

LEASE AGREEMENTS IN THE CANNABIS INDUSTRY

Understanding the details of cannabis legislation when it comes to leasing commercial business space.

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With the province of Saskatchewan having recently unveiled its proposed structure for regulating the retail recreational market for cannabis, and Bill C-45 passing its second reading in the Senate, prospective retailers will be approaching landlords looking to rent out retail space in Saskatchewan.

The Saskatchewan Liquor and Gaming Authority (SLGA) will be issuing approximately 51 cannabis retail permits to private operators in 32 Saskatchewan municipalities and First Nations communities. Retail and wholesaling activities will be regulated by SLGA, but conducted by the private sector. Retail cannabis stores must be standalone operations with an ability to sell online. Retailers will be limited to selling cannabis and related accessories.

Retail permits will be awarded using a two-phase process. The initial phase will be a pass/fail initial screening and the second phase will be a lottery selection of all qualified applicants. Additional details can be found at www.sasktenders.ca for various Saskatchewan municipalities under RFP 18-002, RFP 18-003, RFP 18-004, RFP 18-005, and RFP 18-006. The closing date for the RFPs is April 10, 2018 and the lottery draw is scheduled to occur on June 1, 2018. If you are considering leasing a commercial space to an entity in the cannabis industry, or if you are in the cannabis industry and are looking to rent a space, there are a number of clauses that should be contemplated when your lease agreement is prepared.

PERMITTED USE

It is important to be specific about what activities are permitted on the premises, such as production, retail, or storage of cannabis for medical or recreational products. As a tenant, you want to ensure that the permitted use for the rental space is consistent with the commercial activities you intend to carry out. As a landlord, it is important that the permitted use is not inconsistent with restrictive covenants granted to other tenants and that you are clear about what activities are permitted on the premises. If landlords do not want their properties to be used as cannabis retail stores or cannabis producers, they should ensure that the use provisions in their leases are not generic use clauses providing for “any legal use”.

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COMPLIANCE WITH LAWS AND LICENSING REQUIREMENTS

Lease agreements should not only specify that a tenant must hold all applicable licenses to sell or produce cannabis, but should further require that the tenant comply with all municipal laws, by-laws, and regulations in addition to all applicable federal and provincial laws.

The cannabis industry will be strictly regulated and failure to comply with applicable laws can result in severe consequences, including fines and penalties. Landlords should ensure their leases contain appropriate remedies to deal with any tenant conducting illegal/non-permitted cannabis activities. Landlords who become aware of illegal activities and fail to act, may be opening themselves to sanctions under the Criminal Code of Canada.

TENANT IMPROVEMENTS

Depending on the nature of the cannabis business, significant alterations may be needed to make the leased space appropriate for operation. All leases should include provisions to deal with issues such as: requiring the landlord's permission before physical changes are made to the premises; clarifying who is responsible for any costs related to improvements (typically the tenant's expense); confirming who is responsible for utility costs, especially if the premises are not separately metered; specifying that the landlord is under no obligation to reimburse the tenant for improvements that are unique to the cannabis industry, such as upgraded electrical, water, and security systems; and confirming that at the end of the agreement, upon the request of the landlord, the tenant must remove any improvements at its cost.

INSURANCE AND DAMAGE TO PROPERTY

Landlords should confirm that having tenants participating in the cannabis industry will not affect, limit or void their insurance coverage. Specifically, landlords should confirm that any loss or damage caused by their tenants would be covered by their insurance policies. If a tenant intends to produce cannabis, for example, there may be a greater risk of certain types of damage, such as theft or increased humidity from growing cannabis. The lease agreement should take into account how damage and repairs specific to the cannabis industry will be dealt with. All leases should have appropriate indemnification provisions to ensure that all liability regarding the cannabis operation rests with the tenant and not the landlord.

ACCESS TO THE PROPERTY

Lease agreements typically provide the landlord with access upon reasonable notice or in emergency scenarios. Due to the strict regulations in the cannabis industry, these provisions may need to be amended and, in some cases, severely restricted. Tenants should insist that landlords be subject to the terms of their license/ permit. Typically, a designated representative of the tenant would need to be present when the landlord accesses the premises. Tenants must be vigilant to ensure that any landlord access is restricted in accordance with the tenants' obligations under their permits/licenses. Landlords may want to consider requiring tenants to provide details of any and all restrictions associated with their permits/licenses.

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THIRD PARTIES

It is not surprising that existing tenants in commercial spaces with multiple units are concerned about potential impact of a cannabis retail store on their businesses. If you are considering having a tenant in the cannabis industry, it may be necessary to include clauses that prevent employee or customer consumption of cannabis near the premises, loitering, or conduct that may amount to nuisance, such as ventilation and noise. Many of these types of concerns will be regulated by the federal, provincial, or municipal government; however, landlords may wish to specifically address these types of issues in their leases.

MORTGAGES AND CONDOMINIUMS

Notwithstanding that the retailing or production of cannabis may be legal, landlords should confirm that their mortgages and, if applicable, condominium documents and by-laws, do not prohibit leasing to the cannabis industry.

REMEDIES AND TERMINATION RIGHTS

Due to strict licensing requirements surrounding cannabis production, sale, and possession, remedies typically found in commercial leases may need to be revisited. Distress rights may not be available to a landlord, as seizing cannabis may result in the landlord running afoul of the law. The lease agreement should permit the landlord to terminate the agreement if the tenant does not comply with all applicable laws or regulations. Conversely, tenants may want to include a clause that permits termination of the lease agreement if they are unable to obtain or maintain the required licensing/permits.



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