Ballard Spahr LLP

BUSINESS CRIMES BULLETIN

Smoke & Mirrors: The New York Cannabis Law's Illusory Lease Mandate

November 2021

By Marjorie J. Peerce, Michael P. Robotti, and Kamera Boyd

New York's recently enacted cannabis law, the Marijuana Regulation and Taxation of 2021 (MRTA), created a maze of new legal requirements. These provisions affect not only cannabis companies, but also the companies that conduct business with them. Navigating this maze can be tricky, especially since much of the MRTA conflicts with federal law. One particularly complex area is the regulation of New York real estate as it relates to cannabis companies. Cannabis companies and landowners alike should be wary of the legal pitfalls in this area and seek appropriate legal guidance.

Under the MRTA, New York will grant licenses to companies to distribute cannabis. Although these companies will be state-licensed, it likely will violate the federal "stash-house law" to lease property to them. Landowners may be reluctant to lease to licensed cannabis businesses and risk federal criminal liability, when they could lease to other types of businesses without that risk. This landowner reluctance could create a Catch-22 for cannabis companies: to get a state license, they need property from which to operate their cannabis business; but to get property, under federal law, they cannot plan to sell cannabis from it.

The MRTA contains a provision that seems like it could help cannabis companies with reluctant landowners; specifically, it has a lease mandate, which prevents landowners from discriminating against at least some participants in the legal cannabis market. Precisely who the lease mandate protects, though, is subject to debate. While it could be read to prevent landowner discrimination against cannabis consumers *and* cannabis companies — as opposed to just cannabis consumers — such an interpretation likely would result in federal preemption of the mandate. To avoid preemption, courts likely will interpret the mandate narrowly, prohibiting discrimination only against cannabis consumers. So, cannabis companies should not put too much stock in this mandate when attempting to secure a property.

Cannabis Licenses Are Tied to Property

The MRTA creates a licensing scheme for the legal cannabis market, requiring businesses operating at each supply chain level to obtain licenses. *See*, "What is in the Law – Adult-Use License Types," cannabis.ny.gov. It confers authority on the Office of Cannabis Management Control Board (Board) to grant licenses. Typically, an applicant must have an

appropriate premises from which to operate before getting a license. *See*, MRTA §§61, 64.1(e), 126. For instance, the law requires that a license set forth a description of the licensed premises, and it specifies that each facility generally must have a separate license. *See*, *id*. §61. The Board will evaluate whether an applicant "possesses or has the right to use sufficient land, buildings, and equipment to properly conduct a cannabis business" or, if applying under the law's social and economic equity provisions, "has a plan to do so." *Id*. §64. And, for retail and on-site use dispensaries, they must be located in a storefront with a street-level entrance. *Id*. §72.5. To get a license, then, securing an appropriate premises will be necessary.

The Federal Stash-House Law

The federal stash-house law complicates these real estate requirements. That law makes it unlawful for a landowner to knowingly and intentionally "rent, lease, profit from, or make available for use" a location for the purpose of "unlawfully manufacturing, storing, distributing, or using a controlled substance." 21 U.S.C. §856(a)(2). Because marijuana remains a controlled substance under federal law, *see, id*. §841, this statute likely will apply to any landowner who leases a premises to a cannabis business for these purposes. Violators face up to 20 years' imprisonment, substantial fines, and criminal forfeiture of their property. *Id*. §§856(b), 881(a)(7). In recent years, the Department of Justice (DOJ), as a matter of discretion, usually has not enforced this law against landowners leasing property to state-licensed cannabis businesses. Yet, it remains a federal crime to do so.

New York's Lease Mandate

Due to the federal stash-house law, some landowners may be hesitant to lease to New York's licensed cannabis businesses. Just as many financial institutions have declined to provide services to state-licensed cannabis businesses, *see*, Beth Moskow-Schnoll & Shawn F. Summers, "Buzzkill: The AML Implications of Banking Marijuana-Related Businesses," 36 Rev. Banking & Fin. Servs. 109, 109-10 (Sept. 2020), some landowners may be equally wary about exposing themselves to federal criminal liability — even if DOJ has elected not to prosecute landowners and cannabis companies who comply with state law in recent years, *see, id*. at 111-16. The MRTA's broad anti-discrimination provisions, however, may help cannabis companies with this landowner reluctance; they include a lease mandate, prohibiting landowner discrimination against at least some legal market participants. But just how broad is this mandate?

Section 127 of the MRTA states in pertinent part:

Protections for the use of cannabis; unlawful discriminations prohibited.

1. No person, registered organization, licensee or permit-tee, employees, or their agents shall be…denied any right or privilege…solely for conduct permitted under [the MRTA].

…

2. *No landlord may refuse to lease to and may not otherwise penalize an individual solely for conduct authorized under [the MRTA], except:*

   (a) if failing to do so would cause the landlord to lose a monetary or licensing related benefit under federal law or regulations….

MRTA §127 (emphasis added).

Based on its plain language, there is an argument that the lease mandate is quite narrow. It prohibits a landlord from refusing to lease to "an individual," a statutory term that arguably does not include companies. *See*, *e.g., Nguyen Thang Loi v. Dow Chem. Co.*, 373 F. Supp. 2d 7, 56 (E.D.N.Y. 2005) ("[T]he plain meaning of the term 'individual' does

not ordinarily include a corporation.") (citations omitted). The MRTA does not specifically define the term "individual"; by comparison, "person" is defined to include "an individual" and certain legal entities, suggesting that "an individual" means a natural person as opposed to such entities, like cannabis companies. MRTA §3.1. In addition, the mandate's use of the word "individual" is notable, as compared to the broader list of terms that encompasses legal entities in the general anti-discrimination provision in preceding paragraph. The more limited word choice suggests that the lease mandate has a narrower application. Thus, based on the mandate's use of the term "individual," there is an argument that it is intended to prevent discrimination against only cannabis consumers entering residential leases — an argument reinforced by the portion of the section title "protections for the use of cannabis." *Id*.

Indeed, several other states that have enacted lease mandates as part of their medical cannabis laws have limited their applicability to patients, suggesting that the New York law might have a similar meaning. *See, e.g.*, Ariz. Rev. Stat. §36-2813 ("No school or landlord may refuse to enroll or lease to and may not otherwise penalize a person solely for his status as a cardholder …."); Del. Code Ann. tit. 16, §4905A(a)(1) ("No school or landlord may refuse to enroll or lease to, or otherwise penalize, a person solely for his or her status as a registered qualifying patient or a registered designated caregiver …."); Haw. Rev. Stat. §329-125.5(similar).

Conversely, there is an argument that this lease mandate is quite broad. On its face, it is not explicitly limited to cannabis consumers seeking to enter residential leases. It draws no distinction between such individuals and individuals, like cannabis company owners, who sign commercial leases or serve as personal guarantors. And, the MRTA specifically authorizes the Board to grant cannabis business licenses to "an individual or an entity," meaning that "individual" licensees will be entering commercial leases, in addition to company representatives. MRTA §3.31; *see, id.* §62.3. Moreover, the mandate explicitly prohibits landowner discrimination against all conduct authorized under the MRTA, which includes cultivating, processing, distributing and selling, not just personal use. Certainly, a landlord's denial of a commercial lease to an individual seeking to operate a cannabis company at that location would "penalize" that individual for legal conduct under the MRTA. In addition, had the legislature, in fact, meant to limit the mandate's protections to cannabis consumers, it knew how to craft such limited language. As noted above, the legislature had clear examples from other states. Additionally, in the MRTA, when the legislature intended to specify a cannabis consumer or personal use, it specifically did so. *See, e.g.*, MRTA §3.6 (defining "cannabis consumer"); *id.* §125.11 (prohibiting house-to-house cannabis sales "at residence or place of business of a cannabis consumer"); §127.6 (noting limited circumstances parole and probation authorities may prohibit "person's cannabis use").

Finally, the lease mandate must be informed by the general anti-discrimination provision in the preceding paragraph, as well as the portion of the section title "unlawful discriminations prohibited." That provision prohibits any "person, registered organization, licensee or permit-tee, employees, or their agents" from being "denied any right or privilege … solely for conduct permitted under [the MRTA]." The provision's breadth signifies a legislative intent to prohibit all discrimination against all legal market participants, suggesting the lease mandate likewise should be read to confer broad protections. *Cf. Green Cross Med., Inc. v. Gally*, 242 Ariz. 293, 298 (Ariz. Ct. App. 2017) (construing provision prohibiting denial of "any right or privilege … by a court" to protect "rights of dispensaries to enter into leases and contracts" that comply with state law (emphasis omitted)). Accordingly, the lease mandate is subject to two very different interpretations.

Like the mandate itself, the first exception to it is somewhat ambiguous. The mandate does not apply if it would cause a landowner to lose a "monetary or licensing related benefit." The law does not explain what qualifies as such a benefit. One question is whether potential federal criminal penalties, like fines and forfeiture, would qualify as loss of a "monetary benefit." That interpretation, though, may stretch the term's meaning, which more logically means a loss of federal grants or subsidies. Further, as discussed above, any landowner who leases to a cannabis business likely violates the federal stash-house law. Thus, if the law exempted any landowner subject to federal criminal penalties from the mandate, the exception would largely swallow the rule, rendering it meaningless in many circumstances.

Ultimately, it will be up to the courts to interpret the mandate. The federal stash-house law necessarily will inform this interpretation. Indeed, to save it from federal preemption, courts may need to select the narrower interpretation of the mandate.

The Stash-House Law May Preempt the Lease Mandate

If New York's lease mandate is broadly interpreted, the federal stash-house law likely preempts it. The Supremacy Clause makes federal law supreme. *See*, U.S. Const. art. VI, cl. 2. "Under the doctrine of federal preemption, 'state laws that conflict with federal law are without effect.'" *Mary Jo C. v. N.Y. State & Local Ret. Sys*., 707 F.3d 144, 161 (2d Cir. 2013). Where a statute does not contain an express preemption provision (which the stash-house law does not), courts have recognized implied "conflict preemption," if "state law 'actually conflicts with federal law.'" *Id*. An actual conflict exists "'when compliance with both federal and state regulations is a physical impossibility'" or, put differently, "where federal law is in 'irreconcilable conflict' with state law." *Id*. There is a presumption against preemption; "if there is any ambiguity as to whether the local and federal laws can coexist," courts will uphold the law. U*.S. Smokeless Tobacco Mfg. Co. LLC v. City of New York*, 708 F.3d 428, 433 (2d Cir. 2013).

Insofar as it prevents landowners from discriminating against cannabis businesses, the lease mandate is likely preempted by the federal stash-house law. If landowners comply with the state mandate and lease their properties to cannabis businesses, they will violate federal law. So interpreted, these laws irreconcilably conflict. Notably, this conflict is different in kind from many other MRTA provisions, which *permit* cannabis companies and consumers to engage in federally illegal activity. While those provisions undoubtedly conflict with federal law, they do not *require* any person or entity to violate it. By contrast, the lease mandate creates a more pronounced conflict by requiring landowners to engage in federally illegal conduct, potentially over their objections. It thus is a "physical impossibility" for landowners to follow both New York and federal law, which creates an actual conflict under federal preemption law.

Other states have largely avoided creating such conflicts with federal law. Some states allow landowners to prohibit cannabis distribution. *See, e.g.*, Durango, Co. Code of Ordinances §13-166("[P]roof of possession shall include a signed statement from the landlord or owner of the premises consenting to the use of the property for the purposes of operating a retail marijuana establishment."); Ann. L. Mass. Ch. 94D §2(d)(1) (landlord may prohibit or regulate cannabis "consumption, display, production, processing, manufacture or sale"); Vt. Stat. Ann. Tit. 18, §4230a(b)(E)(landlord may ban "possession or use of cannabis in lease agreement"); *see also, Green Cross Med., Inc.*, 242 Ariz. at 298 (declining to void dispensary lease as illegal under federal law, in part, because Arizona law did not require landowner to enter lease). Others, as noted above, have limited anti-discrimination provisions to cannabis consumers. *See, e.g.*, Ariz. Rev. Stat. §36-2813; Del. Code Ann. tit. 16, §4905A(a)(1); Haw. Rev. Stat. §329-125.5. New York's mandate appears to go beyond these laws.

To save the law from preemption, courts may be required to interpret it narrowly to prohibit landowner discrimination only against cannabis consumers entering residential leases. *See*, MRTA §2 ("Nothing in this act is intended … to require any individual to engage in any conduct that violates federal law …."). Landowners leasing to such individuals are likely beyond reach of the federal stash-house law. *See, United States v. Shetler*, 665 F.3d 1150, 1162 (9th Cir. 2011) (holding "incidental" personal drug use at residential premises beyond scope of stash-house law). Alternatively, courts could broadly interpret the first exception to the mandate to exempt any landowner subject to federal criminal exposure. That interpretation would effectively limit the mandate to cannabis consumers. Either way, though, to avoid federal preemption, the MRTA likely cannot require a landowner to lease to a cannabis business that intends to use a property to distribute cannabis. Such a requirement puts landowners in an unconstitutional bind, requiring them to choose between following New York or federal law.

Practical Considerations

What does this mean practically? For cannabis companies, it means that they should not blithely assume that they will be able to secure property easily, considering the legal uncertainty surrounding New York's lease mandate. Reluctant landowners may turn down such lease applications and, if a cannabis company invokes the lease mandate in response, the landowners may litigate, seeking to have it struck down. Cannabis companies should permit themselves ample time in advance of submitting their license applications to the Board to find the required property. It may take time to locate a willing landowner or to litigate with a reluctant landowner in advance of the application deadline.

This new law, which has ushered in a new post-prohibition era in New York, poses significant issues for cannabis companies and landowners alike. Proceeding with caution and seeking appropriate advice before embarking on such ventures is critical.

Author Information

Marjorie J. Peerce, *a member of the* Business Crimes Bulletin *Editorial Board, and* **Michael P. Robotti**, *a former federal prosecutor, are partners in Ballard Spahr's White Collar Defense & Internal Investigations Group in New York.* **Kamera Boyd** *is a law clerk in that group. Mr. Robotti also is a member of the firm's Cannabis Group, which advises companies in the cannabis industry.*

The views expressed in the article are those of the authors and not necessarily the views of their clients or other attorneys in their firm.

Reprinted with permission from the November 2021 issue of Business Crimes Bulletin. © 2021 ALM Media Properties, LLC.
Further duplication without permission is prohibited. All rights reserved.