

## Bogart That Joint, But Don't Bankrupt It: Cannabis Businesses in Bankruptcy

September 29, 2019

New York Law Journal

September 23, 2019 by [Aaron R. Cahn](#)

Among the various state and federal insolvency schemes, the U.S. Bankruptcy Code is, as a practical matter, the only one that allows a business in financial distress to reorganize its debts and continue as a going concern, as opposed to simply closing up shop or selling its assets. The ability to file a federal bankruptcy case is thus an important resource for struggling businesses. It is particularly important to start-up businesses in an emerging field, such as the production and marketing of cannabis-related products.

It is precisely this resource, however, that is currently being denied to cannabis-related businesses. While many states have legalized the use of marijuana, whether in the form of medical marijuana dispensaries or simply approving it for recreational use, use of marijuana for any purpose is still barred by federal law, specifically, the Federal Controlled Substances Act, 21 U.S.C. §§801-904 (the CSA). Thus, cannabis-related businesses—whether growers, marketers, retail stores or medical dispensaries, not to mention anyone whose business involves dealings with one of the above categories—must make sure that they conduct their business so as not to violate federal law. Primarily, this means confining activities to one state so as not to invoke federal jurisdiction.

But if a cannabis-related business runs into financial difficulty and wants to reorganize, it will be forced to invoke federal jurisdiction, in the form of the Bankruptcy Code. The Department of Justice, which monitors all bankruptcy cases through the U.S. Trustee Program, has been taking a very active stance against bankruptcy cases filed by cannabis-related businesses. The U.S. Trustee has argued in case after case—successfully—that to permit the maintenance of a bankruptcy case filed by a cannabis business is improper, since it would require a federal court to put its stamp of approval on a business which would violate federal criminal law. A representative sample of such holdings includes *In re Rent-Rite Super Kegs West, Ltd.*, 484 B.R. 799, 805 (Bankr. D. Colo. 2012); *In re Arenas*, 535 B.R. 845 (10th Cir. BAP 2015); *In re Medpoint Mgmt.*, 528 B.R. 178, 188 (Bankr. D. Ariz. 2015); *In re McGinnis*, 453 B.R. 770, 772 (Bankr. D. Or. 2011); and *In re Way to Grow*, 597 B.R. 111 (Bankr. D. Colo. 2018).

The latest such declaration came on May 21, 2019, from Bankruptcy Judge Thomas Tucker of Detroit. In *In re Basrah Custom Design*, 2019 WL 2202742 (Bankr. E.D. Mich. May 21, 2019), Judge Tucker dismissed a bankruptcy case filed by a company which was not even in the marijuana business itself but whose principal had, in the name of the debtor corporation, leased property he owned to a company which operated a medical marijuana dispensary. Such a business was legal under Michigan law, but was of course a violation of the CSA.

The debtor was primarily in the business of manufacturing handcrafted wooden furniture. However, because it knowingly leased property to a medical marijuana dispensary and sought to profit from that relationship, the court found that to permit the debtor access to the federal bankruptcy court would be effectively condoning a violation of federal criminal law.

And while the *Basrah* court appeared to indicate that it might have reached a different result if the debtor had been able to show that it was attempting to sever its connection with the marijuana related business—an argument that the debtor raised but which the court found was

precluded by the findings in a prior state-court litigation—it made clear that so long as a debtor continues to operate or associate with a business that violates federal law, the bankruptcy courts will not be open to it.

It should be noted that U.S. Trustee, which is an office in the Justice Department that is charged by law with monitoring the progress of bankruptcy cases and which has an open commission to take a position on any issue it deems worthy of the court's consideration, has made a policy decision to object to any bankruptcy case involving a marijuana business, however indirectly. This means that a cannabis-related business can't decide to gamble that no creditor will object to its being in bankruptcy; on the contrary, it can be sure that the U.S. Trustee will bring the issue to the court's attention. Thus, given the unlikelihood that a federal court will decide that federal law should take a back seat to state statutes which directly conflict with the federal criminal code, it seems that the closure of the bankruptcy courts to marijuana businesses is here to stay, absent a change in the statutes.

While a couple of cases have provided some measure of relief from the almost automatic dismissal, they don't really solve the problem. The court in *In re Johnson*, 532 B.R. 53, 58 (Bankr. W.D. Mich. 2015), was loath to dismiss the Chapter 13 case of an elderly man with serious health issues, and clearly in need of relief under Title 11, who was growing marijuana for sale to medical dispensaries as permitted by Michigan law. The court ordered the debtor to exit the marijuana business and destroy his plants and the products thereof as a condition of maintaining the case. But this "solution" is not a practical alternative for cannabis-related businesses.

Some have taken heart from the Ninth Circuit's recent decision in *Garvin v. Cook Invs. NW*, No. 18-35119, 2019 WL 1945280 (9th Cir. May 2, 2019), where the Court of Appeals affirmed the confirmation of a reorganization plan of a cannabis-related business over the protests of the U.S. Trustee. But as the *Basrah* court pointed out (fn 38. Slip op. p.20), the court in *Garvin* did not actually decide the primary question; rather, as a result of procedural missteps by the U.S. Trustee, the court only decided that the proposed plan was not "proposed by any means forbidden by law," which was the confirmation standard on which the trustee hung his hat. *Garvin* held that the quoted confirmation standard was procedural rather than substantive, and so the fact that it was approving a reorganization of a marijuana-related business was not violative of any of the confirmation standards of 11 U.S.C. §1129(a). Thus, it is clear that until something changes, any cannabis-related business or any business in a relationship with one will likely find itself barred from the door of the federal bankruptcy courts.

---

*Aaron R. Cahn is counsel at Carter Ledyard & Milburn.*

Reprinted with permission from the September 23, 2019 edition of the New York Law Journal© 2019 ALM Media Properties, LLC. All rights reserved. Further duplication without permission is prohibited. For information, contact 877-257-3382, [reprints@alm.com](mailto:reprints@alm.com) or visit [www.almreprints.com](http://www.almreprints.com).

## **related professionals**

**Aaron R. Cahn** / Counsel

D 212-238-8629

[cahn@clm.com](mailto:cahn@clm.com)