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ABSTRACT

An increasing number of states are permitting marijuana sales, and an increasing number of individuals are seizing the opportunity to start businesses in an exciting new industry. Though exciting, it is also an industry with an abundance of headwinds: complicated regulatory schemes, high tax rates, and the oversupply of marijuana products as many rush into the industry has led to some firms struggling financially. This Article will summarize the law that prevents such firms from accessing the federal bankruptcy system, analyze some relevant cases pointing at potential routes to bankruptcy for unique situations, and then address state law alternatives to bankruptcy. It will argue that the states that created the environment for these firms' existence should take steps to ensure the firm and its creditors have access to the debtor-creditor law processes that other legal firms of the state enjoy. While federal government action to permit access to bankruptcy would be a more robust protection of debtors and creditors, most states have room to improve their laws such that their bankruptcy alternatives are available to marijuana businesses.

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I. INTRODUCTION

Business dynamism, or the process by which firms enter, grow, contract, and exit the market, is essential to advanced economies' growth.[1] Firm failure allows resources to be reallocated to more efficient firms or other industries entirely, and is thus an essential component of aggregate economic growth.[2] Society accepts that this means entrepreneurship is both essential and risky. In each annual cohort of new business entities from 1994 to 2005, only about 35% still operated ten years after their start.[3] In order for resources to be reallocated such that dynamism is a force for aggregate growth, firm failure cannot be so painful that those involved are unable to take on new risks in the future. Policy experts recommend reducing regulatory barriers, improving bankruptcy regulations, and facilitating access to capital to promote dynamism.[4] Unfortunately, entrepreneurs in the state-legal marijuana business do not benefit from any of these policy protections.

Consider Jeremy, a marijuana grower in Washington state.[5] Jeremy faces a 37% state tax, is not allowed to deduct any expenses from his federal income taxes,[6] and must comply with a complicated state regulatory scheme, including keeping his property closely monitored by state mandated security systems,[7] as well as maintaining a license that costs over $1,000 annually.[8] He is likely unable to use traditional credit markets, and even if he has access to a federally-regulated banking system for a checking account,[9] it costs him much more than it would a typical banking customer.[10] These heightened borrowing costs mean that Jeremy likely operates his business mostly with cash; an estimated 70% of marijuana businesses operated in cash only in 2020 due to this and other barriers.[11] Much of the west coast of the United States, including Washington, is currently facing an oversupply of marijuana which cannot be shipped out of state, putting downward pressure on prices in an industry with thin margins.[12] If these pressures became enough that Jeremy finds himself thinking an exit would be appropriate, he will be limited to

1. ORG. FOR ECON. COOP. AND DEV., *Declining Business Dynamism: Cross-Country Evidence, Drivers and the Role of Policy* (Jan. 2021), https://www.oecd.org/sti/ind/declining-business-dynamism.pdf.

2. *Id*.

3. BUREAU OF LABOR STATISTICS, *Business Employment Dynamics: Entrepreneurship and the U.S. Economy*, https://www.bls.gov/bdm/entrepreneurship/bdm_chart3.htm

4. ORG. FOR ECON. COOP. AND DEV., *supra* note 1.

5. Gene Johnson et al., *Guanja Glut? With Excess Weed, Growers Seek Interstate Sales,* AP NEWS (Apr. 19, 2023) https://apnews.com/article/cannabis-marijuana-420-legal-california-oregon-washington-ae7880387eee7dbfcfecaff563d0b211.

6. 26 U.S.C. § 280E.

7. WASH. ADMIN. CODE §§ 314-55-083(2), (3) (2023).

8. WASH. ADMIN. CODE § 314-55-075(2023).

9. Shariq Khan, *U.S. Pot Sellers Stash Cash as Banks Leave Them High and Dry*, REUTERS (May 24, 2021) (Five hundred fifteen of the more than 8,200 federally registered banks and one in thirty credit unions in the United States worked with marijuana businesses at the end of 2020).

10. See Mia Getlin, Navigating Today's Wild West: Cannabis Clients Lack Banking Options Amid Onerous Federal Requirements, Or. St. Bar Bull., Apr. 2019, at 32, 34 (stating that high cost of banking services "leads many [cannabis-related] businesses to continue operating in cash.").

11. Anh Hatzopoulos, *The Cost of Cash for Unbanked Cannabis Businesses*, FORBES (July 13, 2020, 8:20 AM), https://www.forbes.com/sites/forbesfinancecouncil/2020/07/13/the-cost-of-cash-for-unbanked-cannabis-businesses/?sh=1debb7cff4dd (stating that "an estimated 70% of cannabis businesses resort to cash-run operations.").

12. *See* Johnson, *supra* note 5.

the options available under state law. As a marijuana grower, he is directly involved with a federally illegal industry and will be barred from bankruptcy protection.

This Article will analyze the limited relief available to financially struggling marijuana businesses[13] under federal bankruptcy law and related state law. To do this, it will first present the status of state law and public opinion to highlight how this problem stands to become even more pronounced if additional states implement similar laws. It will then address relevant provisions of the Controlled Substance Act[14] and the Bankruptcy Code[15] to explain why bankruptcy courts are left with no choice but to dismiss most cases brought by debtors involved in the marijuana industry. Finally, this Article will conclude that, despite recent cases permitting limited availability of bankruptcy relief to marijuana businesses, these cases are of limited use to most insolvent marijuana businesses. Because bankruptcy offers minimal relief to most marijuana businesses, states that have legalized the sale of marijuana should take steps to ensure that state law insolvency proceedings, including receivership and assignments for the benefit of creditors, are fully available to marijuana businesses.

A. The Grass is Always Greener: Varying State Policies

Thirty-eightlaws that allow marijuana use in state borders.[16] At least twenty-three states and D.C. have adopted laws allowing for recreational use of the drug.[17] Although state law will continue to vary based on local opinions and support,[18] polling now indicates that the majority of Americans support marijuana legalization.[19] In fact, Gallup polls indicate that even the majority of Republicans support legalization of the drug in some form.[20]

Perhaps the growing number of states legalizing the use and sale of marijuana is unsurprising: the policy preference now reflected by the majority of states did not appear out of thin air. As the "laboratories of democracy,"[21] states have

13. Throughout this article, I will refer to the businesses at issue as "marijuana businesses." Some articles discuss these businesses instead as "cannabis businesses." Cannabis refers to all products derived from the plant *Cannabis sativa.* Since 2018, however, there is a distinction between all cannabis and marijuana that is relevant to legality under the Controlled Substances Act: hemp, a product derived from the plant *Cannabis sativa* but with under 0.3 percent of THC, the intoxicating compound marijuana is known for, was distinguished from intoxicating marijuana and permitted for cultivation. John Hudak, *The Farm Bill, Hemp Legalization, and the Status of CBD: An Explainer*, BROOKINGS (Dec. 14, 2018), https://www.brookings.edu/blog/fixgov/2018/12/14/the-farm-bill-hemp-and-cbd-explainer.

14. 21 U.S.C. §§ 801-971.

15. 11 U.S.C. §§ 101-1532.

16. CONF. OF STATE LEGISLATORS, *State Medical Cannabis Laws* (Apr. 3, 2023), https://www.ncsl.org/health/state-medical-cannabis-laws.

17. *Id.*

18. Alex Leeds Matthews et al., *Where is Marijuana Legal and How Do People Feel About It?*, CNN (Mar. 7, 2023), https://www.cnn.com/2023/03/07/us/20230306-oklahoma-marijuana-vote-five-charts-dg/index.html (noting that Oklahoma will reject a recreational marijuana initiative).

19. *Id.*

20. *Id.*

21. New State Ice Co. v. Liebmann, 285 U.S. 262, 311 (1932) (Brandeis, J., dissenting) ("[A] single, courageous State may…serve as a laboratory; and try novel social and economic experiments without risk to the rest of the country.").

experimented with differing levels of access to marijuana since 1996.[22] More cautious states took note of the effects of allowing greater access, and some opted to follow suit.

Even states more hesitant to adopt robust marijuana use rights, including Missouri, could not ignore the opportunity to capture excise tax revenue. In just its first month of legalizing recreational marijuana, Missouri generated $71 million in marijuana sales revenue.[23] With a state tax on marijuana of 6% for recreational and 4% for medical, and options to allow local governments to tack on up to an additional 3%,[24] lawmakers who might have been otherwise hesitant to endorse the legalization of marijuana use can justify the decision as one that makes fiscal sense. In 2021, tax revenue from marijuana in the 11 states that allowed recreational marijuana was greater than the revenue raised from the alcohol industry in those same 11 states.[25]

This increasingly accepting state landscape has opened the door to opportunities for marijuana entrepreneurs. However, individuals looking to become involved in the marijuana industry must accept even more risk than is typically taken on when starting a new business venture. Given the conflict between restrictive federal criminal laws and more permissive state laws concerning the use and sale of marijuana, businesses that are involved with the marijuana industry do not have access to the kinds of federally regulated industries or federally managed processes that other entrepreneurs might take for granted.[26] For example, in the event of insolvency, a business even tangentially involved in the marijuana business will likely not have access to bankruptcy protection.

22. Mary Barna Bridgeman & Daniel T. Abazia, *Medicinal Cannabis: History, Pharmacology, And Implications for the Acute Care Setting,* (Mar. 2017), https://www.ncbi.nlm.nih.gov/pmc/articles/PMC5312634 ("In 1996, California became the first state to permit legal access to and use of botanical cannabis for medicinal purposes under physician supervision with the enactment of the Compassionate Use Act.").

23. Sara Melanson, & Delaney Tarpley, *Recreational Marijuana Sales in Missouri Exceeds $70 Million in First Month*, KOMU (Mar. 7, 2023), https://www.komu.com/news/state/recreational-marijuana-sales-in-missouri-exceeds-70-million-in-first-month/article_fe5c63c2-bd27-11ed-9aae-8b032ff169bd.html.

24. *Id*. This option has been carried out in several Missouri cities, including Kansas City, St. Louis, and Columbia. Rudi Keller, *Local Marijuana Sales Taxes Pass Easily in Most Communities in Missouri elections*, MO. INDEPENDENT (Apr. 5, 2023), https://missouriindependent.com/2023/04/05/local-marijuana-sales-taxes-pass-easily-in-most-communities-in-missouri-elections.

25. Carl Davis & Mike Hegemen, *Cannabis Taxes Outraised Alcohol by 20 Percent in States with Legal Sales Last Year*, INST. ON TAX. AND ECON. POLICY (Apr. 19, 2022) https://itep.org/cannabis-taxes-outraised-alcohol-by-20-percent-in-states-with-legal-sales-last-year (authors also notes that neither raised as much revenue as tax on tobacco).

26. David S. Ruskin, Horwood Marcus & Berk, *Counseling a Cannabis-Related Business: Overview*, Practical Law Practice Note Overview w-019-3208 (Thomson Reuters ed., 2019).

II. A FEDERALISM HAZE: WHEN CAN BANKRUPTCY COURTS ALLOW STATE-LEGAL MARIJUANA BUSINESS DEBTORS TO FILE FOR BANKRUPTCY IF MARIJUANA IS A SCHEDULE 1 CONTROLLED SUBSTANCE?

A. The Controlled Substances Act

Lack of access to bankruptcy court for marijuana businesses is due to the Controlled Substances Act of 1970, ("CSA").[27] Section 841(a)(1) of the CSA provides that it is "unlawful for any person knowingly or intentionally . . . to manufacture, distribute, or dispense, or possess with intent to manufacture, distribute, or dispense, a controlled substance," except as otherwise authorized by the CSA.[28] The CSA places all substances that are in some way regulated by federal law in one of five schedules based on the substance's use, potential for abuse, and safety or dependence liability.[29] Marijuana falls in Schedule 1.[30]

Schedule 1 is the most restrictive designation in the CSA, and the only purpose authorized under the CSA for Schedule 1 substances is use in federally authorized research.[31] All other activities that are currently being done to facilitate the growth of this new industry—including the "manufacture, distribution, dispensing or possession with intent" to do one of those things—.

Additionally, § 846 states that, "[a]ny person who attempts or conspires to commit any offense defined in [the CSA] shall be subject to the same penalties as those prescribed for the offense, the commission of which was the object of the attempt or conspiracy." In general, federal appellate courts have determined that, in drug conspiracy cases, the prosecution must prove beyond a reasonable doubt that a conspiracy existed, and that the accused knew of it and knowingly and voluntarily joined it.[32] No overt act is necessary to establish a violation.[33]

Finally, § 856 makes clear that knowingly opening, leasing, renting, using, or maintaining of any place, "whether permanently or temporarily, for the purpose of manufacturing, distributing, or using" marijuana is a violation of its own.[34] So is managing or controlling any place, "whether permanently or temporarily, either as an owner, lessee, agent, employee, occupant, or mortgagee," "with or without compensation …for the purpose of unlawfully manufacturing, storing, distributing, or using" marijuana.[35] Violation of the CSA is punishable with possible imprisonment

27. 21 U.S.C. §§ 801-971.
28. § 841.
29. UNITED STATES DRUG ENFORCEMENT ADMINISTRATION, *The Controlled Substances Act*, https://www.dea.gov/drug-information/csa (last accessed Apr. 18, 2023).
30. 21 C.F.R. § 1308.11 (2023) (opium derivatives, heroin, and morphine are also included in Schedule 1).
31. *See* 21 U.S.C. § 823.
32. *See*, *e.g.*, United States v. Ross, 58 F.3d 154, 159 (5th Cir. 1995).
33. United States v. Shabani, 513 U.S. 10, 11 (1994) (explaining that 21 U.S.C. § 846, the drug conspiracy statute, does not require the government to prove a conspirator committed an overt act in furtherance of the conspiracy).
34. § 856(a)(1).
35. § 856(a)(2).

of up to 20 years and a possible criminal fine of up to $2 million "for a person other than an individual,"[36] as well as the possibility of substantial civil penalties.[37]

While many states have decriminalized the use and possession of marijuana, the federal government has not.[38] Just because a given state has decided not to include in its criminal code an offense does not mean that a business is not subject to federal criminal liability. This limits access to bankruptcy for actors all along the chain of the marijuana business.

B. Bankruptcy

Bankruptcy is explicitly addressed in the Constitution as the founders decided there should be bankruptcy policies that apply uniformly across the U.S.[39] Bankruptcy law was not addressed in the Articles of Confederation, and the insolvency laws that states created and enforced were often pro-debtor and disadvantaged out-of-state creditors.[40] Two of the primary public policies underlying the modern bankruptcy system are the orderly, equitable distribution of bankruptcy estate assets to similarly situated creditors and the chance for an honest debtor to obtain a fresh start.[41] These policies lay the foundation for much of the text and application of the Bankruptcy Code. This subsection will first describe the general legal provisions applicable in all bankruptcy cases that uphold the policies of equitable distribution to similarly situated creditors and the chance at a fresh start for the debtor. It will then briefly summarize relevant chapters of the Bankruptcy Code that may apply when a bankruptcy court considers whether a marijuana business may file for bankruptcy.

The Bankruptcy Code was adopted in 1978 and significantly amended by the Bankruptcy Abuse Prevention and Consumer Protection Act ("BAPCPA") in 2005.[42] The Bankruptcy Code first includes Chapters 1, 3, and 5, which are general

36. § 856(a)(2).

37. *See* §§ 856(b), 856(d).

38. There has been a *de facto* policy for the federal government to not enforce penalties pursuant to the CSA against businesses operating in compliance with state law, starting in the Obama administration with what is often referred to as the "Cole Memo." James M. Cole, *Memorandum for All United States Attorneys*, U.S. DEP'T OF JUST., (Aug. 29, 2013), https://www.justice.gov/iso/opa/resources/3052013829132756857467.pdf. While not followed by all subsequent attorneys general, and not the explicit policy of the current administration, current Attorney General Merrick Garland signaled the policy of his department will be "very close" to the Cole memo. Jane Haviland, *AG Garland Signals That Department Of Justice's Cannabis Policy Will Be "Very Close" To Cole Memorandum*, JDSUPRA (Mar. 16, 2023), https://www.jdsupra.com/legalnews/ag-garland-signals-that-department-of-1762337. Additionally, President Biden issued a pardon for all those convicted of simple possession and has called for a review of the marijuana's Schedule 1 classification. The White House, *Statement from President Biden on Marijuana Reform* (Oct. 6, 2022), https://www.whitehouse.gov/briefing-room/statements-releases/2022/10/06/statement-from-president-biden-on-marijuana-reform. There have also been attempts at creating a safe harbor for financial institutions to handle state-legal businesses cut down on how much of the business is run in cash. *See, e.g.*, H.R.1996 SAFE Banking Act of 2021 117th Congress (2021) (passed House). While these are signals of more tolerance, none cure the federal illegality under the CSA.

39. *See* U.S. CONST. art. 1, § 8, cl. 4 (authorizing Congress to enact "uniform Laws on the subject of Bankruptcies throughout the United States").

40. Michelle M. Harner, *Rethinking Preemption and Constitutional Parameters in Bankruptcy*, 59 WM. & MARY L. Rev. 147, 158 (2017).

41. Margaret Howard, *A Theory of Discharge in Consumer Bankruptcy*, 48 OHIO ST. L.J. 1047, 1048 (1987).

42. William L. Norton III, *BAPCPA*, NORTON BANKR. L. & PRAC. 3d. (2023).

provisions that apply to all bankruptcy cases. For example, a debtor is protected by an "automatic stay" from any debt collection efforts from the moment he files his petition.[43] The automatic stay is generally immediately effective, regardless of a creditor's knowledge of the bankruptcy case.[44] Violation of the automatic stay can result in fines and other penalties.[45] This halt of collection activities is meant to give the debtor "breathing room," to formulate his next steps, and can be seen as a preview of the "fresh start" that the debtor might earn with successful completion of bankruptcy.[46]

Another general provision applicable in all bankruptcy cases is the priority in which creditors get paid. In reorganization bankruptcies, each class of claimholders must receive at least as much on their claims as they would in a Chapter 7, so the liquidation process sets the floor for distribution requirements.[47] That process pays creditors in a very specific order. First, the Bankruptcy Code respects the state law property interests reflected in valid security interests, so secured creditors are paid the greater of the value of their claim or the value of the collateral that secures their claim.[48] Next, if there is any remaining amount owed after collateral value is exhausted, the secured creditor has an unsecured claim for that remaining amount.[49] After secured creditors are paid, the Bankruptcy Code provides an order in which some unsecured creditors are paid through a priority list, reflecting the value placed on particular categories of creditors.[50] After each category of priority unsecured creditor is paid in full, general unsecured creditors get a pro rata distribution of their claims for any amount of money left to be distributed, if there is any.[51] This scheme illustrates what is meant by "similarly situated creditors," placing a higher priority on certain claims.

Bankruptcy also grants the person acting as the trustee the power to review all executory contracts and unexpired leases and, with a few exceptions, determine which of those obligations to assume and which to reject.[52] Obligations which are assumed may generally be assigned to third parties to preserve value for the estate.[53]

Additionally, the Bankruptcy Code has provisions beyond the automatic stay to prevent creditors from behaving badly and putting more pressure on an already distressed debtor. Trustees can void preferential transfers, which are payments made on existing debt while the debtor was insolvent that makes the creditor better

43. § 362 Automatic Stay, 10 NORTON BANKR. L. & PRAC. 3D 11 U.S. § 362 (2023).
44. *See, Id.* at § 362(b).
45. *Id.* at § 362(k)(1).
46. There are limits to this powerful tool. While the automatic stay generally lasts until the earlier of the dismissal or close of a bankruptcy case, in the event of a repeat filing, the automatic stay might only last for 30 days or never go into effect. *Id.* at §§ 362(c)(3), (c)(4). Additionally, in some cases a secured creditor may request relief from the automatic stay to ensure their collateral is "adequately protected." §§ 361, 362(d)(2023).
47. § 1129(a)(7)(2023).
48. § 506(a)(2023).
49. *Id.*
50. 11 U.S.C. § 507. (Describing for example, second priority goes to expense of bankruptcy estate administration, seventh to unpaid rent, and eighth to various tax claims). *See* 11 U.S.C. §§ 507(a)(2),(7),(8) (2023).
51. 11 U.S.C. § 726.
52. 11 U.S.C. § 365.
53. 11 U.S.C. § 365(f)(1). (describing that a typical example of "assumed to assign" is when a business has a contract to perform a service at some date in the future over the going market rate. The Estate may assume the contract but sell the right of actual performance to another party closer to the market rate and keep the difference for itself).

off than they would have been through the routine claim payment process in a Chapter 7 bankruptcy case.[54] Trustees have a similar ability to bring actions to void fraudulent transfers for the benefit of general unsecured creditors.[55] These trustee powers ensure that similarly situated creditors are actually treated similarly.

Following the Bankruptcy Code's generally applicable provision chapters, the Bankruptcy Code is divided into chapters outlining how different kinds of honest debtors may utilize the bankruptcy process. Chapter 7 provides for liquidation of a debtor's non-exempt assets by a panel trustee appointed by the court for the orderly satisfaction of creditor claims.[56] An individual, partnership, corporation, or other business entity is eligible to go through the process;[57]however, only individuals that meet particular limitations on income and debts qualify for a discharge under Chapter 7.[58] Alternatively, individuals may also choose to do a reorganization bankruptcy by filing under Chapter 13, where they agree to pay 36 to 60 months of their future disposable income,[59] and are rewarded with a discharge if they successfully make all required monthly payments.[60]

Finally,[61] Chapter 11 is the reorganization Chapter primarily used by businesses.[62] Chapter 11 is for a debtor that wishes to continue operating while repaying creditors through a court-approved plan.[63] Often, the debtor is able to continue making decisions for his [illegible]. The debtor is also the sole party with the ability to propose a plan for reorganization for the first 120 days after filing,[64][illegible] meaning that Chapter 11 debtors retain a level of control over the estate that other chapters of bankruptcy do not provide. To reflect that reality, the debtor is referred to as the "Debtor in Possession" ("DIP"), and a trustee is only appointed if the court determines appointing one is necessary[65]

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54. 11 U.S.C. § 547(b).

55. 11 U.S.C. §§ 544(b); 548.

56. UNITED STATES COURTS, *Chapter 7- Bankruptcy Basics*, SERV. & FORMS, https://www.uscourts.gov/services-forms/bankruptcy/bankruptcy-basics/chapter-7-bankruptcy-basics (last visited Aug. 22, 2023). The federal exemptions scheme is given in § 522(d), but many states have their own exemptions.

57. 11 U.S.C. §§ 101(41), 109(b).

58. 11 U.S.C. § 727(a)(1) (business entities ineligible for discharge); § 704(b) (describing the "means test" which, if failed by the debtor, makes her ineligible for discharge under Chapter 7).

59. 11 U.S.C. § 1325(4)(A).

60. 11 U.S.C. § 1328(a).

61. There are other chapters available to specific types of debtors. For example, Chapter 9 is for the adjustment of debts of a municipality, Chapter 12 is available as a reorganization bankruptcy for family farmers and fishermen, and Chapter 15 is for cross-border bankruptcy. Additionally, Chapter 11 includes a subsection meant to be a faster Chapter 11 process for small businesses. For simplicity, this Article only considers Chapter 11.

62. Chapter 11 is still available to individuals, and individuals with debt too high for a Chapter 13 and income too high for a Chapter 7 might be forced into this option to take advantage of the bankruptcy processes. *See generally* § 109(e). However, because of its greater expense, and being more labor intensive than the average consumer debtor needs, the vast majority of Chapter 11s are filed by business debtors. In 2020, just 547 of the 8,333 (roughly 6.6%) Chapter 11 filings were non-business filings. *Table F-2, U.S. Bankruptcy Courts—Business and Nonbusiness Cases Commenced, by Chapter of the Bankruptcy Code, During the 12-Month Period Ending December 31, 2020*, ADMIN. OFF. U.S. COURTS, http://www.uscourts.gov/sites/default/files/data_tables/bf_f2_1231.2016.pdf.

63. UNITED STATES COURTS, *Process—Bankruptcy Basics*, SERV. & FORMS, https://www.uscourts.gov/services-forms/bankruptcy/bankruptcy-basics/process-bankruptcy-basics (last accessed Apr. 20, 2023).

64. 11 U.S.C. § 1121(b).

65. 11 U.S.C. § 1107(a).

In addition to more flexibility and control, a major benefit in a Chapter 11 is the DIP's ability to use § 365: because it is the DIP acting as the trustee, she is the one that gets to decide which executory contracts and unexpired leases to assume and which to reject. This scheme allows the DIP to consider which contracts are essential to continue operation and which would be better to let go in a consolidated fashion.

III. HASHING THINGS OUT: WHY A MARIJUANA DEBTOR CAN NEVER BE AN "HONEST" DEBTOR IN THE EYES OF THE BANKRUPTCY SYSTEM

Congress wants to limit the benefits of bankruptcy to the honest, but unfortunate, debtor.[66] The Bankruptcy Code has several mechanisms available to courts and parties in interest to prevent a debtor that the law would deem undeserving from gleaning the benefits of bankruptcy. In bankruptcy cases involving a marijuana debtor, courts often return to similar issues.

The most severe tool available to courts is dismissal, which can be done "for cause."[67] "Cause" is a broad category that includes "gross mismanagement of the estate,"[68] notable losses to the estate that are unlikely to be rehabilitated,[69] and a debtor's inability to follow the plan the debtor agreed to follow.[70] The list provided in the Bankruptcy Code defining "cause" is non-exhaustive, so even if courts could not fit a continuing violation of state or federal law into "gross mismanagement of the estate," violation of non-bankruptcy law is an example of activity by the estate that could be "cause" for dismissal. Dismissal may also be justified because bankruptcy is an action in equity, and judges take an oath to uphold the law.[71] Absent the statutory provisions that demand compliance with non-bankruptcy law, judges may be unwilling to permit a debtor to file for bankruptcy to liquidate or reorganize if the business is related to an industry that sells products that are illegal to own or possess under federal law, including the CSA.

Dismissal is one of the most drastic remedies available to a court when a debtor violates its statutory duties under the Bankruptcy Code. Under the same Bankruptcy Code section that allows dismissal "for cause," a court could also convert a reorganization bankruptcy case to a liquidation bankruptcy under Chapter 7 or appoint a trustee or examiner in the place of the DIP in a Chapter 11 case.[72] Although these outcomes are far from ideal for a Chapter 11 debtor, who would prefer to remain in control of the operation of the business and have a chance at a discharge, in many cases, other benefits are enough to make staying in bankruptcy preferable.

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66. Springer et al., *The Bankruptcy Code's Cannabis Challenge: The Past, Present and Future of Bankrupt Cannabis Businesses*, 30 No. 2 J. BANKR. L. & PRAC. NL Art. 1.

67. 11 U.S.C. § 1112(b)(1).

68. 11 U.S.C. § 1113(b)(4)(B).

69. 11 U.S.C. § 1113(b)(4)(A).

70. 11 U.S.C. § 1113(b)(4)(M).

71. *See, e.g., In re* Johnson, 532 B.R. 53, 56-58 (Bankr. W.D. Mich. 2015) (stating that authorizing debtor to continue generating income from marijuana operations appears inconsistent with judicial oath to uphold the law).

72. 11 U.S.C. § 1112(b)(1). An examiner's role is more limited than that of a trustee. Examiners take on investigatory roles of a trustee and perform any roles that a court has ordered a DIP not to perform. 11 U.S.C. § 1106(b).

Even if debtors comply with their statutory obligations under the Bankruptcy Code, if they propose plans that are not in "good faith" or "compliance with the law," their plans filed in reorganization bankruptcy cases cannot be confirmed.[73] A plan that depends even tangentially on criminal activity is typically found to "def[y] existing law and can neither have been proposed in good faith nor overcome its unfeasibility."[74] Similarly, a liquidation bankruptcy case may be dismissed where a trustee would be asked to administer an estate comprised of marijuana assets or proceeds of an illegal operation.[75] For these reasons, it is understandable that bankruptcy courts, with a few potential exceptions in the Ninth Circuit, have been remarkably decisive and harsh in their conclusions about access to the bankruptcy system for debtors even tangentially related to the marijuana industry. While access to bankruptcy sometimes depends on how much involvement with marijuana a debtor has, courts remain likely to smell a CSA violation if reorganization depends on the marijuana industry's success.

Unsurprisingly, the most resounding bar to bankruptcy comes in situations where the debtor is directly involved in the marijuana industry either as a producer, seller, distributor, or as a property owner that profits from "plant-touching" operations. There is no flexibility for courts in a situation where a marijuana debtor intends to carry on as before they entered bankruptcy or, in the case of a liquidation, where the estate has mostly marijuana assets.[76] Even segregating marijuana income from other income and fully funding a reorganization plan with permissible income is unlikely to cure the issues if a debtor is profiting from marijuana in any way, as courts see this as their consenting to the debtor benefiting from illegal actions under the CSA.[77]

Because knowing use of one's property for a marijuana business is as much a crime under the CSA as producing or distributing, [78] courts are similarly resistant to allowing access to bankruptcy for landlords or warehousers knowingly renting to marijuana business lessees.[79] One difference for marijuana landlords might be the ability to more easily distance themselves from the industry, but even that depends

73. 11 U.S.C. § 1129(a)(3).

74. *See* Springer, *supra* note 66.

75. *Id.* ("A marijuana debtor's bankruptcy thus contains the seeds of its own demise: no trustee could legally carry out its responsibilities under the Code when such tasks would necessitate selling and handling the tainted product or demand reliance on revenues derived from an illegal drug, as such cases effectively impel.").

76. *See, e.g.*, *In re* Arenas, 535 B.R. 845 (B.A.P. 10th Cir. 2015) (Case dismissed for "lack of good faith" measured by an objective standard where income generated by the estate was connected to the marijuana industry and could not be administered in Chapter 7, even though disabled debtor was unlikely to find employment to fund a Chapter 13), *In re* Arm Ventures, LLC, 564 B.R. 77, 85 (Bankr. S.D. Fla. 2017) ("[A] plan based on income derived from the sale of marijuana can be deemed 'bad faith.'").

77. *In re* Johnson 532 B.R. 53, 57–58 (Bankr. W.D. Mich. 2015) (Chapter 13 debtor had to choose between marijuana business and bankruptcy protection where he had enough income to fund a plan from Social Security payments, but the other half of his income came from marijuana distribution); *but see* Garvin v. Cook Invs. NW, SPNWY, LLC, 922 F.3d 1031, 1033 (9th Cir. 2019) (allowing a corporate affiliate of the debtor to continue renting to a marijuana business but through a bankruptcy court approved plan).

78. 21 U.S.C. § 856.

79. *See In re* Rent-Rite Super Kegs West Ltd., 484 B.R. 799, 809 (Bankr. D. Colo. 2012) (Debtor's continued collection of rent from tenants cultivating marijuana in his warehouse after entering bankruptcy constituted "gross mismanagement of the estate" under § 1112(b) and required dismissal or conversion to Chapter 7).

on the court's willingness to look past a debtor coming into bankruptcy with continuing ties to their lessees.[80]

Where a debtor is merely tangentially related to the marijuana industry, it can be difficult to discern at what point the connection is too significant to trigger status as a "marijuana business."[81] Courts seem to err on the side of caution: where the success of the debtor's reorganization plan is too closely tied to the success of the marijuana industry, a court may deny confirmation of the debtor's reorganization plan and dismiss the case even if the debtor never themself grows or sells marijuana.[82] While "the mere presence of marijuana near a bankruptcy case does not automatically prohibit a debtor from bankruptcy relief,"[83] if the debtor stands to gain in any way from marijuana activities,[84] a court is likely to dismiss. Courts are so committed to staying away from even tangential connection to the marijuana business that they have permitted involuntary debtors to use it as a shield to prevent creditors from forcing it into bankruptcy.[85]

A. A less blunt instrument from the Ninth Circuit?

Some scholars speculate that a few anomalous cases from the Ninth Circuit represent a growing path into bankruptcy for some marijuana debtors.[86] For individual debtors, in *In re Wright,* a bankruptcy court observed that, *"*[t]he mere fact that a trustee cannot liquidate the debtor's assets does not make the debtor ineligible for Chapter 7 relief... [a]n individual Chapter 7 case [has] two purposes: liquidation of an estate and discharge of a debtor. The ability to liquidate an estate is not a prerequisite to a discharge."[87] The debtor in *Wright*, owned a marijuana business, converted their Chapter 13 case to Chapter 7, no party objected to the case's

80. *See In re* Olson No. 3:17-BK-50081-BTB, 2018 WL 989263, at *6 (B.A.P. 9th Cir. Feb. 5, 2018) (Debtor sought to reject the lease of the dispensary so she could sell underlying real property might be permitted to do so where she severed ties with the dispensary and there are no post-petition CSA violations).

81. *See* Lauren A. Newell, *Hitting the Trip Wire: When Does a Company Become a "Marijuana Business"?,* 101 B.U. L. REV. 1105, 1132 (2021).

82. *In re* Way To Grow, Inc., 597 B.R. 111, 114 (Bankr. D. Colo. 2018), *aff'd In re* Way to Grow, Inc., 610 B.R. 338 (D. Colo. 2019) (Debtor was in the business of creating hydroponic gardening tools which could be used for any kind of indoor gardening, but debtor readily admitted the success of reorganization hinged on continued growth of the marijuana industry in Colorado).

83. *In re* Burton, 610 B.R. 633, 637 (B.A.P. 9th Cir. 2020).

84. *Id.* Debtors were simultaneously litigating a breach of contract claim that arose from operating their marijuana business while in bankruptcy; because potential recovery in contract case would represent lost profits from the illegal endeavor, the court dismissed. *Id.* at 634.

85. *In re* Medpoint Mgmt., 528 B.R. 178 (Bankr. D. Ariz. 2015) Creditors tried to force business whose sole income was fees from trademark licensed to medical marijuana dispensary into bankruptcy; case dismissed as trustee would not be permitted to administer assets obtained in violation of CSA. *Id.* at 188.

86. Kathleen Allare et al., *Distressed Cannabis: Growing Room for Bankruptcy in the Ninth Circuit,* JDSUPRA (Feb. 9, 2023), https://www.jdsupra.com/legalnews/distressed-cannabis-growing-room-for-4705042; Michael Pankow et al., *A Possible, but Narrow, Path for Cannabis in Bankruptcy Court,* BROWNSTEIN (Feb. 28, 2023), https://www.bhfs.com/insights/alerts-articles/2023/a-possible-but-narrow-path-for-cannabis-in-bankruptcy-court.

87. Memorandum re Marijuana Cultivation and Chapter 13 at 23, 26, *In re* Wright, Case No. 07-10375, Dkt. No. 32 (Bankr. N.D. Cal. August 3, 2007).

conversion, and the debtor obtained a discharge.[88] This case has not been generally followed.[89]

In the business debtor context, in *In re Garvin,* the Ninth Circuit approved a Chapter 11 plan where a debtor who leased commercial property to a marijuana grower specifically rejected the grower's lease, even though other real estate holding companies affiliated with the debtor continued to rent to the grower.[90] The plan would not be directly funded through proceeds of the lease, but the U.S. Trustee objected that the illegal proceeds would indirectly benefit the debtor.[91] The court held that § 1129(a)(3) "directs courts to look only to the proposal of a plan, not the terms of the plan."[92] Thus, if nothing on the face of the plan violates the law, the plan may be confirmed.[93] Notably, the Ninth Circuit noted that the U.S. Trustee neglected to renew its motion for dismissal for gross mismanagement of estate assets under § 1112(b). This comment suggests that the Ninth Circuit might have reached a different result if the § 1112(b) objection had been raised.[94]

The Ninth Circuit's interpretation of § 1129(a)(3) was not well received in *In re Basrah Custom Design, Inc* ("*Basrah*").[95] The court decided that because it was a federal court whose inaction would permit a violation of federal law under the CSA, dismissal was warranted.[96] *Basrah* had many other facts that confound the issue of whether a debtor involved in commercial real estate can cure the past wrong of leasing to a marijuana business by rejecting marijuana-related leases,[97] but the reaction of a court outside of the Ninth Circuit is worth noting.

The Bankruptcy Appellate Panel for the Ninth Circuit held in *In re Olson*, that there was not sufficient factual finding to warrant the lower court's dismissal of the debtor's bankruptcy case upon learning of the debtor's past commercial real estate income derived from a marijuana dispensary lessee.[98] The facts in *Olson* were far from typical, however, which make it of little precedential value for other marijuana businesses. In *Olson*, the debtor was 92 years old, blind, and living in an assisted

88. *Id.*

89. *See, e.g., In re* Arenas, 535 B.R. 845, 854 (B.A.P. 10th Cir. 2015); *In re* Johnson 532 B.R. 53, 55 (Bankr. W.D. Mich. 2015).

90. Garvin v. Cook Invs. NW, SPNWY, LLC, 922 F.3d 1031, 1033 (9th Cir. 2019).

91. *Id.*

92. *Id.* at 1035.

93. *Id.*

94. The court seems to hint at as much in describing why its holding will not lead to marijuana businesses using bankruptcy to facilitate legal violations. *Id.* at 1036.

95. *In re* Basrah Custom Design, Inc. 600 B.R. 368, 381 n.38 (Bankr. E.D. Mich. 2019) ("The decision of the Ninth Circuit Court of Appeals in *Garvin* is not binding on this Court, and, with respect, this Court does not necessarily agree with the *Garvin* court's holding about § 1129(a)(3). And, respectfully, one might reasonably question whether the *Garvin* court should have refused to decide the § 1112(b) dismissal issue. That refusal, on waiver grounds, arguably is questionable, because it allowed the affirmance, by a *federal* court, of the confirmation of a Chapter 11 plan under which a debtor would continue to violate *federal* criminal law under the CSA.").

96. *Id.*

97. *Id.* The marijuana business to whom debtor was leasing had shown in state court that its lease included the option to purchase the building in the "green zone" of Detroit for $1.2 million. Debtor did not want to give up the building for what it realized was less than it could get. In the words of the US Trustee, "debtor wants to use this bankruptcy case "'to set aside this illegal contract [*i.e.*, the November Lease] so that he can negotiate a better illegal contract.'" *In re* Basrah Custom Design, Inc., 600 B.R. 368, 382 (Bankr. E.D. Mich. 2019).

98. *In re* Olson, No. 3:17-BK-50081-BTB, 2018 WL 989263, at *1 (B.A.P. 9th Cir. Feb. 5, 2018).

living facility.[99] The debtor's affairs were managed by her son.[100] Her ability to reject the dispensary's lease under § 365 so that she could sell the underlying commercial property turned on her *mens rea* that would indicate her culpability for violating the CSA.[101] If she had no knowledge that she was renting to a dispensary, she could not have violated CSA § 856.[102] The debtor had testified in bankruptcy proceedings that she did not want to be renting to a marijuana business.[103]

In early 2023, a Ninth Circuit bankruptcy court continued to inspire speculation that marijuana businesses might have more access to bankruptcy in *In re Hacienda*.[104] There, the court surprised the debtor and the trustee alike by denying the U.S. Trustee's motion to dismiss for cause under 11 U.S.C. § 1112(b). The debtor was in the "business of wholesale manufacturing and packaging" marijuana products under the "Lowell Herb Co." ("Lowell Farms" or "Lowell") brand.[105] Lowell Farms ceased marijuana-related operations on February 25, 2021.[106] Lowell Farms had at one time owned land intended for marijuana cultivation, but never grew any marijuana. The debtor sold the land in 2020 to pay creditors.[107] When Lowell Farms ceased operations in 2021, it sold all operations to a publicly-traded Canadian company. The sale was structured as a transfer of intellectual property, transferring the "Lowell" brand, not as a sale of an operational marijuana production company.[108] The acquiring company was in the business of marijuana growth and sales, legal under Canadian law.[109] Lowell, in return, got a 9.4% equity interest in the Canadian marijuana company.[110]

After the sale, Lowell filed for bankruptcy under Chapter 11. It initially intended to propose a plan of reorganization that provided for Lowell to sell off the shares of the Canadian marijuana company in an orderly fashion and use the proceeds from the stock sale to pay creditors, or else distribute the shares of the Canadian company to its creditors directly.[111] Lowell's counsel stressed that it would be important to sell to the shares gradually to preserve value for creditors.[112]

The bankruptcy court determined the Bankruptcy Code gave it discretion to decide whether dismissal was appropriate, especially where there were no ongoing post-petition violations.[113] Here, the U.S. Trustee failed to establish that the debtor committed any post-petition violations of the CSA, whether through connection to distribution of marijuana, or through investing in a company connected to

99. *Id.*
100. *Id.*
101. *Id.*
102. *Id.*
103. *Id.*
104. *See, e.g.*, Michael Herz & Keith Owens, *In re The Hacienda Company, LLC—a Flicker of hope for Distressed Cannabis Companies: Can Non-Operating Cannabis Companies Liquidate in Bankruptcy*?, JDSUPRA (Apr. 20, 2023), https://www.jdsupra.com/legalnews/in-re-the-hacienda-company-llc-a-4696468; James Nani, *Cannabis Ruling Offers Narrow Path to Bankruptcy Perks*, BLOOMBERG L. (Feb. 9, 2023), https://news.bloomberglaw.com/bankruptcy-law/cannabis-ruling-offers-narrow-path-to-bankruptcy-perks.
105. *In re* Hacienda Co., LLC, 647 B.R. 748, 750 (Bankr. C.D. Cal. 2023).
106. *Id.*
107. *Id.*
108. *Id.*
109. *Id.*
110. *Id.*
111. *In re Hacienda Co., LLC*, 687 B.R. at 750.
112. *Id.*
113. *Id.*

marijuana.[114] The debtor's proposed plan ensured it would have no part in distributing marijuana and that it would terminate its connection to the business to preserve value for creditors.[115] The debtor's retention and sale of stock in the Canadian marijuana company was for the purposes of paying its creditors, not to preserve its investment in the company.[116]

Additionally, the court held that the U.S. Trustee had not shown that if a trustee had to be appointed, the trustee would be forced to engage in activity that violated the law.[117] The debtor no longer had possession of any marijuana or marijuana related products.[118] Even if the debtor did have possession, the court reasoned that problem could be solved by "asking the responsible federal authorities to dispose of the estate's marijuana" and then fulfill the trustee's statutory duty to "liquidat[e] other estate property for distribution to creditors in accordance with the priorities of [§] 726."[119] Alternatively, the court decided that even if the U.S. Trustee had established a violation of the CSA, there is not a "zero-tolerance" rule mandating dismissal.[120]

B. Potential impact of Hacienda et al.: extracting oneself to reorganize?

While even the most liberal reading cannot understand *Hacienda* to do much to open bankruptcy to those directly involved in the marijuana industry (and hoping to remain that way), it might be construed as an intensification of the trend among Ninth Circuit bankruptcy courts. Under *Hacienda*, bankruptcy may be available to businesses once directly involved in the marijuana industry if it can present a reorganization plan that is not dependent on continuing interaction with the industry. However, to have the best chance at bankruptcy protection, debtors relying on the line of cases from the Ninth Circuit should do all they can to terminate any connection to the marijuana industry well before filing so that there are no post-petition violations of the CSA.

In *Hacienda*, the debtor had not been directly involved in marijuana operations in the United States for over a year.[121] Ceasing operations at least one year before

114. *Id.*
115. *Id.*
116. *Id.* The court also noted that, were the court to do more research on the issue than was required by a motion to dismiss, it might discover that the sale of the Canadian stock was a violation of the CSA. The court merely stated that on the sources provided by the parties there was no proven violation. *Id.* at 752.
117. *In re Hacienda Co., LLC*, 687 B.R. at 752.
118. *Id*.
119. *Id*. at 753 (citing Steven J. Boyajian, *Just Say No to Drugs? Creditors Not Getting a Fair Shake When Marijuana-Related Cases are Dismissed*, 36 AM. BANKR. INST. J. 24, 75 & n. 21 (Sept. 2017)). Interestingly, the *Hacienda* court doubled down on the idea also presented in this article that it is not a guarantee that the government's rights to seize such assets would supersede the creditor's rights, and that a trustee might be duty bound to administer assets instead of handing them over. *Hacienda* 647 B.R. at 753. The U.S. Trustee's office published a paper that pushed back on this idea in 2017, but it is unknown what the response would be today. *See* Clifford J. White III and John Sheahan, *Why Marijuana Assets may not be Administered in Bankruptcy*, https://www.justice.gov/ust/file/abi_201712.pdf/download (last accessed Apr. 21, 2023).
120. *Hacienda*, 647 B.R. at 754 (citing *In re Burton*, 610 B.R. 633, 637 (B.A.P. 9th Cir. 2020) (no per se rule requiring dismissal when marijuana is present)).
121. *Id.* at 576.

filing for bankruptcy is not tenable advice for most businesses in financial distress. While a marijuana business considering filing for Chapter 11 may want to eliminate a business unit as part of its reorganization plan, this is more readily achieved while already in bankruptcy, with available features like the automatic stay and ability to reject undesired executory contracts. Cutting ties to troubling business units prior to enjoying bankruptcy benefits like these makes bankruptcy less useful.

Additionally, the analysis would be different in *Hacienda* if the stock at issue was in a U.S., rather than a Canadian, marijuana company. While the court was hesitant to say that liquidating the Canadian stock did not violate the CSA,[122] finding a CSA violation in that scenario would imply that much larger transactions ignored by the Department of Justice were also violations.[123] It has become increasingly common for major U.S. stock exchanges to include publicly traded stock of foreign marijuana companies that comply with the law of their jurisdiction.[124] Additionally, major U.S.-based asset management firms have created exchange-traded funds that invest in these stocks.[125]

Hacienda's "bankruptcy preparation" model-- selling operations or assets to a company operating in a country where marijuana is completely legalized in exchange for the foreign corporation's stock—is not a workable recommendation for most distressed U.S. marijuana businesses hoping to preserve access to bankruptcy. That said, to carry out a similar transaction with a U.S. marijuana corporation instead of a Canadian corporation would almost certainly violate the CSA.[126] A debtor who holds stock in a U.S. corporation that deals in marijuana in a way that violates the CSA is likely to find itself in a situation more like the Chapter 13 debtor in *Johnson*, where the debtor was forced to choose between destroying the marijuana-related assets or losing bankruptcy protection.[127] When given a choice between only these options, bankruptcy does not offer a significant benefit.

While *Hacienda* may look like a more open door to bankruptcy for marijuana businesses on first glance, it is merely a modest continuation of the cases in the Ninth Circuit and their combined efforts to be as accommodating to a debtor connected to the marijuana industry as the law reasonably permits.[128] In *Hacienda*, the debtor had not been in the industry for over a year, and transferred its marijuana business to a Canadian company. In exchange for selling its business, the debtor

122. *See Hacienda*, 647 B.R. at 757.

123. *See, e.g.*, Joshua Horn & Waverio S. Romeo, *US Investments in Foreign Cannabis: Unspoken Safe Harbor or Federal Tripwire?,* THE LEGAL INTELLIGENCER (May 13, 2022), https://www.foxrothschild.com/publications/us-investments-in-foreign-cannabis-unspoken-safe-harbor-or-federal-tripwire (noting Constellation Brands, Inc., an American alcohol company, made a $4 billion (USD) investment in Canopy Growth Corp., a Canadian cannabis company traded on the NASDAQ).

124. See, e.g., Karl Kaufman, *A Canadian Marijuana Company is now Trading on the NASDAQ*, FORBES (Feb. 28, 2018), https://www.forbes.com/sites/karlkaufman/2018/02/28/a-canadian-marijuana-company-is-now-trading-on-the-nasdaq/?sh=a444877558ed.

125. *See, e.g*., Fox Rothschild LLP, *Opinion on Legal Status of Cannabis Companies Held by the Cannabis Growth ETF*, https://www.sec.gov/Archives/edgar/data/1587982/000139834421015209/fp0067583_ex991611c.htm (legal opinion memo filed with SEC exploring CSA compliance with ETF known as "Cannabis Growth ETF").

126. 21 U.S.C. § 846 ("Any person who attempts or conspires to commit any offense defined in this title shall be subject to the same penalties as those prescribed for the offense . . ..").

127. *See In re* Johnson 532 B.R. at 55-58.

128. For other views that the Ninth Circuit cases might have limited impact on access to bankruptcy for marijuana businesses, *see* Laura N. Coordes, *Open Door or False Passage? Why Cases in the Ninth Circuit are Unlikely to Lead to Bankruptcy Access for Marijuana-Related Debtors*, 42 No. 9 BANKR. L. LETTER NL 1 (Sept. 2022).

received equity in that legally operating Canadian company the debtor sought to sell to pay its creditors while under the protection of bankruptcy. The fact that the *Hacienda* case could still be dismissed while debtors who benefitted from more egregious pre-petition violations of criminal laws[129] have proceeded is more of an illustration of what kind of problem exists because of the conflict between state and federal law than it is a step towards more access for marijuana debtors. Because of the limited bankruptcy relief available to marijuana businesses, those businesses should consider whether state law alternatives to bankruptcy would provide them with a better venue for resolving their debts.

IV. WEEDING THROUGH SOME PATHS FORWARD: STATE RECEIVERSHIP AND ASSIGNMENTS FOR THE BENEFITS OF CREDITOR LAWS, AND POLICY RECOMMENDATIONS

Even the most permissive bankruptcy courts are prevented from allowing marijuana debtors access to the system in most cases. This does not just harm debtors involved in the industry, it also negatively affects creditors, who are prevented access to a process that ensures they will not be beat out by a similarly situated, but quicker and more aggressive, creditor. While not as comprehensive, and potentially at the risk of being preempted,[130] state law does have some options worth exploring.

A. Receiverships and ABCs

Beyond the rights that creditors have under Article 9 of the Uniform Commercial Code and the real property law of the state, and the creative workout agreements that parties are free to negotiate on their own, there are some state-authorized processes that in some ways mirror the tools and protections available in bankruptcy. Where concern for a struggling business is primarily from creditors, one option available to those creditors is receivership. All states have some kind of receivership common law, and many have now codified that law.[131] Typically, receivership is an equitable remedy sought by a creditor when there is a breach by the debtor.[132] States vary on the circumstances in which a receiver may be appointed other than breach, but some allow for appointment of a receiver in the event of a management dispute within a company,[133] meaning in certain situations a struggling marijuana business itself might have access to this tool without input from creditors.

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129. As the *Hacienda* court points out, including Enron and Bernie Madoff's fund. *See Hacienda*, 647 B.R. at 758.

130. Michelle M. Harner, *Rethinking Preemption and Constitutional Parameters in Bankruptcy*, 59 WM. & MARY L. REV. 147, 197 (2017) ("Although the Bankruptcy Code does not expressly preempt state law in the context of the reorganization of a business by either a plan or sale, the overall scheme of the Bankruptcy Code, and its history, strongly support a finding of implied field preemption.").

131. Corporate Receiverships: Overview, Practical Law Practice Note Overview w-013-1951.

132. *Id*.

133. *See, e.g.*, Uniform Commercial Real Estate Receivership Act: Prefatory Note ("Courts have appointed receivers to preserve property of a…legal entity …where the entity is operationally dysfunctional because of ownership or management dispute"); John Schroyer, *Court-Appointed Receivers and Option for Troubled Marijuana Companies*, JMBIZDAILY (Mar. 22, 2017), https://mjbizdaily.com/court-appointed-receivers-option-troubled-marijuana-companies (highlighting Arizona dispute between co-owners prompting receivership appointment for duration of litigation).

Once appointed by a court, a receiver could continue to operate the company in an attempt to improve its financial performance, sell the business, or liquidate and wind down operations.[134] In all states, receivership is a state court-monitored process.[135] A receiver is an officer of the appointing court and a fiduciary to all creditors of the debtor.[136]

While receivership does not offer the protection from creditor actions available in bankruptcy by the imposition of the automatic stay, state courts routinely issue an injunction upon appointment of a receiver preventing creditors with notice of the receivership from interfering with the receivership estate.[137] Some states grant receivers the same power a bankruptcy trustee has over executory contracts and unexpired leases.[138] Some states also permit a receiver to sell property, or the business as a going concern, free of all liens and encumbrances.[139] One benefit of receiverships to creditors is that a professional fiduciary makes key decisions for the business,[140] as opposed to in Chapter 11 where the debtor retains more control over the business and has more exclusive rights in reorganizing its financial affairs.[141] Perhaps the most important variable for a business exploring receivership as a potential alternative to Chapter 11 is whether the business owners may resume owning and operating the business after creditors' claims are paid.[142] Courts consider receivership to be a drastic remedy to be used only in exceptional circumstances.[143] The party seeking the appointment of a receiver bears the burden of proving the necessity of receivership to preserve the property at issue by a preponderance of the evidence.[144]

If a distressed business merely wants an orderly liquidation, most states also have a straightforward process[145] In an Assignment for the Benefit of Creditors ("ABC"), "[a] distressed company [] assign[s] its assets to a trust administered by an assignee selected by the company." [146]Generally, the assignee resembles a Chapter 7 trustee and oversees the liquidation of the assets, pursues claims, and makes distributions to the company's creditors.[147] ABCs in many states have increased flexibility from a state law analogue to a Chapter 7, and even allow for sale of the

134. Michael R. Herz, *The Difficulty Trustees Face in Cannabis-Related Cases Plus, A Look at State Court Alternatives for Debtors*, AM. BANKR. INST. J., 14, 15 (Sept. 2020).
135. Corporate Receiverships: Overview, Practical Law Practice Note Overview w-013-1951.
136. *Id.*
137. *Id.*
138. *Id*; *see also* Harner, *supra* note 130 at 150, 188-189 (citing WASH. REV. CODE § 7.60.015) (notes that many states have recently amended their ABC and receivership laws to resemble the Bankruptcy Code).
139. *See* Harner, *supra* note 130 at 190 (citing WASH REV. CODE § 760.260(2))
140. Kesselman et al., *After the Green Rush: Bankruptcy Alternatives for Restructuring Cannabis Businesses*, ARENTFOX SCHIFF (Feb. 21, 2023), https://www.afslaw.com/perspectives/alerts/after-the-green-rush-bankruptcy-alternatives-restructuring-cannabis-businesses.
141. 11 U.S.C. § 1121(b) (DIP has the exclusive right to file a plan in the first 120 days of bankruptcy); § 1104 (trustee or examiner only appointed if in the best interest of the creditors and the estate).
142. Kesselman et al., *supra* note 140.
143. *See, e.g.*, City & C. of S.F. v. Daley, 20 Cal. Rptr. 2d. 256, 263 (Cal. Ct. App. 1993).
144. *See generally* Ryan C. Griffith, *Cannabis Receiverships: The Alternative for State Legal Cannabis Businesses Seeking Financial Rehabilitation Locked Out of Bankruptcy Court by the Controlled Substances Act*, 45 SEATTLE U. L. REV. 1107, 1117 (2023).
145. Michael R. Herz, *The Difficulty Trustees Face in Cannabis-Related Cases Plus, A Look at State Court Alternatives for Debtors*, AM. BANKR. INST. J., 14, 15, 70 (Sept. 2020) (Thirty-eight states have a codified ABC process, and several others a common law ABC jurisprudence).
146. *Id.* at 15.
147. *Id.*

business as a going concern.[148] While ABCs are meant to be a liquidation proceeding, there are no limitations on what the debtor can do in the future. For example, if negotiated with a buyer prior to the sale of a business through an ABC process, a debtor may be able to be involved in the business in some capacity after the business' assets are sold.[149]

Like receivership, ABCs were once only permitted under common law, but many states have now codified the process.[150] ABCs are less likely than receiverships to have anything like an automatic stay.[151] Court supervision also varies widely by state.[152] Assignor costs can add up quickly, reducing the funds available to pay creditors.[153] In many states, an under-secured creditor must consent to an ABC before proceedings commence, given the low likelihood for their repayment after assignor costs are covered.[154]

A receivership arrangement or an ABC is generally less expensive than a bankruptcy for both debtors and creditors.[155] However, neither proceeding can give the debtor a discharge.[156] Additionally, administering the assets of a marijuana business is uniquely difficult, even assuming the assignee or receiver is authorized to handle them,[157] due to a limited market for sale of its assets. Because of marijuana's checkered legality across the U.S., it would be difficult to draw a buyer from out of state if the buyer would need to transport illegal goods across state lines.

State law alternatives to bankruptcy can be limited in the relief they provide debtors and creditors compared to bankruptcy, but they represent the best option a state can make available. Even with these imperfect solutions, all states with marijuana legalized in any form have complicated licensing schemes. Unless a state's legislature has specifically granted a receiver or assignee the right to use the licenses held by the party affected, it is uncertain whether the fiduciary can do the same things that the license-holder can. Many states have not explicitly addressed this issue.[158]

A Colorado court recently held that the proposed receiver or assignee must already be in compliance with the relevant Colorado marijuana licensing laws before

148. Edward S. Adams, *When Cannabis Businesses Fail: Assignment for the Benefit of Creditors as an Alternative to Bankruptcy*, 2022 UTAH L. REV. 967, 1000, 1003 (2022)

149. *Id.* (noting this depends also on the relationship between the debtor and purchaser, among other factors).

150. *Id.*

151. Harner, *supra* note 130 at 152 (noting Minnesota and Washington have made even their ABC statutes be formatted to resemble the Bankruptcy Code).

152. Carly Landon, *Making Assignments for the Benefit of Creditors as Easy As A-B-C*, 41 FORDHAM URB. L.J. 1451, 1480 (2014).

153. Steven J. Mitnick and Marc D. Miceli, *Assignments for the Benefit of Creditors: Overview*, Westlaw Practical Law Bankruptcy & Restructuring (Thomson Rueters ed., 2023).

154. Nicholas Gebelt, *What Are ABCs? Assignment for the Benefit of Creditors*, S. CAL. BANKR. L. BLOG (July 18, 2011), https://www.southerncaliforniabankruptcylawblog./2011/07/18/what-are-abcs.

155. Mitnick & Miceli, *supra* note 152.

156. Pobreslo v. Joseph M. Boyd Co., 287 U.S. 518, 524 (1933) (deciding that the ABC was not preempted because process does not offer debtor the discharge).

157. See *Infra* notes 156-163 (discussing licensing transfer issues.).

158. Kesselman et al., *supra* note 140 ("The majority of states and territories that have legalized cannabis — including Alabama, Arkansas, Connecticut, Delaware, Florida, Hawaii, Kansas, Louisiana, Maryland, Minnesota, Mississippi, Missouri, Montana, New Jersey, New York, North Dakota, Utah, Vermont, Virginia, West Virginia, DC, and Guam — have not clarified the rules regarding receivership for cannabis companies.").

they can be appointed.[159] As a result of this requirement in the case at issue, the proposed receiver was unable to take control of the business,[160] and additional value for creditors might have been lost. The court acknowledged that the Colorado Constitution reads: "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,"[161] and also that the Colorado Liquor Licensing scheme allows for temporary licenses when receivers are appointed.[162] The court still held that it could not appoint an unlicensed receiver.[163]

Some states, including California, Washington, and Oregon, anticipated this legal issue and enacted laws to allow a receiver or assignee to temporarily operate marijuana businesses and dispose of assets to provide the most benefit to creditors and debtor alike.[164] Oklahoma, which has only legalized the sale, use, and possession of medical marijuana, allows secured creditors or a receiver to operate the medical marijuana business if they would be qualified to hold the license of the business they are to administer and submit proof to that effect to the state licensing authority.[165] The Oklahoma statute also contemplates foreclosures or sales of medical marijuana businesses as going concerns.[166] Laws like these should be the standard for states that allow for any kind of legal marijuana businesses; at minimum, notifying debtors and creditors of the procedures necessary to transfer licenses in these situations prevents wasting court resources.

Outlining procedures for license transfer in assignment or receivership is the minimum. Because marijuana debtors are generally unable to access the federal bankruptcy system, and marijuana debtors and creditors only exist because of state laws legalizing the use and sale of marijuana, those states should have laws that provide feasible solutions for marijuana businesses when the businesses they permitted are in financial distress. States should create authorizations for receivers and assignees to temporarily handle assets as the debtor winds down or sells its business. Debtors need the ability to move on with their lives, and creditors should be able to protect their interests in a risky industry if a state has changed its laws to legalize the existence of that industry.

B. Change in Federal Policy

The state law tools available are not nearly as powerful as those under the Bankruptcy Code, even though some state's debtor-creditor laws are beginning to resemble their bankruptcy counterparts to such an extent that that some scholars doubt that they would survive a federal preemption challenge.[167] While federal

159. Yates v. Hartman, 488 P.3d 348, 352 (Colo. Ct. App. Mar. 8, 2018) (holding court not permitted to appoint receiver who did not possess proper license over licensed medical and recreational marijuana entities).
160. *Id.*
161. *Id.* at 350
162. COLO. REV. STAT. § 44-3-303 (2023).
163. *Yates*, 488 P.3d at 352.
164. Michael R. Herz, *The Difficulty Trustees Face in Cannabis-Related Cases Plus, A Look at State Court Alternatives for Debtors*, AM. BANKR. INST. J., 14, 15-70 (Sept. 2020).
165. OKLA. STAT. tit. 12, § 1560 (2019).
166. Dolcourt et al., *Limited Options for Cannabis-Related Company Liquidations,* JDSUPRA (Apr. 10, 2020), https://www.jdsupra.com/legalnews/limited-options-for-cannabis-related-20348.
167. Harner, *supra* note 130.

reform could mean rescheduling marijuana in the CSA, change could take less drastic, but arguably similarly effective, forms.[168] For example, Congress could codify federal non-intervention into state-legal marijuana operations,[169] or provide an allowance for bankruptcy in a law similar to the failed Secure and Fair Enforcement Banking Act of 2019 ("SAFE Banking Act") which provided carve outs for banks and other financial service firms providing services to marijuana firms.[170] Absent change in federal law, debtors and creditors will be left hoping lesser state solutions are available with receivers or assignees, and observers will be left excited by cases out of the Ninth Circuit that only go as far as the law and facts allow.

V. CLEARING THE SMOKE: AS THE LAW STANDS, MARIJUANA DEBTORS ARE BARRED FROM BANKRUPTCY

Regardless of growing public acceptance and an increasing number of states permitting sales, marijuana remains a Schedule 1 drug under the CSA. Lack of federal enforcement when it comes to marijuana does not make actions that are illegal under the text of the CSA suddenly legal. Bankruptcy courts, as courts of equity bound to the statutory requirements of the Bankruptcy Code, cannot endorse a debtor's violation of the CSA. They especially cannot endorse post-petition violations. While bankruptcy courts are more willing to search for reasons to allow a marijuana debtor to remain under bankruptcy protections, present examples of marijuana debtors successfully navigating bankruptcy are more factual anomalies than they are examples of how other struggling state-legal marijuana firms might use the bankruptcy system to rehabilitate. Because of this, the states that create the environment for the existence of a marijuana debtor should also make sure they create a regulatory scheme that permits transfer of the necessary state licenses under relevant insolvency law. A qualified receiver or assignee should not be barred from administering a marijuana business because he did not previously hold a license.

Recall Jeremy, the struggling marijuana grower from Washington state. Fortunately for his creditors, Washington's regulatory scheme would permit a receiver to temporarily run Jeremy's business if creditors felt that were necessary, even if that receiver did not hold the necessary license.[171] If Jeremy instead operated in Colorado, this would not be true—an individual that did not already hold an appropriate license could not serve as a receiver for a marijuana business.[172] If Jeremy operated in California, there would be law he could point to that would permit him to assign his license in an assignment for the benefit of creditors arrangement for an orderly wind-down.[173] In all states where Jeremy and his creditors have been permitted to exist, they should also have full use of the state debtor-creditor laws available to other legal businesses, subject to reasonable limitations. The states that have not explicitly addressed this issue need to do so.

168. Springer et al., *supra* note 66.
169. This would make a plan proposed based on a marijuana business' operation no longer in contravention of federal law, and a debtor participating in compliance with state law not one "lacking good faith," *see* discussion *supra* Section III.
170. H.R. 1595, 116th Cong.; S. 1028; S. 3032, 115th Cong. (2018).
171. WASH. ANN. CODE § 314-55-135.
172. *Yates*, 488 P.3d at 352.
173. CAL. CODE REGS. tit. 4, § 15024.

Jeremy and his creditors might be just as happy if Congress mooted this whole discussion by rescheduling marijuana, or enacted some other federal act that would make state-legal marijuana businesses legal under federal law. As there are an increasing number of marijuana businesses, there will be an increasing number of distressed marijuana businesses. While resources might be better allocated away from some distressed businesses, the overall economy is harmed when firm exit is such a painful process that an entrepreneur and his creditors are unable to take on new risks after a previous failed venture. The current bar to bankruptcy for an increasing number of marijuana debtors is understandable, but reasonable alternatives under state law must actually be available to take bankruptcy's place.