

Cannabis Businesses in Bankruptcy

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Client Advisory

June 26, 2019 by Aaron R. Cahn

With many states taking action to legalize the use of marijuana, whether in the form of medical marijuana dispensaries or simply approving it for recreational use, it is well to stay aware that use of marijuana for any purpose, including medicinal, is still barred by federal law. Although there have not appeared to be any criminal prosecutions recently in states which have legalized some form of marijuana use, the federal ban still has considerable power to damage businesses with activities that are otherwise legal. One battlefield that is seeing a rise in activity is the bankruptcy court, where judges in several different cases have decided that a marijuana-related business, or even a business with connections to a marijuana-related business, are not eligible for bankruptcy protection because their activities violate federal criminal law.

The latest such declaration came on May 21, 2019, from Bankruptcy Judge Thomas Tucker of Detroit. In *in re Basrah Custom Design, Inc.*, 2019 WL 2202742 (Bankr. E.D. Mich. May 21, 2019), Judge Tucker dismissed a bankruptcy case filed by a company which was not in the marijuana business itself but whose principal had, in the name of the corporation, leased property he owned to a company which operated a medical marijuana dispensary. Such a business was legal under Michigan law, but was a violation of the Federal Controlled Substances Act, 21 U.S.C. §§ 801-904 (the "CSA").

The Debtor was, as its name suggests, primarily in the business of manufacturing handcrafted wooden furniture. However, because it knowingly leased property to a medical marijuana dispensary – itself a violation of the CSA – 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.

This case followed several other bankruptcy cases reaching the same result, primarily in Colorado, many of which are discussed in the court's opinion. 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 them.

In many, if not all, of these cases, the party objecting to the case remaining in bankruptcy was not a creditor but rather the United States 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. Given that the office has apparently made it a policy to object to any bankruptcy case involving a marijuana business, and 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 would appear that the closure of the bankruptcy courts to marijuana business is here to stay, absent a change in the statutes.

Among the various state and federal insolvency schemes, the United States 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. The ability to file

bankruptcy is thus an important resource for businesses, and this is particularly true in a field that is just beginning to develop. That, at least for the foreseeable future, marijuana-related businesses will be deprived of the protections of the Bankruptcy Code is a point that anyone in the business, or thinking about going into the business, should carefully consider when developing a business strategy.

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