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Brian A. Haskel

Cannabis – Real estate and related legal concerns

A majority of states in the United States permit the regulated sale of cannabis products. The federal government does not, with the exception of Epidiolex, which the FDA recently approved for the treatment of two rare and severe forms of epilepsy. In fact, at the federal level cannabis is in the same class with drugs like heroin and LSD, as drugs with no currently accepted medical use and a high potential for abuse. The penalties for violations of federal law with respect to cannabis may include lengthy prison sentences, significant fines and property forfeiture. Accordingly, managing the legal challenges presented by the conflict between state and federal law raises a number of issues for those engaging directly or indirectly in the business of manufacturing and selling cannabis products, including leasing, banking, financing, insurance, tax deductions, and restructurings.

Under the Obama administration, Deputy Attorney General James Cole provided guidance to federal prosecutors to prioritize the prosecution of activities that posed a serious threat to public safety (the “Cole Memo”). Subsequently the Financial Crimes Enforcement Network issued a memorandum in February 2014 clarifying what services financial institutions are permitted to provide to cannabis-related businesses while remaining compliant with the Bank Secrecy Act. Whatever comfort cannabis-related businesses gained was diminished on January 4, 2018, when then U.S. Attorney Jeff Sessions rescinded the Cole Memo. In addition, the Rohrabacher-Farr Amendment, which bars the DOJ from funding the prosecution of conduct that is in strict compliance with applicable state medical cannabis laws, was due to expire December 7, 2018 but was extended for a short period. It remains to be seen whether it will be extended when the current spending bill expires on December 21st. The law in this area continues to evolve; Kentucky Senator Mitch McConnell included provisions in the proposed 2018

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Farm Bill, which, if approved, would fully legalize industrial hemp, a common source of CBD. Despite being nonpsychoactive, CBD is currently illegal as a cannabis extract. While at the state level many states are seeking to provide guidance and legal protections for cannabis-related businesses that operate legally, absent definitive federal regulation or law, the uncertainty, doubt and limitations presented by the inherent conflict between state and federal law still exist.

Under the applicable federal law, not only is the property of an owner who engages in the manufacturing or distribution of cannabis products subject to forfeiture, but so is the property of an owner who knowingly leases property for the purpose of manufacturing or distributing cannabis products. Accordingly, landlords typically seek significantly higher rents to compensate for the additional risk. Furthermore, the leasing of mortgaged property to a cannabis-related business may be a violation of the law or the terms of the underlying financing agreements. A Landlords' counsel need to incorporate appropriate protections into the relevant agreements to ensure that the lessee complies with state and federal laws, regulations and guidelines, as well as local zoning and other agreements that are relevant to contemplated use of the property. Moreover, due to the continued illegality of cannabis at the federal level, purchasers of real estate will have a difficult time obtaining mortgage financing or title insurance from traditional sources where they intend to use the property for a cannabis-related business.

Cannabis businesses legally operating at the state level are also unable to obtain traditional sources of financing as banks and credit card com-

panies in the United States adhere to federal policies that disallow service to cannabis businesses. In April 2018, the Small Business Administration published guidelines that make clear that cannabis-related businesses are not eligible for SBA loans. In addition, cannabis businesses legally operating at the state level face challenges obtaining insurance because of the conflict between federal and state laws. Even if there is a valid insurance policy in place, insurers may seek to challenge the scope of loss coverage or rely upon specific exclusions that are often set forth in insurance policies based on the business' underlying violation of federal law. In addition to the foregoing challenges, cannabis-related businesses may not be able to take advantage of tax deductions for expenses incurred in connection with the sale of cannabis-related products. Moreover, in the event that a cannabis-related business fails, it may not avail itself of the protections of the United States Bankruptcy Code if its activities are illegal activities under federal law.

The law in this area is complex and evolving, and those engaging or investing in businesses in the cannabis industry should consult with qualified counsel.

Brian A. Haskel is a Member of Sills Cummis & Gross P.C. in New York City, where he practices in the firm's corporate group. He has represented individuals, businesses and funds involved in the cannabis sector in connection with offerings, financings and other transactions. ■

The views and opinions expressed in this article are those of the author and do not necessarily reflect those of Sills Cummis & Gross P.C.