AMERICAN BANKRUPTCY INSTITUTE

2020 Mid-Atlantic Virtual Bankruptcy Workshop

# Cannabis in Bankruptcy


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CONCURRENT SESSION

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# Historical Use, and Eventual Criminalization, of Cannabis

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## Terminology: Hemp vs. Marijuana

- Cannabis plants have varying levels of tetrahydrocannabinol (THC), which is the primary psychoactive compound in the cannabis plant that is responsible for the plant's mind-altering effects.

- Both "hemp" and "marijuana" are derived from the cannabis plant. However, hemp is typically used as a term to classify varieties of cannabis plants that contain 0.3% or less THC content, and marijuana is used to classify cannabis plants that contain more than 0.3 percent THC content.


## Historical Use of Hemp Fiber in Cannabis

- The cannabis plant is the oldest known cultivated fiber plant and, before its medicinal properties became known, the fibrous plant was commonly used for textile manufacturing.

- Hemp fiber from cannabis plants can be used to make clothing, paper, sails and rope, and its seeds were used as food.

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## Hemp is the Strongest Natural Fiber in the World

- It is known to have over 50,000 different uses!


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## Early Colonial Use of Hemp from Cannabis Plants

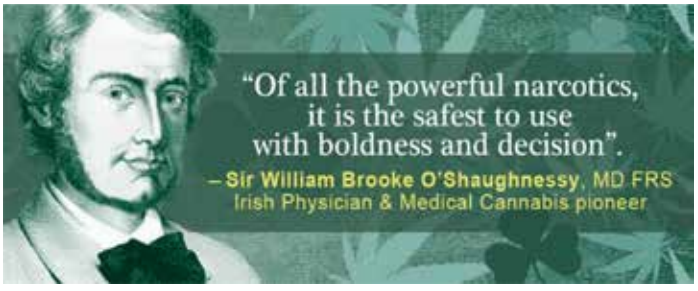
- Cannabis plants were first introduced in North America during the arrival and settlement of European colonists who used it primarily for the strength and the resistance of its fibers.

- In fact, during the early 1600s, farmers in Virginia, Massachusetts and Connecticut were actually required to grow cannabis plants and, in some colonies, hemp was actually exchanged as legal tender.


## Medicinal Use of Cannabis

- About 5,000 years ago, cannabis was first used for its medicinal benefits by the "father" of Chinese agriculture, emperor Shen Nung, who prescribed it for "gout, fatigue, rheumatism and malaria."


- In the 1830s, an army surgeon who had served in India, Sir William Brooke O'Shaughnessy, found that cannabis extracts could help decrease stomach pain and vomiting in people suffering from cholera.




- In Victorian times, it was widely used for many ailments, including muscle spasms, menstrual cramps, rheumatism, and the convulsions of tetanus, rabies and epilepsy; it was also used to promote uterine contractions in childbirth, and as a sedative to induce sleep.

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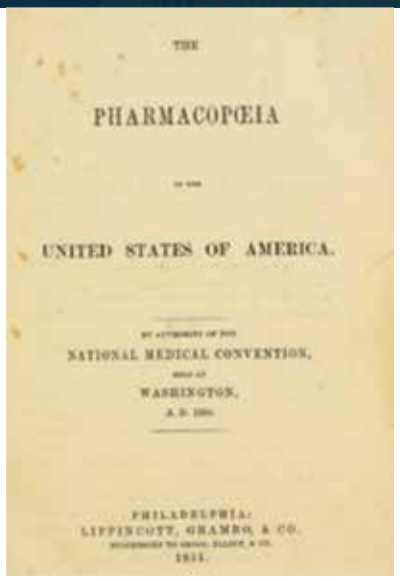


- By 1850, cannabis made its way into the United States Pharmacopeia which listed it as a treatment for numerous afflictions, including: neuralgia, tetanus, typhus, cholera, rabies, dysentery, alcoholism, opiate addiction, anthrax, leprosy, incontinence, gout, convulsive disorders, tonsillitis, insanity, excessive menstrual bleeding, and uterine bleeding, among others.

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- During the late 1800s, cannabis extracts were routinely sold in pharmacies and doctors' offices throughout Europe and the United States to treat stomach problems and other ailments.


# Negative Sentiment Against Cannabis Develops

- After the Mexican Revolution of 1910, Mexican immigrants fled to the U.S. and the term "marijuana" suddenly came into popular usage, apparently because anti-cannabis factions wanted to underscore the drug's "Mexican-ness." These groups claimed that marijuana incited violent crimes, aroused a "lust for blood," and gave its users"superhuman strength." In addition, anti-drug campaigners who supported Prohibition warned against the encroaching "Marijuana Menace" which, they claimed, was personified by "inferior races and social deviants."

- A 1917 Treasury Department report noted that its chief concern was the fact that "Mexicans and sometimes Negroes and lower class whites" smoked marijuana for pleasure, and that they could harm or assault upper-class white women while under its influence."


# The Beginning of the Criminalization of Cannabis

- The Federal Narcotics Bureau (the precursor to the DEA) was established in 1930 and led by Harry Anslinger between 1930-1962. When Prohibition ended in 1933, some believe that Angslinger was worried that he would be out of a job and, therefore, felt compelled to manufacture a drug war. Initially, Anslinger focused on cocaine and heroin, but relatively few people used those drugs. He then turned to marijuana and followed the unsubstantiated claims previously made by anti-drug campaigners that "weed" was connected to violence in order to try to criminalize it, saying "You smoke a joint and you're likely to kill your brother."

*"MARIJUANA IS THE MOST VIOLENCE-CAUSING DRUG IN THE HISTORY OF MANKIND"*

- HARRY J. ANSLINGER -

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- From the beginning, Anslinger conflated drug use, race, and music and said "Reefer makes darkies think they're as good as white men. . .There are 100,000 total marijuana smokers in the U. S., and most are Negroes, Hispanics, Filipinos and entertainers. Their Satanic music, jazz and swing result from marijuana use. This marijuana causes white women to seek sexual relations with Negroes, entertainers and any others."

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## The Marihuana Tax Act of 1937

- Anslinger's campaign against marijuana led to the enactment of the Marihuana Tax Act of 1937 which imposed registration and reporting requirements, as well as a significant tax, on the growers, sellers, and buyers of marijuana. Although marijuana was not banned outright under this law, its effect was the same.

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- The American Medical Association had opposed the Proposed Marihuana Tax Act and its legislative counsel, Dr. William C. Woodward, argued that cannabis "might have important uses in medicine and psychology." He also stated that "[t]here is nothing in the medicinal use of Cannabis that has any relation to Cannabis addiction. I use the word 'Cannabis' in preference to the word 'marihuana', because Cannabis is the correct term for describing the plant and its products...To say… as has been proposed here, that the use of the drug should be prevented by a prohibitive tax, loses sight of the fact that future investigation may show that there are substantial medical uses for Cannabis."

"The American Medical Association knows of no evidence that marijuana is a dangerous drug."

—Dr. William Woodward physician, attorney, chief AMA legal counsel during the 1937 Marihuana Tax Act hearings before the U.S. House of Representatives Ways and Means Committee

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- In 1942 – Cannabis was removed from the US Pharmacopeia in 1942.
- In 1944, the New York Academy of Medicine issued the La Guardia Committee report which confirmed that marijuana was not physically addictive, not a gateway drug and that it did not lead to crime. Harry Anslinger labeled the report as unscientific.


# President Nixon's "War On Drugs"

- As part of the "War on Drugs," President Richard Nixon signed the Controlled Substances Act of 1970 which repealed the Marijuana Tax Act and provisionally listed marijuana as a Schedule I drug—along with heroin, LSD and ecstasy—with no medical uses and a high potential for abuse.


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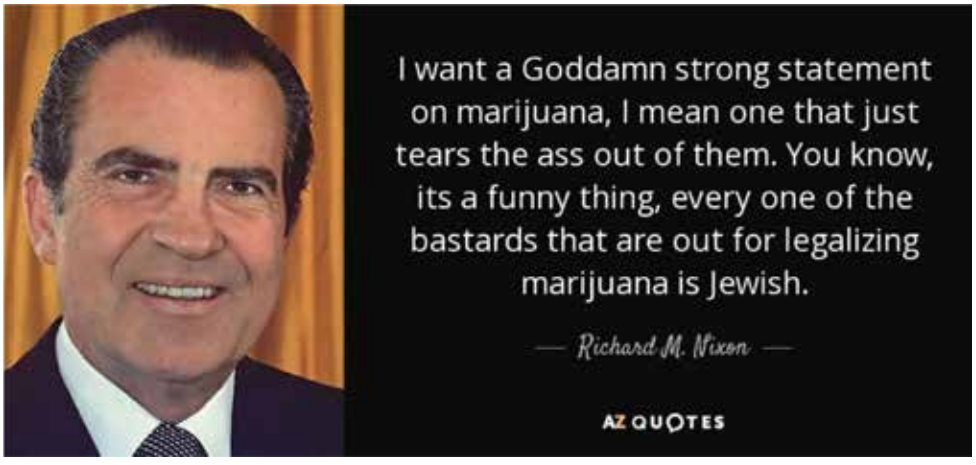

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- At the direction of Congress, Nixon appointed the bipartisan Shafer Commission which considered laws regarding marijuana. The Schafer Commission ultimately determined that personal use of marijuana should be decriminalized…
- Nixon rejected the recommendation.


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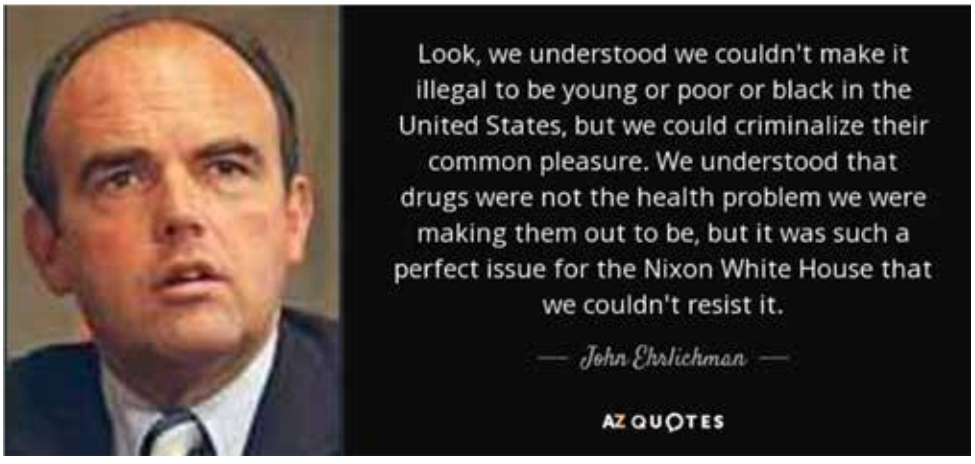

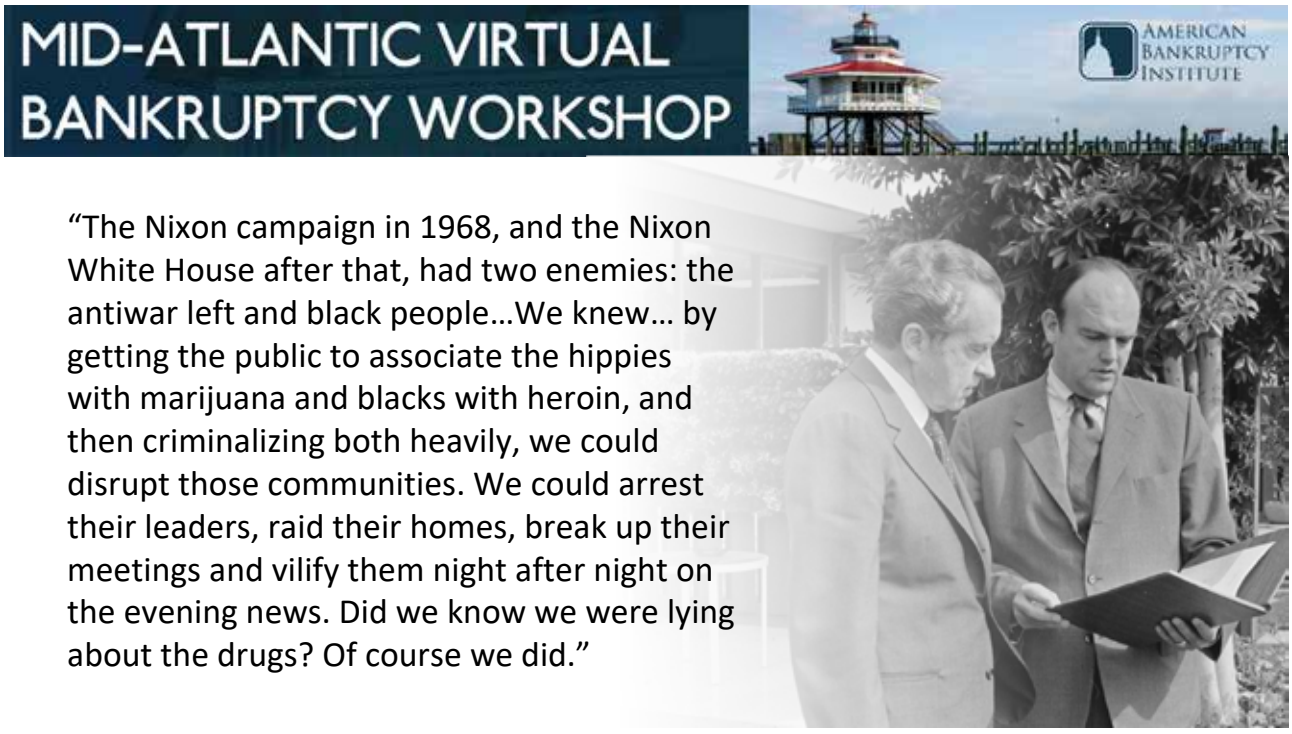


"The Nixon campaign in 1968, and the Nixon White House after that, had two enemies: the antiwar left and black people…We knew… by getting the public to associate the hippies with marijuana and blacks with heroin, and then criminalizing both heavily, we could disrupt those communities. We could arrest their leaders, raid their homes, break up their meetings and vilify them night after night on the evening news. Did we know we were lying about the drugs? Of course we did."


- Beginning in 1996 with California legalizing medical marijuana, political and public sentiment has evolved and medical marijuana is now legal in 33 U.S. states and the District of Columbia.

- Recreational use of marijuana is now legal in 11 states and the District of Columbia.


## Bankruptcy in the Cannabis Industry: A Cross-Border Perspective

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## Introduction: Federal Law, Bankruptcy Cases related to Cannabis, and State Law Options

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## Applicable Federal Law (Non-Bankruptcy)

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- Cultivators and Dispensaries (28 U.S.C. § 841(a)(1))
  ". . . it shall be unlawful for any person knowingly or intentionally to manufacture, distribute, dispense, or possess with intent to manufacture, distribute or dispense, a controlled substance"
- Ancillary Companies (28 U.S.C. § 843(a)(7))
  "It shall be unlawful for any person knowingly or intentionally to manufacture, distribute, export, or import any . . . equipment, chemical, product, or material which may be used to manufacture a controlled substance . . . knowing, intending, or having reasonable cause to believe, that it will be used to manufacture a controlled substance . . ."
- Landlords (21 U.S.C. § 856(a)(1))
  ". . . it shall be unlawful to knowingly open, lease, rent, use, or maintain any place, whether permanently or temporarily, for the purpose of manufacturing, distributing, or using any controlled substance"
- Management (21 U.S.C. § 856(a)(2))
  ". . . it shall be unlawful to manage or control any place, whether permanently or temporarily, either as an owner, lessee, agent, employee, occupant, or mortgagee, and knowingly and intentionally rent, lease, profit from, or make available for use, with or without compensation, the place for the purpose of unlawfully manufacturing, storing, distributing, or using a controlled substance"


## Bankruptcy Code Provisions At Issue With Cannabis Companies

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- Focusing on Chapter 11, although similar provisions are applied in Chapter 7 and 13 proceedings
- Courts are concerned with condoning post-confirmation business operations that are illegal under federal law
- Courts have dismissed cases under multiple Code provisions:
  § 1112(b)(1) – dismissal for "cause"
  § 1129(a)(3) – plan has to be proposed in "good faith"
  § 1129(a)(11) – plan has to be feasible
- Motions have been brought by Office of United States Trustee ("UST") and other parties in interest
  Involuntary debtors have also moved to dismiss involuntary petitions on cannabis grounds
- Chapter 15
  Cross border cases
  § 1506 public policy exception


## Guidance from Department of Justice

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- Ogden Memorandum (Oct. 2009)
  - Prioritizes prosecution over traffickers and disruption of illegal drug manufacturing.
  - DOJ will not focus resources on individuals acting in compliance with state laws.
- Cole Memoranda
  - First Cole Memorandum (June 2011) clarified that Ogden Memorandum was not meant to shield large-scale cultivation centers from federal enforcement even if acting in compliance with state law.
  - Second Cole Memorandum (Aug. 2013) identifies enforcement priorities and states that DOJ will rely on state/local governments to enact laws relating to cannabis.
  - Third Cole Memorandum (Feb. 2014) links violation of Bank Secrecy Act and money laundering statutes to the Second Cole Memorandum's enforcement priorities.
    Puts onus on financial institutions to monitor.
  - Sessions Memorandum (Jan. 2019) rescinds prior DOJ guidance and directs federal prosecutors to weigh all relevant considerations in determining cannabis-related prosecutions.
- Attorney General Barr recently said that he would "not go after" cannabis companies in states where cannabis is legal.


## First, the bad news...

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## *In re Way to Grow, Inc.*, 610 B.R. 338 (D. Colo. 2019)

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- Debtors sold indoor hydroponic and gardening-related supplies.
  - Expansion plans were tied to the cannabis industry, although the debtors also had customers using the hydroponic products to grow other crops.
- A secured creditor moved to dismiss the cases, citing the CSA.
- The bankruptcy court found that the debtors were violating section 843(a)(7) of the CSA.
  - Debtors had reasonable cause to believe that the equipment and product they sold would be used, by at least some of their customers, to manufacture marijuana.
  - The bankruptcy court dismissed the cases "for cause" under section 1112(b) of the Bankruptcy Code.
- District court discussed "three basic propositions" gleaned from the case law:
  - "[A] party cannot seek equitable bankruptcy relief from a federal court while continuing in violation of federal law."
  - "[A] bankruptcy case cannot proceed where the court, the trustee or the debtor-in-possession will necessarily be required to possess and administer assets which are either illegal under the CSA or constitute proceeds of activity criminalized by the CSA."
  - "[T]he focus of this inquiry should be on the debtor's marijuana-related activities during the bankruptcy case, not necessarily before the bankruptcy case is filed."


## *In re Way to Grow, Inc.* (cont'd)

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- District Court affirmed holding:
  - A cannabis company cannot, in violation of section 1129(a)(3) of the Bankruptcy Code, propose a good-faith reorganization plan that relies on profits generated from marijuana.
  - The inability to propose a plan not reliant on cannabis income is cause for dismissal under section 1112(b).
  - Even if the debtors were able to extricate themselves from cannabis, it would be impossible to monitor/ensure compliance.
- The District Court questioned the narrow interpretation of section 1129(a)(3) given by the Ninth Circuit in *Garvin*.
  - The court ultimately avoided opining on what it means for a plan to be "proposed … not by any means forbidden by law" by grounding its holding on section 1129(a)(3)'s requirement that a plan be "proposed in good faith."
  - Because the plan relied on profits generated by the cannabis business, the plan could not be proposed in good faith.


## *In re Rent-Rite Super Kegs West Ltd.*, 484 B.R. 799 (Bankr. D. Colo. 2012)

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- Landlord/debtor derived approx. 25% of revenue from tenants engaged in state-legalized marijuana cultivation.
- Secured creditor, with lien on warehouse, moved to dismiss the bankruptcy arguing that the debtor was barred from seeking relief under unclean hands doctrine and because the bankruptcy was filed in bad faith.
- The bankruptcy court held that the debtor's conduct violated the CSA and justified application of the unclean hands doctrine:
  - "The Debtor has knowingly and intentionally engaged in conduct that constitutes a violation of federal criminal law and it has done so with respect to its sole income producing asset. Worse yet, every day that the Debtor continues under the Court's protection is another day that [the secured creditor's] collateral remains at risk."
- The bankruptcy court held therefore that the debtor's actions constituted "gross mismanagement" for purposes of § 1112(b) and that "cause" existed.
- The court also did not believe the debtor could propose a plan because section 1129(a)(3) prohibits confirmation of a plan that relies in any part on income derived from criminal activity.
- Court scheduled further hearing to consider whether dismissal or conversion was appropriate.


## *In re Basrah Custom Design, Inc.*, 600 B.R. 368 (Bankr. E.D. Mich.2019)

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- Debtor was a custom cabinet manufacturer, which occupied two conjoined buildings.
- The buildings were owned by an affiliate of the Debtor's principal, which entered into a lease with a purchase option with a dispensary.
- There was an issue regarding which entity was the owner or lessor of the buildings and the UST moved to dismiss the case "for cause" on the basis that owning or renting a place operating as a dispensary violates CSA.
- Debtor alleged it filed bankruptcy to disentangle itself from the cannabis space by rejecting the dispensary lease.


## *In re Basrah Custom Design, Inc.* (cont'd)

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- Although the Court found that the lease was not property of the estate and the debtor was not the lessor, the Court found that: (a) the sole purpose of the filing was to facilitate the principal's efforts to avoid the dispensary lease and (b) the debtor filed bankruptcy with unclean hands.
- Court found that cause existed under § 1112(b)(1) to dismiss the case.
- Court speculated that if the dispensary requested stay relief to evict the debtor, the court would have to refuse because the dispensary would also have to have unclean hands.
  - "Just as a federal court cannot be asked to enforce the protections of the Bankruptcy Code in aid of a Debtor whose activities constitute a continuing federal crime," Rent-Rite, 484 B.R. at 805 (footnote omitted), neither can a federal court be asked to enforce any creditor protections under the Bankruptcy Code, such as the relief-from-stay provisions of II U.S.C. § 362(d), in aid of a creditor's commission of a federal crime."


## *Basrah Custom Design, Inc.* (cont'd)

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- Court also acknowledged that while the § 1129(a)(3) good faith issue was not before the Court, it nevertheless felt compelled to address *Garvin* in a footnote stating:
  - "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 CSA."


## *Arenas v. United States Trustee (In re Arenas)*, 535 B.R. 845 (10th Cir. B.A.P. 2015)

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- Debtors operated a licensed growhouse and medical dispensary, and leased space to a licensed dispensary.
- The debtors originally filed under Chapter 7, but later sought to convert to Chapter 13.
- The UST objected to the conversion and argued that the cases should be dismissed for cause under § 707(a).
- The bankruptcy court denied conversion and dismissed for cause.
- BAP affirmed denial of conversion motion, holding that the debtors were unable to propose a plan in good faith because:
  - Plan would be funded with rental income generated in violation of CSA.
  - Chapter 13 trustee would commit federal crimes by administering the plan.
  - Unfairness since the debtors would receive a discharge but the trustee could not pay claims with illegally generated funds.


## Now, let's turn to some good news . . .

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

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- Affirmed confirmation of a Chapter 11 plan where the debtor derived lease income from a tenant in the business of growing marijuana.
- The UST argued that the plan should not have been confirmed because it was proposed by means forbidden by law in violation of section 1129(a)(3).
- The Ninth Circuit rejected the UST's argument and held that section 1129(a)(3) forbids confirmation of a plan that is proposed in an unlawful manner, but does not forbid confirmation of a plan that has substantive provisions that depend on illegality.
  - Court should only to look to the proposal of a plan and not the terms of the plan.
  - Because there was nothing in the proposal of the plan at issue that was unlawful, confirmation was affirmed.
- Not a complete victory for cannabis industry.
  - UST failed to preserve the "gross mismanagement" argument – result may have been different if motion was renewed.
  - Court made clear that confirmation of a plan does not insulate a debtor from prosecution for criminal activity, even if that criminal activity is part of the plan itself.


## *Northbay Wellness Group, Inc. v. Beyries*, 789 F.3d 956 (9th Cir. 2015)

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- The debtor was an attorney accused of converting client trust funds. The client (Northbay) was a medical marijuana dispensary and the funds were proceeds of sales.
- The bankruptcy court dismissed the complaint seeking to declare the client's debt non-dischargeable, on the basis that the doctrine of unclean hands barred Northbay from seeking to recover funds which were the proceeds of marijuana sales.
- The Ninth Circuit held that the doctrine of unclean hands does not automatically bar relief, but requires balancing of the alleged wrongdoing of each party.
  - "Had the bankruptcy court weighed the parties' respective wrongdoing, it necessarily would have concluded that (the attorney's) wrong doing outweighed Northbay's, both as to harm caused to each other and as to harm caused to the public." 789 F.2d at 960.
- Northbay was permitted to bring its action in the bankruptcy court.


## *In re Johnson*, 532 B.R. 53 (Bankr. W.D. Mich. 2015)

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- Chief Judge Scot W. Dales considered a Chapter 13 filed by a 55-year old facing foreclosure on a residence the debtor had owned for four years.
- The debtor supplemented his Social Security income by providing, under a state law license, medical marijuana to three patients and a licensed dispensary.
- The debtor testified that all plan payments would come from his Social Security income.
- Court was, however, concerned with allowing the debtor to remain in a bankruptcy that assisted in the advancement of an illegal activity.
- Nothing that "(t)he country's relationship with marijuana is changing, slowly, and one person's pusher is another's caregiver," Judge Dales rejected the UST's request to dismiss the case, provided that the debtor cease operating in the marijuana business.
- Recognizing that the "(t)he Debtor's business is patently incompatible with a bankruptcy proceeding, but his financial circumstances are not", the court concluded that the debtor had to choose between continuing the marijuana business and continuing with his bankruptcy case. 532 B.R. at 57.


## *Olson v. Van Meter (In re Olson)*, 2018 Bankr. LEXIS 480 (9th Cir. B.A.P. Feb. 5, 2018)

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- Chapter 13 case.
- The debtor was a 92-year-old woman who was legally blind and residing in an assisted living facility. Prepetition, the debtor indirectly owned a shopping center and one of the tenants was a state licensed marijuana dispensary.
- The evidence included the declaration from the debtor that she wished to end her relationship with the tenant and sell the property.
- Nonetheless, the bankruptcy court dismissed the case *sua sponte* because the debtor was accepting cannabis rental income post-petition.
- In vacating the dismissal order the 9th Cir. BAP noted that dismissal should be considered pursuant to the statutory framework of the Bankruptcy Code. The BAP stated that dismissal of a case for "cause" under § 1307(c), although not listed, can include "bad faith." However, the BAP held that such an analysis required both consideration of the "totality of the circumstances" and specific findings. The BAP stated that there had been no finding that the trustee would be administering the proceeds of an illegal business, and no evidence that the rents were to be used to fund the plan.


## *In re Olson*, (cont'd)

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- Judge Tighe wrote a separate concurring opinion in which she:
  - Stressed the question of whether the debtor had "knowingly and intentionally" violated federal law:
    - "I concur in the memorandum and write separately to emphasize (1) the importance of evaluating whether the Debtor is actually violating the Controlled Substances Act and (2) the need for the bankruptcy court to explain its conclusion that dismissal was mandatory under these circumstances. With 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. A finding explaining how a debtor violates federal law or otherwise provides cause of dismissal is important to avoid incorrectly deeming a debtor a criminal and denying both debtor and creditors the benefit of the bankruptcy laws."
  - Slightly opened the door to cases where cannabis may not play a central role:
    - "Bankruptcy courts have historically played a role in providing for orderly liquidation of assets, equal payment to creditors, and resolution of disputes that otherwise would take many years to resolve. Although debtors connected to marijuana distribution cannot expect to violate federal law in their bankruptcy case, ***the presence of marijuana near the case should not cause mandatory dismissal***." (emphasis added)


## *In re Cwnevada LLC*, 602 B.R. 717 (Bankr. D. Nev. 2019).

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- Exhaustive analysis of the cannabis cases.
- Debtor was engaged in cannabis and CBD industries.
  - Cannabis activity violated the CSA.
  - CBD activity was likely excluded from the CSA.
- Creditors moved to dismiss under section 1112(b) or for abstention under section 305(a)(1).
- Bankruptcy court concluded that, under the particular facts of that case, dismissal was warranted under section 305(a)(1).
  - Debtor had not opened banking accounts.
  - Debtor did not have disinterested legal counsel.
  - Governance and management issues.
  - Financial issues may have been understated by management.


## *In re Cwnevada LLC,* (cont'd)

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- However, the court may have opened the door to cannabis filings:
  - "There may be cases where Chapter 11 relief is appropriate for an individual or a non-individual entity directly engaged in a marijuana-related business. For the reasons discussed above, this case is not one of them."
  - "If there are 8,700 residents of Nevada employed by the marijuana industry, … then the impact of automatically denying a bankruptcy fresh start to those resident and their dependents would be unconscionable."


## Chapter 15 – A Potential Work Around?

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- U.S. Courts recognize and enforce foreign insolvency proceedings
- Chapter 15 could be used to support insolvency proceedings instituted outside of the U.S. by cannabis companies with affiliates or operations in the U.S.
- US Trustee is certain to object
- Arguments in favor of Chapter 15
  - Section 1506 – public policy exception
    - "Manifestly contrary to the public policy of the United States"
  - No estate to be administered in the U.S.
- Never been tested

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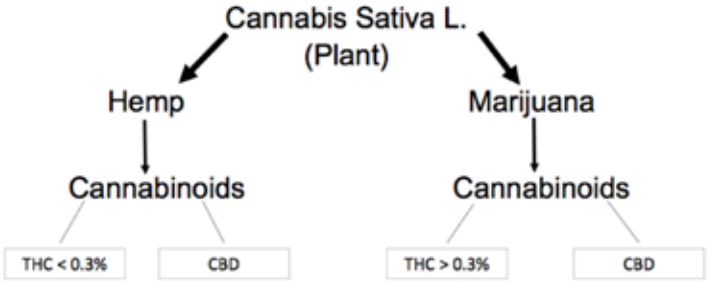
## Hemp v. Marijuana

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## Cannabidiol (CBD) Generally

- Unlike THC, which gives users the "high" feeling, CBD is non-psychoactive.
- Although the data is mixed, CBD may have potential clinical effects on anxiety disorders, movement disorders, cognition, and pain.
- CBD can be ingested/applied in multiple different ways, including:
  - Tinctures (essentially droplets of CBD infused alcohol placed under tongue)
  - Capsules
  - Oil
  - Inhalation of smoke or vapor
  - Infused food/drink
  - Cream
- At least one report suggests that the hemp-CBD market alone is poised to hit $22 billion by 2022.

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## 2018 Farm Bill

- 2018 Farm Bill
  1. Removed "hemp" from CSA definition of "marijuana"
     - Defines "hemp" as "the plant Cannabis sativa L. and any part of that plant, including the seeds thereof and all derivatives, extracts, cannabinoids, isomers, whether growing or not, ***with a [THC] concentration of not more than 0.3 percent on a dry weight basis***."
  2. Gave primary regulatory authority to states.
     - If a state does not regulate, then federal regulations govern.
  3. Forbids states from interfering with interstate shipment of hemp.
  4. Does not affect the Food Drug & Cosmetic Act, among other things, as well as the authority of the FDA to promulgate regulations and guidelines under the FD&C Act.

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## FDA Implications

- Federal Food, Drug, and Cosmetic Act (the "FD&C Act")
  - 2018 Farm Bill preserved the FDA's current authority to regulate products containing hemp-CBD under the FD&C Act.
  - FDA issued a statement on hemp-CBD products that reiterated treatment of CBD as a "drug" and not a "dietary supplement" under FD&C Act, but suggested that this may change in the near future.
    - Epidiolex
    - Sale of a "drug", including "food" containing the "drug", requires FDA regulatory approval

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**In re United Cannabis Corp., et al., Case No. 20-12692 (Bankr. D. Col. 2020)**

- Debtors primarily operate hemp-CBD business.
- However, assets also include formulation patents that are licensed to third-party marijuana companies, as well as equity interests in other non-debtor, marijuana-related businesses.
  - Debtor has moved to reject these license agreements.
- U.S. Trustee claims hemp and marijuana businesses are too intertwined, thus requiring dismissal for cause and a lack of good faith.
- Debtors' largest creditor also argues that the Debtors' sale of hemp-CBD products is a violation of the FD&C act, thus requiring dismissal for cause.
- Decision pending.

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## Alternatives to Bankruptcy

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## Alternatives to Bankruptcy

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- State Court Receiverships
  - Creditors and/or shareholders can seek appointment of receiver
  - Receiver takes control of all property at issue
  - Receiver can operate the business and run a sale process
  - Certain states allow Receivers to operate a cannabis growing/sale business
    - Oregon Administrative Rules § 845-025-1260
      "The Commission may issue a temporary authority to operate a licensed business to a trustee, the receiver of an insolvent or bankrupt licensed business, the personal representative of a deceased licensee, or a person holding a security interest in the business for a reasonable period of time to allow orderly disposition of the business."
    - Washington Administrative Code § 314-55-137
      Addresses role of receiver when licensee is placed in receivership


## Alternatives to Bankruptcy, cont'd.

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- Assignment for the Benefit of Creditors
  - State law remedy
  - Simple procedure – allows for sale of assets
  - Licensing issues
- Article 9 Sale
  - Available to secured creditors
  - Licensing issues


# Pending Legislation

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## SB 1028 STATES (Strengthening the Tenth Amendment Through Entrusting States) Act

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- Introduced by Senators Cory Gardner and Elizabeth Warren on April 4, 2019
- Would amend the Controlled Substances Act to recognize legality of marijuana where legalized pursuant to state or tribal law
- Referred to Committee on the Judiciary (4/4/19)
- Companion Bill HR 2093 referred to Subcommittee on Crime, Terrorism, and Homeland Security (5/15/2019)
- Essentially, STATES Act has been dormant


## HR 1595 SAFE (Secure and Fair Enforcement) Banking Act

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- Opens banking and insurance to cannabis companies
- Passed the House by a vote of 321-103 on Sept. 25, 2019
- Was included by Speaker Pelosi in the HEROES Act that was passed by the House in May 2020
  - HEROES Act is proposed sequel to CARES Act
- Unclear whether SAFE Banking Act will ultimately be in the next consensus COVID-19 measure signed into law


Severn Bank

Severn Select


Severn Bank

- The Cole Memoranda, Bank Secrecy Act, Anti-money Laundering Act, and guidance from the Financial Crimes Enforcement Network (FinCEN) puts the onus on banks to monitor marijuana related businesses.

Severn Select


Severn Bank

- Banks that provide accounts for marijuana related businesses undertake a heavy burden, to monitor compliance with federal law, state law, regulations and regulatory guidance. In order to do that, banks need to significantly augment their usual policies and procedures, and follow them precisely under the watchful eyes of the regulators. This requires a staff of trained professionals dedicated to the cause, specialized software, and a system for managing cash.

Severn Select


Severn Bank

- Marijuana related businesses that are looking for a bank account have to demonstrate a commitment to compliance during the onboarding process. They should be prepared to provide documentation to prove their commitment, both initially and on an on-going basis. They should know that every aspect of their business will be monitored and analyzed, and that currency transaction reports (CTRs) and Suspicious Activity Reports (SARs) will be filed with the government on a regular basis. They should expect periodic site visits, frequent reviews, and limitations on their ability to use typical banking services such as checks and wires. Compliance violations or deviations from the bank's requirements could result in the termination of the account.

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Severn Bank

- A marijuana banking program involves a commitment on the part of the bank to devote the necessary resources. The costs involved are not insignificant, and are passed on to the customers. Prospective customers should expect to pay an onboarding fee, and a monthly fee.

Severn Select