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DANKRUPTCY: WHEN THE GREEN RUNS OUT, MARIJUANA DEBTORS HAVE FEW OPTIONS

Jorge J. Rodriguez*

INTRODUCTION

The legalized marijuana industry is lucrative but surrounded with uncertainties. The divergence between state and federal law has pushed this industry into a state of limbo. Furthermore, at the federal level, the lack of enforcing the prohibition has only exacerbated the uncertainty. Historically, the federal government has taken a very relaxed approach and allowed marijuana businesses to operate with minimal interference. As a result, there is a thriving legalized marijuana industry operating throughout the majority of the United States. However, there are many obstacles which plague and threaten the future of this relatively young industry. Of particular importance, and the subject of this Article, is the marijuana industry's lack of access to the bankruptcy courts.¹

Throughout modern history, bankruptcy has been a solution for businesses and individuals suffering from financial difficulties.² Bankruptcy enables a debtor to restructure their obligations, often with the ultimate goal of restoring the business to a level of financial stability.³ The result is usually that through negotiation or operation of law, a debtor's obligation to a creditor

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1. See, e.g., Clifford J. White III & John Sheahan, *Why Marijuana Assets May Not Be Administered in Bankruptcy*, 36 AM. BANKR. INST. J., Dec. 2017, at 34, 34, reprinted in [perma.cc/66JG-HA83] (last visited Sept. 18, 2019).

2. *No Recourse: Putting an End to Bankruptcy's Student Loan Exception*, DEMOS, 3 (Nov. 24, 2015), [https://perma.cc/6UET-QG74].

3. *Id.* at 17.

is significantly decreased or sometimes wiped out altogether.⁴ The extent of restructuring typically depends on the debtor's assets, current income, or both.⁵ The legal term is that part or all of the original obligation is "discharged."⁶ The ability to restructure debt is of the utmost importance for debtors who have accumulated unsustainable debt.⁷ Ultimately, unsustainable debt hinders debtors because the high debt-to-income ratio stifles potential economic growth.⁸

Furthermore, bankruptcy's collective nature and the automatic stay are beneficial to both debtors and creditors alike.⁹ The alternative to bankruptcy would be a state remedy such as a foreclosure, lien, or even a receivership.¹⁰ Typically, such state remedies are less evenhanded because a race-to-the-courthouse mentality is often emphasized.¹¹ In other words, whichever creditor gets to the courthouse and files their claim first is the creditor who has the highest possibility of getting paid.¹² Because of this mentality, at the first sniff of financial distress, creditors tend to rush to get paid before money runs out, even if the business is not necessarily failing.¹³ A non-bankruptcy framework is problematic because creditors, as a result of their own business interests, could potentially destroy an otherwise viable business.¹⁴ A bankruptcy framework would provide

4. David A. Skeel Jr., *When Should Bankruptcy Be an Option (for People, Places, or Things)?*, 55 WM. & MARY L. REV. 2217, 2222 (2014).

5. *Id.* at 2222-23.

6. *Id.* at 2223.

7. *See id.* at 2233.

8. *See id.* (stating that a business might find itself unable to raise the necessary funds it needs to pursue investments that could otherwise benefit both its creditors and itself).

9. The automatic stay is "an injunction [that] is generally imposed against certain creditors who want to start or continue taking action against a debtor or the debtor's property." *Automatic Stay, What Is It and Does It Protect a Debtor from All Creditors?*, U.S. BANKR. CT. CENT. DIST. CAL., [perma.cc/PDT3-UH3V] (last visited Sept. 18, 2019) [hereinafter *Automatic Stay*]; *see* Skeel Jr., *supra* note 4, at 2223 (stating that a bankruptcy framework is beneficial because it adjusts the debtor's relationship with most or all of its creditors, not just one).

10. *See e.g.*, Andy Turner, *New Oklahoma Receivership Law for Marijuana Businesses*, CONNER & WINTERS (May 31, 2019), [perma.cc/2T6V-2FPK].

11. Susan Block-Lieb, *Fishing in Muddy Waters: Clarifying the Common Pool Analogy as Applied to the Standard for Commencement of a Bankruptcy Case*, 42 AM. U. L. REV. 337, 356 (1993).

12. *See id.*

13. *See* Skeel Jr., *supra* note 4, at 2227.

14. *Id.*

debtors with the benefit of the automatic stay, allowing them “breathing room” to configure a repayment plan.¹⁵ Importantly, it would also help in preventing the premature and unnecessary liquidation of state legalized marijuana operations.¹⁶

In 2017, the total amount of bankruptcies filed in the United States amounted to 789,020.¹⁷ Of that number, 23,157 were filed by businesses.¹⁸ The remaining 765,863 were consumer filings.¹⁹ Obviously, bankruptcy is a lucrative option for both businesses and individuals.²⁰ However, unlike most businesses, and despite the growing popularity and acceptance, the legalized marijuana industry is almost categorically barred from the protections of bankruptcy.²¹ Because the bankruptcy laws of the United States are codified under federal law, specifically Title 11 of the United States Code, all bankruptcy cases are heard in federal courts.²² The disparity between federal and state marijuana laws is the main reason that marijuana debtors²³ are unable to avail themselves of the benefits of the Bankruptcy Code.²⁴ With very few exceptions, bankruptcy courts have been adamant in dismissing cases filed by marijuana debtors.²⁵ As a general rule, “[businesses] or individuals that directly derive their income from

15. The automatic stay, triggered by the mere filing of the bankruptcy petition, forces most debt collection efforts to immediately come to a halt. John D. Ayer et al., *An Overview of the Automatic Stay*, 22 AM. BANKR. INST. J., Jan. 2004 at 16, 16, reprinted in [perma.cc/S3FE-8U9W] (last visited Sept. 23, 2019). There are certain debts not covered by the automatic stay. Most common, if a creditor wishes to proceed against the debtor, the creditor will be required to file a motion for relief from the automatic stay. If the bankruptcy judge grants the motion, the automatic stay will either be removed or modified so that the creditor can resume or begin collection efforts against the debtor. *Automatic Stay*, *supra* note 9.

16. Skeel Jr., *supra* note 4, at 2235-36.

17. *Annual Business and Non-Business Filings by Year (1980-2017)*, AM. BANKR. INST., [perma.cc/EXW5-V3M2] (last visited Sept. 23, 2019) (compiling data from the Administrative Office of the U.S. Courts).

18. *Id.*

19. *Id.*

20. *See id.*

21. *See* White III & Sheahan, *supra* note 1.

22. *About Bankruptcy*, U.S. CTS., [perma.cc/N6FF-7DP7] (last visited Sept. 23, 2019).

23. Throughout this article, the term “marijuana debtor” will refer to any debtor who derives income, whether directly or indirectly, from state sanctioned marijuana activity.

24. Alexander Barnes, *Bankruptcy Courts Just Say No to the Marijuana Industry*, OBERMAYER REBMANN MAXWELL & HIPPELL LLP: COM. BANKR. ADVISOR (Jan. 9, 2018), [perma.cc/PH5D-QDE7].

25. *Id.*

the manufacturing, distributing, dispensing[,] or possessing of marijuana are ineligible for bankruptcy relief.”²⁶

This Article in Part I will begin with a brief overview of the history of marijuana, specifically the growing societal acceptance and economic benefits of marijuana. Additionally, Part I explores the inconsistency in the federal prohibition on marijuana and the various state laws that have legalized the drug. Part II will explore the current legal jurisprudence of marijuana as it relates to bankruptcy. Lastly, Part III offers comments and potential solutions to the marijuana industry’s barrier to bankruptcy.

I. HISTORY AND THE CURRENT STATUS OF THE MARIJUANA INDUSTRY

The Controlled Substances Act (CSA) is the main federal statute regulating possession and use of certain substances, such as heroin, marijuana, and cocaine.²⁷ The CSA has five schedules that rank these substances based on three main attributes—potential for abuse, existence of a current medical use, and its potential for safe use under medical supervision.²⁸ The Department of Health and Human Services (HHS) and the Drug Enforcement Administration (DEA) make these determinations.²⁹ Schedule I is for substances that HHS and DEA have determined have the highest potential for abuse with no currently accepted medical use.³⁰ Despite the legalization of marijuana in certain states, under federal law, any use, even simple possession, of any amount of a Schedule I substance is prohibited.³¹

However, notwithstanding the fact that the CSA remains the controlling law, there have been various indications from the federal government which suggest a certain degree of leniency. In response to the legalization of marijuana in certain states, the Obama administration distributed a memorandum to federal prosecutors encouraging them not to prosecute businesses who

26. *Id.*

27. 21 U.S.C. §§ 801-904 (2018); Michael Gabay, *The Federal Controlled Substances Act: Schedules and Pharmacy Registration*, 48 HOSP. PHARMACY 473, 473-74 (2013), <https://www.ncbi.nlm.nih.gov/pmc/articles/PMC3839489/>.

28. 21 U.S.C. § 812 (2018); *see Gabay, supra note 27.*

29. *See Gabay, supra note 27, at 473.*

30. *See id. at 473-74.*

31. *See id. at 474.*

possess, distribute, or manufacture marijuana for medical purposes in accordance with state law.³² Additionally, in 2013, the United States Department of Justice (DOJ) updated their marijuana enforcement policy to reflect the leniency encouraged by the Cole Memo.³³ The DOJ's new policy announced that marijuana enforcement would be deferred to states, but only to those states which had passed their own marijuana measures.³⁴

However, under the administration of President Trump, the DOJ reversed their policy.³⁵ The Attorney General at the time, Jeff Sessions, issued a Marijuana Enforcement Memorandum that annulled the prior Cole Memo.³⁶ The new memorandum allows federal prosecutors to decide individually how to prioritize the enforcement of federal marijuana laws. Specifically, the memorandum directs U.S. Attorneys to “weigh all the relevant considerations, including federal law enforcement priorities set by the Attorney General, the seriousness of the crime, the deterrent effect of criminal prosecution, and the cumulative impact of particular crimes on the community.”³⁷ Despite the recent reversal in federal policy, recent legislation continues to suggest that the stance on marijuana is relatively more relaxed than in prior years.³⁸ For example, Congress recently passed the Farm Bill, which legalized hemp.³⁹ Additionally, Congress has also passed legislation which reduces mandatory sentences, among other things, for non-violent criminal offenses.⁴⁰ Lastly,

32. This memorandum is more commonly referred to as the Cole Memo. Memorandum from James M. Cole, Deputy Att’y Gen., U.S. Dep’t of Justice, on Guidance Regarding Marijuana Enforcement to All United States Att’ys (Aug. 29, 2013), [perma.cc/7V4D-QQUG] [hereinafter The Cole Memo]; see also Laura Jarrett, *Sessions Nixes Obama-era Rules Leaving States Alone That Legalize Pot*, CNN (Jan. 4, 2018), [perma.cc/TSSU-EWPP].

33. *Id.*

34. The Cole Memo, *supra* note 32.

35. Jarrett, *supra* note 32; see also Memorandum from Jefferson B. Sessions, Att’y Gen., U.S. Dep’t of Justice, on Marijuana Enforcement to All United States Attorneys (Jan. 4, 2018), [perma.cc/FRU3-H7JU].

36. *Id.*

37. Memorandum from Jefferson B. Sessions, *supra* note 35.

38. John Hudak, *The Farm Bill, Hemp Legalization and the Status of CBD: An Explainer*, BROOKINGS (Dec. 14, 2018), [perma.cc/K5R8-UC8K].

39. The hemp must be below a certain THC level and regulated through taxation. See *id.*

40. See First Step Act of 2018, Pub. L. No. 115-391, 132 Stat. 5194 (2018); see also CONG. RES. SERV., R4558, THE FIRST STEP ACT OF 2018: AN OVERVIEW (2019).

and most recently, Attorney General William Barr testified before Congress that he would not prosecute businesses operating under the previous Cole Memo.⁴¹ The pressure on the federal government will only continue to increase as more and more states legalize the drug.

A. Societal Acceptance of Marijuana

There have been many policy arguments advanced in favor of marijuana's legalization.⁴² Commonly cited reasons for supporting the legalization of marijuana include the failure on the war on drugs, creation of a new tax revenue, and compassionate care for the sick.⁴³ While the principles behind these policies are still hotly debated, the fact remains that in many states, elected officials and citizens have been persuaded by these arguments.

In 1969, the first year that Gallup asked Americans whether marijuana should be legalized, a mere twelve percent supported legalization.⁴⁴ Steadily however, support for the legalization of marijuana began to grow. Gallup asked again in 2001, and by then, nearly a third of Americans favored the legalization of marijuana.⁴⁵ The most recent Gallup poll shows sixty-four percent of Americans support the legalization of the drug.⁴⁶ Reflecting this change in attitude, many states have legalized marijuana for medical or even recreational use.⁴⁷ Currently, thirty-three states, the District of Columbia, Guam, Puerto Rico and the US Virgin Islands have legalized marijuana in some form.⁴⁸ The first state to legalize marijuana was California in 1996.⁴⁹ Some of the most recent states to legalize marijuana are

41. Tom Angell, *Trump Attorney General Pick Puts Marijuana Enforcement Pledge in Writing*, FORBES (Jan. 29, 2019) [perma.cc/8L6M-TXEZ].

42. See Deborah White, *Pros and Cons of Legalizing Marijuana in the U.S.*, THOUGHTCO. (July 8, 2019), [perma.cc/9A4J-QKKC].

43. *Id.*

44. Justin McCarthy, *Record High Support for Legalizing Marijuana in the U.S.*, GALLUP (Oct. 25, 2017), [perma.cc/FT79-ZSL9].

45. *Id.*

46. *Id.*

47. *State Medical Marijuana Laws*, NAT'L CONF. OF ST. LEGISLATURES (July 2, 2019), [perma.cc/U94K-XN2F].

48. *Id.*

49. *Id.*

Arkansas, Oklahoma, and Utah.⁵⁰ These states are of particular significance because these are three states that are normally considered to be conservative in terms of political ideology. Arguably, this is a clear indicator in the shift in public opinion towards marijuana. The following chart illustrates the states that have passed measures that legalize marijuana. Different states have taken different approaches in how they have accomplished the legalization. A number of states have passed constitutional amendments while others have passed legislation. The left column indicates the state or territory; the middle column indicates whether the state authorizes medical, recreational, or both; and lastly, the final column provides the mechanism used to pass the measure and the date in which the measure was passed.

Breakdown by State

State	Medicinal (M) Recreational (R) Both (B)	Statute
AK	B	Medicinal: Ballot Measure No. 8 (Alaska 1998); S.B. 94, 21st Leg., 1st Sess. (Alaska 1999). Recreational: Ballot Measure No. 2 (Alaska 2014).
AZ	M	Proposition 203 (Ariz. 2010).
AR	M	Issue 6 (Ark. 2016).

50. Sean Murphy & Andrew Demillo, *Conservative States Balk at Voter-Approved Medical Marijuana*, U.S. NEWS (July 13, 2018), [perma.cc/3NC7-LUZD]; Tom Angell, *Utah Voters Approve Medical Marijuana*, FORBES (Nov. 7, 2018), [perma.cc/3DLE-RAJY].

CA	B	Medicinal: Proposition 215 (Cal. 1996); S.B. 420, 2003–2004 Leg., Reg. Sess. (Cal. 2003). Recreational: Proposition 64 (Cal. 2016).
CO	B	Medicinal: Initiative 20 (Colo. 2000). Recreational: Amendment 64 (Colo. 2012); AMENDMENT 64 IMPLEMENTATION TASK FORCE, TASK FORCE REPORT ON THE IMPLEMENTATION OF AMENDMENT 64 (2013).
CT	M	H.B. 5389, 2012 Gen. Assemb., Reg. Sess. (Conn. 2012).
DE	M	S.B. 17, 146th Gen. Assemb., Reg. Sess. (Del. 2011).
FL	M	Amendment 2 (Fla. 2016).
HI	M	S.B. 862, 20th Leg., Reg. Sess. (Haw. 1999).
IL	B	Medicinal: H.B. 1, 98th Gen. Assemb., 2013–2014 Reg. Sess. (Ill. 2013). Recreational: H.B. 1438, 101st Gen. Assemb., 2019–2020 Reg. Sess. (Ill. 2019).
LA	M	S.B. 271, 2016 Leg., Reg. Sess. (La. 2016)

ME	B	<p>Medicinal: Question 2 (Me. 1999); L.D. 611, 120th Leg., 2d Reg. Sess. (Me. 2002); Question 5 (Me. 2009); L.D. 1811, 124th Leg., 2d Reg. Sess. (Me. 2010); L.D. 1296, 125th Leg., 1st Reg. Sess. (Me. 2011).</p> <p>Recreational: Question 1 (Me. 2016); L.D. 1719, 128th Leg., 2d Reg. Sess. (Me. 2018).</p>
MD	M	<p>H.B. 702, 2003 Gen. Assemb., Reg. Sess. (Md. 2003); S.B. 308, 2011 Gen. Assemb., Reg. Sess. (Md. 2011); H.B. 180, 2013 Gen. Assemb., Reg. Sess. (Md. 2013); H.B. 1101, 2013 Gen. Assemb. Reg. Sess. (Md. 2013); S.B. 923, 2014 Gen. Assemb. Reg. Sess. (Md. 2014).</p>
MA	B	<p>Medicinal: Question 3 (Mass. 2012).</p> <p>Recreational: Question 4 (Mass. 2016).</p>
MI	B	<p>Medicinal: Proposal 1 (Mich. 2008).</p> <p>Recreational: Proposal 1 (Mich. 2018).</p>
MN	M	<p>S.F. 2471, 88th Leg., Reg. Sess. (Minn. 2014).</p>
MO	M	<p>Amendment 2 (Mo. 2018).</p>

MT	M	Initiative 148 (Mont. 2004); S.B. 423, 62nd Leg., Reg. Sess. (Mont. 2011); Initiative 182 (Mont. 2016).
NV	B	Medicinal: Question 9 (Nev. 2000); A.B. 453, 71st Leg., Reg. Sess. (Nev. 2001). Recreational: Question 2 (Nev. 2016).
NH	M	H.B. 573, 2013 Leg., Reg. Sess. (N.H. 2013).
NJ	M	S.B. 119, 213th Leg., Reg. Sess. (N.J. 2008).
NM	M	S.B. 523, 48th Leg., 1st Reg. Sess. (N.M. 2007).
NY	M	Assemb. B. 6357, 2013-2014 Leg. Sess., Reg. Sess. (N.Y. 2014).
ND	M	Statutory Measure No. 5 (N.D. 2016).
OH	M	H.B. 523, 131 Gen. Assemb., Reg. Sess. (Ohio 2016).
OK	M	State Question No. 788 (Okla. 2018).
OR	B	Medicinal: Ballot Measure 67 (Or. 1998); S.B. 161, 74th Leg. Assemb., Reg. Sess. (Or. 2007). Recreational: Ballot Measure 91 (Or. 2014).
PA	M	S.B. 3, 2015 Gen. Assemb., Reg. Sess. (Pa. 2016).
RI	M	S.B. 791, 2007 Gen. Assemb., Reg. Sess. (R.I. 2007); S.B. 185, 2009 Gen. Assemb., Reg. Sess. (R.I. 2009).

UT	M	Utah Proposition 2 (2018).
VT	B	Medicinal: S.B. 76, 2003-2004 Gen. Assemb., Reg. Sess. (Vt. 2003); S.B. 7, 2007-2008 Gen. Assemb., Reg. Sess. (Vt. 2007); S.B. 17, 2011-2012 Gen. Assemb., Reg. Sess. (Vt. 2011). Recreational: H.B. 511, 2017-2018 Gen. Assemb., Reg. Sess. (Vt. 2018).
WA	B	Medicinal: Initiative 692 (Wash. 1998); S.B. 5798, 61st Leg., Reg. Sess. (Wash. 2010); S.B. 5073, 62d Leg., Reg. Sess. (Wash. 2011). Recreational: Initiative 502 (Wash. 2012); WASH. ADMIN. CODE §§ 314-55-005 to -540 (2013).
WV	M	S.B. 386, 2017 Reg. Sess. (W. Va. 2017).

B. Economic Impact

In line with this upward trend of legalization at the state level, the marijuana industry is booming. “In 2017, the worldwide legal marijuana trade grew by 37% and was worth \$9.5 billion.”⁵¹ At \$8.5 billion, the U.S. accounted for the highest market share

51. Thomas Pellechia, *In 2017 and Beyond, U.S. Enjoys the Highest Legal Cannabis Market Share Worldwide*, FORBES (June 26, 2018), [perma.cc/5Y4P-A34D] (last visited Aug. 29, 2019).

of the worldwide legal marijuana trade—nearly 90% of the market.⁵² By 2022, legal marijuana revenue in the United States is projected to hit \$23.4 billion.⁵³ Furthermore, the legalized marijuana industry has created over 200,000 jobs throughout the United States.⁵⁴ Additionally, the current and potential tax revenue is enormous. It is estimated that if marijuana were wholly legal in all 50 states, it would create at least \$131.8 billion in federal tax revenue between 2017 and 2025 and more than a million new jobs.⁵⁵ As indicated above, marijuana is legal for adult recreational use in eleven states.⁵⁶ As of 2017, in the three states where adult use has been legal for the longest period of time—Colorado, Washington, and Oregon—there had been a combined total of \$1.3 billion in tax receipts.⁵⁷ The economic benefits of legalization are undeniable.

II. THE TREATMENT OF MARIJUANA IN BANKRUPTCY

As a component of the federal court system, bankruptcy judges have been steadfast in dismissing cases in which the estate is tainted with marijuana assets.⁵⁸ While it is not clear if a bankruptcy court may dismiss a case sua sponte, it may dismiss a case upon the motion of a United States trustee.⁵⁹ In April, Clifford J. White III, Director of the United States Trustee Program (USTP), said in a letter that his office was noticing an

52. *Id.*

53. *Id.*

54. Eli Mcvey, *Chart: Cannabis Industry Employs 165,000–Plus Workers*, MARIJUANA BUS. DAILY (June 26, 2017) [perma.cc/YY6C-E35V] (discussing data indicating that the legalized marijuana industry has generated 165,000-230,000 full and part time jobs).

55. That figure is based on an estimated fifteen percent retail sales tax, payroll tax deductions and business tax revenue. Katie Zezima, *Study: Legal Marijuana Could Generate More Than \$132 Billion in Federal Tax Revenue and 1 Million Jobs*, CHI. TRIB. (Jan. 10, 2018), [perma.cc/C2E5-P7UK].

56. See White, *supra*, note 42; Jeremy Berke & Skye Gould, *Illinois Just Became the First State to Legalize Marijuana Sales Through the Legislature—Here Are All the States Where Marijuana Is Legal*, BUS. INSIDER (June 25, 2019), [perma.cc/7UJU-P7YG].

57. See Zezima, *supra* note 55.

58. Tom Angell, *No Bankruptcy Aid for Marijuana Businesses, Justice Department Officials Say*, FORBES (Dec. 5, 2017), [perma.cc/J6QK-BWKH]; see also D. Alexander Barnes, *Bankruptcy Courts Just Say No to the Marijuana Industry*, JDSUPRA (Jan. 9, 2018), [perma.cc/4MNX-93YC].

59. *In re Arenas*, 535 B.R. 845, 847 (B.A.P. 10th Cir. 2015).

increase in the number of bankruptcy cases involving marijuana assets.⁶⁰ The courts have generally ruled that marijuana debtors cannot obtain relief under the Bankruptcy Code because marijuana remains classified as an illegal substance under the CSA.⁶¹ Additionally, the USTP, an arm of the U.S. Department of Justice overseeing the administration of bankruptcy, has taken the position to seek dismissal of all cases in which marijuana or assets derived from the sale of marijuana are present.⁶² Specifically, the USTP's position to seek a dismissal is premised on the notion that the Bankruptcy Code does not provide a mechanism to administer assets that cannot be legally possessed or sold under federal law.⁶³ Additionally, a secondary argument is that a trustee cannot legally carry out its responsibilities because it would require the trustee to sell and handle profits from an illegal drug.⁶⁴ Thus, it is not surprising that where debtors are directly involved in the cannabis business, such as a dispensary or a grower, "bankruptcy courts have been uniform in dismissing [] cases" or otherwise denying access to the bankruptcy process.⁶⁵ However, the denial of bankruptcy relief goes beyond debtors which were directly involved in the marijuana industry. The following cases illustrate various scenarios and the specific bankruptcy provisions that are being used to deny marijuana debtors relief.

A. *In re Arenas*

The state of Colorado has some of the most expansive and liberal marijuana laws in the United States. Colorado was also one of the earliest states to legalize the drug.⁶⁶ Accordingly, some of the first cases involving marijuana business seeking to file for bankruptcy arose in Colorado.⁶⁷ In the case of *In re Arenas*, debtors, Frank and Sarah Arenas, were licensed to grow and

60. See Angell, *supra* note 58.

61. *Id.*

62. U.S. DEPARTMENT OF JUSTICE, UNITED STATES TRUSTEE PROGRAM, FISCAL YEAR 2020 PERFORMANCE BUDGET 4 (2002).

63. *Id.*

64. *In re Arenas*, 535 B.R. at 848.

65. Barnes, *supra* note 58.

66. See *State Medical Marijuana Laws*, *supra* note 47.

67. See generally Kelsey Butler, *Bankruptcy Filing Isn't Allowed for Marijuana Businesses—So Now What?*, THE STREET, (Oct. 5, 2015), [perma.cc/Q2KP-P3CN].

dispense medical marijuana in the state of Colorado, and they also leased a building to a third party who used it to dispense medical marijuana.⁶⁸ After litigation with the third-party renters resulted in a judgment against them, the debtors filed a Chapter 7 bankruptcy petition.⁶⁹

Because of the marijuana related activities, the trustee sought guidance from USTP as to whether the assets could be administered in bankruptcy.⁷⁰ The USTP determined that the assets could not be administered because marijuana was illegal under the CSA, though legal in Colorado.⁷¹ The trustee “filed a motion to dismiss for cause under § 707(a).”⁷² The debtors promptly objected to the motion to dismiss and moved to convert their case to Chapter 13.⁷³ After an evidentiary hearing on both motions, the bankruptcy court issued a written order denying the debtors’ motion to convert and granting the USTP’s motion to dismiss.⁷⁴ Subsequently, the debtors filed a timely appeal.⁷⁵

The Bankruptcy Appellate Panel (BAP) of the Tenth Circuit focused its inquiry on “whether engaging in the marijuana trade, which [was] legal under Colorado law but a crime under federal law, amount[ed] to ‘cause’ including a ‘lack of good faith’ that effectively disqualif[ie]d the[] otherwise eligible debtors from bankruptcy relief.”⁷⁶ Despite the fact that the debtors’ business was legal under Colorado state law, the Court used *Marrama*⁷⁷ to conclude that the debtors failed to meet the “good faith” requirement of the Bankruptcy Code because the administration of the estate’s assets was forbidden by federal law.⁷⁸ Additionally, the BAP found that by administering the Chapter 7

68. *Arenas*, 535 B.R. at 847.

69. *Id.*

70. *Id.* at 848.

71. *Id.*

72. *Id.* at 848 (Section 707(a) provides that a court may dismiss for cause, including: (1) unreasonable delay; (2) nonpayment of fees; and (3) failure to file the information required by 521(a)).

73. *Arenas*, 535 B.R. at 848.

74. *Id.*

75. *Id.* at 849.

76. *Id.*

77. *See generally* *Marrama v. Citizens Bank of Mass.*, 549 U.S. 365 (2007). In *Marrama*, the Supreme Court held that a debtor who had acted in bad faith by concealing assets while in Chapter 7 could not qualify as a debtor under Chapter 13 because the Chapter 13 case would be dismissed “for cause” under § 1307 of the Bankruptcy Code.

78. *Arenas*, 535 B.R. at 850-53.

estate, the trustee would be required to violate federal law by taking possession and selling the marijuana assets.⁷⁹ Accordingly, the BAP entered an order denying the debtors' motion to convert their case and granting the USTP's motion to dismiss the Chapter 7 case.⁸⁰

B. Unclean Hands: *In re Rent-Rite Super Kegs West Ltd.*

Unlike the case of *In re Arenas*, *In re Rent-Rite Super Kegs West Ltd.* (*Rent-Rite*) does not involve a debtor directly engaged in the marijuana industry, but rather a debtor who merely leased warehouse space to tenants who legally grew marijuana under Colorado law.⁸¹ The debtor in *Rent-Rite* derived approximately twenty-five percent of its revenue from leasing warehouse space to tenants who were engaged in the business of cultivating marijuana.⁸² The debtor filed a Chapter 11 petition and a secured creditor, VFC Partners 14 LLC, filed a motion to dismiss under the “clean hands doctrine.”⁸³ The Court concluded that because the debtor had knowingly and intentionally leased the warehouse to a tenant whose activities violated federal law, the application of the clean hands doctrine was warranted.⁸⁴ Additionally, the Court reasoned that under § 1129(a)(3) plan confirmation requires plans to be “proposed in good faith and not by any means forbidden by law,” and because the debtor’s plan would have been funded through illegal activities, the plan had no reasonable expectation of being confirmed.⁸⁵ The Court ultimately concluded that “cause” existed under § 1112(b), warranting either a conversion or dismissal.⁸⁶

79. *Id.* at 854.

80. *Id.*

81. *In re Rent-Rite Super Kegs W. Ltd.*, 484 B.R. 799, 803-04 (Bankr. D. Colo. 2012).

82. *Id.* at 803.

83. *Id.* at 802.

84. *Id.* at 807-09.

85. *Id.* at 809.

86. *In re Rent-Rite Super Kegs W. Ltd.*, 484 B.R. at 811; *see also*, 11 U.S.C. § 1112(b) (2010). Section 1112(b) governs requests for conversion or dismissal by anyone other than the debtor. 11 U.S.C. § 1112(b). Formally, it provided that upon the request of a party-in-interest, “absent unusual circumstances specifically identified by the court that establish that the requested conversion or dismissal is not in the best interests of creditors and the estate, the court shall convert a case under this chapter to a case under chapter 7 or dismiss a case under this chapter, whichever is in the best interests of creditors and the estate, if the movant establishes cause.” 11 U.S.C. § 1112(b) (2005).

C. *In re Johnson*

In *In re Johnson*, Jerry L. Johnson was a “licensed caregiver and marijuana grower” operating legally under the Michigan Medical Marihuana Act (MMMA).⁸⁷ After falling behind on his house payments, Johnson filed a Chapter 13 to prevent a foreclosure sale of his house.⁸⁸ About one-half of the debtor’s monthly income was from Social Security benefits and the other one-half from his cultivation and sale of marijuana to three patients and a regulated dispensary, pursuant to the MMMA.⁸⁹ The Court took the position that it would not support any “impropriety of requiring the Standing Trustee to hold proceeds of the Debtor’s criminal activity and to use those funds to pay claims under a court-approved plan.”⁹⁰ Nonetheless, the Court declined to dismiss the case and gave the debtor an opportunity to discharge his debts.⁹¹ Because the Court recognized the debtor’s legitimate need for relief under Chapter 13 but was mindful of the continued CSA violations, it stated that:

Under these unusual circumstances, the Debtor must make a choice. He can either continue his medical marijuana business or avail himself of the benefits of the Bankruptcy Code, but not both. If he chooses the latter, the court will require him to discontinue growing, selling[,] and transferring marijuana to any and all patients and dispensaries immediately and to cease using property of the estate to further this activity.⁹²

Ultimately, the Court was sympathetic to the debtor in *Johnson*. The decision to allow the debtor to abandon the illicit assets is symbolic of the overarching conflict between state and federal law.⁹³ The Court created a solution to avoid the unintended but harsh penalty that the debtor would have suffered otherwise. In retrospect, the solution is equitable considering that the debtor likely had no idea that his marijuana operation, albeit

87. *In re Johnson*, 532 B.R. 53, 54 (Bankr. W.D. Mich. 2015) (internal quotations omitted).

88. *Id.*

89. *Id.* at 55.

90. *Id.* at 56.

91. *Id.* at 58.

92. *Johnson*, 532 B.R. at 58.

93. *Id.* at 58-59.

sanctioned under state law, would later preclude him from the protections of the Bankruptcy Code.

D. *In re Olson*

In re Olson bears a resemblance to *Rent-Rite* in that the debtor in each case was involved in the marijuana industry only by virtue of being a landlord to a marijuana business.⁹⁴ In *Olson*, the debtor was a ninety-two-year old, legally blind landlord who owned a commercial real estate property.⁹⁵ One of the tenants at the property operated a state sanctioned marijuana dispensary.⁹⁶ The debtor filed a Chapter 13 petition to prevent foreclosure on the property.⁹⁷ Post-petition, the debtor continued collecting rent payments from the marijuana dispensary.⁹⁸ The debtor's plan called for the sale of the commercial real estate to pay off creditors and, as a result, required rejection of the lease with the marijuana dispensary.⁹⁹ Nonetheless, the district court dismissed the case sua sponte on grounds that the debtor's post-petition acceptance of rents from the dispensary business was an ongoing criminal violation precluding federal bankruptcy relief.¹⁰⁰

Olson appealed, arguing that the bankruptcy court abused its discretion by dismissing the case.¹⁰¹ The Ninth Circuit BAP agreed with the debtor.¹⁰² In vacating the bankruptcy court's order, the BAP found that the bankruptcy court did not adequately articulate the legal basis for its ruling or make findings to support its conclusion that the debtor was violating federal law.¹⁰³ The BAP held that the court could not issue a blanket dismissal of the bankruptcy case, but rather was required to take evidence and make findings on issues of bad faith and unclean hands, as well

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

95. *Id.* at *3.

96. *Id.* at *1.

97. *Id.* at *2-3.

98. *Id.* at *4.

99. *Olson*, 2018 WL 989263, at *3.

100. *Id.* at *4.

101. *Id.* at *4-5.

102. *Id.* at *6.

103. *Id.*

as whether the debtor was actually committing a CSA violation.¹⁰⁴

The concurring opinion written by Judge Maureen A. Tighe also pointed out that “[w]ith over twenty-five states allowing the medical or recreational use of marijuana, courts increasingly need to address the needs of litigants who are in compliance with state law while not excusing activity that violates federal law.”¹⁰⁵ According to Judge Tighe, “the presence of marijuana near the [bankruptcy] case should not cause mandatory dismissal.”¹⁰⁶ Judge Tighe further adds that “[i]f . . . the basis for dismissal is the court’s concern that the Debtor [has] committed a crime[,] . . . an explicit finding of the facts required for criminal liability is needed.”¹⁰⁷ Specifically, the concurrence suggests that any dismissal based on a violation of the CSA would require a showing beyond a reasonable doubt that all the elements of the offense were satisfied.¹⁰⁸

III. FINDING A SOLUTION

First and foremost, the most obvious solution is the removal of marijuana from the CSA. Removing marijuana from the CSA would decriminalize marijuana and allow for the administration of marijuana in bankruptcy.¹⁰⁹ Just recently, Rep. Earl Blumenaur filed a bill to remove marijuana from the federal CSA.¹¹⁰ The bill, H.R. 420, would essentially treat marijuana like alcohol and tobacco if passed.¹¹¹ However, practically speaking, this is the least plausible solution. With the current political climate, the likelihood of Congress passing legislation that would remove marijuana from the CSA is very low.

104. *Olson*, 2018 WL 989263, at *6.

105. *Id.*

106. *Id.* at *7.

107. *Id.*

108. *Id.*

109. See Aaron R. Cohn, *Bogart That Joint, but Don’t Bankrupt It: Cannabis Businesses in Bankruptcy*, LAW.COM (New York Law Journal) (Sep. 20, 2019), [perma.cc/QUH7-8RBG] (discussing the current options cannabis business-owners have and implying that decreased regulation would result in greater financial possibilities).

110. Tom Angell, *New Congressional Marijuana Bill Is Actually Numbered H.R. 420*, FORBES (Jan. 9, 2019), [perma.cc/MA3P-TCGB].

111. *Id.*

A. “STATES Act”

Importantly, the solution to removing the bankruptcy barrier does not require a complete federal legalization of marijuana. Simply, or maybe not so simply, the solution only requires that the court be able to comply with the state law and federal law concurrently.¹¹² One manner in which that could be accomplished is by the federal government deferring marijuana enforcement to the states. The complete removal of marijuana from the CSA is not necessary to accomplish such a measure. An amendment to the CSA’s enforcement and control provision would allow the CSA to continue to criminalize marijuana, but in states that have legalized the drug, the federal government would defer enforcement to those respective states. In 2018, the “STATES Act” was first introduced in the 115th Congress.¹¹³ The proposed bill would not have decriminalized marijuana, but instead would have amended the CSA so that it would not apply to marijuana-related conduct that is legal under state law.¹¹⁴ Even though the STATES Act did not pass, it is relevant because the bill was a bipartisan effort and signals a change in federal legal policy that is likely to continue growing.¹¹⁵

Additionally, although the bill was not directly introduced to solve the bankruptcy dilemma, the passage of the bill would have had the inadvertent effect of allowing marijuana debtors to proceed through the bankruptcy courts.¹¹⁶ Of course, the limitation would be that marijuana debtors would only be able to file for bankruptcy in states which have legalized marijuana. Although, because of jurisdiction and venue considerations, the marijuana debtor would likely always file in a state which had legalized marijuana. Though the support required for the passage of the STATES Act was not quite strong enough in 2018, an additional eight states have since passed legislation that legalized marijuana.¹¹⁷ As more and more states continue to pass their own

112. *Id.*

113. The bill was recently reintroduced in 2019. Matt Laslo, *Lawmakers Optimistic About New Federal Marijuana Bill*, [perma.cc/ZJ9X-E6DT] (last visited Aug. 10, 2019).

114. *Id.*

115. *Id.*

116. Angell, *supra* note 58.

117. *Marijuana Overview*, NAT’L CONF. OF ST. LEGISLATURES (July 26, 2019), [perma.cc/QF9U-Z3WR].

marijuana legislation, the societal acceptance will be such that legislatures will not be able to ignore the desires of their constituents.¹¹⁸

B. *Garvin v. Cook*

The Ninth Circuit recently gave marijuana debtors a sliver of hope in the case of *In re Way to Grow*.¹¹⁹ Facing insolvency, five real estate holding companies owned and managed by Michael Cook (collectively “Cook”) sought Chapter 11 protection.¹²⁰ Cook leased some of its property to N.T. Pawloski, LLC (Green Haven), which used the property to legally grow marijuana.¹²¹ The debtors proposed a plan of reorganization which proposed to pay all creditors in full and provided for Cook to continue operating.¹²² The Trustee, however, objected to confirmation of the plan because the plan was “proposed . . . by . . . means forbidden by law and [was] thus unconfirmable under 11 U.S.C. § 1129(a)(3).”¹²³ Reluctantly, the district court dismissed the debtor’s petition.¹²⁴ The district court stated,

The result in this case may be viewed by many as inequitable. The Debtors are insolvent, and their business could benefit significantly from reorganization under the Bankruptcy Code. The Debtors likely did not seek bankruptcy relief in bad faith on a subjective standard. But for the marijuana issue, this would be a relatively run-of-the-mill Chapter 11 proceeding. . . . At bottom, if the result in this case is unjust, Congress alone has power to legislate a solution.¹²⁵

118. See, e.g., Tom Agnell, *Texas Republican Party Endorses Marijuana Decriminalization*, MARIJUANA MOMENT (June 17, 2018), [perma.cc/KQ49-6ZWN]. Interestingly, President Trump has indicated that he would “probably end up supporting” such a bill if it ever came across his desk. Christian Britschgi, *Trump Endorses Marijuana Federalism Bill* (June 8, 2018), [perma.cc/DL5V-ZESG].

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

120. *Id.*

121. *Id.*

122. *Id.*

123. *Id.* (internal quotations omitted).

124. *In re Way to Grow, Inc.*, 597 B.R. 111, 133 (Bankr. D. Colo. 2018).

125. *Id.*

However, on appeal, the Ninth Circuit Court of Appeals decided it was tired of waiting for Congress to legislate.¹²⁶ In a complete reversal of nationwide precedent, the Ninth Circuit became the first Circuit court to confirm a plan involving income derived from the sale of marijuana.¹²⁷ At contention was § 1129(a), which provides that the court shall confirm a plan only if “the plan has been proposed in good faith and not by any means forbidden by law.”¹²⁸ Throughout the Chapter 11 proceeding, Cook continued to receive rent payment from New Haven, which provided the basis of the Trustee’s argument that the plan could not be confirmed because it was proposed by means forbidden by law.¹²⁹

In resolving the Trustee’s objection, the Ninth Circuit interpreted § 1129(a) narrowly.¹³⁰ Instead of focusing the inquiry on the terms of the plan, the Ninth Circuit instead focused on the proposal of the plan.¹³¹ It held that a statutory interpretation of § 1129(a) mandates the outcome in *Garvin*.¹³² Specifically, the Ninth Circuit stated that “the phrase ‘not by any means forbidden by law’ modifies the phrase ‘the plan has been proposed.’”¹³³ Thus, according to the Ninth Circuit, a plain reading of § 1129(a) does not require that the plan comply with all applicable laws, only that the plan not be *proposed* by means forbidden by law.¹³⁴

This narrow interpretation, albeit beneficial to marijuana debtors, ignores the fact that a trustee, an arm of the federal government, would nonetheless still be administering marijuana assets. Unfortunately, it seems that the district court, despite being subject to the precedent in *Garvin*, was correct in saying that “Congress alone has power to legislate a solution.”¹³⁵ As the social acceptance of the legalized marijuana industry continues to grow, it is likely that courts throughout the country will find technical solutions, such as the one employed by the *Garvin* court,

126. *Garvin*, 922 F.3d at 1033.

127. *Id.* at 1035.

128. *Id.* (internal quotations omitted).

129. *Id.*

130. *Id.* at 1035-36.

131. *Garvin*, 922 F. 3d at 1035.

132. *Id.*

133. *Id.*

134. *Id.*

135. *Way to Grow, Inc.*, 597 B.R. at 133.

to craft holdings more consistent with modern ideologies. Ultimately, however, no amount of statutory interpretation can change the fact that a trustee would be required to handle marijuana, a substance currently still prohibited at the federal level. Until Congress decides to legislate a solution, it seems that any solution crafted by the bankruptcy courts will be at odds with federal policy.

CONCLUSION

The marijuana industry is already a multibillion-dollar industry and will only continue to grow. The need of marijuana debtors to avail themselves of bankruptcy protections is of paramount importance. The most practical solution to removing the barrier that the marijuana industry faces is by congressional action. Members of Congress should vote to pass the STATES Act or a similar bill. A bill that would effectively continue to criminalize marijuana at the federal level, but exempt state legalized activity would allow marijuana debtors access to the bankruptcy courts. Such a bill would solve the conflict because the bankruptcy courts would no longer be faced with the issue of administering a federally criminal substance. Marijuana would only be a criminal offense if the debtor was engaged in conduct prohibited by the CSA and not otherwise allowed by state law. Additionally, the fact that more than half of all states have legislation which have in some shape or form legalized marijuana is indicative of the nationwide acceptance.