION
STATE OF COLORADO

INVENTORY LIST

Name/DBA	Physical Address	City/State/ZIP
JMMP Enterprises, Inc. d/b/a Grateful Meds	110 Snyder Street	Nederland, CO 80466
	2640 East 43rd Avenue	Denver, CO 80216
Applicant/Licensee Name	**Mailing Address**	**City/State/ZIP**
JMMP Enterprises, Inc.	3773 Cherry Creek North Drive, #575	Denver, CO 80209

MED Investigator/Name	Date of on-site Inventory Inspection	Application/License Numbers
H. Hasler		402-00496 and 403-00733

SECTION 1 MITS INVENTORY

- ☐ MITS inventory printout attached. Date printed ________________.
- ☐ MITS inventory confirmed via on-site inspection.

SECTION 2 ON-SITE INVENTORY *

Inventory Description	Quantity	Weight/Serial Number	Other

* Additional Inventory page(s) may follow the signature block

EXHIBIT A
Administrative Hold

HH Initials – Marijuana Enforcement Division

DEPARTMENT OF REVENUE
STATE LICENSING AUTHORITY
MARIJUANA ENFORCEMENT DIVISION
STATE OF COLORADO

Investigation Number________

☐ **THE INVENTORY LISTED IN SECTIONS 1 AND/OR 2 IS SUBJECT TO AN <u>ADMINISTRATIVE HOLD</u>.**

☒ **<u>ALL MARIJUANA AND MARIJUANA-PRODUCT INVENTORY</u> RELATED TO BUSINESS APPLICATION NUMBERS 402-00496 AND 403-00733 IS SUBJECT TO AN <u>ADMINISTRATIVE HOLD</u>.**

The Applicant or Licensee must comply with the inventory tracking requirements pursuant to State Licensing Authority rules during the period of administrative hold.

For the Division:	
By: [signature]	
Date: 4/1/2014	

[initials] Initials – Marijuana Enforcement Division

STATE OF COLORADO

DEPARTMENT OF REVENUE
State Capitol Annex
1375 Sherman Street, Room 409
Denver, Colorado 80261
Phone (303) 866-3091
Fax (303) 866-2400

John J. Hickenlooper
Governor

Barbara J. Brohl
Executive Director

April 3, 2014

JMMP Enterprises, Inc.
d/b/a Grateful Meds
110 Snyder Street
Nederland, Colorado 80466

JMMP Enterprises, Inc.
d/b/a Grateful Meds
2640 East 43rd Avenue
Denver, Colorado 80216

JMMP Enterprises, Inc.
d/b/a Grateful Meds
3773 Cherry Creek North Drive, #575
Denver, Colorado 80209

David Furtado
3773 Cherry Creek North Drive, #575
Denver, Colorado 80209

Robert Gimenez
11711 Chambers Drive
Commerce City, Colorado 80022

Gerardo Uribe
816 Acoma Street
Denver, Colorado 80204

NOTICE OF DENIAL

Re: Business Application Numbers: 402-00496 and 403-00733
Associated Key Application Numbers: M07421 and M07420

Dear Mr. Furtado, Mr. Gimenez, Mr. Uribe, and JMMP Enterprises, Inc.:

The Department of Revenue's Executive Director ("State Licensing Authority") has reviewed your applications to operate a medical marijuana center (application number 402-00496), an optional premises cultivation facility (application number 403-00733), and Mr. Furtado's and Mr. Gimenez's applications for associated key licenses (application numbers M07421 and M07420). The State Licensing Authority has **DENIED** your license applications for good cause as defined in subsection 12-43.3-104(1), C.R.S., and/or section 12-43.3-307, C.R.S. The grounds for denial include, but are not limited to[1], the following:

[1] If a hearing is requested in this matter, the Notice of Grounds for Denial may include some or all of the allegations contained herein, and may contain additional allegations if warranted after further review.

On October 16, 2013, at the time of inspection of your medical marijuana center located at 110 Snyder Street, Nederland, Colorado, you failed to apply for and receive a permit from the Division for a change of location of your business prior to changing the location of your business in violation of Rule M 206, 1 CCR 212-1 (2013); you failed to notify the Marijuana Enforcement Division ("Division") at least forty-eight hours in advance of abandoning your premises or otherwise ceasing operations and without accounting for and forfeiting to the Division for destruction all marijuana or products containing marijuana in violation of subsection 12-43.3-901(4)(o), C.R.S.; you failed to file necessary applications to alter or modify your premises with the Division pursuant to Rule M 303(A), 1 CCR 212-1 (2013); and you failed to obtain approval from the Division prior to subletting any portions of your premises in violation of Rule M 302(C), 1 CCR 212-1 (2013).

On October 26, 2013, at the time of inspection of your optional premises cultivation facility located at 2640 East 43rd Ave., Denver, Colorado, you failed to describe all limited access areas by the filing of a diagram of your premises in violation of Rule M 301(D), 1 CCR 212-1 (2013); you failed to maintain camera coverage of areas where medical marijuana is grown, tested, cured, manufactured, or stored in violation of Rule M 306(C)(6), 1 CCR 212-1 (2013); you failed to maintain a log of all activity for the surveillance room and a current list of employees and service personnel authorized to access the surveillance room in violation of Rule M 306(D)(3), 1 CCR 212-1 (2013); you employed or contracted to perform work for your business individuals without a valid license issued by the Division in violation of Rules M 231(C)(9) and 233(B), 1 CCR 212-1 (2013); and you employed another person at a medical marijuana facility who had not passed a criminal history check in violation of section 12-43.3-307(1)(i), C.R.S.

On December 18, 2013, at the time of inspection of your medical marijuana center located at 110 Snyder Street, Nederland, Colorado, you failed to complete, maintain, or make available records necessary to demonstrate business transactions for inspection by the Division in violation of section 12-43.3-701, C.R.S. and Rule M 901(A), 1 CCR 212-1 (2013); your center indicated it had patients authorized for more than six medical marijuana plants and two ounces of medical marijuana, however, you failed to provide documentation from the patients' physicians evidencing the patients needed more than six plants and two ounces of product in violation of subsection 12-43.3-901(4)(e), C.R.S.; you failed to maintain surveillance recordings for a minimum of forty (40) days in violation of Rule M 306(E)(2), 1 CCR 212-1 (2013); and you failed to have a security alarm system installed by an alarm installation company on all perimeter entry points and perimeter windows in violation of Rule M 305(A)(1), 1 CCR 212-1 (2013).

In addition, you failed to have a MITS account activated and functional for both your medical marijuana center and optional premises cultivation facility on or before December 31, 2013 in violation of Rules M 309(A) and 406, 1 CCR 212-1 (2013); you failed to report each transfer or change of financial interest in the business to the Division in violation of Rule M 205(A)(1), 1 CCR 212-1 (2013); you failed to file with the Division applications and fees for transfers of ownerships in violation of rule M 205(A)(2), 1 CCR 212-1 (2013); and you failed to apply for and receive a permit from the Division for a change of location of your business prior to changing the location of your business in violation of Rule M 206, 1 CCR 212-1 (2013).

You have operated the licensed premises[2] in a manner that adversely affects the public health or welfare or the safety of the immediate neighborhood in which your establishments are located in violation of subsection 12-43.3-104(1)(c), C.R.S. Moreover, you have cultivated, manufactured, distributed, and sold medical marijuana in a manner not in compliance with article 43.3 of title 12 in violation of subsection 12-43.3-102(2), C.R.S.

Based on the foregoing grounds for denial of your medical marijuana center application, your optional premises cultivation facility license, application number 403-00733, related to your medical marijuana center application cannot be issued pursuant to subsections 12-43.3-401(1) and 12-43.3-403(1), C.R.S, and your associated key license applications cannot be issued with regard to business application numbers 402-00496 and 403-00733 pursuant to Rules M 103 and 204, 1 CCR 212-1 (2013), and subsection 12-43.3-401(1), C.R.S.

Pursuant to subsection 24-4-104(9), C.R.S., you have the right to request a hearing regarding the denial of your applications. In order to exercise this right, you must deliver a request for a hearing in writing to the **Marijuana Enforcement Division, 455 Sherman Street, Suite 390, Denver, CO 80203** within **sixty (60) days** from the certified date of service of this letter. A request for a hearing received after that date, as determined by the date stamp by the Marijuana Enforcement Division, will not be considered. Additionally, verbal or email requests will not be considered.

If you request a hearing, you have the right to have an attorney represent you at the hearing at your expense, to present any relevant and admissible evidence on your behalf, rebut any evidence presented against you, and cross-examine any witnesses testifying against you. In a hearing, you will bear the burden of proof to demonstrate by a preponderance of the evidence that you are qualified to hold the licenses for which you have been denied.

If you choose, you may ask to withdraw your applications. If you wish to request that your applications be withdrawn at this time, please inform the Marijuana Enforcement Division in writing as soon as possible but no later than **thirty (30) days** from the date of this letter. Asking to withdraw your application does not extend the time within which you must request a hearing; as stated above, any request for a hearing must be in writing and received by the Marijuana Enforcement Division within **sixty (60) days** of the certified date of service of this letter.

The Division has placed all marijuana plants, marijuana, finished marijuana products, marijuana-infused products or other marijuana inventory within your possession and control related to business application numbers 402-00496 and 403-00733 on administrative hold pursuant to Rule M 1202, 1 CCR 212-1 (2013) and subsection 12-43.3-103(2)(c), C.R.S. The Notice of Administrative Hold dated April 1, 2014 is enclosed.

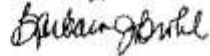
Please note that neither the State Licensing Authority nor the Marijuana Enforcement Division is able to provide you with legal advice. If you have questions as to how to proceed legally, please consult with an attorney.

---

[2] The term licensed premises is used as defined in Rule M 103, 1 CCR 212-1 (2013). *See also* § 12-43.3-103(2)(c), C.R.S., regarding an operating applicant's requirement to follow all rules promulgated pursuant to the Medical Marijuana Code, sections 12-43.3-101 *et seq*, C.R.S.

Should you have any other type of question regarding this letter or the State Licensing Authority's decision, you may contact the attorneys for the Marijuana Enforcement Division, Assistant Attorneys General John Viverito at john.viverito@state.co.us or Kelly Rosenberg at kelly.rosenberg@state.co.us.

Sincerely,



Barbara J. Brohl
Executive Director
Department of Revenue
State Licensing Authority

EXHIBIT F

HOA OBJECTION LETTER

Alison E. Eastley
(970) 925-3476
aeeastley@hollandhart.com
08861.0032

May 9, 2014

VIA EMAIL
HOA
c/o, President

Re: Proposed Retail Marijuana Products Manufacturing in HOA Building

Dear President:

Thank you for sharing information with us regarding Mr. OWNER'S proposal to lease Condominium Unit 121, as a "commercial marijuana infused bakery."

On behalf of the "Association", you have asked us to provide you with our comments on the legal issues associated with retail marijuana licensing and the special issues that arise from marijuana based activities in a mixed-use condominium project such as the HOA Building.

As you know, a recent amendment to the Colorado Constitution authorizes the operation of licensed retail marijuana facilities and provides municipalities with the authority to prohibit or regulate marijuana establishments within their respective jurisdictions. The City of Aspen regulates and licenses all types of retail marijuana facilities, including retail marijuana products manufacturing facilities. The City of Aspen presently allows retail marijuana products manufacturing facilities within the SCI (Service/Commercial/Industrial) zone district, the zone district in which the HOA Building is located. For your reference, a retail marijuana products manufacturing facility may purchase marijuana and manufacture, prepare and package marijuana products, and sell these products to other marijuana stores, but not to consumers.

Despite authorization at the state and local levels, the Federal Controlled Substances Act still bans the cultivation, sale, use, and possession of marijuana for recreational purposes. Until that law is changed, selling marijuana *and* aiding and abetting such sales remain illegal. Any approval by the Association of a "commercial marijuana infused bakery" or the attendant modifications to the existing HVAC system to accommodate such use subjects the Association to potential liability for aiding and abetting marijuana sales.

Furthermore, the Association's Condominium Declaration prohibits any use, in a condominium unit *or* any common elements, that violates federal law *or* results in the increase or cancellation of insurance maintained by the Association. The federally

regulated insurance and financial systems are loathe to provide insurance coverage or loans to persons committing illegal acts *or* facilitating and assisting illegal activity. So, a "commercial marijuana infused bakery" not only violates the Condominium Declaration as a result of its violation of federal law but also uses common element ventilation, air conditioning, piping, and parking that arguably subjects other Association condominium unit owners to a risk of insurance premium increases, insurance coverage issues, and/or reluctant mortgage lenders.

Finally, the Condominium Declaration provides the Executive Board with the authority to regulate and restrict uses that are deemed by the Board to constitute a nuisance or adversely affect the health, safety, and welfare of the condominium unit owners and occupants. Retail marijuana products manufacturing presents a special hazard, as production of hash oil (which is a permitted activity under Colorado law for these kinds of manufacturers) and problems with proper ventilation have led to numerous fire incidents in Colorado. All kinds of marijuana operations may attract criminal mischief, potentially subjecting other condominium unit owners and occupants to thefts and break-ins. As crime rates increase, project-wide real estate values diminish. Finally, the odor attributable to a retail marijuana product manufacturing facility may unreasonably interfere with other condominium unit owners and occupants' use and enjoyment of their units.

Based on the forgoing, we are of the opinion that it is in the best interests of the Association for the Executive Board to oppose Mr. OWNER's proposal to lease Unit 121 for use as a commercial marijuana infused bakery.

Please call if you have any questions or would like to discuss this matter further.

Sincerely yours,

Alison E. Eastley
for Holland & Hart LLP

AEE:aee

cc: Thomas Todd, Esq., *via email*

6860433_1.DOCX

EXHIBIT G

LANDLORD NOTICE

CALLAHAN
MANAGEMENT

Dominion Towers
600 17th Street
Denver, CO 80202
Tel: 303 628 1130
Fax: 303 628 1120

January 27, 2014

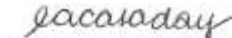
RE: Dominion Towers Marijuana Policy
600 17th Street
Denver, CO 80202

To our Valued Tenants:

As you probably know, Colorado voters approved an amendment to the Colorado Constitution, Article XVII, Section 16, commonly known as "Amendment 64." Amendment 64 allows property owners and landlords to prohibit the possession and use of all types of marijuana on their property. Your Landlord has chosen to prohibit the possession, consumption, display, sale, transportation, cultivation and use of all types of marijuana within the entirety of Dominion Towers and this letter serves as notice that the Rules and Regulations for Dominion Towers are hereby deemed amended to prohibit all such activities. This prohibition applies to the entirety of Dominion Towers including the office tower, parking garage and all common areas including the open plaza on 17th Street, Welton Street and your premises. Amendment 64 also prohibits marijuana use on public sidewalks and various ordinances passed by the City and County of Denver make it illegal to consume marijuana in city parks or to consume, display or transfer marijuana on the 16th Street Mall or in public parks. Finally, the possession and use of marijuana remains illegal for all purposes under federal law and thus any such use or possession within Dominion Towers would constitute a violation of your lease.

Should you have any questions about this policy, please do not hesitate to contact me at staci.casaday@callahan-management.com or via phone at 303.628.1130.

Sincerely,



Staci Casaday, LEED AP O+M
General Manager

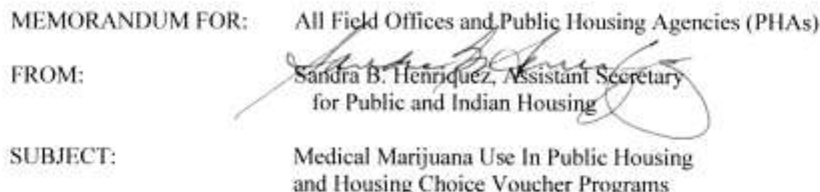
EXHIBIT H

HUD LETTER

U.S. DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT
WASHINGTON, DC 20410-5000

ASSISTANT SECRETARY FOR
PUBLIC AND INDIAN HOUSING

February 10, 2011



MEMORANDUM FOR: All Field Offices and Public Housing Agencies (PHAs)

FROM: Sandra B. Henriquez, Assistant Secretary for Public and Indian Housing

SUBJECT: Medical Marijuana Use In Public Housing and Housing Choice Voucher Programs

Overview

The Department has recently received numerous inquiries regarding the use of medical marijuana[1] in the Public Housing (PH) and Housing Choice Voucher (HCV) programs[2]. This memorandum intends to serve as guidance for field offices and PHAs on admissions, continued occupancy, and termination policies in states that have enacted laws that allow the use of medical marijuana. Currently fourteen states (Alaska, California, Colorado, Hawaii, Maine, Michigan, Montana, Nevada, New Jersey, New Mexico, Oregon, Rhode Island, Vermont, and Washington) and the District of Columbia have laws that legalize medical marijuana use.

New Admissions

Based on federal law, new admissions of medical marijuana users are prohibited into the PH and HCV programs. The Controlled Substances Act (CSA) lists marijuana as a Schedule I drug, a substance with a very high potential for abuse and no accepted medical use in the United States. The Quality Housing and Work Responsibility Act (QHWRA) of 1998 (42 U.S.C. §13661) requires that PHAs administering the Department's rental assistance programs establish standards and lease provisions that prohibit admission into the PH and HCV programs based on the illegal use of controlled substances, including state legalized medical marijuana. State laws that legalize medical marijuana directly conflict with the admission requirements set forth in QHWRA and are thus subject to federal preemption.

Current Residents

For existing residents, QHWRA requires PHAs to establish occupancy standards and lease provisions that will allow the PHA to terminate assistance for use of a controlled substance. However, the law does not compel such action and PHAs have discretion to determine continued occupancy policies that are most appropriate for their local communities. PHAs can also determine whether to deny assistance to or terminate individual medical marijuana users, rather than entire households, for both applicant and existing residents when appropriate. PHAs have discretion to determine, on a case-by-case basis, the appropriateness of program termination of existing residents for the use of medical marijuana.

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[1] The Department defines medical marijuana as marijuana which, when prescribed by a physician to treat a serious illness such as AIDS, cancer, or glaucoma, is legal under State law.

[2] Housing Choice Voucher programs include tenant-based vouchers and project-based vouchers.

PHAs in states that have enacted laws legalizing the use of medical marijuana must therefore establish a standard and adopt written policy regarding whether or not to allow continued occupancy or assistance for residents who are medical marijuana users. The decision of whether or not to allow continued occupancy or assistance to medical marijuana users is the responsibility of PHAs, not of the Department.

Food and Drug Administration Approved Drugs

PHAs should also be aware that the Food and Drug Administration (FDA) has approved drugs for medical uses which are comprised of marijuana synthetics, such as Marinol and Cesamet. These drugs are not medical marijuana and are legal under federal laws. These products have been through the FDA's rigorous approval process and have been determined to be safe and effective for their indications. They are therefore allowed in the public housing and voucher programs.

Thank you for your partnership and participation in the Department's programs, and for your attention to this important issue in providing quality housing and communities for all residents of public housing and voucher programs. Questions regarding this memorandum may be directed to Ms. Diane Yentel at 202-402-6051 or Diane.E.Yentel@hud.gov.