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Got Pot? The Feds Try to Make Mortgagee Banks Liable Under the Crack House Statute

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Banks holding mortgages now have one more thing to worry about: potential criminal and civil liability and forfeiture under the federal "crack-house" statute. Sound crazy? Read on, because late last year the four U.S. Attorneys in California threatened banks with liability simply because mortgaged properties were being used as medical marijuana dispensaries, even though such dispensaries are legal under state law.

First, the legal background: The federal crack-house statute (21 U.S.C. § 856) was enacted in the mid-1980′s to combat the crack cocaine epidemic and crack-house phenomenon by creating criminal and civil liability for using property for drug operations involving any "controlled substance." The property is also subject to forfeiture. (See 21 U.S.C. § 881(a)(7).) The crack-house statute, however, was drafted hurriedly and quite broadly. It covers those who "manage and control" the property, even as a "mortgagee," if they know of the drug operations and make the property "available" for such use. (See § 856(a)(2)).

Given this background, three obvious questions arise: First, since medical marijuana dispensaries are legal in California, can the feds still target such dispensaries as illegal drug operations? Answer: Yes. Without getting into the politics, because federal law trumps state law, federal law enforcement can regard medical marijuana dispensaries as illegal drug operations.

Second, is mere status as a mortgagee bank enough to "manage and control" the property used in the drug operations? Unfortunately, legislative history does not explain what was meant or intended. Neither does case law answer this question.

Nevertheless, the word “mortgagee” is expressly used in the crack-house statute, so it must mean something. Case law does suggest that a person must have a legal relationship to the property and can be held liable by allowing the activity to continue, which implies that the person must be in a position to stop it. Whether a mortgagee has the power to stop illegal activity on the property may depend upon nuances of real estate law, e.g., mortgagees may not be in privity with the offenders, who may not be the mortgagors, but instead tenants or merely occupants.

Third, how would a mortgagee bank “know” that the property was being used for illegal drug operations? Ordinarily, it would not know; but of course, this is where things get interesting.

In the Fall of 2011, the four California U.S. Attorneys began serving banks with ***notices*** that properties on which they held mortgages were being used to operate medical marijuana dispensaries in violation of federal law, giving the banks forty-five days to stop the illegal activity or else. In other words, the government provided notice to prove — and to create — the mortgagee’s knowledge of the illegal drug operations. This is a classic set up which the government no doubt hopes will eliminate an “innocent owner” defense and enable forfeiture of the secured property free and clear of the mortgagee’s lien.

In effect, the feds are trying to transform innocent banks into knowing participants in drug operations by technically putting the banks on notice, and then trying to coerce the banks into enforcing the law on behalf of the federal government under threat of criminal liability and forfeiture. What chutzpah! And from a practical standpoint, banks are being put in a completely untenable position. Mortgagees rarely are in actual possession of the property, and foreclosure and eviction takes more time than the forty-five days typically given by the government to stop the illegal activity.

At some point, there may be a judicial pronouncement that clarifies the scope of this supposed “mortgagee” liability, probably by explaining when mortgage holders “manage and control” the property for purposes of the crack-house statute. The immediate problem, however, is what mortgagee banks and their counsel should do in response to this situation. Coordinated lobbying and appeals to congressional representatives seem appropriate. Banks should also review their portfolios to identify potential

problem properties and explore the possibility of drafting loan documentation giving them the ability to oust owners, tenants, and occupants more expeditiously. And if a bank receives a “notice” letter in the meantime? Ask the government for more time.

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