Colorado's Amendment 64
Considerations for Commercial Real Estate

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Preface

This guidance paper has been prepared by the law firm of Otis, Coan & Peters, LLC under the overall direction of the Board of Directors for the Northern Colorado Commercial Association of Realtors ("NCCAR"). This paper is designed to provide general guidance and awareness to commercial real estate owners and professionals and should not be construed as providing legal advice to the reader for any particular transaction or circumstance. This paper is intended to educate persons with interests in commercial real estate about a host of complexities and risks associated with potential business opportunities that may be presented after passage of Amendment 64 and the accompanying regulatory framework that may be adopted in Colorado. In addition to a general overview of Amendment 64, this paper addresses several issues including the following: potential criminal law implications; insurance concerns; effects on banking and financial institutions; entity management and control considerations; risks related to contracts, leases and loan documents; and potential impacts from land use restrictions. Otis, Coan & Peters, LLC thanks NCCAR for the opportunity to work on this project. We hope this guidance paper will assist NCCAR's members and their clients in making good, informed business decisions related to the risks of being involved with the expected development of a marijuana industry in Colorado.

Introduction and Background

By: Jennifer Lynn Peters, Esq.

Rocky Mountain High has a whole new meaning now that Colorado voters have approved a ballot measure legalizing the recreational use of marijuana. Known as "Amendment 64," the measure adds an amendment to the Colorado Constitution making it legal to possess, use and grow marijuana for personal use, subject to certain limits. The Amendment represents a significant departure from prior state law, and directly contradicts federal law. So what does the adoption of Amendment 64 mean? And how will it affect business and real estate owners? These are some of the considerations that will be addressed in this guidance paper.

Amendment 64 officially became law in Colorado on December 10, 2012, when it was certified by Governor John Hickenlooper in Executive Order No. D 2012-052. Generally speaking, Amendment 64 makes legal the personal use, possession and limited home-growing of marijuana for anyone over the age of 21. It is important to note that it is still illegal in Colorado to sell marijuana in any quantity, unless licensed, or to use marijuana in public. Amendment 64 also creates an entire industry around the cultivation, sale and manufacture of marijuana for personal use by specifically authorizing retail marijuana stores, marijuana cultivation facilities, marijuana product manufacturing facilities, and marijuana testing facilities.

Amendment 64, the full text of which is attached hereto as Appendix I, is broken into nine sections. The first contains general statements of the intent of the voters in adopting the

amendment. The second section contains definitions of the terms used in the official text of the Amendment.

Section Three governs the personal use of marijuana and provides as follows:

Personal Use (Section Three)

It is not unlawful in Colorado or any locality[1] within Colorado to do the following, if you are 21 or older:

(a) Possess, use, display, purchase or transport marijuana accessories[2] or one ounce or less of marijuana;
(b) Possess, grow, process or transport no more than six marijuana plants, with three or fewer being mature flowering plants,
(c) Possess the marijuana produced by the plants on the premises where the plants were grown, provided that
    (1) the growing takes place in an enclosed, locked space;
    (2) is not conducted openly or publicly; and
    (3) is not made available for sale.
(d) Transfer one ounce or less of marijuana without payment of any kind to a person who is at least 21
(e) Consume marijuana, provided that such consumption is not done openly and publicly or in a manner that endangers others
(f) Assist another person who is at least 21 in any of the acts described above

Section Four of Amendment 64 pertains to the operation of marijuana-related facilities.

Cultivation and Sale (Section Four)

It is not unlawful in Colorado if you are 21 or older to manufacture, possess, purchase or sell marijuana accessories to a person who is at least 21

It is not unlawful in Colorado to the do the following, if you are 21 or older and have obtained or work for someone who has obtained a current, valid license to operate a retail marijuana store:

(a) Possess, display or transport marijuana or marijuana products
(b) Purchase marijuana from a marijuana cultivation facility
(c) Purchase marijuana or marijuana products from a marijuana product manufacturing facility
(d) Sell marijuana or marijuana products to consumers

A "retail marijuana store" means an entity licensed to purchase marijuana from marijuana cultivation facilities and marijuana products from marijuana product manufacturing facilities and to sell marijuana and marijuana products to consumers.

[1] As used in Amendment 64, "locality" refers to any county or municipality.
[2] A "marijuana accessory" is any equipment, product or material used or intended for use in planting, cultivating, growing, preparing, testing, analyzing, producing, processing, storing, or using marijuana.

It is not unlawful in Colorado to do the following, if you are 21 or older and have obtained or work for someone who has obtained a current, valid license to operate a marijuana cultivation facility:

(a) Cultivate, harvest, process, package, transport, display or possess marijuana
(b) Deliver or transfer marijuana to a marijuana testing facility
(c) Sell marijuana to a marijuana cultivation facility, a marijuana product manufacturing facility, or a retail marijuana store
(d) Purchase marijuana from a marijuana cultivation facility

A "marijuana cultivation facility" means an entity licensed to cultivate, prepare and package marijuana and to sell marijuana to marijuana product manufacturing facilities or retail marijuana stores, but not to consumers.

It is not unlawful in Colorado to do the following, if you are 21 or older and have obtained or work for someone who has obtained a current, valid license to operate a marijuana product manufacturing facility:

(a) Package, process, transport, manufacture, display or possess marijuana or marijuana products
(b) Deliver or transfer marijuana or marijuana products to a marijuana testing facility
(c) Sell marijuana or marijuana products to a retail marijuana store or a marijuana product manufacturing facility
(d) Purchase marijuana from a marijuana cultivation facility
(e) Purchase marijuana or marijuana products from a marijuana product manufacturing facility

A "marijuana product manufacturing facility" means an entity licensed to purchase marijuana, prepare and package marijuana products, and sell marijuana and marijuana products to other marijuana product manufacturing facilities and to retail marijuana stores, but not to consumers.

Under Section Four of Amendment 64, it is also legal to possess, cultivate, process, repackage, transport, display, transfer and deliver marijuana or marijuana products if licensed or working for a licensed marijuana testing facility. A "marijuana testing facility" is an entity licensed to analyze and certify the safety and potency of marijuana.

Section Four also specifically makes it legal to "lease or otherwise allow the use of property owned, occupied or controlled by any person, corporation or other entity for any of the activities" made lawful in Section Four. Interestingly, there is no such provision in Section Three on personal use.

Both Sections Three and Four of Amendment 64 specifically provide that the acts described as lawful shall not be the basis for seizure or forfeiture of any assets under Colorado law.

Section Five spells out how and when regulations pertaining to the operation of retail marijuana stores, marijuana cultivation facilities, marijuana product manufacturing facilities, marijuana testing facilities and the other acts specifically made lawful by Amendment 64 shall be made. Generally, Section Five requires that by July 1, 2013, the Colorado Department of Revenue adopt regulations implementing the provisions of the amendment. The regulations are to include procedures for licensing, qualifications for obtaining a license, security for such facilities, requirements to restrict sale to those under 21, restrictions on advertising and display of marijuana, and health, safety and labeling requirements. Applications are to be accepted no later than October 1, 2013, and be issued within 45-90 days of receipt. If regulations are not adopted by the Colorado Department of Revenue, then no later than October 1, 2013, local governments are to enact an ordinance or regulation pertaining to the licensing of marijuana stores and facilities.

Regardless of whether the Colorado Department of Revenue adopts regulations, a local government may, under Section Five, prohibit the operation of marijuana cultivation facilities, marijuana product manufacturing facilities, marijuana testing facilities, or retail marijuana stores or otherwise limit the time, place, and number of such stores or facilities. This "opt-out" provision is similar to the one included in Colorado's Medical Marijuana Code. Although local municipalities have time to decide what they will do, some, like Douglas County, are already moving to ban retail marijuana stores and related marijuana facilities. Others, like Aspen and Colorado Springs, are taking steps to ban "marijuana clubs," or unofficial "bring your own pot" bars or restaurants which have begun to pop up across the state.

Section Five also requires the Colorado legislature to adopt an excise tax on marijuana sold or transferred by a marijuana cultivation facility at a rate not to exceed 15%.

Section Six specifically provides that employers are not required to permit or accommodate the use, consumption, possession, transfer, display or growing of marijuana. It also allows employers to have policies restricting the use of marijuana by employees. Perhaps most important to property owners and managers is the provision in Section Six that specifically states that nothing in Amendment 64:

> "shall prohibit a person, employer, school, hospital, detention facility, corporation or any other entity who occupies, owns or controls a property from prohibiting or otherwise regulating the possession, consumption, use, display, transfer, distribution, sale, transportation, or growing of marijuana on that property."

Section Seven clarifies that nothing in Amendment 64 affects existing medical marijuana laws. Section Eight states that any conflicting state statutes or local laws are specifically superseded by Amendment 64. Finally, Section Nine confirms the provisions of the amendment become effective upon certification of the vote by the governor, which occurred on December 10, 2012.

So, what do all these legal provisions of Amendment 64 really mean? It means if you are 21, you may legally possess, use and carry up to one ounce of marijuana and personally grow up to six plants. It also means that the Colorado Department of Revenue or your local municipality will soon adopt regulations pertaining to the licensing and operation of marijuana-related businesses, including retail stores, through which marijuana can be grown, cultivated, processed, turned into products, and sold to consumers. The provisions of Amendment 64 also allow an employer, property-owner or business owner to ban or restrict the use of recreational marijuana or the operation of marijuana-related businesses, and allow a local municipality to ban or restrict the operation of marijuana-related businesses, but not the personal use of marijuana. What regulations will be adopted remains unknown at this point in time. An even bigger unknown is what action, if any, the federal government will take.

It is, however, well known that federal law, specifically the Controlled Substances Act, makes the use, possession, sale and distribution of marijuana illegal. This means that even with the passage of Amendment 64, those using, possessing, selling or distributing marijuana are still in violation of federal law and could be prosecuted in federal court. Although the U.S. Department of Justice has not said what stance it will take in relation to Amendment 64, the federal government lacks the resources required to prosecute and punish individuals using marijuana. It is thus widely believed that the personal use provisions of Amendment 64 will not be challenged by the federal government nor will individuals be prosecuted for using or growing marijuana in compliance with Amendment 64.

The same is not necessarily true with regard to the newly-created regulated marijuana industry contemplated by Amendment 64. Generally, federal law trumps state law when the two are in conflict or the federal law is so pervasive as to leave no room for a state to adopt its own laws on the same subject. Legal scholars disagree, however, about whether in this instance the federal Controlled Substances Act would preempt or otherwise invalidate the regulatory provisions of Amendment 64. Although it will likely be January 2014 before Colorado sees a retail marijuana store or other facility that will require this issue to be resolved, Colorado's congressional delegation has already introduced a bill that would resolve the conflict between Amendment 64 and the federal Controlled Substances Act. The outcome of that and similar legislation may resolve these issues. If not, the courts will have to step in.

In the meantime, some are looking to the U.S. Department of Justice's actions with regard to medical marijuana laws for guidance on how the federal government may react. In response to the numerous states that have legalized medical marijuana, the U.S. Department of Justice has adopted a policy that it will not enforce federal law where individuals and businesses are in compliance with state laws on the use, sale and distribution of medical marijuana. It is not clear that the same policy would be followed in this instance, however, and the federal authorities are staying quiet on what they will do. Even if such a policy were adopted, it would be subject to change depending on who is in the office of President and Attorney General or the specific circumstances of each case. Furthermore, such policies have proven to be selectively followed.

Even after adopting its non-enforcement policy related to medical marijuana, the Department of Justice has, on occasion, targeted and shut down medical marijuana dispensaries or cultivation facilities. Mostly, these actions have come when such facilities are near schools or involve other criminal elements, but these actions illustrate that a simple non-enforcement policy is of little comfort to those wishing to take advantage of Colorado's new marijuana industry.

While many things remain unclear about how the conflict between the federal Controlled Substances Act and Amendment 64 will play out, Colorado is clearly embarking upon a historic effort to become the first state to create a regulated marijuana industry. To assist in this effort, a task force has been formed by Colorado Governor Hickenlooper. Among the many issues the task force will consider are what Colorado state statutes need to be changed, what security regulations are necessary for marijuana establishments, what labeling and public education on the harmful effects of using marijuana are necessary, and what the effect of this amendment on employers will be.

The task force will most likely not be able to answer the key question on everyone's mind however: if I get involved in this new industry, am I going to be prosecuted under federal law, and if so, what consequences do I face?

Criminal Law Analysis

By: Shannon D. Lyons, Esq.

Amendment 64 fundamentally altered the landscape of state criminal law in Colorado as it relates to marijuana offenses. However, Amendment 64 did not eliminate all state criminal laws restricting the use, possession, distribution and manufacture of marijuana. Amendment 64 did absolutely nothing to alter federal law relating to marijuana offenses. This section discusses the changes to state criminal law and the existing federal criminal law for marijuana-related offenses. It then explores the practical implications that one may wish to consider before deciding whether to enter into business arrangements with other businesses involved in the marijuana trade.

Prior to the passage of Amendment 64, the State of Colorado criminalized the possession of marijuana with large loophole exceptions. First, possession of two ounces or less of marijuana was classified as a petty offense. The maximum penalty is a $100 fine. Second, medical marijuana regulation permitted both the sick and the not so sick to legally cultivate and possess limited quantities of marijuana. Amendment 64 actually brings more consistency to marijuana regulation under state law. Now, as discussed above, anyone aged 21 years or older can legally possess and use one ounce or less of marijuana. Furthermore, properly licensed businesses may grow, harvest, manufacture and/or sell marijuana products.

The State laws affecting marijuana remain in effect because Amendment 64 does not completely legalize all conduct related to marijuana. See generally C.R.S., § 18-18-406.

Therefore, as of the date of this guidance paper, it remains possible to violate State law concerning marijuana offenses, as follows:

- Possession of 1 ounce or less: Now legal for persons aged 21 years or older. Remains a Class 2 Petty Offense (maximum $100 fine) for persons under the age of 21.
- Possession of 1 to 2 ounces: Class 2 Petty Offense (maximum $100 fine).
- Public Use or Consumption of 2 ounces or less: Class 2 Petty Offense ($100 fine to 15 days jail).
- Possession of 2 to 6 ounces: Class 2 Misdemeanor (3-12 months jail; $250-1000 fine; $600 drug offender surcharge).
- Possession of 6 to 12 ounces: Class 1 Misdemeanor (6-18 months jail; $500-5,000 fine; $1000 drug offender surcharge).
- Possession of 12 ounces or more: Class 6 Felony (12-18 months prison, up to 3 years prison if aggravated; $1000-100,000 fine; $1,250 drug offender surcharge).
- Transferring or Dispensing 1 ounce or less without Remuneration: Now legal for persons aged 21 years or older. Remains a Class 2 Petty Offense (maximum $100 fine) for persons under the age of 21.
- Transferring or Dispensing 1 to 2 ounces without Remuneration: Class 2 Petty Offense (maximum $100 fine).
- Manufacture/Processing Marijuana without a License: Class 4 Felony (2-6 years prison, up to 12 years prison if aggravated; $2000-500,000 fine; $2,000 drug offender surcharge).
  - With a prior conviction: Class 3 Felony (4-12 years prison, up to 24 years prison if aggravated; $3000-750,000 fine; $3,000 drug offender surcharge).
- Distribution of 1 to 5 pounds without a License (includes dispensing, selling, possessing with intent to sell or distribute): Class 5 felony (1-3 years prison, up to 6 years prison, if aggravated; $1000-100,000 fine; $1,500 drug offender surcharge).
- Distribution of 5 to 100 pounds without a License (includes dispensing, selling, possessing with intent to sell or distribute): Class 4 felony (2-6 years prison, up to 12 years prison, if aggravated; $2000-500,000 fine; $2,000 drug offender surcharge).
- Distribution of more than 100 pounds without a License (includes dispensing, selling, possessing with intent to sell or distribute): Class 3 felony (4-12 years prison, up to 24 years prison, if aggravated; $3000-750,000 fine; $3,000 drug offender surcharge).
- Growing 6 plants or fewer: Now legal for persons aged 21 or older, and those holding medical marijuana cards. Remains a Class 1 Misdemeanor (6-18 months jail; $500-5,000 fine; $1000 drug offender surcharge) for persons under the age of 21.
- Growing 7 to 29 plants: Class 5 felony (1-3 years prison, up to 6 years prison, if aggravated; $1000-100,000 fine; $1,500 drug offender surcharge).
- Growing 30 or more plants: Class 4 felony (1-3 years prison, up to 6 years prison, if aggravated; $2000-500,000 fine; $2,000 drug offender surcharge).
- All of the above jail and prison sentences carry the possibility of probation in lieu of jail or prison, if the defendant is probation eligible. Generally, defendants are probation eligible unless they have suffered 2 or more felony convictions.

- Individuals sentenced to prison must serve an additional mandatory period of parole of between 1 and 5 years, depending on the class of felony conviction.

Marijuana concentrate or hash is treated differently than possession of marijuana buds. Possession of one ounce or less of hash is permitted; however, possession of greater amounts of hash are still subject to criminal penalties. In addition, both individuals and businesses may be prosecuted under Colorado law for engaging in attempts and conspiracies with other individuals to commit the offenses identified above.

Furthermore, Colorado has enacted statutes against organized crime to penalize various forms of organized criminal activity, including the illicit drug trade. Individuals who knowingly receive any proceeds derived, directly or indirectly, from a pattern of racketeering activity are guilty under the Colorado Organized Crime Control Act (COCCA) statute. "A pattern of racketeering activity" means engaging in two or more violations of enumerated criminal laws, including violations of laws governing controlled substances. Convictions under the COCCA statute are classified as class 2 felonies, which carry a possible sentence of 8 to 24 years in prison, and up to 48 years if the conduct is aggravated, and forfeiture of all proceeds received during the criminal enterprise.

The one area that Amendment 64 completely legalizes under Colorado law is the manufacture, sale and possession of "marijuana accessories" (i.e., drug paraphernalia and growing equipment, etc.). See Section 16(4)(a). Therefore, all "head shops" and hydroponic stores are now fully legitimate business operations.

The key feature of Amendment 64, which permits the legal cultivation and sale of marijuana, is a current, valid license to operate a specified marijuana facility (i.e., cultivation facility, product manufacturing facility, testing facility, or marijuana store). Attaining a valid license serves to make otherwise illegal conduct legal. Furthermore, Amendment 64 protects against the possibility of seizure or forfeiture of assets, if the party possesses a current and valid license.

As you can see from the state criminal penalties identified above, businesses holding a current, valid license will have an overwhelming advantage against illicit street dealers. Amendment 64 effectively divides "marijuana professionals" into two classes: the protected (licensed) and the highly exposed (unlicensed).

Amendment 64 does not completely legalize marijuana under Colorado law. Rather, Amendment 64 regulates the trade and possession of marijuana. If one is inclined to do business with individuals and entities involved in the marijuana industry, one should first request a copy of the individual or entity's current, valid marijuana license. Whether the business has a valid license is the difference between doing business with a legitimate business under state law and doing business with an illicit drug dealer.

The Controlled Substances Act, 21 USC § 801 et seq. defines and governs illegal drugs under federal law. The United States Congress passed the Controlled Substances Act in 1970; therefore, it applies in all states and territories within the United States of America. This Act applies to and is enforceable in Colorado after passage of Amendment 64.

The Controlled Substances Act categorizes drugs into one of five classes. The class into which a drug falls is determined by its addictive qualities, its medical utility, and whether the drug can be safely administered. Class I substances are defined by Congress as having the following characteristics:

(a) the drug or other substance has a high potential for abuse;
(b) the drug or other substance has no currently accepted medical use in the United States; and
(c) there is a lack of accepted safety for use of the drug or other substance under medical supervision.

Marijuana is defined as a Class I controlled substance. See 21 USC § 812. Federal law criminalizes the possession of marijuana as follows:

- Possession of 50 kg (110lbs.) or less, or fewer than 50 plants: up to 5 years prison; up to $250,000 fine for an individual, $1 million for a business. See 21 USC § 841.
- Possession of 100 kg (220 lbs.) or more, or 100 plants or more regardless of weight: 5 to 40 years prison. See 21 USC § 841.
- Possession of 1000 kg (2200 lbs.) or more, or 1,000 plants or more regardless of weight: 10 years to life in prison. See 21 USC § 841.

The marijuana need not be in pure form. For example, a marijuana brownie bakery in possession of 250 pounds (113.4 kg) of brownies would be subject to the penalties for possession of 100 kg or more of marijuana.

- Continuing criminal enterprise: Any person who engages in a continuing criminal enterprise shall be sentenced to a term of imprisonment of 20 years to life, and a fine of up to $2,000,000 for an individual, or $5,000,000 for an entity, and to forfeiture proceedings. The Court shall sentence a defendant to life imprisonment if the defendant's enterprise generated $10 million in gross receipts during any 12-month period of the enterprise, or the defendant is one of the leaders/organizers/principals of the enterprise and the violation involved at least 30,000 kg or 30,000 marijuana plants. See 21 USC § 848.
- Criminal forfeiture: Any person convicted of a crime punishable by one year or more shall be subject to forfeiture of all property used in the commission of the offense or paid for with proceeds, received directly or indirectly, from commission of the offense. There is a rebuttable presumption that any property of a person convicted of a felony drug offense is subject to forfeiture, if such property was acquired during or after engaging in the drug business and there was not a likely alternative source for the funds. See 21 USC § 853.

- Internet Violations: It is unlawful to use the Internet to dispense or distribute marijuana without a valid registration pursuant to federal law. Violations will result in penalties in accordance with the possession offenses described above. See 21 USC § 841.
- Attempts and conspiracies: Any person who attempts or conspires to commit any offense described above shall be subject to the same penalties as those prescribed for the offense itself. See 21 USC § 846.
- **Maintaining Drug-Involved Premises: It is unlawful to "knowingly open, lease, rent, use, or maintain any place, whether permanently or temporarily, for the purpose of manufacturing, distributing or using any controlled substance," or to "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." Violations of this section subject a person to up to 20 years imprisonment and a $500,000 fine, or if a business entity a $2,000,000 fine. See 21 USC § 856.**
- Drug Paraphernalia: It is unlawful for any person to sell or offer for sale drug paraphernalia. Any person convicted faces up to 3 years imprisonment and fines. See 21 USC § 863.
- Sentence Enhancers: Various types of conduct subject a defendant in federal court to sentence enhancement. For example, selling a controlled substance to a person under the age of 21 will subject a defendant to twice or three times the maximum punishment provided by § 841. Distributing within 1000 feet of a school, college, university, public playground, public housing, or within 100 feet of a public swimming pool, youth center or video arcade will subject a defendant to twice or three times the maximum punishment provided by § 841.
- Civil penalties: In addition to the criminal penalties described above, the various types of conduct described are subject to civil penalties and civil forfeiture. See 21 USC § 881. These civil penalties and civil forfeiture proceedings do not replace criminal proceedings. Rather, the government may proceed with both civil and criminal claims.

Individuals and businesses that choose to become involved in the marijuana trade should additionally be aware of and consider the implications associated with federal laws governing organized crime. Colorado's COCCA statute is based on the U.S. government's Racketeer Influenced and Corrupt Organizations (RICO) Act. RICO prohibits individuals and businesses from knowingly receiving any proceeds derived, directly or indirectly, from a pattern of racketeering activity. "A pattern of racketeering activity" means engaging in two or more violations of enumerated criminal laws, including violations of laws governing controlled substances. Conviction under the federal RICO law carries a sentence of up to 20 years imprisonment, fines and civil penalties.

Additional considerations should be given to involvement in the marijuana trade, where the parties intend to cover up such business activity in order to make it appear like an otherwise legal business or legal transaction. For example, a landlord may wish to rent his warehouse to a

marijuana distribution business because he stands to receive above-market leasing terms. Such lease is clearly prohibited under federal law by 21 USC § 856. Therefore, the landlord and future tenant agree that the tenant will lease the warehouse space for use as a "plant nursery," so that the landlord can assert plausible denial. Following this verbal understanding, the landlord mails the lease to the future tenant, and the parties thereafter enter into the lease. These actions are arguably not fraudulent because both parties were aware of their false pretenses. However, if either the landlord or tenant present the lease to a third party, such as to a bank to secure financing, both the landlord and tenant may be subject to prosecution for Mail Fraud, not to mention Bank Fraud. Sending the draft lease as a PDF by e-mail does not improve matters. The parties would still face the prospect of a Wire Fraud prosecution. Indeed, if any version of the cover-up lease is sent by mail or e-mail, and later presented to a third party to derive any benefit, both parties may be subject to prosecution under theories of fraud. Both Mail Fraud and Wire Fraud carry penalties of up to 20 years imprisonment and fines.

Let us imagine you are a commercial real estate broker who facilitates your landlord client leasing warehouse space to a marijuana distributor, with said lease resulting in your landlord client losing its warehouse facility due to federal forfeiture proceedings. Aside from the prosecution you might face under § 856 for Maintaining Drug-Involved Premises, could your landlord client sue you under a tort theory of professional negligence for failure to properly advise your landlord client of the consequences of entering into the lease with a marijuana distributor? Probably. Would your insurance carrier cover your "negligence" that resulted in you intentionally assisting in the commission of criminal activity? Probably not. See below for our discussion on Insurance.

Federal authorities, by virtue of their limited charge and limited resources, have historically been far more selective in their prosecution of criminal offenses than state authorities. Where state authorities would arrest and prosecute a person who sells drugs worth several hundred dollars, federal authorities would pass on such a prosecution. Such an offense is simply too minor to warrant federal resources. It is impossible to provide precise guidance on where the line is for the United State Attorney's Office, as it depends on the unique facts affecting each case. However, it is generally true that U.S. Attorneys select more significant crimes, often involving more sophisticated and organized criminal schemes, which have the potential to significantly impact ongoing crime in a particular area or particular field. U.S. Attorneys sometimes seek to prosecute higher profile crimes and crimes that will garner media coverage in order to signal to the public that such crimes are taken seriously.

Certainly, a marijuana business that sells $1 million of product a year would warrant federal inquiry, if not actual prosecution. It is also possible that federal authorities would become interested at a lower monetary threshold. The point is the bigger the business, the bigger the target for prosecution.

It is furthermore unclear how the state regulation of the marijuana industry will impact the coordination between state, local and federal law enforcement. Will state and local law enforcement officials cease or limit sharing investigative information with federal officials? Will

the lack of state and local assistance impact the ability of federal officials to conduct investigations and operations into large-scale marijuana operations? The oddity of Amendment 64 is that state and local officials are now charged with the duty of prosecuting unlicensed, underground marijuana dealers, whereas federal officials will now be able to easily identify "legal," licensed marijuana dealers. It is possible that federal authorities will join with state and local authorities to prosecute only the unlicensed marijuana dealers, but it is difficult to fathom that result.

Whether federal authorities will additionally target individuals and businesses that assisted the large marijuana business is an open question. There is no doubt that federal authorities have the legal right to prosecute individuals and businesses that participate in or facilitate criminal activity. As discussed above, such prosecution could be based on theories of conspiracy and/or racketeering, as well as the underlying offense. It is possible that federal authorities would find that the prosecution of bankers, accountants, landlords and real estate brokers is impractical for both legal and political reasons. But an aggressive U.S. Attorney could certainly make a case against professionals who knowingly assisted the local marijuana distributor in its illegal business pursuits. In fact, federal authorities are renowned for indicting fringe or lower-level participants in a criminal scheme in order to secure favorable testimony against the ringleaders or primary targets.

Furthermore, law enforcement officials operate in a manner that is far different from that which business professionals are accustomed to dealing with in government officials. As a businessperson, one must adhere to any number of government regulations. Most businesses must complete paperwork and obtain approval or licensure in order to operate. Regulators often have the power to come into a business and inspect its operations. If the business has fallen out of compliance, it may have been issued a warning letter from the regulatory agency, or perhaps a "notice of violation." A business may be required to comply with a subpoena and produce reams of documents that were previously believed to be confidential and protected. All of your previous interactions with government, onerous though they may have seemed, have been business-like and business-friendly.

Law enforcement officials do not notify businesses that they are engaged in criminal conduct and should, therefore, take corrective action. Law enforcement officials are empowered under the United States Constitution to obtain a search warrant in secret and to then execute the search warrant by surprise. Law enforcement officials are further empowered to seize any and all articles reasonably believed to have been utilized in the illicit business. This includes all computers, cell phones and other devices where information is stored. Items are routinely broken and damaged in this process. Finally, law enforcement authorities have the power to indefinitely shut down physical access to the building(s) identified in the search warrant in order to complete their investigation. These powers are exercised every single day. Raids are conducted at residences and businesses alike. A similar but much more predictable process in the civil/business context is an FDIC bank closure.

Current federal law and the application of such laws create an abundance of uncertainty with respect to marijuana activities in Colorado. Although it is clear that federal law restricts the sale and possession of marijuana, federal law permits the Attorney General to reclassify or remove any drug or substance from the schedules "if he finds that the drug or other substance does not meet the requirements for inclusion in any schedule." See 21 USC § 811. Such reclassification requires specific and formal findings by the Attorney General. It is very unlikely that the Attorney General will remove marijuana from the list of controlled substances due to Colorado's new view of the drug, but it is technically possible. As more states authorize the use of medical marijuana, the likelihood of reclassification or removal by the Attorney General increases. Additionally, federal authorities have allowed the medical marijuana industry to grow without any substantial enforcement of existing federal law against such enterprises. Therefore, it remains unclear whether federal authorities will choose to allow State-licensed marijuana businesses to operate with impunity.

The interaction between Amendment 64 and state law is only half the story. It may ultimately be the most important half of the story; however, it is too early to tell how federal law enforcement authorities will react to the growth of an open, free-market marijuana industry. Federal authorities have the power to stamp out this industry altogether or to ignore it and let it blossom. The industry pioneers have the opportunity for a lifetime of riches and a lifetime in prison.

Insurance Considerations

By: Brett Payton, Esq.

The consistent questions, concerns and thoughts related to the possession, distribution and cultivation of marijuana focus on the dichotomy between the State and the Federal governments. There simply is no escaping the fact that marijuana is a controlled substance under the federal Controlled Substances Act. As a result when we talk about illegal acts or what is considered to be an illegal act under any insurance policy it is wholly insufficient to simply say that Colorado has made possession, distribution and cultivation legal. Furthermore, the impact of the dichotomy spreads across virtually any and all lines of insurance coverage from health insurance to auto insurance to general business policies.

The other fundamental issue business owners and purchasers of insurance policies face is that every policy purchased from any of the numerous insurance providers will have its own coverage language and exclusion language relating to specific acts or forms of coverage. As an example, there is a whole new industry with new lines of insurance related to marijuana, insuring dispensaries, crops/growers and medical professionals. As such, this article will focus on general principals related to insurance coverage under typical policies as well as common terms and exclusions that are included in most policies. We will generally reference a Business Owners coverage policy which provides coverage related to business operations as well as business-owned property (real and personal). You must also keep in mind that there are as many factual

scenarios related to insurance losses as there are insurance policies written and for any given loss the facts will be viewed by the carrier through the lens of the individual policy.

The first exclusion we will cover is the Property Not Covered term. Generally, every policy will have a term or provision that follows language along the lines of the following. Similar "Illegal Acts" exclusions and terms will be found in nearly any policy and line of coverage:

> **Property Not Covered**
> Property Covered does not include:
> Contraband or property in the course of illegal transportation, commerce or trade.
> Exclusions:
> We do not insure under any coverage for any loss which would have occurred in the absence of one or more of the following excluded events. We do not insure for such loss regardless of the cause of the excluded event or any combination of these:
> (a) Malicious, dishonest, criminal or illegal acts, including intentional violation of any law, regulation, statute or ordinance
>
> (b) Ordinance or Law
> (1) The enforcement of any ordinance or law:
> (2) This exclusion, Ordinance or Law, applies whether the loss results from:
> a. An ordinance or law that is enforced even if the property has not been damaged; or
> b. The increased costs incurred to comply with an ordinance or law in the course of construction, repair, renovation, remodeling or demolition of property or removal of its debris, following an accidental direct physical loss to that property.

As a general rule and starting point, there is a universal public policy that one cannot contract for illegal acts. This public policy consideration is generally manifest in insurance policy exclusions for illegal acts. In any claim instance involving illegal acts, the critical factors are the actual language of the policy and the type of charges filed, whether the act is a misdemeanor or a felony. It is generally accepted that the commission of a felony is deemed sufficient for the denial of benefits under an insurance policy. Coverage has been properly denied to insureds who kill another individual when driving while intoxicated or are killed themselves while driving under the influence. Baker v. Provident Life & Accident Ins. Co., 171 F.3d 939, 942–43 (4th Cir. 1999); Weisenhorn v. Transamerica Occidental Life Ins. Co., 769 F. Supp. 302, 305–06 (D. Minn. 1991).

Generally speaking, insurance policies do not differentiate between state offenses and federal offenses. As such, the fact that Colorado has made possession and cultivation legal in certain limited quantities does not mean that insurers will be required to provide coverage, because those acts are still illegal under federal law.

To trigger the Illegal Acts exclusion, the illegal act must rise to the level of a felony. Since the federal government has put very tight tolerances on what is considered felony possession of marijuana, we will assume throughout this guidance paper that a marijuana business, by the nature of being in the business of cultivating, harvesting, selling or otherwise distributing marijuana, will be working with sufficient quantities or marijuana to be considered a felony.

Closely related to the Illegal Acts exclusions are the "Government Acts" exclusions. Once again, nearly every policy will have an exclusion for government acts along the following lines:

> Exclusions:
> We do not insure under any coverage for any loss which would have occurred in the absence of one or more of the following excluded events. We do not insure for such loss regardless of the cause of the excluded event or any combination of these:
> (a) Governmental Action
> (b) Seizure or destruction of property by order of governmental authority.
> (c) But we will pay for acts of destruction ordered by governmental authority and taken at the time of a fire to prevent its spread, if the fire would be covered under this coverage form.

We have, in the past, seen claims made by individuals requesting coverage for losses related to the seizure of property by the police or other governmental officials. Illegal Acts exclusions aside, damages or loss resulting from any actions taken by state or federal agencies related to the seizure or destruction of any property related to a marijuana business or operation will not be covered by a standard insurance policy.

The Government Acts exclusion applies to actions taken by law enforcement such as the seizure of real and personal property, the destruction of dangerous, hazardous or otherwise illegal substances and damage to any property that is the result of authorized and reasonable force by the authorities

Aside from business casualty insurance and property casualty insurance, as brokers and property managers, you will also likely have errors and omissions insurance that generally provides you coverage for claims your clients make related to your services as a broker or property manager. Unfortunately, the results are not much different from the discussion above.

Remember, the universal rule that one cannot contract for illegal acts. Typically, errors and omissions policies will contain the following exclusions:

> Exclusions:
> We do not insure under any coverage for any loss which would not have occurred in the absence of one or more of the following excluded events. We do not insure for such loss regardless of the cause of the excluded event or any combination of these:
>
> - Malicious, dishonest, criminal or illegal acts, including intentional violation of any law, regulation, statute or ordinance

As has been discussed in other portions of this guidance paper, the federal government casts a very wide net over those tied or related to illegal drug operations and they have extensive legal tools to draw in anyone even tangentially related to an illegal drug operation or enterprise. The federal government will therefore consider even the broker who negotiated the lease for a marijuana business to have been a part of the criminal conduct.

To help bring some of these concepts and ideas into focus we will briefly cover a few hypothetical scenarios.

1. Property owner opens up a marijuana growing operation in a warehouse. New heat lamps are properly installed, along with other necessary equipment, and the business begins. A heat lamp fails and a fire is started by a heat lamp that destroys not only the owner's building but the building next door.

   The federal government considers this kind of operation to be illegal. The Illegal Acts exclusion is given broad application, and since the source of the fire came from an illegal activity, there will be no coverage under the standard policy for either the loss of the owners building or the building next door.

2. Property owner leases property out to a marijuana business. A customer of the marijuana business slips and falls on the property and is injured. The customer brings suit against the property owner.

   The federal anti-drug statutes are broad enough that even the property owner may be considered as engaging in an illegal act. As such, the Illegal Acts exclusion can be applied and coverage denied.

3. Broker/property manager negotiates and writes a lease to a marijuana business on behalf of property owner. The business is raided by the DEA and the property owner is no

longer receiving income from the property. Property owner sues the broker for negligence.

In this instance the broker would look to his or her errors and omissions policy for coverage. However, the same Illegal Acts exclusion will be applied to the broker and again, since the federal government would consider the broker to be a part of the illegal activity, the exclusion will apply and there will be no errors and omissions coverage.

4. Property owner leases property out to a marijuana business. The business thrives and grows quite large. The DEA raids the property seizing all personal property and real property related to the marijuana business. The property owner either loses the property through the seizure or is otherwise unable to market the property during the pendency of any prosecution against the marijuana business.

   Property owner has no recourse with his or her insurance company. The Government Acts exclusion provides no coverage for the *seizure* or *destruction* of property.

5. Property owner leases property out to a marijuana business. The business thrives and grows quite large. The DEA raids the property in an attempt to seize all personal property and real property related to the marijuana business. The marijuana business owner barricades himself into the property and a fire fight ensues causing damage to 75% of the building.

   Property owner likely has no recourse with his or her insurance company. The Government Acts exclusion provides no coverage for the *seizure* or *destruction* of property.

6. Property owner's building is next door to a marijuana business but has nothing to do with the business and does not operate its own marijuana business. The DEA raids the property next door and mistakenly enters into property owner's building destroying a wall and breaking several windows. The DEA did not have authority to enter property owner's property.

   The property owner will have coverage under his or her insurance. One caveat to the Government Acts and Illegal Acts exclusions is that law enforcement must be right about the fact that a particular property is a part of the illegal enterprise.

As you can see, there are many circumstances under which insurance coverage for losses can be denied to the owners of properties related to marijuana businesses, despite Colorado's passage of Amendment 64. Keep in mind that coverage under any insurance policy is dependent on the facts and circumstances surrounding the loss and the specific language of the insurance policy. Exclusions can sometimes be defeated based on the circumstances around which a loss has occurred.

Banking and Lending Issues

By: Michael C. Payne, Esq.

Notwithstanding the fact that passage of Amendment 64 made the possession, distribution and cultivation of limited quantities of marijuana by persons twenty-one years and older legal under Colorado law, the laws of the United States of America still deem such activities to be illegal. This fact restricts the ability of financial institutions in the State of Colorado to transact business with entities engaged in any of the foregoing activities. Indeed, due to the nature of existing federal law and the interrelatedness of the myriad federal agencies responsible for implementing and enforcing the same, Colorado's financial institutions are unable, if not prohibited, from lending money to marijuana-related enterprises, accepting collateral that is associated with marijuana-related enterprises and/or holding deposits of monies that flow through marijuana-related enterprises. This fact has serious consequences upon the ability of commercial real estate professionals to conduct business with such enterprises.

The purpose of this section is not to provide the reader with an exhaustive laundry list of all of the potential pitfalls that await financial institutions, brokers, landlords and the like that transact business with a marijuana-related enterprise, but to advise the reader of some of the most concerning aspects of such a relationship. In researching this section, we spoke with representatives of financial institution trade groups, banking regulators and internal bank compliance officers, all of whom uniformly voiced grave concerns regarding the prospect of financial institutions lending money to or accepting deposits from marijuana-related enterprises (and those that do business with them), particularly given the novelty of the intersection of the statewide but limited legalization of marijuana in Colorado with federal laws expressly prohibiting the same.

First and foremost, interested parties should concern themselves with the 18 U.S.C. § 1956, titled "Laundering of Monetary Instruments." This statutory provision states, in pertinent part, "[w]hoever, knowing that the property involved in a financial transaction represents the proceeds of some form of unlawful activity, conducts or attempts to conduct such a financial transaction which in fact involves the proceeds of specified unlawful activity with the intent to promote the carrying on of specified unlawful activity … shall be sentenced to a fine of not more than $500,000 or twice the value of the property involved in the transaction, whichever is greater, or imprisonment of not more than twenty years, or both." It is widely understood in banking that under this statute, a financial institution cannot lend money to, cannot extend credit to, and cannot accept money from persons or entities that are actively involved in marijuana-related enterprises, since such enterprises are specifically prohibited by 21 U.S.C. § 801, *et seq.* (the "Controlled Substances Act"). To do so, would violate 18 U.S.C. § 1956 because the financial institution would be intentionally promoting the carrying on of acts in violation of the Controlled Substances Act. Furthermore, commercial real estate brokers, real property sellers/purchasers and landlords could potentially be held liable under this statutory provision if, for example, they received proceeds through a closing with a marijuana-related enterprise or accepted proceeds from same and deposited said proceeds into their respective bank accounts.

Essentially, these actions could be viewed as money laundering in an attempt to undermine the Controlled Substances Act.

Additionally, a financial institution that lends to or accepts deposits from a marijuana-related enterprise could be in violation of the Controlled Substances Act itself by serving as an accomplice to or conspiring with a principal to violate said Act. It is also possible that such a party could be deemed in violation of the Racketeer Influenced and Corrupt Organizations Act (18 U.S.C. § 1962) ("RICO") because acts involved in dealing with controlled substances are deemed racketeering activities and because a valid argument could be made that such a party aided in the procurement of income derived from a pattern of racketeering activity.

In the event that a financial institution is suspected to be in violation of 18 U.S.C. § 1956, it may be subject to federal asset forfeiture laws. Specifically, 18 U.S.C. § 981, titled "Civil Forfeiture" states, in pertinent part, that real or personal property involved in a transaction or attempted transaction in violation of federal money laundering laws (or property traceable thereto) is subject to forfeiture to the United States Attorney General. Additionally, 18 U.S.C. § 982, titled "Criminal Forfeiture," provides for a similar penalty if a person is convicted of an offense under 18 U.S.C. § 1956. Furthermore, 21 U.S.C. § 853 provides for criminal forfeiture of property constituting or derived from any proceeds obtained in violation of the Controlled Substances Act, whereas 18 U.S.C. § 1963 provides for criminal forfeiture of property constituting or derived from proceeds obtained in violation of RICO. Notwithstanding the fact that a federal trial court judge in Massachusetts recently rejected the Justice Department's effort to seize a family-owned motel due to what the judge said was a lack of a substantial connection between the motel and the forfeitable crimes, the statutes themselves and the weight of authority appear to indicate that federal seizure of assets is a strong possibility for those that are found to be in violation of federal money laundering, racketeering or controlled substances laws.

In essence, if a financial institution were to loan money to a marijuana-related enterprise and accept inventory, proceeds or even commercial real estate involved with such enterprise as collateral, then such collateral would be subject to seizure, thereby causing such loan to be wholly unsecured. Similarly, cash deposits arising from marijuana-related operations would also be a forfeiture risk. Even when a lender's collateral consists of commercial real property, and said property is leased to a marijuana-related enterprise, said collateral is subject to federal seizure. Indeed, anecdotal evidence shared by a financial institution trade group indicates that at least one Colorado financial institution has been forced by the federal government to call a loan immediately due under such circumstances or pressure its borrower to immediately evict the offending tenant. Similarly, one could foresee federal seizure of brokerage commissions, sales proceeds or management fees under the above-referenced statutory provisions in addition to the criminal penalties.

In addition to the imposition of criminal sanctions and the seizure of its property, financial institutions should also consider that 12 U.S.C. § 1818 provides for the very real possibility that their status as insured depository institutions could be terminated by the Federal Deposit Insurance Corporation (the "FDIC") if said agency were to determine that transacting

business with marijuana-related enterprises constituted an unsafe and unsound banking practice. Given that as recently as June, 2011, the U.S. Department of Justice articulated, in an official memorandum, a determination to enforce the Controlled Substances Act against "persons who are in the business of cultivating, selling or distributing marijuana *and those who knowingly facilitated those activities*," it is not unreasonable to assume the FDIC would consider engaging in such transactions unsafe and unsound practices. This is especially true when the U.S. Department of Justice's memorandum also expressly stated that "[t]hose who engage in transactions involving the proceeds of such activity may also be in violation of federal money laundering statutes and other federal financial laws." It is reasonable to conclude that violating federal criminal laws and risking forfeiture of bank assets is an unusual banking practice. Obviously, the loss of FDIC insurance would be catastrophic to the viability of a financial institution and could result in serious consequences for all of its stockholders.

Another consideration that financial institutions must keep in mind is that, by virtue of the federal Bank Secrecy Act (31 U.S.C. § 1501, *et seq.*), they are obligated to assist U.S. government agencies in detecting and preventing money laundering. Specifically, the Bank Secrecy Act requires financial institutions to keep records of cash purchases of negotiable instruments, to file reports of daily aggregate cash transactions exceeding $10,000, and to report suspicious activity that might signify money laundering or other criminal activities. In essence, financial institutions engaged in lending and/or depository relationships with marijuana-related enterprises (including landlords and brokers) have an obligation to report such customers to the Financial Crimes Enforcement Network, which is a law enforcement agency of the U.S. Department of Treasury. In theory, to the extent a financial institution is aware that a commercial broker, landlord, or property management company is depositing funds derived from a marijuana-related enterprise, said institution likely has an obligation to report that fact. Clearly, this is an unpalatable situation for both the financial institution and its customers. One can imagine a scenario where a financial institution that voluntarily engaged in business with such customers and then mandatorily reported such activities pursuant to the Bank Secrecy Act could be subject to common law privacy claims asserted by its customers.

Currently, due the nature of federal law, there is no workable way for financial institutions to transact business with marijuana-related enterprises (including landlords), nor is there any workable way for such enterprises to procure valid financial services. Furthermore, commercial real estate professionals are likely subject to various criminal and civil penalties in the event they transact business with marijuana–related enterprises and then deposit proceeds from same into a financial institution. While certain members of Colorado's legislature and an Amendment 64 task force appointed by Governor Hickenlooper have recently explored the idea of a state-owned bank or credit union devoted exclusively to the marijuana industry in Colorado, such a concept has been deemed unfeasible. Even a state-owned bank likely needs to be connected to the United States' payment system, which is an amalgam of systems whereby the Federal Reserve assists depository institutions by maintaining accounts and providing various payment services, including collecting checks, electronically transferring funds and distributing and receiving currency and coin. Given federal regulation of the payment system, checks from a state-owned bank could not be deposited in other financial institutions, credit/debit cards could

not be issued and funds could not be wired to/from other financial institutions. In short, such a state-owned bank would be an island unto itself and could only accept cash deposits at its own branches.

In summary, because lending to, extending credit to and accepting deposits from marijuana-related enterprises remains a violation of federal law, financial institutions in Colorado are unlikely to engage in or continue relationships with persons or businesses that are involved, directly or indirectly, with such enterprises. This means that lenders, borrowers and customers alike should closely inspect the nature of their relationships and the uses of collateral, lest they be found to be in violation of federal law and at risk of having collateral or proceeds seized by federal authorities. Commercial real estate owners and professionals not only risk being in violation of federal criminal law by doing business with marijuana enterprises, all such parties risk harm to, if not absolute loss of, their banking and lending relationships with financial institutions.

Entity Management and Control Concerns

By: Daniel W. Jones, Esq.

Much commercial real estate is owned by entities, such as limited liability companies ("LLCs") or corporations, instead of by individuals. Often, the specific purpose of such entities is to manage those properties so that the properties can be leased to commercial tenants and generate profitable income for the members or the shareholders of the LLCs or corporations that own the properties.

With the passage of Amendment 64, four new kinds of commercial entities, separate from the previously-approved medical marijuana centers, have become lawful under Colorado state law. These new "marijuana establishments" include marijuana cultivation facilities, marijuana product manufacturing facilities, marijuana testing facilities, and retail marijuana stores. As with medical marijuana centers, many proprietors of these newly-created businesses will be looking to lease commercial properties from which to operate, be it retail space for a marijuana store, warehouse space, or other commercial space in which to manufacture, test, or cultivate various marijuana products.

Managers, directors, and officers of commercial-property-owning entities should take several factors under consideration when deciding whether it would be prudent to accept any of the new marijuana establishments as tenants. Fiduciary duties to other members or shareholders, considerations about the best interests of the property-owning entities, and access to indemnification by the property-owning entities in the event of claims made against managers or directors related to use of the properties by marijuana establishments should all be considered by those with the authority to make such leasing decisions.

The Colorado Limited Liability Company Act, found at Article 80 of Title 7 of the Colorado Revised Statutes, states, at § 7-80-404(2), the following: "Each member in a limited

liability company, the articles of organization of which provide that management is vested in the members, and each manager owes to the limited liability company a duty of care in the conduct and winding up of the business of the limited liability company, which shall be limited to refraining from engaging in grossly negligent or reckless conduct, intentional misconduct, *or a **knowing violation of law***." [Emphasis added.] Additionally, § 7-80-103 states, "A limited liability company may be formed under this article ***for any lawful business***, subject to any provisions of law governing or regulating such business within this state." [Emphasis added.]

Similarly, with corporations, the Colorado Business Corporation Act, at § 7-108-401(1), requires that directors and officers of corporations discharge their respective duties "(a) In good faith; (b) With the care an ordinarily prudent person in a like position would exercise under similar circumstances; and (c) In a manner the director or officer reasonably believes to be in the best interests of the corporation." Further, pursuant to § 7-108-401(4), a director or officer is not liable to the corporation for acts or omissions if acting otherwise in compliance with this section. Similar to the purposes for which an LLC may be formed, § 7-103-101, states "Every corporation incorporated under articles 101 to 117 of this title has the purpose of engaging ***in any lawful business*** unless a more limited purpose is stated in the articles of incorporation."

Clearly, it is lawful for LLCs and corporations to own commercial real properties and to lease those properties to tenants. Leasing to marijuana establishments, as such are defined in Amendment 64, is now lawful under Colorado law. However, owners of commercial properties must remain cognizant of the fact that the manufacture, sale, and distribution of marijuana – any or all of which may be activities performed by such marijuana establishments - remain unlawful under federal law.

Thus, a dilemma arises for entity owners of commercial real properties that are considering leasing such properties to marijuana establishments. Entities (and their decision makers) that knowingly lease commercial space to marijuana establishments will be acting contrary to federal law by providing such establishments with facilities in which to manufacture, sell, and/or distribute what remains a Schedule I controlled substance under federal law. It is not a stretch to envision a scenario in which federal authorities would view the provision of such facilities to marijuana establishments as aiding, abetting, or otherwise conspiring to violate federal marijuana laws as well as a direct violation of such laws. Therefore, such leases may draw unwelcome attention from federal authorities, and lead to actions that are harmful to the corporations or LLCs that grant leases to marijuana establishments.

Such leases, if they cause problems for the property-owning LLCs and corporations, could also cause problems for the managers, officers, and/or directors of those entities who are responsible for the approval of such leases. In particular, the managers, officers, or directors may find that they are disqualified from indemnification by the LLC or corporation in the event they incur expenses for defending against alleged liabilities.

In the case of LLCs, § 7-80-407 of the Colorado Limited Liability Company Act provides that the LLC "shall reimburse a member or manager…for liabilities incurred by the person, in

the ordinary course of the business of the limited liability company…if such liabilities [were] incurred ***without violation of the person's duties to the limited liability company***." [Emphasis added.] Many LLC operating agreements contain similar language. As set forth above, one such duty of a member or manager is to refrain from a knowing violation of law. If the manager of an LLC knows that the business purpose of a prospective tenant will be a clear and unambiguous violation of federal law, but executes a lease to such tenant on behalf of the LLC anyway, the manager would face a substantial risk of having committed a knowing violation of law, which violation is also contrary to the best interests of the LLC, and may be disqualified from access to indemnification from the LLC in the event such manager faces legal liabilities.

Similar statutes apply to officers and directors of corporations. § 7-109-102(1) of the Colorado Business Corporation Act provides that a corporation "may indemnify a person made a party to a proceeding because the person is or was a director against liability incurred in the proceeding if: (a) The person's conduct was in good faith; and (b) The person reasonably believed…that such conduct was in the corporation's best interests;…that such conduct was at least not opposed to the corporation's best interests; and…the person ***had no reasonable cause to believe the person's conduct was unlawful***." [Emphasis added.] According to §7-109-107, the same indemnification protections may be extended to officers. However, leases signed by directors or officers, granting leasehold interests in commercial real properties to tenants that will be committing clear violations of federal laws regarding controlled substances, call into question to reasonableness of any beliefs that might provide such officers or directors with indemnification protections in the event those officers or directors face legal liabilities for their actions.

In addition to the risk of legal liabilities and the potential loss of access to indemnification, managers, directors, and officers of property-owning entities also face the risk that they may be removed from their positions or face liabilities to the entity or other owners of same. If a decision to lease the entity's commercial real property to a marijuana establishment causes harm to the entity's reputation, insurance coverage, banking relationships or bottom line, the manager, director, or officer who approved such a lease may be subject to removal from management and, in the case of some LLCs, may even be subject to expulsion. Said company officials may also have personal liability to the company and its other owners for any such damages.

When faced with the potential to lease entity-owned commercial space to a marijuana establishment in the wake of the passage of Amendment 64, the managers, directors, and officers of the property-owning entities need to look beyond the happy prospect of having the entity's space leased. Because, for now, marijuana establishments will continue to operate in violation of federal law, careful consideration should be given to risks any such lease may pose not only to the LLC or corporation that owns the property, but also to those individuals who approve and execute such leases on behalf of their respective entities.

Contracts, Leases and Loan Documents

By: G. Brent Coan, Esq.

Other Sections of this guidance paper have explained the conflicts between State and Federal Law as related to the marijuana possession, consumption, use, display, transfer, distribution, sale, transportation and cultivation. There is no need to restate the conclusions from other sections but it is helpful to see a side-by-side comparison of such conflicting provisions that are directly on point for commercial real estate owners and professionals.

Subsection (4)(f) of Amendment 64 states that the following is <u>not unlawful</u>:

> (f) Leasing or otherwise allowing the use of property owned, occupied or controlled by any person, corporation or other entity for any of the activities conducted lawfully in accordance with paragraphs (a) through (e) of this subsection.

Paragraphs (a) through (e) of Subsection 4 relate to the business side of the Amendment 64 marijuana law. Therefore, it is clear under Colorado law, that a property owner or manager will eventually be legally permitted to lease a property to a licensed marijuana enterprise. That being said, keep in mind that Amendment 64 allows cities and counties to decide whether or not to allow marijuana enterprises to be conducted in that local jurisdiction as follows:

> … A locality may prohibit the operation of marijuana cultivation facilities, marijuana product manufacturing facilities, marijuana testing facilities, or retail marijuana stores through the enactment of an ordinance or through an initiated or referred measure; provided, any initiated or referred measure to prohibit the operation of marijuana cultivation facilities, marijuana product manufacturing facilities, marijuana testing facilities, or retail marijuana stores must appear on a general election ballot during an even numbered year. (Amendment 64 Subsection (5)(f).)

Therefore, don't forget to consider the potential local regulation and/or outright prohibition of marijuana business activities in the locality in which the subject property is located. Now, contrast the authority for leasing and use of property under Subsection (4)(f) with the following summarization of 21 USC § 856:

> <u>Maintaining Drug-Involved Premises</u>: It is unlawful to "knowingly open, lease, rent, use, or maintain any place, whether permanently or temporarily, for the purpose of manufacturing, distributing or using any controlled substance," or to

> "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." Violations of this section subject a person to up to 20 years imprisonment and a $500,000 fine, or if a business entity a $2,000,000 fine.

The above comparison is a perfect example of the direct conflict of laws commercial real estate professionals and owners have to understand and confront. The prohibitions under 21 USC § 856 are directly on point for commercial property owners and professionals and as Mr. Lyons provided above, there are many other provisions of the law that could entangle a commercial property owner or professional involved with a marijuana use or enterprise.

With this context, we examine common contract provisions that are likely to be encountered in the commercial real estate industry and that should be considered and understood. Contracts and contract forms vary from one document to another and this section should not be considered to be a comprehensive guide to contract document provisions. This is a representative (not exhaustive) sampling of contract issues and provisions to raise awareness of the vast extent of possible trip wires that may be encountered if dealing with a business or use that is illegal under federal law.

A basic tenet of contract law is that you cannot contract for illegal acts and that illegal contracts are not enforceable. In *McMullen v. Hoffman*, 19 S.Ct. 839 (1899), the United States Supreme Court stated:

> The authorities from the earliest time to the present unanimously hold that no court will lend its assistance in any way towards carrying out the terms of an illegal contract. In case any action is brought in which it is necessary to prove the illegal contract in order to maintain the action, courts will not enforce it, nor will they enforce any alleged rights directly springing from such contract. In cases of this kind the maxim is, '*Potior est conditio defendentis*.'
>
> … Being of the opinion that the contract proved in this case was illegal, in the sense that it was fraudulent, and entered into for improper purposes, the law will leave the parties as it finds them.

So, what is an illegal contract? That is not always easy to understand or identify in advance of contracting. But, in this case it is easy. As set forth above, federal law expressly states that it is unlawful to "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." It is expressly illegal to knowingly lease property to a marijuana enterprise; therefore, the lease itself is illegal and will be unenforceable. The landlord is without most rights under the lease that would otherwise be expected and the owner or property manager would likely have no enforceable right to collect rent and receive the benefits bargained for under the lease. Both parties to the lease would have a very difficult time getting a court to intervene and enforce the terms of the lease in the event the other party disregards its obligations and commitments.

Leases are just one example to consider and the reader should apply this concept to all permutations of commercial property uses and contracts. Please note that it is beyond the scope of this section to analyze the result if the lease (or other contract) expressly provides that Colorado law applies and that federal law does not apply. By the way, the Latin phrase used by the Court in the above quote means: "Better is the condition of the defendant, than that of the plaintiff." The concept contained in that maxim should make commercial real estate landlords and professionals uncomfortable.

With the above context in mind, we provide a survey of common contract provisions that commercial real estate owners and professionals should keep in mind.

The Real Estate Commission Approved Contract to Buy and Sell Real Estate (Commercial) which was effective 01/31/2013 does not contain any representations regarding use of the property nor does it address the legality of the current use. That being said, the Real Estate Commission approved form calls for a Seller's Property Disclosure to be completed and delivered to the Buyer. This disclosure form amounts to representations by the Seller to the Buyer.

The Real Estate Commission Approved Seller's Property Disclosure (all Types of Properties) states:

> Seller states that the information contained in this Disclosure is correct to Seller's CURRENT ACTUAL KNOWLEDGE as of this Date. Any changes will be disclosed by Seller to Buyer promptly after discovery. …
>
> The information contained in this Disclosure has been furnished by Seller, who certifies to the truth thereof based on Seller's CURRENT ACTUAL KNOWLEDGE.

Take a close look at the contractual disclosure requirements and also consider the common law disclosure obligations of a Seller. If seller knows that the nature of any existing use of the subject property violates the law, the seller may have a disclosure obligation related to the

same. A seller cannot conceal material adverse facts about the status of the property and the uses thereof.

Other contracts may have express language addressing the legality of current uses. A contract working its way through the process at OCP contains the following representation of seller:

> To the best of Seller's knowledge, Seller and all beneficial owners of Seller are in compliance with all laws, statutes, rules and regulations of any federal, state or local governmental authority in the United States of America…

Knowledge of any marijuana cultivation, distribution or use on the property violates this representation. Another contract pending at OCP contains the following Seller's Affirmative Covenant:

> Seller covenants that from and after the date hereof and until physical possession of all the Property at Closing has been delivered to Purchaser, Seller will…
>
> b. Comply with and abide by all laws, ordinances, regulations and restrictions affecting the Property or its use; ….

Any authorized marijuana cultivation, distribution or use of or on the property would violate this covenant.

The Bradforms Commercial Lease (Gross) and Commercial Lease (NNN) both contain the following paragraph regarding legal compliance with both state and federal law (17.d. in both forms):

> d. Legal Compliance: Tenant and its licensees and invitees shall comply with and abide by all federal, state, county, and municipal laws and ordinances in connection with the occupancy and use of the Premises. Tenant and its licensees and invitees may not possess, or consume alcoholic beverages on the Premises unless they are of legal age. … No illegal drugs or controlled substances (unless specifically prescribed by a physician for a specific person occupying or present upon the Premises) shall be permitted upon the Premises. Tenant hereby covenants and agrees to use its reasonable efforts to prevent and preclude its employees, guests, invitees, etc. from the aforementioned illegal conduct.…

Because of the potential pitfalls of dealing with marijuana enterprises, we advise that landlords and property managers start confronting the marijuana issue in leases. OCP recently drafted a lease agreement that specifically addressed the marijuana concern as follows:

> Marijuana. Colorado Amendments 20 and 64 permit the cultivation, distribution and use of marijuana in specific and limited circumstances. The State of Colorado has also passed additional legislation governing the use of medical marijuana (hereafter, "Colorado Marijuana Laws"). Despite these state laws, the Federal Controlled Substances Act categorizes marijuana as a Schedule 1 Controlled Substance, and further provides that the cultivation, distribution, or possession of marijuana is a federal criminal offense. The Tenant hereby expressly acknowledges and agrees that any possession, consumption, use, display, transfer, distribution, sale, storage, transportation or cultivation of marijuana on or in the Premises shall constitute a default under this Lease.

Other leases we have drafted contain provisions that broadly address all aspects of legal compliance and that would be applicable to marijuana enterprises as set forth below. Provisions like the following have been used extensively and are not just a recent addition as a result of Amendment 64. We provide this language as an example of language that may be in your leases and that address uses that violate federal law such as those involving marijuana.

> Tenant shall, at its sole cost and expense, comply with all laws, regulations and ordinances of any governmental entity, board, commission or agency having jurisdiction over the Leased Premises.

Finally, a professional office lease may specifically prohibit the landlord from allowing other tenants in the building to operate generally undesirable uses. Marijuana uses would arguably violate this provision in a lease since marijuana uses are illegal under federal law. It seems logical to conclude that illegal uses are undesirable uses.

The Colorado Real Estate Commission approved Deeds of Trust (Due on Transfer – Strict, Due on Transfer – Creditworthy and Assumable – Not Due on Transfer) contain language about preserving the property and lender's security interest therein but do not specifically address legal use of the property or contain a representation from Grantor that it will remain in legal compliance associated with the property under state and federal laws. The forms do, however, contain the following provision which arguably requires compliance with laws even though the word law is not used:

> Borrower shall perform all of Borrower's obligations under any declaration, covenants, by-laws, rules or other documents governing the use, ownership or occupancy of the Property.

Most banks do not use a Real Estate Commission Approved deed of trust. Many banks use prepackaged documents that are found in one of several loan document software programs such as the Laser Pro Lending forms program. The Laser Pro Deed of Trust contains the following warranty and defense of title provision:

> Compliance With Laws. Grantor warrants that the Property and Grantor's use of the Property complies with all existing applicable laws, ordinances, and regulations of governmental authorities.

A Deed of Trust and Security Agreement recently drafted by OCP provides:

> Improper Use of Property or Chattels. Grantor will not use the Property or the Chattels for any purpose or in any manner that violates any applicable law, ordinance or other governmental requirement, the requirements or conditions of any insurance policy, or any private covenant.

Clearly, many deeds of trust contain restrictions or other provisions that impact the advisability of allowing marijuana enterprises to operate on the secured lands. Violating any of these applicable provisions would be an event of default under most deeds of trust, and would permit the lender to accelerate the amounts due under the evidence of debt, take the property into foreclosure, or allow lender to require a payoff or refinance of the secured debt. As Mr. Payne points out above, it will be difficult to refinance if you have a marijuana enterprise on the property and language such as quoted above would make it easy for the lender to force the property owner's hand in the event of requirements from the regulators.

The Colorado Real Estate Commission Approved Promissory Notes do not contain any "legal compliance" provisions but a recent OCP drafted Promissory Note states:

> Event of Default. As used herein the term "Event of Default" shall mean … (h) any collateral securing this Note is used in a manner or for a purpose which threatens confiscation by a legal authority or diminishes the value of said collateral … (k) a default under the terms of the Loan Agreement between the parties of even date herewith (the "Loan Agreement");….

Loan Agreements are frequently used in commercial loan transactions and clearly contain additional rights for the lender and additional obligations for the borrower. OCP recently worked on a loan transaction that included a Loan Agreement with the following provision:

> Default. If any one or more of the following Events of Default shall occur and shall not have been remedied: … Borrower shall in any material respect fail to comply with any statute, rule, regulation, ordinance, order, or other law or judicial decree regarding Borrower or its premises or assets….

The common Laser Pro Loan Agreement used by many local banks requires the borrower to agree to comply with the following affirmative covenant:

> Compliance with Governmental Requirements. Comply with all laws, ordinances, and regulations, now or hereafter in effect, of all governmental authorities applicable to the conduct of Borrower's properties, businesses and operations, and to the use or occupancy of the Collateral, including without limitation, the Americans With Disabilities Act. Borrower may contest in good faith any such law, ordinance, or regulation and withhold compliance during any proceeding, including appropriate appeals, so long as Borrower has notified Lender in writing prior to doing so and so long as, in Lender's sole opinion, Lender's interests in the Collateral are not jeopardized. Lender may require Borrower to post adequate security or a surety bond, reasonably satisfactory to Lender, to protect Lender's interest.

Clearly, borrowers need to look closely at the loan agreement and all other documents signed in connection with a loan secured by commercial real estate. There is a high probability that loan documents from a bank will require compliance with all applicable laws.

We reviewed five different property management forms and none of such forms expressly required the property manager to maintain legal compliance with the property nor limited the property manager's ability to lease the premises for only legal uses. In fact, most property management agreements we reviewed were rather brief and surprisingly one-sided for the benefit of the property manager. One very common description of the property manager's duty to the owner is to: "Use reasonable measures for the orderly management of the property." Arguably, this provision would require the property manager to maintain legal compliance with all areas of the property.

It is our opinion that all property managers should avoid leasing managed properties for any use or purpose that violates the law. It is our opinion that a property manager that

knowingly leases a property for an illegal use or that knowingly permits an illegal use to be conducted on the property will violate the intent of the property management agreement and the agency relationship of the parties thereto. Clearly, such tenants and uses put the owner's property at significant risk. In such an instance, the property management agreement could be terminated and any damages suffered by the property owner as a result of such permitted illegal use could be sought from the property manager.

In the commercial real estate industry, there are numerous types of contracts with various parties that may contain provisions that address violations of the law. As set forth above, allowing (knowingly) the use of the property for marijuana enterprise is illegal and the consequences of the same are varied depending on the context and the contract. The consequences of contracting with marijuana enterprises could range from unenforceability of the contract to confiscation of the property to fines and prison sentences for those involved.

Commercial Declarations, Private Covenants, and Defensible Fees

By: R. Clay Bartlett, Esq.

Despite Amendment 64, most land use restrictions related to violation of the law, whether in owners association or condominium commercial declarations, private covenants, or defeasible fees, will remain unchanged with respect to marijuana use or related commercial activities. It has been the general practice to draft such provisions broadly, so as to be sure to include, and protect against, illegal activity of any kind. Typically, illegal activity is defined as including violations of any applicable law, with no distinction between Federal and State laws. So, even after Amendment 64, any marijuana use or related commercial activity which violates Federal law would still breach the typical private land use restrictions related to violation of the law.

After reviewing sixteen sets of commercial covenants, as well as three books on Association Law, we have found land use restrictions related to violation of the law in commercial covenants were typically provided for in one of the two following forms:

1. Nuisances Prohibited. No obnoxious, illegal, dangerous or offensive trade, services, or activities shall be conducted on a lot nor shall anything be done thereon which may be or become an annoyance or nuisance to the owners or permitees of the other lots within the property by reason of unsightliness or excessive omission of fumes, odors, glare, vibration, gases, radiation, dust, liquid waste, smoke or noise.

2. Restrictions. Nothing shall be done or kept in any unit or within any common elements or any part thereof which would be a violation of any statute, rule, ordinance, regulation, permit, or any other validly imposed requirement of any governmental body having jurisdiction.

The effect of Amendment 64 is the same under either of these provisions. Both provisions, which define illegal activity in short as simply "illegal" activity or by the longer

"violation of any statute, rule, ordinance, regulation, permit, or any other validly imposed requirement of any governmental body having jurisdiction," still include Federal law as a basis for determining illegality. So, activities which are allowed by Amendment 64, but are still illegal under Federal law, would breach these provisions.

In addition, beyond restrictions relating specifically to violations of the law, other typical provisions should be carefully read as they too may be triggered by activities allowed by Amendment 64. Of particular concern are Permitted Use Clauses, Prohibited Use Clauses, Nuisance Clauses, "First Class" Operation Clauses, and "Consent of Authority" Clauses. Language requiring or allowing only activities of a certain character should be considered and understood in the context of marijuana enterprises.

On the other hand, private covenant and defeasible fee language varies much more. Private covenants are sometimes referred to as deed restrictions. They are restrictions on the deed that limit the use of property. Defeasible fees are interests in property which continue until the happening of certain events, for instance, an interest that continues until marijuana is used on the property. If the language in either of these two types of land restrictions is broad, defining illegal activities as is typical in commercial declarations, the provisions will still be breached by activities allowed by Amendment 64 but still illegal under Federal law. If they are narrower, there may not be a breach. Provisions must be examined on a case by case basis.

Enforcement of violations relating to private land use restrictions is typically left to the discretion of either associations, association members or, in the case of private covenants and defeasible fees, private individuals possessing the applicable benefit or interest. However, in certain cases, enforcement may be automatic. One such situation is if the provision for enforcement has an automatic trigger for enforcement, such as mandatory charges or fines. Another is in the case of a fee simple determinable, a type of defeasible fee, where a violation of a restriction will automatically trigger the end of the interest. Thus, how enforcement is handled, which depends on the individual agreements, is critical to understanding how activities allowed under Amendment 64 will impact private land use restrictions.

Importantly, covenants found in certain financing options, including, but not limited to, certain tax credit financing, bond financing or those in any way involving federal funds, may also be implicated. Such implications are beyond the scope of this section.

Appendix I

Full Text Colorado Constitutional Amendment
Personal Use and Regulation of Marijuana

Effective: December 10, 2012

Constitution of the State of Colorado [1876]
Article XVIII. Miscellaneous
Section 16. Personal use and regulation of marijuana

(1) Purpose and findings.

(a) In the interest of the efficient use of law enforcement resources, enhancing revenue for public purposes, and individual freedom, the people of the state of Colorado find and declare that the use of marijuana should be legal for persons twenty-one years of age or older and taxed in a manner similar to alcohol.

(b) In the interest of the health and public safety of our citizenry, the people of the state of Colorado further find and declare that marijuana should be regulated in a manner similar to alcohol so that:

(I) Individuals will have to show proof of age before purchasing marijuana;

(II) Selling, distributing, or transferring marijuana to minors and other individuals under the age of twenty-one shall remain illegal;

(III) Driving under the influence of marijuana shall remain illegal;

(IV) Legitimate, taxpaying business people, and not criminal actors, will conduct sales of marijuana; and

(V) Marijuana sold in this state will be labeled and subject to additional regulations to ensure that consumers are informed and protected.

(c) In the interest of enacting rational policies for the treatment of all variations of the cannabis plant, the people of Colorado further find and declare that industrial hemp should be regulated separately from strains of cannabis with higher delta-9 tetrahydrocannabinol (THC) concentrations.

(d) The people of the state of Colorado further find and declare that it is necessary to ensure consistency and fairness in the application of this section throughout the state and that, therefore, the matters addressed by this section are, except as specified herein, matters of statewide concern.

(2) Definitions. As used in this section, unless the context otherwise requires,

(a) "Colorado Medical Marijuana Code" means article 43.3 of title 12, Colorado Revised Statutes.

(b) "Consumer" means a person twenty-one years of age or older who purchases marijuana or marijuana products for personal use by persons twenty-one years of age or older, but not for resale to others.

(c) "Department" means the department of revenue or its successor agency.

(d) “Industrial hemp” means the plant of the genus cannabis and any part of such plant, whether growing or not, with a delta-9 tetrahydrocannabinol concentration that does not exceed three-tenths percent on a dry weight basis.

(e) “Locality” means a county, municipality, or city and county.

(f) “Marijuana” or “marihuana” means all parts of the plant of the genus cannabis whether growing or not, the seeds thereof, the resin extracted from any part of the plant, and every compound, manufacture, salt, derivative, mixture, or preparation of the plant, its seeds, or its resin, including marihuana concentrate. “Marijuana” or “marihuana” does not include industrial hemp, nor does it include fiber produced from the stalks, oil, or cake made from the seeds of the plant, sterilized seed of the plant which is incapable of germination, or the weight of any other ingredient combined with marijuana to prepare topical or oral administrations, food, drink, or other product.

(g) “Marijuana accessories” means any equipment, products, or materials of any kind which are used, intended for use, or designed for use in planting, propagating, cultivating, growing, harvesting, composting, manufacturing, compounding, converting, producing, processing, preparing, testing, analyzing, packaging, repackaging, storing, vaporizing, or containing marijuana, or for ingesting, inhaling, or otherwise introducing marijuana into the human body.

(h) “Marijuana cultivation facility” means an entity licensed to cultivate, prepare, and package marijuana and sell marijuana to retail marijuana stores, to marijuana product manufacturing facilities, and to other marijuana cultivation facilities, but not to consumers.

(i) “Marijuana establishment” means a marijuana cultivation facility, a marijuana testing facility, a marijuana product manufacturing facility, or a retail marijuana store.

(j) “Marijuana product manufacturing facility” means an entity licensed to purchase marijuana; manufacture, prepare, and package marijuana products; and sell marijuana and marijuana products to other marijuana product manufacturing facilities and to retail marijuana stores, but not to consumers.

(k) “Marijuana products” means concentrated marijuana products and marijuana products that are comprised of marijuana and other ingredients and are intended for use or consumption, such as, but not limited to, edible products, ointments, and tinctures.

(l) “Marijuana testing facility” means an entity licensed to analyze and certify the safety and potency of marijuana.

(m) “Medical marijuana center” means an entity licensed by a state agency to sell marijuana and marijuana products pursuant to section 14 of this article and the Colorado Medical Marijuana Code.

(n) “Retail marijuana store” means an entity licensed to purchase marijuana from marijuana cultivation facilities and marijuana and marijuana products from marijuana product manufacturing facilities and to sell marijuana and marijuana products to consumers.

(o) “Unreasonably impracticable” means that the measures necessary to comply with the regulations require such a high investment of risk, money, time, or any other resource or asset that the operation of a marijuana establishment is not worthy of being carried out in practice by a reasonably prudent businessperson.

(3) Personal use of marijuana. Notwithstanding any other provision of law, the following acts are not unlawful and shall not be an offense under Colorado law or the law of any locality within Colorado or be a basis for seizure or forfeiture of assets under Colorado law for persons twenty-one years of age or older:

(a) Possessing, using, displaying, purchasing, or transporting marijuana accessories or one ounce or less of marijuana.

(b) Possessing, growing, processing, or transporting no more than six marijuana plants, with three or fewer being mature, flowering plants, and possession of the marijuana produced by the plants on the premises where the plants were grown, provided that the growing takes place in an enclosed, locked space, is not conducted openly or publicly, and is not made available for sale.

(c) Transfer of one ounce or less of marijuana without remuneration to a person who is twenty-one years of age or older.

(d) Consumption of marijuana, provided that nothing in this section shall permit consumption that is conducted openly and publicly or in a manner that endangers others.

(e) Assisting another person who is twenty-one years of age or older in any of the acts described in paragraphs (a) through (d) of this subsection.

(4) Lawful operation of marijuana-related facilities. Notwithstanding any other provision of law, the following acts are not unlawful and shall not be an offense under Colorado law or be a basis for seizure or forfeiture of assets under Colorado law for persons twenty-one years of age or older:

(a) Manufacture, possession, or purchase of marijuana accessories or the sale of marijuana accessories to a person who is twenty-one years of age or older.

(b) Possessing, displaying, or transporting marijuana or marijuana products; purchase of marijuana from a marijuana cultivation facility; purchase of marijuana or marijuana products from a marijuana product manufacturing facility; or sale of marijuana or marijuana products to consumers, if the person conducting the activities described in this paragraph has obtained a current, valid license to operate a retail marijuana store or is acting in his or her capacity as an owner, employee or agent of a licensed retail marijuana store.

(c) Cultivating, harvesting, processing, packaging, transporting, displaying, or possessing marijuana; delivery or transfer of marijuana to a marijuana testing facility; selling marijuana to a marijuana cultivation facility, a marijuana product manufacturing facility, or a retail marijuana store; or the purchase of marijuana from a marijuana cultivation facility, if the person conducting the activities described in this paragraph has obtained a current, vaild license to operate a marijuana cultivation facility or is acting in his or her capacity as an owner, employee, or agent of a licensed marijuana cultivation facility.

(d) Packaging, processing, transporting, manufacturing, displaying, or possessing marijuana or marijuana products; delivery or transfer of marijuana or marijuana products to a marijuana testing facility; selling marijuana or marijuana products to a retail marijuana store or a marijuana product manufacturing facility; the purchase of marijuana from a marijuana cultivation facility; or the purchase of marijuana or marijuana products from a marijuana product manufacturing facility, if the person conducting the activities described in this paragraph has obtained a current, valid license to operate a marijuana product manufacturing facility or is acting in his or her capacity as an owner, employee, or agent of a licensed marijuana product manufacturing facility.

(e) Possessing, cultivating, processing, repackaging, storing, transporting, displaying, transferring or delivering marijuana or marijuana products if the person has obtained a current, valid license to operate a marijuana testing facility or is acting in his or her capacity as an owner, employee, or agent of a licensed marijuana testing facility.

(f) Leasing or otherwise allowing the use of property owned, occupied or controlled by any person, corporation or other entity for any of the activities conducted lawfully in accordance with paragraphs (a) through (e) of this subsection.

(5) Regulation of marijuana.

(a) Not later than July 1, 2013, the department shall adopt regulations necessary for implementation of this section. Such regulations shall not prohibit the operation of marijuana establishments, either expressly or through regulations that make their operation unreasonably impracticable. Such regulations shall include:

(I) Procedures for the issuance, renewal, suspension, and revocation of a license to operate a marijuana establishment, with such procedures subject to all requirements of article 4 of title 24 of the Colorado Administrative Procedure Act or any successor provision;

(II) A schedule of application, licensing and renewal fees, provided, application fees shall not exceed five thousand dollars, with this upper limit adjusted annually for inflation, unless the department determines a greater fee is necessary to carry out its responsibilities under this section, and provided further, an entity that is licensed under the colorado medical Marijuana Code to cultivate or sell marijuana or to manufacture marijuana products at the time this section takes effect and that chooses to apply for a separate marijuana establishment license shall not be required to pay an application fee greater than five hundred dollars to apply for a license to operate a marijuana establishment in accordance with the provisions of this section;

(III) Qualifications for licensure that are directly and demonstrably related to the operation of a marijuana establishment;

(IV) Security requirements for marijuana establishments;

(V) Requirements to prevent the sale or diversion of marijuana and marijuana products to persons under the age of twenty-one;

(VI) Labeling requirements for marijuana and marijuana products sold or distributed by a marijuana establishment;

(VII) Health and safety regulations and standards for the manufacture of marijuana products and the cultivation of marijuana;

(VIII) Restrictions on the advertising and display of marijuana and marijuana products; and

(IX) Civil penalties for the failure to comply with regulations made pursuant to this section.

(b) In order to ensure the most secure, reliable, and accountable system for the production and distribution of marijuana and marijuana products in accordance with this subsection, in any competitive application process the department shall have as a primary consideration whether an applicant:

(I) Has prior experience producing or distributing marijuana or marijuana products pursuant to section 14 of this article and the Colorado Medical Marijuana Code in the locality in which the applicant seeks to operate a marijuana establishment; and

(II) Has, during the experience described in subparagraph (I), complied consistently with section 14 of this article, the provisions of the Colorado Medical Marijuana Code and conforming regulations.

(c) In order to ensure that individual privacy is protected, notwithstanding paragraph (a), the department shall not require a consumer to provide a retail marijuana store with personal information other than government-issued identification to determine the consumer's age, and a retail marijuana store shall not be required to acquire and record personal information about consumers other than information typically acquired in a financial transaction conducted at a retail liquor store.

(d) The general assembly shall enact an excise tax to be levied upon marijuana sold or otherwise transferred by a marijuana cultivation facility to a marijuana product manufacturing facility or to a retail marijuana store at a rate not to exceed fifteen percent prior to January 1, 2017 and at a rate to be determined by the general assembly thereafter, and shall direct the department to establish procedures for the collection of all taxes levied. Provided, the first forty million dollars in revenue raised annually from any such excise tax shall be credited to the public school capital construction Assistance Fund created by article 43.7 of title 22, C.R.S., or any successor fund dedicated to a similar purpose. Provided further, no such excise tax shall be levied upon marijuana intended for sale at medical marijuana centers pursuant to section 14 of this article and the Colorado medical marijuana Code.

(e) Not later than October 1, 2013, each locality shall enact an ordinance or regulation specifying the entity within the locality that is responsible for processing applications submitted for a license to operate a marijuana establishment within the boundaries of the locality and for the issuance of such licenses should the issuance by the locality become necessary because of a failure by the department to adopt regulations pursuant to paragraph (a) or because of a failure by the department to process and issue licenses as required by paragraph (g).

(f) A locality may enact ordinances or regulations, not in conflict with this section or with regulations or legislation enacted pursuant to this section, governing the time, place, manner and number of marijuana establishment operations; establishing procedures for the issuance, suspension, and revocation of a license issued by the locality in accordance with paragraph (h) or (i), such procedures to be subject to all requirements of article 4 of title 24 of the Colorado Administrative Procedure Act or any successor provision; establishing a schedule of annual operating, licensing, and application fees for marijuana establishments, provided, the application fee shall only be due if an application is submitted to a locality in accordance with paragraph (i) and a licensing fee shall only be due if a license is issued by a locality in accordance with paragraph (h) or (i); and establishing civil penalties for violation of an ordinance or regulation governing the time, place, and manner of a marijuana establishment that may operate in such locality. A locality may prohibit the operation of marijuana cultivation facilities, marijuana product manufacturing facilities, marijuana testing facilities, or retail marijuana stores through the enactment of an ordinance or through an initiated or referred measure; provided, any initiated or referred measure to prohibit the operation of marijuana cultivation facilities, marijuana product manufacturing facilities, marijuana testing facilities, or retail marijuana stores must appear on a general election ballot during an even numbered year.

(g) Each application for an annual license to operate a marijuana establishment shall be submitted to the department. The department shall:

(I) Begin accepting and processing applications on October 1, 2013;

(II) Immediately forward a copy of each application and half of the license application fee to the locality in which the applicant desires to operate the marijuana establishment;

(III) Issue an annual license to the applicant between forty-five and ninety days after receipt of an application unless the department finds the applicant is not in compliance with regulations enacted pursuant to paragraph (a) or the department is notified by the relevant locality that the applicant is not in compliance with ordinances and regulations made pursuant to paragraph (f) and in effect at the time of application, provided, where a locality has enacted a numerical limit on the number of marijuana establishments and a greater number of applicants seek licenses, the department shall solicit and consider input from the locality as to the locality's preference or preferences for licensure; and

(IV) Upon denial of an application, notify the applicant in writing of the specific reason for its denial.

(h) If the department does not issue a license to an applicant within ninety days of receipt of the application filed in accordance with paragraph (g) and does not notify the applicant of the specific reason for its denial, in writing and within such time period, or if the department has adopted regulations pursuant to paragraph (a) and has accepted applications pursuant to paragraph (g) but has not issued any licenses by January 1, 2014, the applicant may resubmit its application directly to the locality, pursuant to paragraph (e), and the locality may issue an annual license to the applicant. A locality issuing a license to an applicant shall do so within ninety days of receipt of the resubmitted application unless the locality finds and notifies the applicant that the applicant is not in compliance with ordinances and regulations made pursuant to paragraph (f) in effect at the time the application is resubmitted and the locality shall notify the department if an annual license has been issued to the applicant. If an application is submitted to a locality under this paragraph, the department shall forward to the locality the application fee paid by the applicant to the department upon request by the locality. A license issued by a locality in accordance with this paragraph shall have the same force and effect as a license issued by the department in accordance with paragraph (g) and the holder of such license shall not be subject to regulation or enforcement by the department during the term of that license. A subsequent or renewed license may be issued under this paragraph on an annual basis only upon resubmission to the locality of a new application submitted to the department pursuant to paragraph (g). Nothing in this paragraph shall limit such relief as may be available to an aggrieved party under section 24-4-104, C.R.S., of the Colorado administrative Procedure Act or any successor provision.

(i) If the department does not adopt regulations required by paragraph (a), an applicant may submit an application directly to a locality after October 1, 2013 and the locality may issue an annual license to the applicant. A locality issuing a license to an applicant shall do so within ninety days of receipt of the application unless it finds and notifies the applicant that the applicant is not in compliance with ordinances and regulations made pursuant to paragraph (f) in effect at the time of application and shall notify the department if an annual license has been issued to the applicant. A license issued by a locality in accordance with this paragraph shall have the same force and effect as a license issued by the department in accordance with paragraph (g) and the holder of such license shall not be subject to regulation or enforcement by the department during the term of that license. A subsequent or renewed license may be issued under this paragraph on an annual basis if the department has not adopted regulations required by paragraph (a) at least ninety days prior to the date upon which such subsequent or renewed license would be effective or if the department has adopted regulations pursuant to paragraph (a) but has not, at least ninety days after the adoption of such regulations, issued licenses pursuant to paragraph (g).

(j) Not later than July 1, 2014, the General Assembly shall enact legislation governing the cultivation, processing and sale of industrial hemp.

(6) Employers, driving, minors and control of property.

(a) Nothing in this section is intended to require an employer to permit or accommodate the use, consumption, possession, transfer, display, transportation, sale or growing of marijuana in the workplace or to affect the ability of employers to have policies restricting the use of marijuana by employees.

(b) Nothing in this section is intended to allow driving under the influence of marijuana or driving while impaired by marijuana or to supersede statutory laws related to driving under the influence of marijuana or driving while impaired by marijuana, nor shall this section prevent the state from enacting and imposing penalties for driving under the influence of or while impaired by marijuana.

(c) Nothing in this section is intended to permit the transfer of marijuana, with or without remuneration, to a person under the age of twenty-one or to allow a person under the age of twenty-one to purchase, possess, use, transport, grow, or consume marijuana.

(d) Nothing in this section shall prohibit a person, employer, school, hospital, detention facility, corporation or any other entity who occupies, owns or controls a property from prohibiting or otherwise regulating the possession, consumption, use, display, transfer, distribution, sale, transportation, or growing of marijuana on or in that property.

(7) Medical marijuana provisions unaffected. Nothing in this section shall be construed:

(a) To limit any privileges or rights of a medical marijuana patient, primary caregiver, or licensed entity as provided in section 14 of this article and the Colorado Medical Marijuana Code;

(b) To permit a medical marijuana center to distribute marijuana to a person who is not a medical marijuana patient;

(c) To permit a medical marijuana center to purchase marijuana or marijuana products in a manner or from a source not authorized under the Colorado Medical Marijuana Code;

(d) To permit any medical marijuana center licensed pursuant to section 14 of this article and the Colorado Medical Marijuana Code to operate on the same premises as a retail marijuana store.; or

(e) To discharge the department, the Colorado Board of Health, or the Colorado Department of Public Health and Environment from their statutory and constitutional duties to regulate medical marijuana pursuant to section 14 of this article and the Colorado Medical Marijuana Code.

(8) Self-executing, severability, conflicting provisions. All provisions of this section are self-executing except as specified herein, are severable, and, except where otherwise indicated in the text, shall supersede conflicting state statutory, local charter, ordinance, or resolution, and other state and local provisions.

(9) Effective date. Unless otherwise provided by this section, all provisions of this section shall become effective upon official declaration of the vote hereon by proclamation of the governor, pursuant to section 1(4) of article V.

CREDIT(S)

Added by Initiative Nov. 6, 2012, eff. upon the proclamation of the governor, Dec. 10, 2012.

HISTORICAL AND STATUTORY NOTES

This section, proposed by Initiative, as Amendment 64, was ratified by the electorate at the general election on Nov. 6, 2012, effective upon the proclamation of the vote by the governor, Dec. 10, 2012.

C. R. S. A. Const. Art. 18, § 16, CO CONST Art. 18, § 16

Current with amendments adopted through the Nov. 6, 2012 General Election