AMERICAN BANKRUPTCY INSTITUTE

New York City Bankruptcy Conference 2021

Liquidating Outside of Chapter 11: Considerations for Cannabis and Other Companies Not Eligible for Chapter 11

Gerard DiConza, Moderator
Archer

William A. Brandt, Jr.
Development Specialists, Inc.

Hon. Rosemary Gambardella
U.S. Bankruptcy Court (D. N.J.)

Marc E. Hirschfield
Royer Cooper Cohen Braunfeld LLC

Jennifer L. Rodburg
Fried, Frank, Harris, Shriver & Jacobson LLP

Suzzanne Uhland
Latham & Watkins LLP

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LIQUIDATING OUTSIDE OF CHAPTER 11 (CONSIDERATIONS FOR CANNABIS AND OTHER COMPANIES NOT ELIGIBLE FOR CHAPTER 11)

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Presentation Time:

Thursday, May 20, 2021
11:15 AM – 12:30 PM ET (Via Zoom)

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Panelists:

Honorable Rosemary Gambardella
United States Bankruptcy Judge, District of New Jersey

Gerard DiConza, Moderator
Archer & Greiner

William A. Brandt
Development Specialists, Inc.

Marc Hirschfield
Royer Cooper Cohen Braunfeld LLC

Suzzanne Uhland
Latham & Watkins

Jennifer Rodburg
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LIQUIDATING OUTSIDE OF CHAPTER 11 (CONSIDERATIONS FOR CANNABIS AND OTHER COMPANIES NOT ELIGIBLE FOR CHAPTER 11)

I. Compare and Contrast Liquidations/Wind-Downs Under Chapter 11, Federal and State Receiverships, ABCs, and Dissolutions

A. Alternatives to Chapter 11 (compare/contrast tools available in and risks attendant to each):

1. ABCs
2. Receiverships (State and Federal)
3. Article 9 foreclosure
4. Dissolution under applicable state law (Judicial, Statutory)
5. Compositions
6. Other forms of winddown?

B. Pros and cons of each:

1. Costs
2. Sales free and clear?
3. *In Pari Delicto* – does this equitable defense apply to receivers?
4. Avoidance Actions – can fiduciary outside bankruptcy pursue?
5. No Automatic Stay
6. Coordination and reach of State receiverships if Federal not available
7. Confirmed Chapter 11 plan binds all creditors (what about ABCs, Receiverships?)
8. Can receivership order prevent a debtor from filing Chapter 11?
9. Potential for involuntary. Abstention under Section 305(a)
10. Access to necessary financing during the proceedings

II. Restructuring and Liquidating Companies Not Eligible for Chapter 11

A. Necessity for alternatives to Chapter 11

1. Higher Education Act

a. Colleges/Universities lose Title IV funding if file for Chapter 11.

b. Bankruptcy filing results in immediate closure.

c. Alternatives necessary to implement going-concern sales and/or orderly wind-down that minimizes student and other claims.

2. Controlled Substances Act

a. Marijuana is classified as a "Schedule I" controlled substance.

b. It is illegal under federal law for any purpose – cannot be grown, processed, retailed, used or possessed.

c. Will the Justice Department enforce the CSA against cannabis companies? *See e.g.*, January 2018 Justice Department Memorandum (https://www.justice.gov/opa/pr/justice-department-issues-memo-marijuana-enforcement) (provides guidance on when to pursue charges against cannabis businesses).

d. Notwithstanding, no significant activity from federal enforcement to prosecute companies in compliance with state cannabis laws.

e. Cannabis and cannabis-related companies, however, may not use federal bankruptcy law to restructure/wind-down.

f. United States Trustee letter dated April 26, 2017 to Chapter 7 and 13 Trustees: (https://www.justice.gov/ust/file/marijuana_assets.pdf/download) ("It is the policy of the United States Trustee Program that United States Trustees shall move to dismiss or object in all cases involving marijuana assets on grounds that such assets may not be administered under the Bankruptcy Code even if trustees or other parties object on the same or different grounds.")

g. *See also* Clifford J. White III and John Sheahan, *Why Marijuana Assets May Not be Administered in Bankruptcy*, Amer. Bankr. Inst. J., Dec. 2017.

B. Cannabis Insolvencies

1. Cannabis-related bankruptcy cases generally dismissed

a. *In re Medpoint Management, LLC*, 528 B.R. 178 (Bankr. D. Ariz. 2015) (involuntary petition dismissed because debtor provided management services and intellectual property to cannabis business).

b. *In re Rent-Rite Super Kegs*, 484 B.R. 799 (Bankr. D. Col. 2012) (dismissing case where rent from cannabis business comprised 25% of debtor's income).

c. *In re Arenas*, 535 B.R. 845, 852-53 (Bankr. B.A.P. 10th Cir. 2015) (on motion of U.S. Trustee upholding dismissal of debtors' cases based on findings that debtors were unable to confirm plan without using proceeds of their marijuana business).

2. Is the tide turning?

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

- Five related and jointly administered debtors, four of which derived revenues from leasing commercial real estate. One debtor leased premises to a company that used the property to grow marijuana.

- United States Trustee's initial motion to dismiss denied because bankruptcy court determined debtors could possible "propose a plan that does not rely on the income from the marijuana operation lease." Invited US Trustee to renew motion at confirmation hearing.

- Debtors' plan called for rejection of marijuana-related lease. US Trustee objected to confirmation on basis of section 1129(a)(3) because it was proposed by means forbidden by law.

- UST did not seek dismissal and did not argue lack of good faith. Argued plan was proposed by "means forbidden by law".

- Bankruptcy court rejected UST argument and confirmed plan. District court affirmed.

- On appeal, Ninth Circuit upheld confirmation, concluding plain text of 1129(a)(3) directs bankruptcy court to "police the means of a reorganization plan's *proposal*, not its substantive provisions."

- Narrow ruling?

b. *Olson v. Van Meter* (*In re Olsen*), 2018 WL 989263, **4-6 (B.A.P. 9th Cir. Feb. 5, 2018)

- Bankruptcy court dismissed case *sua sponte* concluding debtor was in violation of federal law for leasing property to, and collecting post-petition rent from a cannabis company, which was operating legally under applicable California law. In dismissing, bankruptcy court was not persuaded by debtor's attempts to distance herself from the cannabis business, having ceased to take rent from the dispensary and moving to reject the lease. *Olsen*, at *4.

- The BAP vacated dismissal and remanded for further findings on the specific criminal activity and the legal standard for dismissing the case.

- BAP signaled that not all cannabis-related companies are excluded from federal bankruptcy protection. Rather than adopting a rigid approach, BAP focused on the specific "knowledge" requirement that the CSA imposed for prohibiting leasing space to a cannabis business and addressed the unique facts of this case. The *Olsen* debtor was a nearly blind, elderly debtor, residing in a nursing home and relying on others to operate her business.

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

- Post-*Garvin* decision dismissing cannabis cultivator and dispensary case filed after receivership commenced but acknowledging that CBD business may no longer be prohibited from using Chapter 11 after enactment of Farm Improvements Action of 2018 (Farm Bill).

- Farm Bill signed into law in 2019 and legalized hemp, which contains 0.03% or less of THC marijuana.

- Court noted: "There may be cases where Chapter 11 relief is appropriate for an individual or non-individual entity directly engaged in a marijuana-related business.").

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

- Another post-*Garvin* decision where District Court affirmed the dismissal of a seller of equipment, products and other material utilized in the manufacture of cannabis.

- Cases were dismissed on secured lender's motion to dismiss filed on basis that the debtors' business violated the CSA.

- District court questioned the narrow interpretation give 112(a)(3) by the *Garvin* court and held that a marijuana company cannot, in violation of section 1129(a)(3), propose a good-faith plan that relies on profits generated from marijuana. The inability to propose a good faith plan is cause for dismissal under section 1112(b).

C. Alternatives for Cannabis Liquidations/Restructurings

1. ABCs?

2. License transfer issues?

3. State Court Receiverships (no federal)

4. Article 9 Foreclosure

5. Out-of-court workouts

6. Use of Chapter 15?

    a. Canada – the Silicon Valley of Marijuana. In 2018 Canada legalized cannabis on federal level

    b. *E.g.*, MedMen Enterprises Inc. has operations in California, New York and Nevada and is listed on the Canadian Securities Exchange.

    c. Will a Canadian insolvency proceeding of a cannabis company be recognized under Chapter 15?

    d. Public policy violation under Section 1506?

D. Higher Education Company Going-Concern Sales and Orderly Wind Down (Case Study) - Education Corporation of America (ECA College)

1. Receiverships for Higher Education Companies when Chapter 11 is not an option

2. Compared to chapter 11 and 7 liquidations (*i.e.*, Corinthian College)

ABI/NYC Conference May 20, 2021

LIQUIDATING OUTSIDE OF CHAPTER 11 (CONSIDERATIONS FOR CANNABIS AND OTHER COMPANIES NOT ELIGIBLE FOR CHAPTER 11)

Why Not Use Chapter 11

- Costs
  - Professional Fees
  - Other Costs
    - Reputational
    - Stigma
- Eligibility
  - Higher Education Act
  - Controlled Substances Act

Alternatives To Chapter 11

- Assignments for the Benefit of Creditors
  - Mechanics of ABCs
  - Pros
  - Cons
    - Involuntary?
    - Section 305
    - Avoidance Actions
    - Executory Contracts
    - Sales free and clear
  - Applicable state law

Alternatives to Chapter 11 (Cont.)

- Compositions
  - Pros
  - Cons
- Article 9 Foreclosures
- Dissolution

Receiverships

- State v. Federal
- Who may seek the appointment of a receiver?
- Standing and jurisdictional issues
- Pros
  - Broad injunctive powers
  - Claims resolution process
  - Sales free and clear
- Cons
  - What happens if bankruptcy filed?
  - Who's in control?
    - Former management
    - Receiver

Higher Education Act

- Chapter 11 filing and Title IV funding
- Alternatives for Colleges
- ECA Colleges
  - Use of federal receivership to winddown
- Corinthian Colleges – bankruptcy filing resulted in immediate loss of federal funding

Controlled Substances Act

- Marijuana is classified as controlled substance and is illegal under federal law
- United States Trustee enforcement of CSA in bankruptcy cases
- Cannabis-related bankruptcy cases were generally dismissed upon UST motion
- Is the tide turning?
- *Garvin v. Cook Invs. NW, SPNWY, LLC*, 922 F.3d 1031 (9th Cir. 2019)
- Is it a narrow ruling?
- *In re CWNevada LLC*, 602 B.R. 717 (Bankr. D. Nev. 2019) (dismissal of chapter 11 case authorized by managing member of LLC filed after commencement of receivership)
- *In re Way to Grow, Inc*., 610 B.R. 338 (D. Colo. 2019) (dismissal of cannabis debtor case upheld)
- Chapter 15 for cannabis company?
  - Section 1506?

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Liquidating Outside of Chapter 11

(Considerations for Cannabis and Other Companies Not Eligible for Chapter 11)

Panel Members
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Assignment for the Benefit of Creditors

Assignment for the Benefit of Creditors ("ABC")

- A state law alternative to an in-court liquidation, receivership or an out of court dissolution, and providing for the orderly, controlled liquidation of assets under applicable state law:
- State law varies with respect to whether court supervision is required:
  - For example, in New York, an ABC is governed by statute and is a court-supervised process. N.Y. Debt. & Cred. Ch. 12, Art. 3 § 2 – 24.
  - California, on the other hand, does not require a public court filing for an ABC. Cal. Code Civ. Pro. § 493.
  - Other states, like North Carolina, have no such statutes, requiring debtors to utilize the bankruptcy or receivership process.

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Process of an ABC

- Selection of Assignee (generally friendly/known to the Debtor)
- Debtor (Assignor) assigns all its assets to Assignee
  - Terms of assignment are normally negotiated in an Assignment Agreement between the Debtor and Assignee, which also provides for payment terms for Assignee
- Assignee acts as a fiduciary/trustee for all creditors and liquidates assets and distributes proceeds per priority scheme
  - Priority scheme is determined by state law, but often provides more flexibility than a debtor would have in chapter 7

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Benefits of an ABC

- Usually cheaper and faster than a bankruptcy liquidation, while still providing structure (via statutory or common law) for the resolution of debts
  - ABI handbook estimates Assignee fees average about 5-10% of proceeds
- Assignee may realize more value than chapter 7 trustee in liquidating assets (e.g., Assignee is selected by Assignor, while trustee is appointed by the bankruptcy court, Assignee is likely to have more experience in Assignor's industry)

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Benefits of an ABC, (Cont'd)

- No disclosure required in SEC filings
  - Reg. S-K typically requires disclosure for five years by executive officers or directors of a reporting company if they were executive officers (not directors) of a company that filed bankruptcy at the time the company filed or during the two years prior to filing. An ABC is not a bankruptcy for these purposes.
- Trustee-like powers:
  - Most states give the assignee the power of a judicial lien creditor, which allows the assignee to invalidate unperfected liens.
  - Most states provide Assignee with the power to bring fraudulent conveyance actions
  - Many states have preference statutes similar to bankruptcy law

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Limitations of an ABC

- Loss of Certain Bankruptcy-Related Powers & Protections
  - No ability to force or "cram down" a deal on secured creditors
  - Generally no ability to assume and assign contracts, licenses without the consent of the counterparty
  - No prohibition on *ipso facto* clauses
  - No automatic stay (although practically most creditors stop collection)
  - Likely no ability to force landlords to allow GOB sales
  - Likely no ability to get releases for Debtor and other protected parties
  - No discharge from liabilities for the Company

Final Considerations

- An ABC is less effective for companies with complex capital structures or more substantial business operations.
- An ABC is most effective where company has minimal assets and can be used to implement a going concern sale
  - *E.g.,* common with tech start-ups

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Receiverships

Examples in Practice

State Court Receiverships

- A receivership is a state-law-based judicial remedy available to a creditor after a debtor has defaulted on an obligation, following the creditor's initiation of a lawsuit against the debtor.
  - A receivership is only a provisional remedy in an action that seeks some other relief by final judgment.
- Receivership allows the court-appointed receiver to either attempt to turn the business around or liquidate assets and pay off obligations, including debts owed to investors.
- Grounds for receivership may vary by state.
  - Insolvency or imminent insolvency of a company is generally sufficient.

State Court Receiverships (Cont'd)

Advantages

- Affords similar protections to those in bankruptcy.
- Freezes actions by other creditors.
- Can reject executory leases or unexpired contracts.
- Can rescue deteriorating collateral.
- Helps to protect against fraud.
- Many of the details of a receivership can remain private.

Risks

- While cheaper than a bankruptcy proceeding, still meaningful costs
  - In Green Growth (discussed *infra*) the proposed receiver charged $290 / hr.
  - If the estate does not produce enough to pay the receiver, the movant may be obligated to pay.
- Some of the details are public in these proceedings.

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Green Growth Brands LLC

Joint Motion to Appoint Receiver

JOINT MOTION OF THE PARTIES HEREIN, FOR IMMEDIATE APPOINTMENT OF RECEIVER FOR DEFENDANT GREEN GROWTH BRANDS LLC AND AFFILIATED SUBSIDIARIES GGB BEAUTY LLC, GGB LICENSES LLC, GREEN GROWTH BRANDS REALTY LLC, GGB GN LLC, AND GGB KIOSKS LLC

Now comes Defendant Green Growth Brands LLC[1], by and through its undersigned counsel and Digico Imaging, Inc. (collectively, the "Movants") pursuant to Ohio Revised Code ("R.C") §§ 2735.01 *et seq.*, and move for the immediate appointment of a receiver (the "Receiver") over Green Growth Brands LLC and its above-named affiliated subsidiary companies: GGB Beauty LLC; GGB Licenses LLC; Green Growth Brands Realty LLC; GGB GN LLC; and GGB Kiosks LLC (Green Growth Brands LLC and its subsidiaries, collectively, "Green Growth"), for the benefit of their creditors. The basis for such appointment is that the Green Growth are each in imminent danger of insolvency and desire to wind up their respective affairs in a manner that

Filed in Franklin County, Ohio on April 3, 2020

- Green Growth Brands LLC ("GG") is a cannabis company.
- On March 17, 2020, creditor Digico Imaging ("Digico") sued GG for ~$85,000 for unpaid goods and services
- GG and Digico filed a joint receivership motion on behalf of GG and six subsidiaries
- GG was in "imminent danger of insolvency."
- Goals:
  - Assistance liquidating assets.
  - Avoiding multiplicity of suits (race to the courthouse) from >400 creditors by appointing a receiver thereby staying all pending actions
- The Court entered the Agreed Order on April 3, 2020

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Standard Terms of Order

- **Authority of Receiver**
  - Deliver custody and control of assets to the Receiver; authorize Receiver to protect and preserve the Assets; authorize Receiver to collect revenues and pay all expenses
  - Use Movants' bank accounts and invest funds, maintain books and records, complete tax returns;
  - Subject to further court approval, marketing and sale of assets and employment of professionals
  - Authority to engage in lawsuits and settlements;
- **Treatment/resolution of claims**
  - Treatment of leases and executory contracts; Priority treatment of receivership expenses; Payment of critical pre-receivership liabilities, including payroll, insurance, and certain utilities
  - Procedures for filing and resolving Proofs of Claim
- **Other relevant provisions & benefits**
  - The Receiver is required to post a bond to ensure performance and is shielded from personal liability with certain carve outs (gross and willful misconduct, etc.);
  - A stay and injunction from certain creditor activities;
  - Reporting obligations of the Receiver

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Garvin and Progeny

Historically Dismissed

- As the cases that follow indicate, cannabis-related bankruptcy cases have historically been dismissed (even if company filing for chapter 11 is/was not directly involved in the cannabis industry)

In re Rent-Rite Super Kegs

- 484 B.R. 799 (Bankr. D. Colo. 2012)
- Creditor moved to dismiss chapter 11 case filed by Colorado debtor (a warehouse owner) that derived roughly 25% of its revenues from leasing warehouse space to tenants who, to debtor's knowledge, were engaged in business of growing marijuana, arguing that the case should be dismissed (i) under the "clean hands doctrine" and / or (ii) for being filed in bad faith
- The bankruptcy court dismissed the case, finding it could dismiss on grounds that the debtor had both unclean hands and the case was filed in bad faith

In Re Rent-Rite Super Kegs (Con't)

- The court held debtor had "unclean hands" because it engaged in conduct that constituted a violation of federal criminal law and then sought equitable relief of the Bankruptcy Code. (Found dismissal was appropriate whether the Court applied the unclean hands as "cause" or as separate grounds for dismissal).
- The court held the plan was also unconfirmable for lack of good faith under §1129(a)(3) because a portion of the debtor's income was derived from an illegal activity

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In re Medpoint Management, LLC

- 528 B.R. 178 (Bankr. D. Ariz. 2015)
- Medpoint Management, LLC ("Medpoint") was a dispensary-management entity. Medpoint's only source of revenue at the time of the petition was licensing fees from IP (specifically, the "Bloom" name and trademark) which Medpoint licensed to a dispensary and under which marijuana was sold. Medpoint also had limited other assets (lawsuit against former client dispensary and 100% interest in former dispensary manager).

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In re Medpoint Management, LLC (Con't)

- Creditors, comprised of consultants and lenders of Medpoint, filed an involuntary chapter 7 petition against Medpoint. Medpoint filed a Motion to Dismiss or for Abstention, arguing that (i) a bankruptcy trustee could not lawfully administer a bankruptcy estate's marijuana-related assets without violating the CSA, which constituted cause for dismissal under §707(a) and (ii) Creditors' hands were unclean due to their involvement in a medical marijuana enterprise

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In re Medpoint Management, LLC (Con't)

- The court granted Medpoint's motion and dismissed the petition holding that: (i) granting the petition would result in chapter 7 trustee necessarily violating federal law, and the dual risks of forfeiture of Medpoint's assets and a trustee's inevitable violation of the CSA in administration of the estate constituted cause to dismiss, (ii) Creditors had unclean hands in that they knowingly assisted with and profited from marijuana-related business and so they could not now seek relief from the bankruptcy court
- However, the Court held the Creditors did *not* file petition in bad faith ("[n]ot every failed reason for filing an involuntary petition amounts to 'bad faith.'")

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In re Arenas

- 535 B.R. 845 (Bankr. B.A.P. 10th Cir. 2015)
- The debtors jointly owned a commercial building in Denver that consisted of two units, which were used to grow and sell marijuana by the debtors (the second unit was leased to a dispensary). Most of the debtors' income stemmed from rental income of the units and the debtors' marijuana business. Their nonexempt assets were 25 marijuana plants and the building.
- The debtors filed a Chapter 7 petition that they later attempted to convert to Chapter 13. ("UST") asked that the case be dismissed, alleging that it would be impossible for a chapter 7 trustee to administer the assets without violating federal law.

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In re Arenas (Con't)

- The bankruptcy court denied the debtors' motion to convert their Chapter 7 case to Chapter 13, and concluded that the debtors could not receive Chapter 7 relief because engaging in federal criminal conduct demonstrated a lack of good faith that would bar confirmation of their Chapter 13 plan and was cause to dismiss their Chapter 7 case, too
- On appeal, this BAP, reviewing the order for abuse of discretion, (reviewing findings of fact for clear error and conclusions of law *de novo*), affirmed.

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In re Arenas (Con't)

- The BAP Found:
  - finding of lack of good faith is entitled to highest level of deference, (ii) finding was based on the fact that the plan was likely not feasible due to, among other factors, the debtors' lack of income to fund the plan even with the rental income from the dispensary, and not just the fact that marijuana is involved and (iii) if debtors are incapable of proposing a confirmable plan, the plan is proposed in bad faith
  - inability to lawfully administer the estate constituted cause for dismissal under §707(a)

Changing Positions?

- The BAP and Ninth Circuit's more recent respective rulings in *Olson* and *Garvin* indicate an increased willingness in the Ninth Circuit to consider cannabis-related companies eligible for chapter 11.

In re Olson

- 2018 WL 989263, **4-6 (B.A.P. 9th Cir. Feb. 5, 2018)
- Bankruptcy court dismissed case *sua sponte* concluding debtor was in violation of federal law for leasing property to, and collecting post-petition rent from, a cannabis company, which was operating legally under applicable California law. In dismissing, bankruptcy court was not persuaded by debtor's attempts to distance herself from the cannabis business, having ceased to take rent from the dispensary and moving to reject the lease

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In re Olson (Con't)

- The BAP vacated dismissal and remanded for further findings on the specific criminal activity and the legal standard for dismissing the case under §1307(c). The BAP first noted the bankruptcy court did not make a finding of "cause" sufficient under the statute, i.e. that proceeds from an illegal business were needed to fund the plan, or that the trustee would need to administer funds from illegal activities
- BAP also focused on the specific "knowledge" requirement that the CSA imposed for prohibiting leasing space to a cannabis business, noting the debtor was nearly blind, elderly, residing in a nursing home and relying on others to operate her business

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In re Olson (Con't)

- In ordering this case be remanded, the BAP signaled that perhaps not all cannabis-related companies are necessarily excluded from federal bankruptcy protection. Rather than adopting a rigid approach, the BAP indicated that in the Ninth Circuit, a court would need to make specific findings to justify dismissal.

Garvin v. Cook Invs. NW, SPNWY, LLC

- 922 F.3d 1031 (9th Cir. 2019)
- One debtor (which derived revenues from leasing commercial real estate) leased premises to a company that used the property to grow marijuana.
- UST's initial motion to dismiss for cause under §1112(b) denied because bankruptcy court determined debtors could possibly "propose a plan that does not rely on the income from the marijuana operation lease."

Garvin (Con't)

- Debtors' subsequently filed plan called for rejection of the marijuana-related lease and the plan was structured so that obligations would be paid without revenue from marijuana operations.
- UST objected to confirmation on basis of section 1129(a)(3) because it was proposed by means forbidden by law (but not on lack of good faith). Bankruptcy court rejected UST argument and confirmed plan. District court affirmed.

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Garvin (Con't)

- On appeal, the Trustee challenged the bankruptcy court's refusal to dismiss under §1112(b) for "gross mismanagement of the estate," but Ninth Circuit concluded argument was waived because not raised before bankruptcy court
- The Ninth Circuit, engaging in a textual analysis focusing on the language in the plain text of 1129(a)(3) which notes the plan has "not been proposed" by any means forbidden by law, upheld confirmation, concluding plain text of 1129(a)(3) directs bankruptcy court to "police the means of a reorganization plan's *proposal*, not its substantive provisions."

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Garvin (Con't)

- In making this ruling, the Court disagreed with other courts, including the *Rent-Rite* court, which have held that dismissal was appropriate for bad faith where a significant portion of the debtors' income was derived from an illegal activity
- "[F]ocus is [] on the plan proponent's actions specifically related to the plan proposal process, rather than whatever actions might occur pursuant to the plan itself or the proponent's behavior during the bankruptcy case more generally."

In re CWNevada LLC

- 602 B.R. 717 (Bankr. D. Nev. 2019)
- Post-*Garvin* decision dismissing cannabis cultivator and dispensary case filed after receivership commenced but acknowledging that CBD business may no longer be prohibited from using Chapter 11 after enactment of Farm Improvements Action of 2018 (Farm Bill)
- Creditor filed Dismissal Motion, which numerous other parties joined, seeking dismissal of the Chapter 11 case based on Section 305(a)(1), or Section 1112(b)

In re CWNevada (Con't)

- Court noted that in chapter 7, 11, and 13 cases, the common thread was that cases were not automatically dismissed for mere involvement of marijuana related assets, and in chapter 11 and 13 cases, bankruptcy courts consider whether a debtor could propose a feasible plan that did not rely on income received through a violation of the CSA
- Court noted further that "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
- Ultimately dismissed the case pursuant to §305(a)(1) for unrelated reasons

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Outside the Ninth Circuit…

- Outside of the Ninth Circuit, the majority of courts following the *Garvin* ruling have disagreed with the Court's holding or otherwise sought to distinguish the case. Within the Ninth Circuit, the BAP in *Burton* appeared to delineate *Garvin's* applicability to a more narrow subset of potential debtors, depending on their relationship to the cannabis industry

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In re Basrah Custom Design, Inc.

- 600 B.R. 368 (Bankr. E.D. Mich.)
- The debtor was listed as landlord, as agent of the owner, on a lease of property to a medical marijuana dispensary ("MJCC"). MJCC sued debtor and owner, among others, to enforce its right to purchase the land pursuant to the lease terms in state court. When the state court found for MJCC, the debtor filed its bankruptcy case
- The UST objected and filed a motion to dismiss the bankruptcy case for "cause" under §1112(b), alleging that the debtor pursued the bankruptcy case with unclean hands to enable its owner to profit from a marijuana business.

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In re Basrah Custom Design (Con't)

- The Court dismissed the bankruptcy case, finding that the debtor had unclean hands and there was cause to dismiss pursuant to §1112(b)(1).
  - The Court also held the debtor was collaterally estopped from denying that it wanted to continue to operate an illegal marijuana business due to a prior state court finding that the debtor intended to continue operating the business.

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In re Basrah Custom Design (Con't)

- Court distinguishes *Garvin* as being out of circuit and notes that it refused to decide the 1112(b) dismissal issue
  - "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."

In re Way to Grow, Inc.

- 610 B.R. 338 (D. Colo. 2019)
- Another post-*Garvin* decision where District Court affirmed the dismissal of a seller of equipment, products and other material utilized in the manufacture of cannabis. In their first day motions debtors stated that future business expansion plan is tied to the growing cannabis industry which is heavily reliant on hydroponic gardening, but added that they do not own or do business with cannabis

In re Way to Grow, Inc. (Con't)

- Creditor filed motion to dismiss because the debtors' aided and abetted in violation of the CSA and dismissal was warranted pursuant to §1129(a)(3) because the plan was not proposed in good faith, given the debtors' tainted revenues and assets at risk of forfeiture
- The bankruptcy court found that the debtors could not sever ties with marijuana industry and remain in operation and therefore determined debtors were likely in violation of the CSA and dismissed the case on that basis, finding the violation to be cause under §1112(b)

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In re Way to Grow, Inc. (Con't)

- The District Court affirmed and found that a Chapter 11 debtor cannot propose a good-faith reorganization plan that relies on knowingly profiting from the marijuana industry; which is cause under §1112(b) for dismissal
- District court questioned the narrow interpretation given to 1129(a)(3) by the *Garvin* court.

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In re Way to Grow, Inc. (Con't)

- States that *Garvin* misreads the dismissal in *Rent-Rite* pursuant to 1129(a)(3) as being based upon the "and not by any means forbidden by law" language, when in reality the basis was good faith
- "it is frankly inconceivable that Congress could have ever intended that federal judicial officials could, in the course of adjudicating disputes under the Bankruptcy Code, approve a reorganization plan that relies on violations of federal criminal law."

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Concluding Thoughts

- While *Garvin* and *Olson* seem to indicate movement in the Ninth Circuit away from the stricter precedent refusing chapter 11 relief to any chapter 11 debtor with ties to the cannabis industry, they have not had widespread impact outside of the Ninth Circuit
- Within the Ninth Circuit, there is no *per se* rule forbidding debtors with ties to the marijuana industry from utilizing chapter 11. However, it seems unlikely that these opinions could be relied upon as an affirmative mechanism for a marijuana business (as opposed to a business that merely has ties to cannabis industry) that seeks to continue to operate its prepetition operations.

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Use of Chapter 15

What is Chapter 15?

- Chapter 15 of the Bankruptcy Code offers bankruptcy protection within the United States to debtors that are subject to an insolvency proceeding in another country, in order to provide comity with foreign courts and foreign bankruptcy proceedings

Is Chapter 15 Available for Cannabis Entities?

- As discussed previously, the typical challenge to a chapter 11 proceeding initiated by a cannabis company is to dismiss the chapter 11 because the plan is in "bad faith" or proposed by means forbidden by law, pursuant to § 1129(a)(3). In the chapter 15 context, a cannabis debtor may face similar challenges pursuant to the public policy exception, codified in § 1506. § 1506 states: "Nothing in this chapter prevents the court from refusing to take an action governed by this chapter if the action would be manifestly contrary to the public policy of the United States."

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Is Chapter 15 Available for Cannabis Entities?

- Chapter 15 codifies the Model Law on Cross-Border Insolvency in substantially the same way it was written by the United Nations Commission on International Trade Law ("**UNCITRAL**"). The Guide to Enactment of the Model Law (the "**Guide**") published by UNCITRAL outlines the meaning and purpose of the provisions that are embodied in chapter 15.

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Is Chapter 15 Available for Cannabis Entities?

- There, UNCITRAL explains "the purpose of the expression 'manifestly,' used also in many other international legal texts as a qualifier of the expression 'public policy,' is to emphasize that public policy exceptions should be interpreted restrictively and that [the public policy exception] is only intended to be invoked under exception circumstances concerning matters of fundamental importance for the enacting State."
- The Guide provides that these fundamental policies would need to implicate some constitutional guarantees

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Is Chapter 15 Available for Cannabis Entities?

- Indeed, the House Report accords with this interpretation, stating that § 1506 follows the Model Law exactly, and has been narrowly interpreted on a consistent basis in courts around the world. Additionally, the House Report specifically indicated the Guide "should be consulted for guidance as to the meaning and purpose of [chapter 15's] provisions." The House Report further notes that international usage of the word "manifestly" restricts the public policy exception to the most fundamental policies of the United States

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Interpretation of § 1506

- "Fundamental policies" is not defined in the Code
- Courts have adhered to two principles in determining whether a fundamental policy is at risk:
  - "[d]eference to a foreign proceeding should not be afforded in a [c]hapter 15 proceeding where the procedural fairness of the foreign proceeding is in doubt or cannot be cured by the adoption of additional protections"; and
  - "[a]n action should not be taken in a [c]hapter 15 proceeding where such action would frustrate a U.S. court's ability to administer the [c]hapter 15 proceeding and/or would impinge severely a U.S. constitutional or statutory right." 480 B.R.

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Cases Finding Violations of § 1506

- *In re Toft*, 453 B.R. 186, 198 (Bankr. S.D.N.Y. 2011)
- Insolvency administrator (trustee) of German debtor initiated a chapter 15 proceeding in order to gain access to debtor's email accounts stored in the United States and for an order in effect granting him a wiretap on debtor's future emails
- Prior to filing a motion with the Bankruptcy Court, the insolvency administrator sought and received German and English court (where debtor relocated) orders granting the above relief

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In re Toft (Con't)

- The Bankruptcy Court noted that while comity is generally available for German and English proceedings, the Electronic Communications Privacy Act would require notice to the debtor for such acts, and the wiretap would be illegal under the Wiretap Act. As such, the Court found against the insolvency administrator, saying it was a "rare case" where § 1506 applies
- The Court noted that foreign procedures are not routinely imported into U.S. law and disclosure must be in accordance with U.S. practices and principles

In re Toft (Con't)

- The relief sought was denied for several reasons: (1) the relief is banned under U.S. law and would seemingly result in criminal liability under the Wiretap Act and Privacy Act for those who carried it the terms of any US court order; (2) it would directly compromise privacy rights subject to a comprehensive scheme of statutory protection available to aliens; (3) the statute at issue invoked the protections of the Fourth Amendment as well as the constitutions of many States. As such, such relief would "impinge severely a U.S. Constitutional or statutory right."

In re Gold & Honey, Ltd.

- 410 B.R. 357, 372–373 (Bankr. E.D.N.Y. 2009)
- In a series of chapter 15 cases, Petitioners were appointed as receivers in Israel for debtors who had already commenced a chapter 11 case. Despite being in violation of the automatic stay already issued by the U.S. Bankruptcy Court in the chapter 11, Petitioners argued the Israel proceeding should be recognized as a main foreign proceeding under chapter 15

In re Gold & Honey (Con't)

- The Court denied this request because the receivership proceedings in Israel violated both the automatic stay and the Court's orders reinforcing that stay. The Court invoked § 1506 because such recognition would reward and legitimize the petitioner's violation of the stay and orders regarding the stay

Cases Finding No Violation of § 1506

- *In re Metcalfe & Mansfield Alt. Inv.*, 421 B.R. 685, 697 (Bankr. S.D.N.Y. 2010)
- Debtors in a Canada Companies' Creditors Arrangement Act ("**CCAA"**) proceeding sought chapter 15 recognition of very broad third-party non-debtor release and injunction
- The Bankruptcy Court requested briefing on whether recognition of these releases under chapter 15 would be proper, as such releases would not be available in the Second Circuit in a chapter 11 proceeding

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In re Metcalfe & Mansfield Alt. Inv. (Con't)

- After recognizing the CCAA as the foreign main proceeding, the court noted "chapter 15 specifically contemplates that the court will exercise its direction consistent with principles of comity." "The key determination required by this Court is whether the procedures used in Canada meet our fundamental standards of fairness."
- Citing the House Report, the Court held the Canadian releases are entitled to comity because Canadian bankruptcy law provides procedural fairness. "The relief granted in the foreign proceeding and the relief available in a U.S. proceeding need not be identical."

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In re Ephedra Prods. Liab. Litig.

- 349 B.R. 333, 335-337 (Bankr. S.D.N.Y. 2006)
- Canadian debtors requested chapter 15 recognition of Canadian orders requiring mandatory meditation of personal injury and wrongful death claims. Four claimants objected to the relief on the grounds that it deprived claimants of the right to a jury trial under U.S. law
- In interpreting "manifestly contrary to the public policy of the United States," the Court looked to a similar issue for guidance: determining when to enforce "foreign judgments rendered on the basis of foreign proceedings that were plainly fair but that did not include some commonplace of American practice."

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In re Ephedra Prods. Liab. Litig. (Con't)

- Looking to Supreme Court precedent, the Court highlighted comity should be granted if "[the foreign] proceedings are according to the course of a civilized jurisprudence. *i.e.,* fair and impartial." (citing *Hilton v. Guyot*, 159 U.S. 113, 159 (1985)).
- After citing to other legal systems which do not allow jury trials in similar contexts, the court held claimants were afforded a fair and impartial proceeding and nothing more was required by § 1506 or any other law

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In re Ephedra Prods. Liab. Litig. (Con't)

- Notably, this result came after the debtor and other interested parties negotiated a claims resolution procedure which was subsequently approved by order of the Ontario court. The debtors then moved for that order to be recognized in the U.S. The U.S. Bankruptcy Court requested certain procedural changes to "assure greater clarity and procedural fairness," which were thereafter approved by the Ontario court.

In re Rede Energia S.A.

- Ad Hoc Group raised several objections to chapter 15 recognition of Brazilian debtors' plan
- After rejecting these objections for various reasons, the Court noted, "[w]here, as here, the proceedings in the foreign court progressed according to the course of a civilized jurisprudence and where the procedures followed in the foreign jurisdiction meet our fundamental standards of fairness, there is no violation of public policy."

§ 1506 Violation Cases Are Distinguishable

- *In re Toft*, the petitioners functionally sought a wiretap in contravention to several privacy-related statutes
- The distinctions between the relief sought in *In re Toft* and a cannabis-related bankruptcy are twofold:
  - First, the relief sought in *In re Toft* would be contrary to statutory rights provided in the U.S., where the Fourth Amendment underpins those statutory rights.
  - Second, depending on the relief being sought, it is not necessarily the case that the relief requested by a cannabis or cannabis-related business in a chapter 15 proceeding (i.e., enforcement of the automatic stay) would require the Debtor or other parties to engage in criminal activity to implement such an order.

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§ 1506 Violation Cases Are Distinguishable

- Likewise, in *In re Gold & Honey*, the court was concerned that the foreign court had instituted a receivership proceeding in contradiction of an ongoing U.S. court proceeding and in violation of the automatic stay. The case is fact-specific and could be categorized in part as the court's reaction to the Israel court's failure to recognize the US proceeding

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Concluding Thoughts

- While Chapter 15 has not yet been successfully tested in the context of a cannabis-related recognition proceeding, there are meritorious arguments that chapter 15's public policy exception is not implicated in a cannabis or cannabis-related bankruptcy proceeding because the rights to be protected are not "fundamental."

ASSIGNMENT FOR THE BENEFIT OF CREDITORS

INTRODUCTORY SUMMARY
PRESENTED BY
DEVELOPMENT SPECIALISTS, INC.

What is an Assignment for the Benefit of Creditors ("ABC")?

- State law alternative to liquidation that provides a means of liquidating the assets of a business in an orderly, controlled manner
  - Used for the sale or liquidation of business assets
  - Not to financially rehabilitate or to "turn around" a business
- General Assignments are either statutory or common law and the law varies from state to state as to which approach governs
  - Statutory requires typically requires court supervision of the assignment and the assignee
  - Common law permits an assignment to proceed without court supervision but requires that the assignee follow whatever common law or statutory structure in that state governs the liquidation of a business and its assets
- Essentially the state law equivalent to a Chapter 7 bankruptcy under federal law

2

ABC Key Features

- Assignments must involve all of the assignor's assets to qualify as a general assignment
  - Otherwise, an assignment is a specific assignment and common law and/or statutory law does not apply; The assignee will not have the rights of a lien creditor pursuant to Commercial Code § 9-309 (12)
  - Employee benefit plans, such as 401(k) plans, are not assets of an assignor, so an assignee does not typically wind down those plans (the beneficiaries "own" the Plan assets)
- Transfer of assets is subject to any and all existing liens
  - Assignee must validate any alleged secured claims. Creditors with pre-existing liens have the right to take possession of their collateral. Therefore an assignee will need to obtain the consent of properly perfected lien creditors' collateral before liquidation those assets
  - General assignments do not give an assignor a discharge or "releases", as a discharge of debts can only be achieved through a bankruptcy filing
  - State statutes that come close to giving bankruptcy type relief, like the automatic stay, are subject to being invalid as only a bankruptcy can provide an automatic stay, discharges, etc. by reason of the U.S. Constitution's Supremacy Clause

3

ABC Key Features

- Board and shareholder approval are required because going out of business is not generally authorized act under the organizational documents
- Assignment "contracts" typically will give an assignee a Power of Attorney to enable an assignee to take actions on behalf of the assignor
  - Includes bringing claims against third parties to recover on breach of contract claims, file tax returns, etc.
  - Outlines the priorities for creditor claims following applicable state and federal law

4

Assignee Qualifications

- Should be someone who is not related to or directly involved in the management or day-to-day operations and affairs of the assignor; A disinterested third party/person
- Should not be a creditor of the assignor
- Typically an individual or corporate entity with such experience (depending upon state law) in the process of liquidating businesses
- Some states require that an assignee be a resident of the state or county where the assignor resides
- Some states require the assignee to be an individual
- Many states have a requirement for the assignee to post a bond to insure the value of assets is not squandered by the assignee, including breach of fiduciary duty claims

5

Assignee Duties

- Becomes a fiduciary on behalf of any and all creditors of the assignor
  - Holds the assets in trust for creditors
  - Assignee however is not liable for the Assignor's debts
- Marshals the assets and liquidates the assets
  - Uses business judgment when disposing of the assets
- Notices creditors of the ABC for filing of proofs of claim
  - Reviews and addresses claims filed
  - Most states require notice be sent within 30 days, with anywhere between 60-180 days from the date of the ABC for creditors to file claims
- Distributes the proceeds pursuant to the state's priority scheme and applicable federal law (see 31 USC § 3713) after the claims bar date has run
- Does not have the authority to dissolve a corporate entity or file a bankruptcy proceeding

6

Proofs of Claim/Bar Date Process

- Bar date for notice to creditors and filing of claims usually set by state law
- Some statutes also deem filing of a proof of claim an "assent" to the general assignment
- Failure to file a claim will cause the creditor to lose the right to share in creditor recoveries
  - Late filing puts a creditor behind the claims that were timely filed by creditors
- Assignee generally does not make a distribution to timely filed and valid unsecured creditor claims until the bar date has passed
- Secured creditors will usually be paid from the proceeds of its collateral as the assets are liquidated

7

Typical Priority Sequence for Creditor Claims

- Secured Creditor
- Costs of Administration
- Federal Claims (i.e., claims filed by any agency of the federal government such as, the EPA, SBA, IRS, etc.)
- Employee Priority Wages and Unpaid Benefits
- Accrued in the 90-180 days depending on applicable state status before making of the ABC
- Subject to cap on amount of claim
- State and Local Taxes

8

Typical Priority Sequence for Creditor Claims

- Customer Deposits (if applicable such as if the debtor is a retail business)
- General Unsecured Claims
- Equity/Shareholder Interests
- Each class set must be paid in full before paying the claims below that class

9

Typical Priority Sequence for Creditor Claims

- Ability to select the fiduciary to oversee the process
- Speed of the process vs Chapter 7 cases
- Flexibility in the sale of assets
- Ability to sell assets quickly after accepting an assignment assuming
  - Pre-assignment marketing
  - Confirmation of any existing security interests and secured creditor consents
  - Insider offers should be subject to marketing and competitive sale process
- Lien limitations
  - Assignee's lien right (UCC 9-309(12)) effectively limits creditors to the amount and priority of their claim at the time of the ABC
  - Assignee's funds are not subject to the levy by creditors
  - Ability to terminate pre-assignment writs of attachment or lien of a temporary protective order (select states)

10

ABC Advantages

- Creditors can still litigate unpaid claims, but can only liquidate (fix) the amount of the claim
  - No priority for judgment over other unsecured creditor claims
- In court supervised states
  - Speed is a function of applicable state law as to notice, sale process, etc.
  - May be a limitation on timing except for sale of perishable goods
  - Courts typically look to comparable bankruptcy law (e.g. §363 sales)
  - Need for appraisals, bond by assignee and other more formal processes
  - Creditor distribution(s) need to be by court order
- An assignor's Board of Directors is not held to be liable for breach of fiduciary duty by making the decision to use an ABC versus a bankruptcy case (*see* Berg & Berg Enterprises LLC v. Boyle, 2009 DJDAR 15513 (2009) (applying California law)

11

ABC Drawbacks

- No automatic stay under state law
- ABCs are an event of default or breach in most commercial contracts/leases
  - Rely on assignee right to occupy leased premised (California statute) but subject to paying rent
  - Typically no limitation on landlord claims for breach of lease claims other than the objection to mitigate damage (i.e. release the property)
- Clauses that indicate an assignor is in breach of their contract based upon a certain event occurring are valid (i.e., *This Agreement shall terminate, without notice, (i) upon the institution by or against either party of insolvency, receivership or bankruptcy proceedings or any other proceedings for the settlement of either party's debts, (ii) upon either party making an assignment for the benefit of creditors, or (iii) upon either party's dissolution or ceasing to do business)*

12

ABC Drawbacks

- In states without preference statutes, no ability to recover on such claims
- In non-court supervised states
  - Mechanisms to resolve disputed claims are limited
  - Declaratory relief or interpleader actions are most common if disputes cannot be resolved on a business basis
  - Equitable subordination rights may not be available under state law vs under the federal bankruptcy code

13

Involuntary Bankruptcies

- Creditors can file an involuntary petition within the first 120 days after the making of the ABC
- Such petitions are subject to "abstention" by the bankruptcy court pursuant to 11 U.S.C. § 3713 (see Memorandum Decision on Korean Radio Broadcasting, Inc.'s Motion to Dismiss or For Abstention, In re Korean Radio Broadcasting, Inc., No. 19-46322-ESS, 2020 WL 2047990, at *2 (Bankr. E.D.N.Y. Mar. 31, 2020))
- Bankruptcy Court must refrain from taking jurisdiction of an involuntary case filed more than 120 days from the date of the ABC pursuant to 11 U.S.C. §543(d)(2)

14

DSI Authored Publications/Articles

Below is a partial list of publications about ABCs authored by DSI staff which you and your clients may find helpful

- *General Assignments for the Benefit of Creditors, the ABCs of ABCs, 4th Edition* (published March 2019)
- *Strategic Alternatives for Distressed Businesses*, West Publishing (2008, 2010, 2012, 2014, 2016/17, 2018/19 and 2020 editions); Contributing Editor, contributor of chapters on General Assignments for the Benefit of creditors and on application of Assignments under California Law
- *ABI Law Review Symposium, Model Rules for General Assignments for the Benefit of Creditors: The Genesis of Change*, American Bankruptcy Institute Law Review, Spring 2009
- *Delaware as a Venue for ABC's: Some Pro's and Con's*, (Association of Insolvency & Restructuring Advisors Journal, April 2017)
- *So You Want to Arbitrate a Chose in Action Obtained Through an ABC?*, Web posted January 2016, American Bankruptcy Institute and the American Bankruptcy Institute Journal

15

DSI Authored Publications/Articles

Continued:

- *Sales of Assets by an Assignee for the Benefit of Creditors*, Web posted and Copyright © October 2012, American Bankruptcy Institute and the American Bankruptcy Institute Journal
- *Priority of U.S. Government Claims in Non-Bankruptcy Proceedings: The Application of 31 U.S.C.§3713*, Web posted and Copyright © February 1, 2005, American Bankruptcy Institute and the American Bankruptcy Institute Journal
- *Do "Insured vs. Insured" Exclusions Apply to Assignees in Assignments for the Benefit of Creditors?* (co-author), Web posted and Copyright © February 1, 2004, American Bankruptcy Institute
- *Non-Bankruptcy Alternative: Assignments for the Benefit of Creditors*, New York Law Journal, September 2, 2015

16

28 No. 1 J. Bankr. L. & Prac. NL Art. 3

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By Gerard DiConza [*]

Receiverships and their Interplay with the Bankruptcy Code

Companies facing financial distress have several restructuring options. They can file for Chapter 11 relief under the Bankruptcy Code or use other remedies available under state or other federal law, including receiverships. While a Chapter 11 may have its advantages, there may be reasons why Chapter 11 does not work, including exorbitant administrative fees and costs. In addition to these direct costs, a Chapter 11 restructuring may have certain indirect costs, including the potential for litigation brought by trustees or committees, stigmas associated with the very public Chapter 11 process and potential loss of skilled and talented employees.

While the direct and indirect costs may present a barrier to Chapter 11, certain companies facing distress may not use Chapter 11 as a restructuring option. Unless already shut down and no longer operating, Chapter 11 is not a viable option for higher education institutions, which could lose their accreditation and rights to federal funding if they file for Chapter 11. [1] Companies in the growing cannabis industry are generally prohibited from using Chapter 11 as cannabis remains a federal crime.

A receivership may provide an efficient, cost-effective alternative to restructuring the affairs of a company in distress. This article provides a general background on receiverships, including their advantages and disadvantages, and explores the use of receiverships as an alternative to Chapter 11 for those companies that cannot afford, or simply may not use, Chapter 11 to restructure. This article also reviews some of the issues that arise when a bankruptcy case is filed after a receiver is appointed.

I. Receiverships — What are They and How Do They Work?

Receivers are appointed by either federal [2] or state courts [3] and are typically appointed to take possession and preserve property or a business. The court appointing the receiver will determine the power, duties and responsibilities of the receiver, while the receivership order typically places the debtor's property under the dominion and control of the receiver.

a. Pros and Cons of Receiverships

A receivership is often a less expensive restructuring alternative to the Chapter 11 process due to less-stringent procedural requirements and fewer constituencies involved. The significant procedural requirements imposed by the Bankruptcy Code, the Bankruptcy Rules and applicable local rules, can translate into significant costs and expenses. In a Chapter 11 case, the debtor is required to pay the fees of its professionals and those hired by a duly appointed creditors' committee. These fees are not required in a receivership. A receivership proceeding is also typically shorter than a Chapter 11 case since there are fewer hearings and procedural requirements.

Moreover, careful drafting of the proposed receivership order can provide creditors with many of the protections and safeguards afforded by the Bankruptcy Code and may even offer additional control to creditors dealing with distressed

borrowers and their collateral. For example, the automatic stay afforded to debtors by section 362 of the Bankruptcy Code may be replicated in the receivership order in a provision enjoining creditor action against the borrower or its property during the pendency of the receivership.[4] Virtually all receivership proceedings typically include injunctive relief to prevent interference with the receiver's control, management, and administration of assets. In the federal context, statutory authority provides support for a receiver's control over receivership assets to the exclusion of others, regardless of where those assets may be located in the United States.[5]

Another potential advantage of a receivership over Chapter 11 is the level of transparency and publicity involved. Unlike a bankruptcy proceeding, a debtor under a receivership order is not required to file schedules of assets and liabilities, a statement of financial affairs and monthly operating reports. As such, a receivership may be preferable in circumstances where the stigma of a bankruptcy filing could result in the loss of customers and good will.

While a receivership may reduce the costs and potential public stigmas, there are disadvantages, including inconsistent state laws and the lack of jurisdiction by federal courts over the assets of a debtor. Although some states have enacted comprehensive receivership statutes, many have not.[6] Given the jurisdictional inconsistencies, receivership may be less practical in a case where a borrower maintains assets in various states. Moreover, in jurisdictions that do not have laws governing receivership proceedings, courts may not be receptive to this remedy, and acceptance may vary. Some state courts may be reluctant to approve the appointment of a receiver. As a result, a receivership may result in delay and costly litigation over whether a court has jurisdiction over the debtor and its property and whether it may appoint a receiver.

b. Appointing a Federal Receiver

Due to inconsistencies in state receivership laws, appointment of a federal receiver, if appropriate, may be beneficial for companies with businesses across state lines.[7] As a result of their broad equitable powers, federal district courts have the power and authority to appoint receivers.[8] When assessing whether a federal receivership is appropriate, federal courts first determine whether they may exercise jurisdiction and then consider the following factors: "(1) the probability that fraudulent conduct has occurred or will occur; (2) the validity of the claim by the party seeking the appointment; (3) whether there is an imminent danger that property will be concealed, lost, or diminished in value; (4) the inadequacy of [alternative] legal remedies; (5) the lack of a less drastic equitable remedy; and (6) the likelihood that appointing the receiver will do more good than harm."[9] Federal courts, however, have appointed receivers even in the absence of fraud when dire financial circumstances justify the appointment.[10]

While typically granted as an ancillary or tag-along remedy,[11] receivers have been appointed in the absence of a pending foreclosure action.[12] In *U.S. Bank N.A. v. Nesbitt Bellevue Prop. LLC, et al.*,[13] for example, the District Court for the Southern District of New York granted a secured lender's request for appointment of a receiver in the absence of pending foreclosure actions over real property spread over six states.[14] Although the secured lenders in *Nesbitt* had not commenced a foreclosure action, the court granted their receivership motion after finding that the secured lenders intended to commence a foreclosure action and established there was risk of substantial and preventable decline in value of the property.[15] The *Nesbitt* court noted:

> While receiverships should be 'be watched with jealous eyes lest their function be perverted,' and while the rule that a party may not simply bring a naked action for a receiver in the absence of some path to further, final relief (namely foreclosure and liquidation of the Collateral) serves that vigilance, it would not serve the purpose of equity to dismiss this case and force the plaintiff to file a foreclosure action in six different states before the appointment of a receiver.[16]

II. Use of Receiverships When Chapter 11 Not an Option

While the direct and indirect costs outlined above may prevent some companies from using Chapter 11, for certain companies a receivership may be the only viable alternative. For example, Chapter 11 is usually not an option for higher education institutions and cannabis companies, although technically eligible to file for Chapter 11 relief.

The Higher Education Act ("**HEA**") provides that a college filing for bankruptcy immediately and irrevocably loses access to the federal loans and grants authorized under Title IV of the HEA.[17] Under the HEA, a bankruptcy filing disqualifies an institution from participating in Title IV funding programs.[18] Filing for Chapter 11 may also result in the loss of accreditation by the higher education institution. These restrictions make filing for Chapter 11 relief prohibitive for most colleges.

In addition to higher education institutions, cannabis companies and companies that generate revenue from cannabis-related companies may be foreclosed from filing for Chapter 11. The legalization of marijuana in many states has caused a proliferation of companies in the cannabis industry or with connections to the cannabis industry. Marijuana, however, remains an illegal product under the federal Controlled Substances Act ("**CSA**")[19] and, as a result, using Chapter 11 or a federal receivership may be off limits for cannabis companies or companies with relations to cannabis companies.[20] The United States Trustee takes the position that "rather than make its own marijuana policy, the USTP will continue to enforce the legislative judgment of Congress by preventing the bankruptcy system from being used for purposes that Congress has determined are illegal."[21] As a result, bankruptcy courts have been careful to ensure that the bankruptcy process is not used to enable a debtor to continue to participate in a federal crime and, for the most part, dismiss cases for companies that are directly involved in the cannabis industry, including retailers, dispensaries, growers and their principals.[22] Companies with indirect connections to cannabis, e.g., landlords who lease space to a marijuana company, may also be barred from Chapter 11, depending on the knowledge of the insiders.[23]

ECA College — Practical Use of Receivership When Chapter 11 is Not an Option

Since Chapter 11 is not a viable option for higher education institutions, federal receiverships may be a viable alternative to restructuring their debts. At least with respect to higher education companies,[24] a federal receivership could avert a de-funding and loss of accreditation, while the institution seeks to implement a restructuring with the advantages of Chapter 11, but without the attendant costs.

Recently, Education Corporation of America ("**ECA**"), the parent company of Virginia College, LLC ("**VC**") and New England College of Business and Finance, LLC ("**NECB**") attempted a creative use of federal receivership to avoid Chapter 11.[25] After years of declining revenues and student enrollment, ECA determined to winddown its affairs by closing certain schools and selling the remaining schools to its secured lenders (the "**ECA Restructuring Proposal**"). As a condition to the ECA Restructuring Proposal, including additional financing to wind-down operations, ECA's lenders required the appointment of a receiver. The ECA Restructuring Proposal also provided for a "teach out" plan for students to complete their degrees at the closed locations.[26] On September 5, 2018, ECA informed the United States Department of Education (the "**DOE**") of its Restructuring Proposal,[27] and approximately one month later, on October 16, 2018, ECA filed a declaratory action against the DOE in the United States District Court for the Northern District of Alabama seeking an injunction and the appointment of a receiver (the "**Alabama Action**").[28]

In the Alabama Action, ECA sought a declaration that the Restructuring Proposal would not interfere with the access and eligibility of ECA institutions that are expected to continue operating in the ordinary course under the Restructuring Proposal. The DOE opposed ECA's requested relief, arguing that the HEA does not give rise to a private cause of action

and the district court lacked jurisdiction to enter equitable relief requested by ECA, including the appointment of a federal receiver. According to the DOE, ECA was seeking federal court protection principally to prevent harm arising from state-court creditor actions. [29]

In an unpublished decision dated November 5, 2018, the Alabama District Court agreed with the DOE and dismissed the Alabama Action for lack of subject matter jurisdiction, finding that there was no case or controversy between ECA and the DOE. [30] The court found that ECA did not satisfy the proper grounds for either the issuance of an injunction or the appointment of a receiver and noted that "ECA did not cite any case in which a [party] sought a federal receivership to protect the [party's] interest in its own assets …, and the court has found no such case." [31]

While the Alabama Action was pending, ECA was sued for non-payment of rent by a landlord in the Georgia state court. Based on diversity jurisdiction, ECA successfully removed the state action to federal district court in the Northern District of Georgia (the "**Georgia Action**"). [32] Undeterred by the November 5, 2018 decision of the Alabama District Court, the next day ECA filed a motion in the Georgia District Court seeking injunctive relief and the appointment of a federal receiver. On November 14, 2018, the Georgia District Court, relying on *Nesbitt*, [33] granted ECA's request for appointment of a federal receiver. The receiver order granted the receiver broad authority to, among other things, operate ECA's business, sell assets and winddown the affairs of ECA. A subsequent order entered by the court authorized the ECA receiver to obtain financing from the secured lenders. In addition, the Georgia District Court granted broad injunctive relief staying all creditors from enforcing their rights and claims against ECA. [34]

Notwithstanding appointment of a receiver, ECA's Restructuring Proposal was essentially tabled after the Accrediting Council for Independent Colleges and Schools (ACICS) suspended accreditation for ECA schools other than NECB, which receives its accreditation from the New England Association of Schools and Colleges Inc. In December 2018, ECA announced it was closing all of its locations other than NECB. Although its restructuring efforts faltered, ECA's resourceful use of federal receivership may provide a roadmap for higher education institutions seeking to restructure outside of Chapter 11.

III. Filing of Bankruptcy When Receiver in Place

While a receivership may lead to a resolution of a debtor's restructuring, receiverships may also ultimately wind up before a bankruptcy court, either voluntarily or through an involuntary filing. When a post-receiver bankruptcy case is filed, bankruptcy courts are generally called to determine several issues, including (a) whether the debtor's filing was properly authorized, (b) whether the receiver may remain in possession of the debtor and avoid turnover of receivership property to the trustee or debtor in possession, and (c) whether the receiver may be paid.

A. Authority to File Chapter 11 Petition When Receiver in Place

Most receivership orders provide broad injunctive relief, typically divesting the debtor's former officers and directors from their positions and vesting all corporate authority with the receiver. [35] Although the receiver is in control, a filing by the debtor's former insiders may not necessarily result in a dismissal of the Chapter 11 case.

Recently, the Ninth Circuit addressed this issue in the Chapter 11 case filed by Sino Clean Energy, Inc. [36] In *Sino*, the Ninth Circuit upheld the state court order appointing the receiver and enjoining the debtor's former insiders from filing a Chapter 11 case on behalf of the debtor. Relying on applicable Nevada law, the Ninth Circuit held that the directors who were previously removed by the receiver had no authority to file the Chapter 11 case. The court emphasized that state law dictates who has the authority to make policy decisions on behalf of companies, including the filing for bankruptcy relief, and such decision-making authority is not preempted by federal law. [37] The Ninth Circuit relied in its prior ruling in *Oil & Gas Company v. Duryee,* [38] where the court upheld dismissal of a Chapter 11 case and enforced a state court

order appointing a rehabilitator to run an insurance company and enjoining the company's former president from filing a bankruptcy petition. [39]

The *Sino* decision called into question a 2006 decision in the Chapter 11 cases filed on behalf of *Corporate and Leisure Event Productions, Inc.* [40] In *Corporate and Leisure*, the bankruptcy court recognized the authority of the debtors' former insiders to file Chapter 11 cases and disregarded a state court receivership order that not only removed them, but expressly prohibited the filings by the former insiders. Relying on the preemption doctrine, the court concluded that state court receivership proceedings may not bar a debtor from seeking bankruptcy protection, despite the broad authority granted to the receiver in the appointment order. [41] While the *Corporate and Leisure* decision was subsequently followed by other bankruptcy courts, [42] the *Sino* decision appears to halt any attempt by former insiders to file a Chapter 11 if the receivership order removes, and enjoins a filing by, the former insiders. [43]

B. Whether the Receiver May Remain in Possession of the Debtor

In addition to the requisite filing authority, a bankruptcy court may be called to determine questions over who will control the debtor and its property in a bankruptcy case filed after a receiver is appointed. The Bankruptcy Code provides that the filing of a bankruptcy case after the appointment of a receiver places all the debtor's property under the jurisdiction of the bankruptcy court. [44] Section 543 provides that a "custodian" who has knowledge of the commencement of a bankruptcy case is generally barred from taking any further action in the administration of the debtor's property and must turnover any assets of the estate in its possession. [45] In addition, a custodian is directed to deliver the debtor's property to the bankruptcy trustee, and then file an accounting of the property, proceeds, products, rents, or profits. [46] A receiver is considered a "custodian" [47] and, unless excused by the bankruptcy court, must turnover any property of the debtor to the trustee or debtor in possession. [48] Section 543 also forbids the receiver from taking action except as necessary to preserve the property. [49] While sections 543(a) and (b) require turnover of the receivership property, section 543(d) allows a bankruptcy court to excuse a receiver from the turnover requirements if in the best interest of creditors. [50]

While a bankruptcy court may excuse a receiver from the turnover requirements of section 543, the Bankruptcy Code does not state whether a receiver may remain in possession and manage the debtor's affairs in a Chapter 11 case or otherwise provide for who should run the debtor if a receiver is excused from turnover. Decisions vary, with some courts leaving a pre-petition receiver in place to act as the debtor's manager, and others replacing the receiver with a chapter 11 trustee.

In the *Bayou Group LLC* Chapter 11 cases, [51] prior to the Chapter 11 filing, the District Court for the Southern District of New York determined that the debtor and various related entities were operating a Ponzi scheme and appointed a federal equity receiver. The order appointing the receiver also installed the receiver as the managing member of the debtor. After the receiver caused Bayou to file for Chapter 11, the United States Trustee filed a motion to appoint a Chapter 11 trustee, arguing that the former insiders were incapable of running the debtor and the receiver's role as manager ceased on the Chapter 11 filing. The bankruptcy court denied the motion and on appeal, the district court affirmed. In interpreting its own *receivership* order, the district court noted that while the receiver was appointed under the federal receivership statute, the court relied on different authority, i.e., federal securities laws and its general equitable power, to appoint him as corporate manager. [52] As a result, unlike its receivership role, the receiver's corporate management role did not end on the bankruptcy filing. [53] The district court construed the receiver as "the exclusive managing member of a debtor in possession" who was subject to the obligations imposed on debtors in possession under the Bankruptcy Code. [54] The Second Circuit affirmed, concluding that the receiver held "two hats—one as custodian, and one as 'sole and exclusive' managing member of Bayou. While [the receiver's] 'custodian' hat came off upon the commencement of the Chapter

11 proceedings, his 'managing member' hat remained." [55] In affirming, the Second Circuit was compelled to note the outstanding results achieved by the receiver and that the creditors were pleased and supported his continuation. [56]

Post-*Bayou*, courts have generally allowed a receiver to remain in possession, especially where the receiver was appointed by a federal district court. [57] Recently, however, the *Bayou* decision has been questioned and some courts have denied requests to maintain the receiver in possession, at least when the receiver was appointed by a state court. [58] These courts limit *Bayou* on the basis that (a) the plain language of section 543 requires turnover *to a trustee*, (b) federal receivership orders, unlike state orders, are entered by district courts, which have original jurisdiction over bankruptcy cases, [59] and (c) section 105(b) of the Bankruptcy Code expressly prohibits the appointment of a receiver in a bankruptcy case. [60]

In *In re Ute Lake Ranch, Inc.*, [61] the Bankruptcy Court for the District of Colorado refused to extend *Bayou* to a state receiver, even though the receivership order was similar to *Bayou* and vested the receiver with managerial power over the debtors. After the receiver caused the debtors to file for Chapter 11, he moved to remain in possession as debtor in possession. The United States Trustee opposed, arguing the receiver as a custodian was required to turn over possession to a trustee pursuant to section 543. Agreeing with the United States Trustee, the Bankruptcy Court distinguished *Bayou* on the basis that the federal receiver was appointed under federal securities laws as well as the district court's inherent equitable powers to act as managing member of the debtor. The court noted that the *Bayou* district court invoked separate sources of authority in appointing the receiver and corporate manager. The state receiver in *Ute Lake*, however, was appointed pursuant to a state receivership statute and only petitioned the state court for managerial power after he determined the debtor's assets should be liquidated. While acknowledging that the receiver was best suited to manage the Chapter 11 debtors, the court declined to extend *Bayou* on the basis that it could not ignore the plain meaning of section 543. It also cautioned against use of *Bayou*-type orders to state receiverships in the future:

> In this Court's view, applying the *Bayou* decision's reasoning to the facts of this case would create the proverbial 'exception that swallows the rule.' Any state court-appointed receiver or custodian could avoid the prohibitions of § 543 by simply asking the state court to change its title to 'manager' just prior to a bankruptcy filing. The wording of the July 1 Order would become a roadmap for court-appointed receivers and custodians to retain control of a debtor's assets in bankruptcy. This Court declines to adopt such an interpretation. [62]

These decisions show that allowing a pre-petition receiver to stay in possession remains uncertain unless the receiver was appointed by a federal receivership order that expressly provides for the continuation of the receiver as manager upon a filing, while the receiver's time as custodian, ends.

C. Whether Receivership Trumps — Abstention and Excusing Turnover

Another alternative for a receiver upon a bankruptcy filing is to seek abstention by the bankruptcy court pursuant to section 305(a) of the Bankruptcy Code. Section 305(a) authorizes dismissal or suspension of proceedings only if in the interest of both the creditors and the debtor. [63] In addition to abstention under section 305(a), section 543(d) of the Bankruptcy Code provides that a receiver may be excused from the turnover requirements. Essentially, section 543(d) is a modified abstention principle that echoes the abstention doctrine of section 305. [64] Unlike section 305, section 543(d) considers the concerns and interests of creditors, [65] and the interests of the debtor are not to be considered in the court's decision. [66]

Thus, despite the turnover requirements of section 543, sections 305(a) and 543(d) provide creditors and other parties in interest with an avenue to excuse compliance with turnover. [67] While section 543(d) may excuse a receiver from complying with the turnover provisions, the Bankruptcy Code does not provide guidance on the duties and obligations of a receiver if excused.

If the bankruptcy court excuses a receiver from turnover, the receiver remains subject to the terms of the pre-petition order appointing receiver, but the bankruptcy court may enter further orders to supervise the receiver and authorize payment of professionals. [68] Courts disagree over whether professionals engaged by a receiver must obtain bankruptcy court approval of their engagement if the receiver remains in possession. Some courts hold that the receiver becomes the functional equivalent of a trustee and bankruptcy court approval is a condition to payment of receiver's professionals. [69] In *In re 400 Madison Avenue Limited Partnership*, the bankruptcy court disagreed and held that the Bankruptcy Code does not require section 327(a) approval of a receiver-in-possession's professionals. [70] According to *400 Madison Avenue*, as long as the order appointing the receiver authorized the receiver to engage and pay professionals, no new retention application is required when a bankruptcy intervenes. [71]

D. Paying the Receiver and Receiver Professionals in Bankruptcy

Receivers are entitled to reimbursement for their expenses and to compensation for their services from the bankruptcy estate. Section 543(c)(2) states that the court "shall … provide for payment of reasonable compensation for services rendered and costs and expenses incurred by such custodian." [72] This compensation is entitled to administrative priority under section 503(b)(3)(E) of the Bankruptcy Code. [73] In addition to the expenses and compensation that may be awarded to a receiver under section 503(b)(3)(E), section 503(b) also allows compensation for a receiver's professionals. [74] Section 503(b)(4) grants an allowed administrative expense for "reasonable compensation for professional services rendered by an attorney or an accountant" of a receiver. [75] Even if a receiver has been superseded under section 543(d), it would be entitled to payment of its expenses and compensation under section 543(c)(2). [76]

Footnotes

* Gerard DiConza is a partner in the Bankruptcy, Restructuring and Insolvency Litigation Group at Archer & Greiner, P.C. The author thanks his colleague, Lance A. Schildkraut, for his tremendous efforts and invaluable assistance in completing this article.

1 Loss of accreditation and federal funding may serve as a death knell for higher education institutions.

2 Pursuant to 28 U.S.C.A. § 959, a receiver is authorized to manage and operate the property in accordance with laws of state where the property is located, to extent that such laws do not conflict with federal statutes or place an undue burden on federal receiverships.

3 Most states have their own statutory framework for the appointment of a receiver. See e.g., Minn. Stat. § 576.21; Mo. Rev. Stat. § 515.500; N.Y. CPLR 5228; Wash. Rev. Code § 7.60. See also N.Y. RPL § 254(10) (provides a mortgagee with right to appointment of a receiver in mortgage foreclosure action if the mortgage documents contain "receiver clause", i.e., a clause providing that "the holder of this mortgage, in an action to foreclose it, shall be entitled to the appointment of a receiver."

4 Federal courts may also grant broad stays under receivership orders, which stay all actions, wherever commenced against the debtor. See, e.g., S.E.C. v. Wencke, 622 F.2d 1363, Fed. Sec. L. Rep. (CCH) P 97533 (9th Cir. 1980).

5 See 28 U.S.C.A. § 754; see also 28 U.S.C.A. § 1692 (providing that federal receivers appointed in one district have the statutory authority to execute process in any district in which receivership property is located).

6 For example, Michigan recently enacted the Uniform Commercial Real Estate Receivership Act, effective May 7, 2018, which applies to both real estate and personal property. The Uniform Act grants a receiver with authority similar to a bankruptcy trustee, including the ability to sell assets free and clear of certain liens, and permits a secured creditor to credit bid at the sale.

7 See, e.g., S.E.C. v. American Capital Investments, Inc., 98 F.3d 1133, 1144 (9th Cir. 1996) (abrogated on other grounds by, Steel Co. v. Citizens for a Better Environment, 523 U.S. 83, 118 S. Ct. 1003, 140 L. Ed. 2d 210, 46 Env't. Rep. Cas. (BNA) 1097, 28 Envtl. L. Rep. 20434 (1998)) ("we conclude that the power of sale is within the scope of a receiver's 'complete control' of receivership assets under sec. 754, a conclusion firmly rooted in the common law of equity receiverships.")

8 See 28 U.S.C.A. §§ 754 and 959 and Fed. R. Civ. P. 66. 28 U.S.C.A. § 754 provides:

> A receiver appointed in any civil action or proceeding involving property, real, personal or mixed, situated in different districts shall, upon giving bond as required by the court, be vested with complete jurisdiction and control of all such property with the right to take possession thereof.
>
> He shall have capacity to sue in any district without ancillary appointment, and may be sued with respect thereto as provided in section 959 of this title.
>
> Such receiver shall, within ten days after the entry of his order of appointment, file copies of the complaint and such order of appointment in the district court for each district in which property is located. The failure to file such copies in any district shall divest the receiver of jurisdiction and control over all such property in that district.

9 Aviation Supply Corp. v. R.S.B.I. Aerospace, Inc., 999 F.2d 314, 316–17 (8th Cir. 1993) (discussing the factors relevant to the receivership inquiry).

10 See D.B. Zwirn Special Opportunities Fund, L.P. v. Tama Broadcasting, Inc., 550 F. Supp. 2d 481, 491 (S.D. N.Y. 2008) (Courts "[have] appointed receivers even where there was no evidence of fraud."); see, e.g., U.S. Bank Nat. Ass'n v. Nesbitt Bellevue Property LLC, 866 F. Supp. 2d 247, 251–54, 82 Fed. R. Serv. 3d 1062 (S.D. N.Y. 2012) (appointing a receiver in the absence of fraud where target faced imminent risk of a loss of enterprise value).

11 Kelleam v. Maryland Cas. Co. of Baltimore, Md., 312 U.S. 377, 381, 61 S. Ct. 595, 85 L. Ed. 899 (1941) ("A receivership is only a means to reach some legitimate end sought through the exercise of the power of a court of equity. It is not an end in itself. … This Court has frequently admonished that a federal court of equity should not appoint a receiver where the appointment is not a remedy auxiliary to some primary relief which is sought and which equity may appropriately grant.")

12 New York law generally requires that the appointment of a receiver be ancillary to a main proceeding, e.g., a foreclosure action. Section 6401 of the New York CPLR provides that the appointment of a receiver must be ancillary to some other proceeding when there is danger that the property may materially lose its value. Similarly, Federal Rule 66 provides that "the appointment of a receiver in equity is not a substantive right but is a remedy that is ancillary to the primary relief prayed for in the suit."

13 U.S. Bank Nat. Ass'n v. Nesbitt Bellevue Property LLC, 866 F. Supp. 2d 247, 82 Fed. R. Serv. 3d 1062 (S.D. N.Y. 2012).

14 866 F.Supp.2d at 251–54.

15 866 F.Supp.2d at 256–57.

16 866 F.Supp.2d at 256 (quoting Kelleam, 312 U.S. at 381).

17 To generate revenue, colleges depend upon tuition and fees from their students, most of whom receive federal student loans authorized under Title IV of the HEA. Title IV of the HEA establishes federal

student financial aid programs through which the government forwards student loan proceeds to eligible higher education institutions. See 20 U.S.C.A. § 1070(a). To be eligible, an institution must meet the HEA Title IV definition of "institution of higher education," as defined in 20 U.S.C.A. §§ 1001, 1002. To participate in Title IV programs, an institution must establish, inter alia, that it is authorized to operate in the state in which it is located; that it is accredited by a recognized accrediting agency; and that it is administratively capable and financially responsible. See 20 U.S.C.A. § 1099c. To demonstrate financial responsibility, an institution must meet certain specified financial obligations and regulatory measures. See 34 C.F.R. §§ 668.171 to 668.173.

18 See 20 U.S.C.A. § 1002(a)(4)(A); see also 34 C.F.R. §§ 600.1 et. seq.

19 21 U.S.C.A. §§ 801 et seq. In January 2018, the Justice Department issued a memorandum (https://www.justice.gov/opa/pr/justice-department-issues-memo-marijuana-enforcement) designed to provide guidance on when it would pursue federal charges against marijuana businesses. In the memorandum, the Attorney General notes the CFA and other federal statutes that reflect "Congress's determination that marijuana is a dangerous drug and marijuana activity is a serious crime."

20 Among the activities prohibited by the CSA is knowingly leasing property to a cannabis grower or making a property available for the sale or distribution of marijuana regardless of how important or unimportant that particular parcel may be to a property owner's overall business. See 21 U.S.C.A. § 856(a).

21 Clifford J. White III and John Sheahan, Why Marijuana Assets May Not be Administered in Bankruptcy Amer. Bankr. Inst. J., Dec. 2017, p.34.

22 See In re Arenas, 535 B.R. 845, 852–53, 74 Collier Bankr. Cas. 2d (MB) 171, Bankr. L. Rep. (CCH) P 82870 (B.A.P. 10th Cir. 2015) (on motion of U.S. Trustee upholding dismissal of debtors' cases based on findings that debtors were unable to confirm plan without using proceeds of their marijuana business); Arm Ventures, LLC, 564 B.R. 77 (Bankr. S.D. Fla. 2017) (dismissing case of commercial property owner when the debtor was unable to propose plan that was not reliant on funding by a tenant engaged in manufacturing medical marijuana); In re Medpoint Management, LLC, 528 B.R. 178, 60 Bankr. Ct. Dec. (CRR) 248, 73 Collier Bankr. Cas. 2d (MB) 781 (Bankr. D. Ariz. 2015), vacated in part on other issue, 2016 WL 3251581 (B.A.P. 9th Cir. 2016) (involuntary petition dismissed because debtor provided management services and intellectual property to cannabis business); In re Rent-Rite Super Kegs West Ltd., 484 B.R. 799, 90 A.L.R. Fed. 2d 777 (Bankr. D. Colo. 2012) (dismissing case where rent from cannabis business comprised 25% of debtor's income).

Rent-Rite was the first reported decision to address the conflict between the CSA and the ability of a cannabis-related business to seek bankruptcy relief. In *Rent-Rite*, the debtor owned a warehouse and leased space to tenants for the cultivation of marijuana and filed a Chapter 11 case. The rent received from the cannabis tenant was only twenty-five percent of the debtor's income. Notwithstanding, the bankruptcy court dismissed the case upon the secured lender's motion, holding that, even though the debtor's business operation was legal under Colorado law, it had discretion to dismiss or convert the bankruptcy case due to the debtor's violation of the CSA.

23 See In re Olson, 2018 WL 989263 at *4–6 (B.A.P. 9th Cir. 2018). In *Olsen*, the bankruptcy court dismissed the case sua sponte concluding that the debtor was in violation of federal law for leasing property to, and collecting post-petition rent from a cannabis company, which was operating legally under applicable California law. In dismissing the case, the bankruptcy court was not persuaded by the debtor's attempts to distance herself from the cannabis business, having ceased to take rent from the dispensary and moving to reject the lease. Olsen, at *4. On appeal, the Bankruptcy Appellate Panel for the Ninth Circuit signaled that not all cannabis-related companies are excluded from federal bankruptcy protection. The BAP vacated a bankruptcy court's dismissal and remanded the case for further findings on the specific criminal activity and the legal standard for dismissing the case. Rather than adopting a rigid approach, the *Olsen* BAP focused on the specific "knowledge" requirement that the CSA imposed for prohibiting leasing space to a cannabis business and addressed the unique facts of this case. The *Olsen* debtor was a nearly blind, elderly debtor, residing in a nursing home and relying on others to operate her business.

24 Due to the CSA, cannabis companies are precluded from using federal receiverships and may only resort to relief under state receivership procedures.

25 ECA runs, among other schools, Virginia College, NECB, Brightwood College and Golf Academy of America. At the time it sought a receivership, about 20,000 students were enrolled in ECA schools at seventy-four campuses throughout the United States, including five campuses in Alabama.

26 In the event that an institution ceases operations or faces possible loss of its license, accreditation, or certification, the institution must submit a teach-out plan specifying how students will be able to complete their degrees. See 34 C.F.R. § 668.14(b)(31).

27 The DOE regulates colleges' eligibility for Title IV programs, and participation in the programs requires DOE approval.

28 See Educ. Corp. of America, et al. v. U.S. Dep't of Educ. et al., Case No. 18-cv-01698-AKK (N.D. Ala.), ECF Dkt. No. 58.

29 National Partnership Inv. Corp. v. National Housing Development Corp., 153 F.3d 1289, 1291 (11th Cir. 1998).

30 Educ. Corp. of America, et al. v. U.S. Dep't of Educ. et al., Case No. 18-cv-01698-AKK (N.D. Ala.), ECF Dkt. No. 58.

31 Educ. Corp. of America, et al. v. U.S. Dep't of Educ. et al., Case No. 18-cv-01698-AKK (N.D. Ala.), ECF Dkt. No. 58 at p. 15.

32 See VC Mason GA, LLC v. Virginia College, LLC and Educ. Corp. of America, Case No. 18-cv-00388-TES (M.D. Ga.) Certain landlords of ECA colleges have appealed the receivership order entered by the Georgia District Court on the basis that the court lacked authority and jurisdiction to appoint the receiver.

33 Nesbitt, 866 F.Supp.2d at 255–56.

34 Broad injunctive relief has been entered in state court orders providing for a receivership of an educational institution. See, e.g., In re Vatterott Educational Centers, Inc., et al., Circuit Court for St. Louis County, 21st Judicial Circuit, State of Missouri, Case No. 17SC-CC02316 (June 29, 2017).

35 Commodity Futures Trading Com'n v. FITC, Inc., 52 B.R. 935, Bankr. L. Rep. (CCH) P 70516 (N.D. Cal. 1985) (holding that "Once a court appoints a receiver, the management loses the power to run the corporation's affairs. The receiver obtains all the corporation's power and assets. Thus, it was the receiver, and only the receiver, who this court empowered with the authority to place FITC in bankruptcy."); First Sav. & Loan Ass'n v. First Federal Sav. & Loan Ass'n, 531 F. Supp. 251, 255–256 (D. Haw. 1981) (when a receiver is appointed, receiver obtains all powers and assets and company's directors lose power to run its affairs); Prairie States Petroleum Co. v. Universal Oil Sales Corp., 88 Ill. App. 3d 753, 43 Ill. Dec. 875, 410 N.E.2d 1008 (1st Dist. 1980) ("Upon appointment of a receiver, the functions of the corporation's managers and officers are suspended and the receiver stands in their place".)

36 In re Sino Clean Energy, Inc., 901 F.3d 1139, 66 Bankr. Ct. Dec. (CRR) 25 (9th Cir. 2018).

37 901 F.3d at 1141 (citing Price v. Gurney, 324 U.S. 100, 106–07, 65 S. Ct. 513, 89 L. Ed. 776 (1945) (state law determines who has authority to file bankruptcy for a debtor)).

38 Oil & Gas Co. v. Duryee, 9 F.3d 771, 24 Bankr. Ct. Dec. (CRR) 1303 (9th Cir. 1993).

39 9 F.3d at 773 (concluding that "[t]he only person then, who could go to court on behalf of Oil & Gas was [the rehabilitator]. And he not only failed to authorize these actions; he opposed them.")

40 In re Corporate and Leisure Event Productions, Inc., 351 B.R. 724, 729–731, 47 Bankr. Ct. Dec. (CRR) 9, 56 Collier Bankr. Cas. 2d (MB) 891 (Bankr. D. Ariz. 2006).

41 351 B.R. at 729–30.

42 See In re Orchards Village Investments, LLC, 405 B.R. 341, 349, 51 Bankr. Ct. Dec. (CRR) 152, 61 Collier Bankr. Cas. 2d (MB) 1585 (Bankr. D. Or. 2009) ("Allowing terms dictated in a state receivership or insolvency proceeding to determine the availability of federal bankruptcy relief is fundamentally inconsistent with the constitutional grant to Congress of the right to enact uniform laws on the subject of bankruptcy.")

43 In addition to the Ninth Circuit, former insiders may be barred in other circuits as well. See S.E.C. v. Byers, 609 F.3d 87, 53 Bankr. Ct. Dec. (CRR) 80, Bankr. L. Rep. (CCH) P 81788 (2d Cir. 2010) (upholding bankruptcy injunction contained in receivership order based on broad equitable powers in the context of a SEC receivership); Securities and Exchange Commission v. Spence & Green Chemical Co., 612 F.2d 896, 903, Fed. Sec. L. Rep. (CCH) P 97301, 29 Fed. R. Serv. 2d 698 (5th Cir. 1980)

("[A]s a general rule a receiver, standing in the shoes of management, holds the full right … to direct the litigation of the corporation whose care he is entrusted.")

44 See 11 U.S.C.A. § 543(a) & (b). These turnover provisions of section 543 of the Bankruptcy Code are designed to promote the congressional intent that a Chapter 11 debtor be permitted to operate and control its business during the reorganization process. The commencement of a bankruptcy case vests the district court with exclusive jurisdiction over property of the debtor. See 28 U.S.C.A. § 1334(e).

45 11 U.S.C.A. § 543(a). Section 543(a) provides, in part, that a "custodian" with knowledge of the case "may not make any disbursement from, or take any action in the administration of, property of the debtor, proceeds, product, offspring, rents or profits of such property, or property of the estate, in the possession, custody, or control of such custodian, except such action as is necessary to preserve such property."

46 11 U.S.C.A. § 543(b); see In re South Side House, LLC, 474 B.R. 391, 405 (Bankr. E.D. N.Y. 2012); see also In re Lizeric Realty Corp., 188 B.R. 499, 506–507 (Bankr. S.D. N.Y. 1995), as amended, (Nov. 28, 1995).

47 See In re Paren, 158 B.R. 447, 450 (Bankr. N.D. Ohio 1993); In re Snergy Properties, Inc., 130 B.R. 700, 703 (Bankr. S.D. N.Y. 1991); In re Foundry of Barrington Partnership, 129 B.R. 550, 557 (Bankr. N.D. Ill. 1991). Section 101(11) of the Bankruptcy Code defines "custodian" as a "(A) receiver or trustee of any of the property of the debtor, appointed in a case or proceeding not under this title …."). Courts have interpreted the term "custodian" broadly. See Matter of Cash Currency Exchange, Inc., 762 F.2d 542, 553, 13 Bankr. Ct. Dec. (CRR) 262, 12 Collier Bankr. Cas. 2d (MB) 1499, Bankr. L. Rep. (CCH) P 70561, 87 A.L.R. Fed. 255 (7th Cir. 1985).

48 Generally, in addition to possessing a debtor's property, a receiver maintains deposit accounts where pre-petition profits from the receivership property are deposited. Whether a pre-petition receivership account constitutes property of the estate is determined by state law. See In re Buttermilk Towne Center, LLC, 442 B.R. 558, 562, 54 Bankr. Ct. Dec. (CRR) 13, 64 Collier Bankr. Cas. 2d (MB) 1771 (B.A.P. 6th Cir. 2010) (citing Butner v. U.S., 440 U.S. 48, 54, 99 S. Ct. 914, 59 L. Ed. 2d 136, 19 C.B.C. 481, Bankr. L. Rep. (CCH) P 67046 (1979) (citing In re White, 851 F.2d 170, 173, 18 Bankr. Ct. Dec. (CRR) 60, Bankr. L. Rep. (CCH) P 72361 (6th Cir. 1988)); South Side House, 474 B.R. at 406 (applying New York law and holding that pre-petition rents are property of the estate even when the debtor lost possession of the rents to a receiver); In re Sam A. Tisci, Inc., 133 B.R. 857, 859 (N.D. Ohio 1991) (interpreting Ohio law); Matter of Pfleiderer, 123 B.R. 768, 769 (Bankr. N.D. Ohio 1987).

49 See South Side House, 474 B.R. at 405; see also Lizeric Realty, 188 B.R. at 506–507.

50 11 U.S.C.A. § 543(d). Section 543(d) provides that after notice and a hearing the Bankruptcy Court "may excuse compliance" with the turnover requirements if the interests of creditors would be better served "by permitting a custodian to continue in possession, custody, or control of such property …."

51 In re Bayou Group, L.L.C., 363 B.R. 674 (S.D. N.Y. 2007), judgment aff'd, 564 F.3d 541, 51 Bankr. Ct. Dec. (CRR) 155, 61 Collier Bankr. Cas. 2d (MB) 1627, Bankr. L. Rep. (CCH) P 81484 (2d Cir. 2009).

52 Bayou, 363 B.R. at 684.

53 363 B.R. at 684–85.

54 363 B.R. at 688. The district court acknowledged the role of the United States Trustee and that a federal district court's appointing a receiver to manage the debtor "contradicts the spirit" of the Bankruptcy Code. 363 B.R. at 689. The court noted, however, that its ruling was limited to the rare facts before it and found that the United States Trustee could take "solace in the fact that this chain of events will rarely occur. The necessary ingredients—corrupt management, inevitable bankruptcy, and a highly motivated group of creditors desirous of a particular individual to manage a troubled estate—will not often appear ensemble." 363 B.R. at 690. Nevertheless, the court found no express authority prohibiting the appointment of a receiver to manage a Chapter 11 debtor and called on Congress to make explicit changes if necessary. 363 B.R. at 690.

55 Bayou, 564 F.3d at 548.

56 564 F.3d at 544–45.

57 See In re Petters Co., Inc., 401 B.R. 391, 408, 51 Bankr. Ct. Dec. (CRR) 86 (Bankr. D. Minn. 2009), aff'd, 415 B.R. 391 (D. Minn. 2009), aff'd, 620 F.3d 847, 53 Bankr. Ct. Dec. (CRR) 167, Bankr. L. Rep. (CCH) P 81845 (8th Cir. 2010); Byers, 609 F.3d at 92.

58 See In re Briar Hill Foods, LLC, 2017 WL 4404274 at *2-3 (Bankr. N.D. Ohio 2017); In re Roxwell Performance Drilling, LLC, 70 Collier Bankr. Cas. 2d (MB) 1321, 2013 WL 6799118 (Bankr. N.D. Tex. 2013). In *Roxwell Performance*, the pre-petition state receiver, relying on *Bayou*, requested bankruptcy court authorization to continue in possession and manage the post-petition debtor's affairs. The receiver argued that his continued possession gave the debtor the best chance for a successful reorganization and was in the creditors' best interests. The bankruptcy court, however, distinguished and disagreed with *Bayou*. First, it noted that the receiver in *Bayou* was a federal receiver appointed by a federal district court, which has original jurisdiction over federal bankruptcy cases. 2013 WL 6799118 at *4. The court then rejected *Bayou*, relying principally on section 543(b) of the Bankruptcy Code, which obligates receivers to turnover receivership property to the trustee. 2013 WL 6799118 at *4. According to the court, section 543(b) obligates a receiver as custodian to turnover all debtor property to a trustee (or debtor in possession in Chapter 11). Accordingly, the receiver must be an entity separate from the trustee or debtor in possession. Refusing to leave the receiver in place, the court ultimately determined that "cause" existed to appoint a chapter 11 trustee under section 1112(b) of the Bankruptcy Code to avoid a "vacuum of authority going forward."

In *Briar Hill Foods,* the debtors owned real estate and operated several retail grocery stores in Ohio. After default on their secured loans, the debtors' bank commenced foreclosure actions and sought the appointment of a receiver to take possession and control the debtors' property. The receiver commenced a sale process, but was unable to close a sale transaction, partly due to the buyer's concerns over successor liability. As a result, the debtors filed for bankruptcy protection and filed a motion to excuse the receiver's compliance with the turnover provisions of section 543 of the Bankruptcy Code and to authorize the receiver to remain in possession of the receivership property. The debtors asserted that their estates and creditors would be best served by permitting the receiver to continue controlling and managing the receivership property through the sale process. Although no parties in interest objected, including the bank and potential buyer, the court denied the motion, ruling that the administration of a Chapter 11 case must be managed by a trustee or debtor in possession. According to the court, granting these powers to a person that is neither a Chapter 11 trustee nor a debtor in possession, and not a professional employed under section 327 of the Bankruptcy Code, is beyond the scope of the Bankruptcy Court's authority. In re Briar Hill Foods, LLC, 2017 WL 4404274 at *2 Bankr. N.D. Ohio 2017).

59 28 U.S.C.A. § 1334(a).

60 In re Briar Hill Foods, LLC, 2017 WL 4404274 at *1 (Bankr. N.D. Ohio 2017) (noting that allowing a blanket authorization of a receiver's possession of the debtor's assets and continued management of its affairs is the functional equivalent of the appointment of a receiver in the bankruptcy case, a result specifically proscribed by section 105(b) of the Bankruptcy Code); In re Roxwell Performance Drilling, LLC, 70 Collier Bankr. Cas. 2d (MB) 1321, 2013 WL 6799118 at *4 (Bankr. N.D. Tex. 2013) ("the authority under chapter 11 to manage the debtor's assets and affairs lies exclusively with either the debtor as DIP or a chapter 11 trustee.")

61 In re Ute Lake Ranch, Inc., 2016 WL 6472043 at *3–5 (Bankr. D. Colo. 2016).

62 2016 WL 6472043, at *5.

63 Foundry of Barrington P'ship v. Barrett, 129 B.R. at 555.

64 See In re Constable Plaza Associates, L.P., 125 B.R. 98, 103 (Bankr. S.D. N.Y. 1991) (citing In re Pine Lake Village Apartment Co., 17 B.R. 829, 833, 8 Bankr. Ct. Dec. (CRR) 1110, 6 Collier Bankr. Cas. 2d (MB) 83 (Bankr. S.D. N.Y. 1982)); see also Matter of WPAS, Inc., 6 B.R. 40, 43, 6 Bankr. Ct. Dec. (CRR) 1122 (Bankr. M.D. Fla. 1980).

65 In re Poplar Springs Apartments of Atlanta, Ltd., 103 B.R. 146, 150 (Bankr. S.D. Ohio 1989).

66 103 B.R. at 150 (citing In re Dill, 163 B.R. 221, 226 (E.D. N.Y. 1994); Foundry of Barrington P'ship, 129 B.R. at 557)).

67 Pursuant to § 543(d)(1), the court must consider whether the interest of creditors is better served by the receiver remaining in possession of the debtor's assets. Courts typically consider some of the following non-exhaustive factors: likelihood of reorganization; probability that funds required for reorganization will be available; whether there are instances of mismanagement by the debtor; whether the debtor will use the turnover property for the benefit of creditors; and the existence of avoidance

claims. See Poplar Springs, 103 B.R. at 150; In re Falconridge, LLC, 58 Collier Bankr. Cas. 2d (MB) 1415, 2007 WL 3332769 at *10 (Bankr. N.D. Ill. 2007) (citations omitted); Dill, 163 B.R. at 225 (citations omitted). Even if these factors are resolved in favor of the debtor, the court may still excuse compliance if turnover would be injurious to creditors. Poplar Springs, 103 B.R. at 150.

68 See In re 400 Madison Avenue Ltd. Partnership, 213 B.R. 888, 898–899, 31 Bankr. Ct. Dec. (CRR) 793, 38 Collier Bankr. Cas. 2d (MB) 1608 (Bankr. S.D. N.Y. 1997).

69 In re 245 Associates, LLC, 188 B.R. 743, 750, 34 Collier Bankr. Cas. 2d (MB) 866, Bankr. L. Rep. (CCH) P 76822 (Bankr. S.D. N.Y. 1995), corrected, (Nov. 9, 1995); In re Uno Broadcasting Corp., 167 B.R. 189, 201, 25 Bankr. Ct. Dec. (CRR) 1009 (Bankr. D. Ariz. 1994).

70 See In re 400 Madison Avenue Ltd. Partnership, 213 B.R. 888, 894, 31 Bankr. Ct. Dec. (CRR) 793, 38 Collier Bankr. Cas. 2d (MB) 1608 (Bankr. S.D. N.Y. 1997) (disagreeing with earlier case in same district.) The court specifically disagreed with the conclusion that once a receiver remains in possession the receiver becomes the equivalent of a trustee. 213 B.R. at 896 (citing disapprovingly, *245 Assocs.* and *Uno*).

71 213 B.R. at 896 ("Nowhere is there a provision in the Code stating that the term 'trustee' is to be read in Code § 327(a) or elsewhere to include a receiver retained in possession under Code § 543(d).")

72 11 U.S.C.A. § 543(c)(2); see also In re Montemurro, 581 B.R. 565, 572, 65 Bankr. Ct. Dec. (CRR) 67 (Bankr. N.D. Ill. 2018).

73 Section 503(b)(3)(E) provides for an allowed administrative expense for "the actual, necessary expenses … incurred by … a custodian superseded under § 543 of this title, and compensation for the services of such custodian." 11 U.S.C.A. § 503(b)(3)(E); see also Montemurro, 581 B.R. at 572. The court in *Montemurro* provides a thorough discussion on the different standards for compensation under sections 543 and 503. 581 B.R. at 572. ("Under section 543, a custodian is entitled to 'reasonable compensation for services rendered and costs and expenses.' Under section 503, the custodian may receive an administrative expense for 'actual, necessary expenses' and 'compensation for services.'") (quoting 11 U.S.C.A. §§ 543(c)(2) and 503(b)(3)).

74 If the receiver's only source of payment is property of the debtor's estate, the court must apply the heightened standard under section 503(b)(3)(E) to the receiver's application. Montemurro, 581 B.R. at 578. Under section 503(b), any expenses must be "actual and necessary." 581 B.R. at 575. Compensation and expenses under section 543 are subject to a "reasonableness" standard of review. 581 B.R. at 575. The reasonableness standard applies to extent that compensation is from another source or if custodian is excused from compliance under section 543(d). 581 B.R. at 576.

75 11 U.S.C.A. § 503(b)(4).

76 Montemurro, 581 B.R. at 577–78 ("Holding compliance with section 543(b) to be a prerequisite to payment under section 543(c)(2) would exclude from that payment custodians who have been excused from compliance under section 543(d). That does not appear to be the intent of Congress here.")

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Disagreed With by In re Way to Grow, Inc., D.Colo., September 18, 2019

922 F.3d 1031
United States Court of Appeals, Ninth Circuit.

Gregory M. GARVIN, Acting United States Trustee for Region 18, Appellant,
v.
COOK INVESTMENTS NW, SPNWY, LLC; Cook Investments NW, Fern, LLC; Cook Investments NW, LLC; Cook Investments NW, DARR, LLC; Cook Investments NW, ARL, LLC, Appellees.

No. 18-35119
|
Argued and Submitted December 3, 2018 Seattle, Washington
|
Filed May 2, 2019

Synopsis

Background: Trustee objected to Chapter 11 plan proposed by bankrupt real estate holding companies based on fact that one of the debtors' tenants was involved in marijuana growing operation which, while legal under state law, violated federal drug laws. The United States Bankruptcy Court for the Western District of Washington overruled trustee's objection and confirmed plan, and trustee appealed. The District Court, No. 3:17-cv-05516, Benjamin H. Settle, J., 2017 WL 10716993, affirmed. Trustee appealed.

Holdings: The Court of Appeals, McKeown, Circuit Judge, held that:

[1] in deciding whether plan was unconfirmable, as allegedly having been proposed "by any means forbidden by law," court had to look only to the proposal of the plan, not to its terms, and

[2] plan which was negotiated and proposed in lawful manner could not be denied confirmation as having "been proposed … by any means forbidden by law."

Affirmed.

Procedural Posture(s): On Appeal; Objection to Confirmation of Plan; Motion to Convert or Dismiss Case.

West Headnotes (7)

[1] **Bankruptcy** Proceedings

Chapter 11 trustee waived issue of whether bankruptcy case should have been dismissed for "gross mismanagement," based on fact that land owned by debtor had been leased to company engaged in marijuana growing operation which, while legal under state law, violated federal drug laws; trustee failed to renew motion to dismiss at plan confirmation hearing, as invited by bankruptcy court. 11 U.S.C.A. § 1112(b)(4)(B).

1 Cases that cite this headnote

[2] **Bankruptcy** Conclusions of law; de novo review

On appeal in bankruptcy case, the Court of Appeals would determine de novo the proper interpretation of statutory Chapter 11 plan confirmation requirement. 11 U.S.C.A. § 1129(a).

[3] **Bankruptcy** Good faith and legality

In deciding whether proposed Chapter 11 plan was unconfirmable, as allegedly having been proposed "by any means forbidden by law," court had to look only to the proposal of the plan, not to its terms. 11 U.S.C.A. § 1129(a)(3).

10 Cases that cite this headnote

[4] **Bankruptcy** Good faith and legality

Proposed Chapter 11 plan which, while deriving at least indirect financial support from lease payments that bankrupt real estate holding companies' principal would continue to collect from lessee engaged in marijuana growing operation that was illegal under federal law, was

negotiated and proposed in lawful manner, could not be denied confirmation as having "been proposed … by any means forbidden by law." 11 U.S.C.A. § 1129(a)(3).

3 Cases that cite this headnote

[5] **Bankruptcy** Construction, execution, and performance

Criminal Law Defenses in general

Confirmation of Chapter 11 plan does not insulate debtors from prosecution for criminal activity, even if that activity is part of the plan itself.

1 Cases that cite this headnote

[6] **Bankruptcy** Good faith and legality

In deciding whether Chapter 11 plan has been proposed in "good faith," as required for confirmation, courts must determine whether the plan achieves a result consistent with the objectives and purposes of the Code. 11 U.S.C.A. § 1129(a)(3).

6 Cases that cite this headnote

[7] **Bankruptcy** Good faith and legality

Proposed Chapter 11 plan that provided for repayment of creditors and the debtors' ongoing operations was consistent with objectives and purpose of the Bankruptcy Code, and could not be denied confirmation for lack of "good faith" simply because plan derived indirect financial support from the lease payments that bankrupt real estate holding companies' principal would continue to collect from lessee engaged in marijuana growing operation that was illegal under federal law. 11 U.S.C.A. § 1129(a)(3).

1 Cases that cite this headnote

Attorneys and Law Firms

***1032** Sonia Carson (argued) and Mark B. Stern, Appellate Staff; Annette L. Hayes, Acting United States Attorney; Joseph H. Hunt, Assistant Attorney General; Civil Division, United States Department of Justice, Washington, D.C.; Wendy Cox, Trial Attorney; P. Matthew Sutko, Associate General Counsel; Ramona D. Elliott, Deputy Director/ General Counsel; Department of Justice, Executive Office for United States Trustees, Washington, D.C.; for Appellant.

James L. Day (argued) and Aditi Paranjpye, Bush Kornfeld LLP, Seattle, Washington, for Debtors-Appellees.

Appeal from the United States District Court for the Western District of Washington, Benjamin H. Settle, District Judge, Presiding, D.C. No. 3D.C. No. 3:17-cv-05516-BHS

Before: Susan P. Graber, M. Margaret McKeown, and Morgan Christen, Circuit Judges.

OPINION

McKEOWN, Circuit Judge:

***1033** Facing insolvency, five real estate holding companies owned and managed by Michael Cook (collectively, "Cook" or the "Cook companies") sought Chapter 11 protection. Cook's foray into Chapter 11 was by most standards a resounding success. It culminated with the Second Amended Joint Debtors' Plan of Reorganization ("Amended Plan"), which paid all creditors in full and provided for Cook to continue as a going concern. The Amended Plan was confirmed by the bankruptcy court.

But now the United States Trustee ("Trustee") asks that the Amended Plan go up in smoke, because one of the Cook companies leases property to N.T. Pawloski, LLC ("Green Haven"), which uses the property to grow marijuana. The Trustee complains that, even if Green Haven's business complies with Washington law, the lease itself violates federal drug law. The Trustee reasons that this violation proves the Amended Plan was "proposed ... by ... means forbidden by law" and is thus unconfirmable under 11 U.S.C. § 1129(a)(3).

The problem with the Trustee's theory is that it ignores the plain text of § 1129(a)(3), which directs bankruptcy courts

to police the means of a reorganization plan's *proposal*, not its substantive provisions. Resolution of this appeal rests on a straightforward question of statutory interpretation rather than on any conflict between federal and state drug laws. We affirm confirmation of the Amended Plan because it was not proposed "by any means forbidden by law."

BACKGROUND

Cook Investments NW, DARR, LLC ("Cook DARR"), one of the Cook companies, owns commercial real estate in Darrington, Washington (the "Darrington Property"). Cook DARR leased the Darrington Property to two tenants, one of which was Green Haven. The lease with Green Haven (the "Green Haven Lease") provides that Green Haven will use the Darrington Property exclusively as a marijuana establishment. Although Green Haven appears to be in compliance with Washington law, the Green Haven Lease puts Cook in violation of the federal Controlled Substances Act, 21 U.S.C. §§ 801–971, which prohibits "knowingly ... leas[ing] ... any place ... for the purpose of manufacturing, distributing, or using any controlled substance," *id.* § 856(a)(1).

In 2009, one of the Cook companies defaulted on a loan from Columbia State Bank. The loan was secured by Cook's real estate holdings, including the Darrington Property. The bank won default judgments against Cook in state court. Although Cook and the bank reached forbearance agreements, Cook failed to fulfill the agreements' terms. The bank then obtained state-court orders appointing receivers for Cook's properties. At that point, all of the Cook companies filed Chapter 11 bankruptcy petitions, which the bankruptcy court ordered jointly administered.

The Trustee filed a motion to dismiss Cook DARR's Chapter 11 case, asserting that the Green Haven Lease constituted gross mismanagement and thus cause to dismiss under 11 U.S.C. § 1112(b). The bankruptcy court denied the motion to dismiss, but with leave to renew at the plan confirmation hearing.

Cook filed the Amended Plan, which provides for repayment of all creditors' claims in full and for Cook to continue as a going concern. The Amended Plan incorporates ***1034** by reference an earlier Chapter 11 Plan Agreement between Cook and Columbia State Bank, but in the Amended Plan Cook rejected the Green Haven lease and structured the plan so that his monthly obligations would be paid without revenue from Green Haven. Cook's counsel also explained at argument that, pursuant to the Amended Plan, Cook's other tenants pay their rent directly to Columbia State Bank in satisfaction of its claim, while Green Haven rents were presumably paid directly to Cook.

The bankruptcy court confirmed the Amended Plan, over the Trustee's objection that it violated § 1129(a)(3)'s requirement that a plan be "proposed in good faith and not by any means forbidden by law." The Trustee was the only objector; Cook's creditors fully supported the Amended Plan, which satisfactorily provided for their repayment. Because the Trustee failed to renew its motion to dismiss at the confirmation hearing, the district court affirmed the denial of the motion to dismiss Cook DARR's case. Following confirmation, the Trustee moved for a stay, but the district court denied the request. As a result, Cook has continued to make payments pursuant to the Amended Plan during the pendency of this appeal. The unsecured creditors have been repaid and the secured creditor, Columbia State Bank, is in the process of being repaid.

ANALYSIS

[1] On appeal, the Trustee first challenges the bankruptcy court's refusal to dismiss Cook DARR under § 1112(b) for "gross mismanagement of the estate." 11 U.S.C. § 1112(b)(4)(B). We need not decide the merits of this issue because, like the district court, we conclude the Trustee waived the argument by failing to renew its motion to dismiss.

The bankruptcy court initially denied the motion to dismiss but explicitly invited the Trustee to renew the motion at the plan confirmation hearing. The Trustee chose, at its peril, not to do so. As the district court put it: "The Trustee failed to renew the motion or subsequently raise the gross mismanagement argument. Although the Debtors fail to raise waiver, it seems to be plain error for this Court to reverse the bankruptcy court's denial when the Trustee failed to renew its motion." This failure was especially significant because it meant the bankruptcy court had no opportunity to consider whether the claimed gross mismanagement had been "cured." As a consequence, neither the bankruptcy court, nor the district court, nor this court could properly determine the applicability of the exception to dismissal for "unusual

circumstances." *See* 11 U.S.C. § 1112(b)(2) (exception to dismissal for unusual circumstances applies only if, *inter alia*, cause for dismissal "will be cured within a reasonable period of time"); *cf.* *Walsh v. Nev. Dep't of Human Res.*, 471 F.3d 1033, 1037 (9th Cir. 2006) (holding that a claim raised in the complaint was waived when it was not re-raised in response to a motion to dismiss, because "the district court had no reason to consider the contention that the claim ... could not be dismissed" (internal quotation marks omitted)). [1]

We therefore turn to the issue of confirmation. To be confirmed, the Amended Plan had to satisfy § 1129(a), which provides that "[t]he court shall confirm a plan only if" sixteen enumerated requirements are met. The third requirement is that "[t]he plan has been proposed in good faith ***1035** and not by any means forbidden by law." 11 U.S.C. § 1129(a)(3). Only the second prong is at issue here. Because it appears that Cook continues to receive rent payments from Green Haven, which provides at least indirect support for the Amended Plan, the Trustee asserts that it was "proposed ... by ... means forbidden by law." 11 U.S.C. § 1129(a)(3).

[2] We determine de novo the proper interpretation of § 1129(a)(3). *See* *Tighe v. Celebrity Home Entm't, Inc. (In re Celebrity Home Entm't, Inc.)*, 210 F.3d 995, 997 (9th Cir. 2000) (reviewing de novo the bankruptcy court's interpretation of the Bankruptcy Code). Whether the Amended Plan was confirmable depends on whether § 1129(a)(3) forbids confirmation of a plan that is proposed in an unlawful manner as opposed to a plan with substantive provisions that depend on illegality, an issue of first impression in the Ninth Circuit.

[3] Like the First Circuit Bankruptcy Appellate Panel, we conclude that § 1129(a)(3) directs courts to look only to the proposal of a plan, not the terms of the plan. *Irving Tanning Co. v. Me. Superintendent of Ins. (In re Irving Tanning Co.)*, 496 B.R. 644, 660 (1st Cir. B.A.P. 2013). This reading accords with both the statutory text, which does not refer to the substance of the plan, and the weight of persuasive authority. *See In re Gen. Dev. Corp.*, 135 B.R. 1002, 1007 (Bankr. S.D. Fla. 1991) ("Courts addressing the issue have uniformly held that Section 1129(a)(3) does not require that the contents of a plan comply in all respects with the provisions of all nonbankruptcy laws and regulations." (internal quotation marks omitted)).

[4] It is true that some bankruptcy courts have accepted the Trustee's interpretation. In concluding that a bankruptcy case should be dismissed "[b]ecause a significant portion of the Debtor's income [wa]s derived from an illegal activity," the Bankruptcy Court of Colorado stated that "§ 1129(a)(3) forecloses any possibility of this Debtor obtaining confirmation of a plan that relies in any part on income derived from a criminal activity." *In re Rent-Rite Super Kegs W. Ltd.*, 484 B.R. 799, 809 (Bankr. D. Colo. 2012) (footnote omitted). But such decisions fail to "square[ ] that understanding with subsection (a)(3)'s express focus on the manner of the plan's *proposal*." *Irving Tanning*, 496 B.R. at 660.

Turning to the statute, the phrase "not by any means forbidden by law" modifies the phrase "[t]he plan has been proposed." An interpretation that reads the words "has been proposed" out of the second prong of the requirement would be grammatically nonsensical, i.e., "The plan has been ... not by any means forbidden by law." Moving the reference to illegality to before "proposed" fares no better, i.e., "The plan, not by any means forbidden by law, has been proposed in good faith." The Trustee's position would require us to rewrite the statute completely, rather than resort to its clear meaning. *See* *Duncan v. Walker*, 533 U.S. 167, 174, 121 S.Ct. 2120, 150 L.Ed.2d 251 (2001) ("It is our duty to give effect, if possible, to every clause and word of a statute." (internal quotation marks omitted)).

A contrary interpretation not only renders the words "has been proposed" meaningless, but makes other provisions of § 1129(a) redundant. For example, § 1129(a)(1) requires that "[t]he plan complies with the applicable provisions of this title." If § 1129(a)(3) is read to mean that the plan must comply with all applicable law, there would be no need for a separate requirement that the plan comply with the provisions of the Bankruptcy Code specifically. [2]

***1036** **[5]** **[6]** **[7]** We do not believe that the interpretation compelled by the text will result in bankruptcy proceedings being used to facilitate legal violations. To begin, absent waiver, as in this case, courts may consider gross mismanagement issues under § 1112(b). And confirmation

of a plan does not insulate debtors from prosecution for criminal activity, even if that activity is part of the plan itself. *In re Food City, Inc.*, 110 B.R. 808, 812 (Bankr. W.D. Tex. 1990). There is thus no need to "convert the bankruptcy judge into an ombudsman without portfolio, gratuitously seeking out possible 'illegalities' in every plan," a result that would be "inimical to the basic function of bankruptcy judges in bankruptcy proceedings."[3] *Id.*

Because the Amended Plan was lawfully proposed, the Bankruptcy Court correctly concluded that it met the requirements of 11 U.S.C. § 1129(a).

AFFIRMED.

All Citations

922 F.3d 1031, 67 Bankr.Ct.Dec. 34, Bankr. L. Rep. P 83,392, 19 Cal. Daily Op. Serv. 4088, 2019 Daily Journal D.A.R. 3689

Footnotes

1 Although Cook did not raise this issue, the district court ruled on this ground, and the Trustee addressed the issue in its briefing, so Cook's failure to raise waiver did not prejudice the Trustee. *See* *Hall v. City of Los Angeles*, 697 F.3d 1059, 1071 (9th Cir. 2012) ("We may consider an issue sua sponte ... if the opposing party will not suffer prejudice.").

2 Section 1129(a)(16), which requires that "transfers of property under the plan [comply] with [certain] applicable provisions of nonbankruptcy law," would be similarly redundant under the Trustee's interpretation.

3 Cases directing courts to look to the "totality of the circumstances" to determine whether a plan was proposed in good faith do not change the analysis here. Under the good faith prong of § 1129(a)(3), courts must determine whether the plan "achieves a result consistent with the objectives and purposes of the Code." *Platinum Capital, Inc. v. Sylmar Plaza, L.P. (In re Sylmar Plaza, L.P.)*, 314 F.3d 1070, 1074 (9th Cir. 2002); *see also In re Emmons-Sheepshead Bay Dev. LLC*, 518 B.R. 212, 225 (Bankr. E.D.N.Y. 2014) ("The good-faith test speaks more to the process of plan development than to the content of the plan." (internal quotation marks omitted)); *In re 431 W. Ponce de Leon, LLC*, 515 B.R. 660, 673 (Bankr. N.D. Ga. 2014) (holding both that, "[i]n assessing whether the plan was proposed in good faith, the assessment is focused on the plan itself" and "§ 1129(a)(3) requires that only the *plan's proposal*, as opposed to the contents of the plan, be in good faith and in compliance with all nonbankruptcy laws" (internal quotation marks omitted)). Here, the Amended Plan provides for the creditors' repayment and the debtors' ongoing operations, so it is consistent with the objectives and purpose of the Bankruptcy Code.

602 B.R. 717
United States Bankruptcy Court, D. Nevada.

IN RE: CWNEVADA LLC, Debtor.

Case No.: 19-12300-MKN
|
Date: May 15, 2019, Time: 10:30 a.m.
|
Filed June 03, 2019

Synopsis

Background: Creditor filed motion to dismiss debtor limited liability company's (LLC) Chapter 11 petition or, alternatively, for relief from automatic stay to allow receivership and contempt proceedings to continue.

[Holding:] The Bankruptcy Court, Mike K. Nakagawa, J., held that dismissal based on abstention was warranted.

Motion to dismiss granted.

Procedural Posture(s): Motion to Convert or Dismiss Case; Motion for Relief from the Automatic Stay.

West Headnotes (27)

[1] **Bankruptcy** Evidence; witnesses

Bankruptcy court can take judicial notice of documents filed in underlying state court proceedings, as well as in this bankruptcy court. Fed. R. Evid. 201.

[2] **Bankruptcy** Construction and Operation

A limited liability company (LLC) is treated as a "corporation" under the Bankruptcy Code, and therefore is a "person" as defined by the Code. 11 U.S.C.A. §§ 101(9)(A)(iv), 101(41).

[3] **Bankruptcy** Corporations

Debtor limited liability company (LLC) was both a person and an entity, and therefore was permitted under the Bankruptcy Code to file its voluntary Chapter 11 petition. 11 U.S.C.A. §§ 101(9)(A)(iv), 101(15), 101(41), 301(a).

[4] **Corporations and Business Organizations** Disregarding Entity; Piercing Protective Veil

Nevada law limited liability companies (LLC) are subject to the alter ego doctrine that is applied to pierce the veil of Nevada corporations.

[5] **Bankruptcy** Interest of debtor in general
Bankruptcy After-acquired property; proceeds; wages and earnings

Prior to the commencement of a case, a debtor simply holds interests that may ultimately become property of the bankruptcy estate, and after a bankruptcy estate comes into existence, it may thereafter acquire interests in additional property that also become property of the bankruptcy estate. 11 U.S.C.A. § 541(a).

[6] **Bankruptcy** Rights of Action; Contract Rights Generally

Amongst the legal or equitable interests of the debtor in property as of the commencement of a bankruptcy case, which may ultimately become property of the bankruptcy estate, are any claims or causes of action that the debtor may assert against any parties. 11 U.S.C.A. § 541(a).

[7] **Bankruptcy** In general; nature and purpose

Fundamental purpose for allowing businesses and individuals to reorganize in Chapter 11 is to preserve jobs, pay creditors as much as they would receive in a Chapter 7 liquidation, and to preserve the investment equity of shareholders.

[8] **Bankruptcy** Debtor in possession, in general

Because a voluntary Chapter 11 debtor remains in possession of property of its bankruptcy estate, and because it has the rights, powers and duties of a bankruptcy trustee, a Chapter 11 debtor in possession has a fiduciary responsibility to all creditors of the bankruptcy estate. 11 U.S.C.A. § 1107(a).

2 Cases that cite this headnote

[9] **Bankruptcy** Debtor in possession, in general

A Chapter 11 debtor in possession is required to manage and operate the property in its possession according to the requirements of state law. 28 U.S.C.A. § 959(b).

[10] **Bankruptcy** Confirmation; Objections

Creditors who oppose a Chapter 11 debtor's efforts can object at any time during the case and to any plan of reorganization that might be proposed.

[11] **Bankruptcy** Acceptance

As a general rule, a Chapter 11 debtor can propose a plan of reorganization to which all of its creditors agree, and such a consensual plan is confirmed without the necessity of a "cramdown" of plan treatment; if all creditors do not agree, then the plan may be confirmed through cramdown only if the treatment of the objecting creditors' claims is fair and equitable. 11 U.S.C.A. § 1129(b).

[12] **Bankruptcy** Discharge

Party that files for bankruptcy protection does not have a constitutional right to receive a discharge of debts.

[13] **Bankruptcy** Necessity or grounds

Bankruptcy court may appoint a Chapter 11 trustee sua sponte if it determines the appointment of a trustee to be in the interests of creditors, equity security holders, and other interests of the estate. 11 U.S.C.A. § 1104(a)(2).

1 Cases that cite this headnote

[14] **Bankruptcy** Dismissal or suspension

If there are unusual circumstances establishing that conversion or dismissal of a Chapter 11 case is not in the best interests of creditors and the estate, such relief is prohibited if the debtor establishes a reasonable likelihood that a plan will be confirmed in a reasonable amount of time, and, inter alia, that any act constituting cause, including gross mismanagement, will be cured within a reasonable amount of time fixed by the court. 11 U.S.C.A. § 1112(b)(2).

[15] **Bankruptcy** Feasibility in general

Chapter 11 plan proponent must demonstrate that any necessary financing or funding has been obtained, or is likely to be obtained. 11 U.S.C.A. § 1129(a)(11).

[16] **Bankruptcy** Effect as discharge

A Chapter 11 plan may provide for the liquidation of the assets of the estate, but confirmation of a plan does not discharge the debtor if the plan provides for liquidation of all or substantially all property of the estate, the debtor does not engage in business after consummation of the plan, and the debtor would be denied a discharge if the case was a case under Chapter 7. 11 U.S.C.A. §§ 1129(a)(11), 1141(d)(3).

[17] **Bankruptcy** Involuntary Cases

Bankruptcy Individual Debt Adjustment

Relief under Chapter 13 is available only to individuals who are eligible under the Bankruptcy Code and who are willing to devote their future disposable income to the payment

of creditors, and because individuals cannot be subjected to forced labor, they cannot be placed into Chapter 13 involuntarily. 11 U.S.C.A. §§ 109(e), 303(a).

[18] **Bankruptcy** Reorganization cases
Bankruptcy Voluntary Cases
Bankruptcy Involuntary Cases

Relief under Chapter 11 is available to both individuals and non-individuals, and may be initiated both voluntarily and involuntarily.

[19] **Bankruptcy** Effect as discharge

For individual Chapter 11 debtors, a bankruptcy discharge is obtained only upon completion of payments of a confirmed plan, whereas for non-individual Chapter 11 debtors, a bankruptcy discharge is obtained upon confirmation of a plan unless the plan does not provide for continued operations. 11 U.S.C.A. § 1141(d)(5).

[20] **Bankruptcy** Who May Be a Debtor
Bankruptcy Voluntary Cases
Bankruptcy Involuntary Cases

Relief under Chapter 7 is available to both individuals and non-individuals, and may be initiated both voluntarily and involuntarily.

[21] **Bankruptcy** Representation of debtor, estate, or creditors
Bankruptcy Discharge

For individual Chapter 7 debtors, the property of the bankruptcy estate is administered by a bankruptcy trustee, and a bankruptcy discharge is obtained if no timely objections are filed by parties in interest. 11 U.S.C.A. §§ 704(a), 727(b).

[22] **Bankruptcy** Representation of debtor, estate, or creditors
Bankruptcy Discharge

For non-individual Chapter 7 debtors, the property of the bankruptcy estate is administered by a bankruptcy trustee, but a discharge is not available. 11 U.S.C.A. § 727(a)(1).

[23] **Equity** He Who Comes into Equity Must Come with Clean Hands

Proper application of the unclean hands doctrine is designed to preserve public confidence in, as well as the integrity of the court, by preventing it from becoming a participant in inequitable conduct.

[24] **Bankruptcy** Proceedings

The burden of proof on motion to dismiss Chapter 11 case rests with the party seeking relief. 11 U.S.C.A. §§ 305(a)(1), 1112(b).

[25] **Bankruptcy** Dismissal or suspension

Dismissal of debtor limited liability company's (LLC) Chapter 11 case based on abstention was warranted, where debtor was directly engaged in a marijuana-related business which, although apparently authorized under Nevada law, was not authorized under the Controlled Substances Act, debtor had not identified an approved depository institution to open its required debtor in possession accounts, debtor did not have independent counsel to advise debtor in bankruptcy proceedings, there appeared to be no consensus amongst debtor's management in favor of Chapter 11 relief, and upon dismissal, parties could return to state court where receivership application, among other matters, may be fully addressed. 11 U.S.C.A. § 305(a); Comprehensive Drug Abuse Prevention and Control Act of 1970 §§ 202, 401, 21 U.S.C.A. §§ 812(c), 841(a)(1).

[26] **Equity** Application and operation in general

When all sides to a pending dispute may be accused of wrongdoing, a court in equity may simply deny relief to all sides and dismiss the case.

[27] **Bankruptcy** Equitable powers and principles

Equity He Who Comes into Equity Must Come with Clean Hands

Under the "unclean hands" doctrine, bankruptcy courts, like all courts, are required to consider the circumstances of each case rather than routinely dismissing entire swaths of petitions and requests filed by parties seeking legal relief.

Attorneys and Law Firms

***720** Michael D. Mazur, Mazur & Brooks, A P.L.C., Las Vegas, NV, for Debtor.

ORDER REGARDING CREDITOR 4FRONT ADVISORS LLC'S MOTION TO DISMISS BANKRUPTCY PETITION OR, ALTERNATIVELY, MOTION FOR RELIEF FROM THE AUTOMATIC STAY TO ALLOW RECEIVERSHIP AND CONTEMPT PROCEEDINGS TO CONTINUE [1]

Honorable Mike K. Nakagawa, United States Bankruptcy Judge

On May 15, 2019, the court heard Creditor 4Front Advisors LLC's Motion to Dismiss Bankruptcy Petition or, Alternatively, Motion for Relief from the Automatic Stay to Allow Receivership and Contempt Proceedings to Continue ("Dismissal Motion"). The appearances of counsel were noted on the record. After arguments were presented, the matter was taken under submission.

BACKGROUND

On April 16, 2019, a voluntary petition for Chapter 11 reorganization ("Petition") was filed by CWNevada LLC ("Debtor"). (ECF No. 1). Attached to the Petition is a "Resolution Authorizing Bankruptcy" that identifies BCP Holding 7, LLC ("BCP Holding") as managing member of the Debtor, and that authorizes BCP Holding to seek Chapter 11 relief for the Debtor. The Petition filed on behalf of the Debtor is signed by Brian C. Padgett ("Padgett") as manager of BCP Holding, and by Michael D. Mazur, as the Debtor's general counsel.

The voluntary Petition is a "skeleton" petition inasmuch as it is not accompanied by a schedule of assets and liabilities ("Schedules"), a statement of financial affairs (SOFA"), or any of the initial information required to obtain bankruptcy relief. Moreover, the Petition is not accompanied by a "creditor matrix" setting forth the names and addresses of the Debtor's creditors. The Petition is accompanied by an unsigned List of Creditors Who Have the 20 Largest Unsecured Claims and Are Not Insiders ("20 List"). (ECF No. 4). Only ten creditors are identified on the 20 List. [2]

***721** On the same day the skeleton Petition and 20 List were filed, a Notice of Chapter 11 Bankruptcy Case ("Bankruptcy Notice") was issued by the clerk of the court informing creditors that a meeting of creditors would be held on May 16, 2019. (ECF No. 3). Because a creditor matrix was never filed by the Debtor, it appears that the Bankruptcy Notice was served only on the creditors appearing on the 20 List. (ECF No. 12).

On April 17, 2019, an Ex Parte Application for Order Authorizing Rule 2004 Examination ["2004 Exam"] of Brian C. Padgett ("2004 Exam Request") was filed by The CIMA Group, LLC ("CIMA Group"). (ECF No. 8). On April 19, 2019, the clerk of the court signed an order granting the request pursuant to Local Rule 5075(a)(2)(L) because the 2004 Exam Request sought to conduct the examination more than fourteen days later and did not include a request for production of documents ("CIMA 2004 Order"). (ECF No. 10). On the same date, CIMA Group filed a 2004 Exam notice which included a Subpoena for Rule 2004 Examination ("2004 Subpoena") that required the witness to produce various documents. (ECF No. 11). [3]

On April 23, 2019, 4Front Advisors LLC ("4Front") filed the instant Dismissal Motion seeking dismissal of the Chapter 11 case based on Section 305(a)(1), [4] or, Section 1112(b). [5] In the alternative, 4Front seeks relief from the automatic

stay under ***722** Section 362(d) to allow it to proceed with collection activities under non-bankruptcy law. Numerous documents are attached to the Dismissal Motion and marked as exhibits "1" through "24." (ECF No. 18). In support of the Dismissal Motion, 4Front filed the declarations of Kris Krane ("Krane Declaration")[6] and Cory L. Braddock ("Braddock Declaration").[7] (ECF Nos. 20 and 21).[8]

On April 25, 2019, a combined joinder in the Dismissal Motion was filed on behalf of Highland Partners NV LLC, MI-CW Holdings NV Fund 2 LLC, and MI-CW Holdings LLC (collectively "Highland Partners"), as well as by Green Pastures Fund, LLC Series 1 (CWNevada, LLC), Jakal Investments, LLC, Green Pastures Group, LLC, Jonathan S. Fenn Revocable Trust, and Growth Properties, LLC (collectively "Green Pastures"). (ECF No. 26). In support of that combined joinder ("Highland Joinder"), Highland Partners and Green Pastures filed the declarations of David J. Malley, Esq. ("Malley Declaration"), Christopher R. Miltenberger, Esq. ("Miltenberger Declaration"), and Brandon Kanitz ("Kanitz Declaration"). (ECF Nos. 27, 28, and 29).

On April 26, 2019, a joinder in the Dismissal Motion was filed on behalf of Timothy Smits Van Oyen ("Van Oyen"). (ECF No. 37).

On May 2, 2019, a joinder in the Dismissal Motion was filed on behalf of MC Brands, LLC ("MC Brands"). (ECF No. 47).

On May 7, 2019, a limited joinder in the Dismissal Motion was filed on behalf of The CIMA Group ("CIMA Joinder"), to which is attached copies of three documents marked as exhibits "1" through "3." (ECF No. 50).

On May 7, 2019, Debtor filed an opposition to the Dismissal Motion ("Opposition") to which is attached four documents marked as exhibits "A" through "D." (ECF No. 51). The Opposition is supported by the Declaration of Brian C. Padgett ("Padgett Declaration"). (ECF No. 52). On the same date, Debtor filed oppositions to the Highland Joinder, as well as the joinders filed by Van Oyen and MC Brands. (ECF Nos. 54 and 55).

On May 8, 2019, Debtor filed an opposition to the CIMA Joinder ("Additional Opposition"). (ECF No. 56).

***723** [1] On May 8 and May 9, 2019, Debtor filed a request for judicial notice ("RJN") of numerous documents marked as exhibits "A" through "O." (ECF Nos. 57 and 60). Exhibits "A" through "J" apparently consist of copies of the "Register of Actions" or list of docket entries for proceedings of public record pending in State Court, and in this bankruptcy court.[9] Exhibits "K" through "O" consist of documents that were not, until now, of public record.[10]

On May 13, 2019, 4Front filed a reply in support of the Dismissal Motion ("4Front Reply"), to which is attached five documents marked as Exhibits "A" through "E." (ECF No. 68). On the same date, Highland Partners filed a reply in support of the Highland Joinder ("Highland Reply"). (ECF No. 69). On the same date, CIMA Group filed a reply in support of the CIMA Joinder ("CIMA Reply"), to which is attached a single document marked as exhibit "1." (ECF No. 71).[11]

DISCUSSION

Debtor is in the business of cultivating, producing, and distributing medical and recreational marijuana ("Marijuana Business"). See Padgett Declaration at ¶¶ 4-5. It also is in the business of producing and distributing products that contain cannabidiol ("CBD") which apparently are used, *inter alia*, to treat epilepsy ("CBD Business"). Id. at ¶ 6. Debtor apparently operates or once operated marijuana cultivation, production, or dispensary facilities at up to five Nevada locations: three in Las Vegas, one in North Las Vegas, and one in Pahrump. See CWNevada Investor Update, February 2016, attached as Exhibit "1" to Dismissal Motion, at pages 13-17; see also Benchmark Insurance Company - Workers Compensation and Employers Liability Insurance, 04/26/2019 to 04/26/2020, attached as Exhibit "N" to RJN and as Exhibit "A" to Opposition. Debtor's health plan coverage apparently encompasses 54 subscribers. See Health Plan of Nevada Bill Statement for May 2019, attached as Exhibit "M" to RJN and as Exhibit "B" to Opposition. Debtor apparently made a payment of $ 81,850 to the Nevada Department of Taxation ("NDOT") on April 23, 2019. See Marijuana Tax Return dated ***724** March 29, 2019, attached as Exhibit "K" to RJN and as Exhibit "D" to Opposition.[12]

Debtor's business operations apparently are authorized under Nevada law.[13] Debtor's Marijuana Business is prohibited under federal law by provisions of the Controlled Substances Act, 21 U.S.C. § 841(a)(1) and 21 U.S.C. §

812(c), Schedule I(c)(10) [Marihuana] and Schedule I(c)(17) [Tetrahydrocannibinols].[14] Debtor's CBD Business, however, may no longer be prohibited under federal law as a result of the Agriculture Improvement Act of 2018, Pub. L. 115-334, 132 Stat. 4490.

The Agriculture Improvement Act became effective on December 20, 2018, when the bill was signed into law. The Act amended the term "Marihuana" under the Controlled Substances Act to exclude hemp "as defined under section 1639*o* of Title 7." See 21 U.S.C. § 802(16)(B). The Act also amended Schedule I(c)(17) of the Controlled Substances Act to exclude from the definition of "Tetrahydrocannabinols" the "tetrahydrocannabinols in hemp (as defined under section 1639o of Title 7)." See 21 U.S.C. § 812(c), Schedule I(c)(17). Under 7 U.S.C. § 1639o(1), the term hemp "means the plant Cannabis sativa L. and any part of that plant, including the seeds thereof and all derivatives, extracts, cannabinoids, isomers, acids, and salts of isomers, whether growing or not, with a delta-9 tetrahydrocannibinol concentration of not more than 0.3 percent on a dry weight basis." (Emphasis added.) Because products derived from hemp plants containing restricted concentrations of tetrahydrocannabinols ("THC"), which is the active ingredient in marijuana, are no longer in violation of the Controlled Substances Act, the Food and Drug Administration ("FDA") apparently will assume a regulatory role for such products.[15]

Under these circumstances, the portion of the Debtor's operations devoted to the Marijuana Business appears to be in violation ***725** of federal law, while the portion devoted to the CBD Business might be excluded from the Controlled Substances Act if the CBD products sold by the Debtor are derived from the type of hemp permitted under federal law. Notwithstanding its operations of these two businesses in accordance with Nevada law, Debtor apparently defaulted on payment of many of its obligations, including the claim of 4Front. Before 4Front's Receivership Application could be heard by the State Court, however, Debtor filed its voluntary Chapter 11 Petition.

[2] **[3]** **[4]** No one disputes that the Debtor is a limited liability company formed under Nevada law. A limited liability company is treated as a "corporation" under Section 101(9)(A)(iv), and therefore is a "person" as defined under Section 101(41). See AE Rest. Assocs. LLC v. Giampietro (In re Giampietro), 317 B.R. 841, 844 n.3 (Bankr. D. Nev. 2004).[16] Under Section 109(a), a person that resides, has a place of business, or has property in the United States, may be a debtor in bankruptcy. Because the Debtor in this case resides and has a place of business in Nevada, it is eligible under Section 109(a) to file a bankruptcy petition. Additionally, under Section 101(15), a person is included in the term "entity." Under Section 301(a), a voluntary bankruptcy petition commencing a case may be filed by an entity. Because the Debtor is both a person and an entity, it clearly was permitted under Section 301(a) to file its voluntary Chapter 11 Petition.

[5] **[6]** As a result of filing a bankruptcy petition, the automatic stay arose under Section 362(a), applicable to all entities, barring various acts and actions from being taken or continued against the Debtor or property of the bankruptcy estate. See 11 U.S.C. § 362(a)(1 through 8). Property of the bankruptcy estate includes, *inter alia*, all legal and equitable interests of the Debtor in property as of the commencement of the case. See 11 U.S.C. § 541(a)(1).[17] So when the Chapter 11 petition was filed in the instant case, 4Front, Highland Partners, Green Pastures, CIMA Group, MC Brands, Van Oyen, and all other creditors were barred from continuing with their State Court litigation against the Debtor, or engaging in any other acts against the Debtor or any property of the Debtor. See generally Hillis Motors, Inc. v. Hawaii Auto. Dealers' Ass'n, 997 F.2d 581, 585 (9th Cir. 1993).[18]

***726** **[7]** **[8]** **[9]** A fundamental purpose for allowing businesses and individuals to reorganize in Chapter 11 is to preserve jobs, pay creditors as much as they would receive in a Chapter 7 liquidation, and to preserve the investment equity of shareholders. See U.S. v. Whiting Pools, Inc. (In re Whiting Pools, Inc.), 462 U.S. 198, 203, 103 S.Ct. 2309, 2312-13, 76 L.Ed.2d 515 (1983); In re Mohave Agrarian Group, LLC, 588 B.R. 903, 915 (Bankr. D. Nev. 2018). Because a voluntary Chapter 11 debtor remains in possession of property of its bankruptcy estate, and because it has the rights, powers and duties of a bankruptcy trustee, see11 U.S.C. § 1107(a), a Chapter 11 debtor in possession has a fiduciary responsibility to all creditors of the bankruptcy estate. See Woodson v. Fireman's Fund Ins. Co. (In re Woodson), 839 F.2d 610, 614 (9th Cir. 1988) ("[Debtor's] failure to notify his creditors of the $ 1 million in a timely

fashion is especially troubling because [Debtor] is not an ordinary litigant. As debtor in possession he is the trustee of his own estate and therefore stands in a fiduciary relationship to his creditors."). A debtor in possession also is required to manage and operate the property in its possession according to the requirements of state law. See28 U.S.C. § 959(b).

[10] **[11]** **[12]** Creditors who oppose a Chapter 11 debtor's efforts can object at any time during the case and to any plan of reorganization that might be proposed. A Chapter 11 debtor in possession typically has an exclusive period of 120 days to propose a plan of reorganization, after which time a creditor may file its own plan. See 11 U.S.C. § 1121(b). As a general rule, a Chapter 11 debtor can propose a plan of reorganization to which all of its creditors agree, and such a consensual plan is confirmed without the necessity of a "cramdown" of plan treatment. [19] If all creditors do not agree, then the plan may be confirmed through cramdown only if the treatment of the objecting creditors' claims is "fair and equitable." 11 U.S.C. § 1129(b). It is under this legal framework that the court addresses this Dismissal Motion. [20]

1. The Arguments of the Parties.

[13] After describing a litany of events that allegedly preceded the commencement of this Chapter 11 proceeding, see Dismissal Motion at 2:6 to 10:20, 4Front offers eight separate, but overlapping arguments in favor of its request: (1) that Debtor is ineligible for relief under bankruptcy law, id. at 10:25 to 13:20, (2) that all parties are better served by abstention under Section 305(a) through dismissal of the case, id. at 13:23 to 14:10, (3) that appointment of a receiver in State Court offers a superior forum to resolve disputes, id. at 14:12 to 15:13, (4) that the Debtor commenced the Chapter 11 proceeding to frustrate creditor rights, id. at 15:15 to 16:2, (5) that economy and efficiency supports abstention by dismissal, id. at 16:4 to 17:10, (6) that dismissal is warranted under Section 1112(b) because of bad faith, [21] ***727** id. at 17:13 to 18:3, (7) that dismissal is warranted based on the doctrine of unclean hands, id. at 18:5-24, and (8) that the automatic stay should be lifted to permit the actions in State Court to proceed, id. at 18:27 to 19:19. MC Brands simply joins in all of the arguments raised by 4 Front. Highland Partners, Green Pastures, and Van Oyen join in the arguments based on Section 305(a) and Section 1112(b). See Highlands Joinder at 6:15-27 and 7:2 to 10:20; Van Oyen Joinder at 2:1-2. The "joinder" filed by CIMA Group, however, seeks the appointment of a Chapter 11 trustee under Section 1104(a) in the event the case is not dismissed under Section 1112(b). [22] See CIMA Joinder at 8:2 to 12:2. [23]

Debtor does not dispute the characterization of most of the events leading up to the filing of its Chapter 11 petition. See Opposition at 2:26 to 4:4. Instead, it offers eight separate but overlapping arguments of its own: (1) that a Chapter 11 plan will be proposed in good faith, see Opposition at 4:12 to 6:2, (2) that the Justice Department is currently barred from expending funds to enforce the marijuana restrictions applicable under the Controlled Substances Act, id. at 6:5 to 7:13, (3) that abstention through dismissal under Section 305(a) will not better serve the interests of the Debtor, id. at 7:14 to 9:3, (4) that the Debtor is in the process of establishing relationships with banks that currently do business with 4Front, id. at 9:5-12, (5) that the Debtor has workers compensation, employee health, and automobile insurance in place, and made a tax payment to the NDOT on April 23, 2019, id. at 9:14-27, (6) that the doctrine of unclean hands does not bar bankruptcy relief, id. at 10:2-13, (7) that the balance of hardships favor keeping the automatic stay in place, id. at 10:15 to 11:8, and (8) that civil contempt proceedings currently pending in State Court may be exempt from the automatic stay, id. at 11:11-17.

2. The Existing Case Law is Distinguishable. [24]

Interspersed amongst the parties arguments are citations to various decisions by ***728** other courts suggesting why a marijuana-related bankruptcy case should, or should not, be dismissed. None of those decisions, however, are controlling under the circumstances of the case now before this court. [25]

A. The Most Recent Decision of the Ninth Circuit Court of Appeals.

On May 2, 2019, sixteen days after the Debtor commenced this Chapter 11 proceeding, the Ninth Circuit Court of Appeals ("Ninth Circuit") entered its decision in Garvin v. Cook Investments NW, SPNWY, LLC (In re Cook Investments NW), 922 F.3d 1031 (9th Cir. 2019). That Chapter 11 proceeding was commenced in the bankruptcy court for the Western District of Washington and encompassed five related real estate entities. One of those entities, Cook Investments NW DARR ("Cook DARR"), leased property to an unrelated third party licensed under

Washington law to grow marijuana. That lease violated, however, the provision of the Controlled Substances Act that prohibited the knowing lease of any space "...for the purpose of manufacturing, distributing, or using any controlled substance..." 21 U.S.C. § 856(a)(1). The U.S. Trustee filed a motion under Section 1112(b)(1) to dismiss the Chapter 11 proceeding based on gross mismanagement as defined under Section 1112(b)(4)(B). The bankruptcy court denied the motion on the debtors' representation that an amended plan would include a rejection of the lease with the marijuana grower and payments under the plan therefore would not depend on a source that violates federal law. SeeGeiger v. Cook Investments NW, SPNWY, LLC (In re Cook Investments NW), 2017 WL 10716993, at *1 (W.D. Wash. Dec. 18, 2017). The bankruptcy court gave the U.S. Trustee leave to renew the motion at the time of confirmation of the amended plan.[26]

***729** The debtors filed an amended plan along with a separate motion to reject the marijuana tenant's lease. The U.S. Trustee objected to confirmation of the amended plan, but not to the motion to reject the lease. An order was entered authorizing rejection of the lease. The U.S. Trustee objected that the amended plan was not proposed in good faith under Section 1129(a)(3), but did not renew the motion to dismiss under Section 1112(b)(1) based on gross mismanagement. The bankruptcy court overruled the plan objection and confirmed the amended plan under Section 1129(a).[27] Id. at *1-2. On appeal, the federal district court affirmed both the plan confirmation order and the order denying the U.S. Trustee's motion to dismiss. As to dismissal based on gross mismanagement, the district court concluded that the U.S. Trustee had waived the objection by failing to renew the prior motion. Id. at *3. The district court also concluded that it was not an abuse of discretion to deny dismissal because the debtors might be able to propose a Chapter 11 plan that does not rely on income from the marijuana lease. Id. at *4. The district court emphasized that the debtors' plan of reorganization provided for payment of the single creditor whose judgment would be paid in full from non-marijuana income. Id.

[14] On further appeal, the Ninth Circuit again affirmed. In particular, the circuit panel addressed the U.S. Trustee's objection that the debtors' Chapter 11 plan did not meet Section 1129(a)(3) because it had not "been proposed in good faith and not by any means forbidden by law." The Ninth Circuit held that the good faith requirement under Section 1129(a)(3) "...directs courts to look only to the proposal of a [Chapter 11] plan, not to the terms of the plan." 922 F.3d at 1035. (Emphasis added). Because the Debtor's plan had been negotiated during the Chapter 11 proceeding in good faith, it had not been proposed by any means forbidden by bankruptcy or non-bankruptcy law. Id. at 1033-34. With respect to any alleged violations of the Controlled Substances Act, the court observed:

> We do not believe that the interpretation compelled by the text [of Section 1129(a)(3)] will result in bankruptcy proceedings being used to facilitate legal violations. To begin, absent waiver, as in this case, courts may consider gross mismanagement under § 1112(b). And confirmation of a plan does not insulate debtors from prosecution for criminal activity, even if that activity is part of the plan itself...There is thus no need to "convert the bankruptcy judge into an ombudsman without portfolio, gratuitously seeking out possible 'illegalities' in every plan," a result that would be "inimical to the basic function of bankruptcy judges in bankruptcy proceedings."

Id. at 1036 (citations omitted).[28] With respect to dismissal for gross management within the meaning of ***730** Section 1112(b)(4)(B), the Ninth Circuit concluded that the U.S. Trustee had waived the objection by failing to renew its motion at plan confirmation. The circuit panel reached that conclusion because the motion was not presented under Section 1112(b)(1) and therefore there was no opportunity for the bankruptcy court to consider whether any claim of gross mismanagement could be cured under Section 1112(b)(2).[29] Id. at 1034.

[15] While the Ninth Circuit's decision in Garvin is controlling when a good faith objection to plan confirmation is raised under Section 1129(a)(3), there is no proposed Chapter 11 plan before the court at this time. Similarly, the Garvin decision does not address other requirements for Chapter 11 plan confirmation, such as feasibility under Section 1129(a)(11).[30] At this stage, the Debtor wants to remain under the protection of the automatic stay while it tries to formulate a plan of reorganization. The Garvin panel

did not preclude consideration of a motion to dismiss under Section 1112(b)(1), even at plan confirmation, but did not do so only because the U.S. Trustee had waived the ground by failing to renew its prior motion. So procedurally, the Garvin decision offers no guidance on whether dismissal under Section 1112(b)(1) on the basis of mismanagement under Section 1112(b)(4)(B), or any other ground, would be appropriate in the present case.

On the other hand, the more obvious factual distinction is that the Chapter 11 debtor in Garvin was not engaged in the cultivation, production and distribution of marijuana. Unlike the debtor in Garvin, this is not a case where proceeds of the Marijuana Business would provide merely "indirect support" for a confirmed plan.[31] Rather, the Marijuana Business operated by the Debtor appears to be the primary source of the Debtor's revenue and appears to be in clear violation of the Controlled Substances Act.

Perhaps more important is that the Garvin decision does not address whether dismissal ***731** independently based on abstention under Section 305(a) is appropriate. The debtors in Garvin were not subject to multiple state court actions brought by creditors clamoring to enforce their claims against limited assets. The Debtor in the current case is.

[16] Under these circumstances, the recent decision in Garvin is informative, but neither procedurally nor factually apposite.[32]

B. The Remaining Cases Cited by the Parties.

The other cases cited by the parties involved marijuana-related bankruptcy relief under various chapters of the Bankruptcy Code, but under very different circumstances. Three other non-bankruptcy cases cited by the parties are not persuasive.

(1) Chapter 13 Cases.

[17] Relief under Chapter 13 is available only to individuals who are eligible under Section 109(e) and who are willing to devote their future disposable income to the payment of creditors. Individuals essentially commit to earn income from their labors over time in exchange for a discharge in Chapter 13. Because individuals cannot be subjected to forced labor, they cannot be placed into Chapter 13 involuntarily. See 11 U.S.C. § 303(a).

In In re McGinnis, 453 B.R. 770 (Bankr. D. Or. 2011), a Chapter 13 debtor proposed a plan that would be partially funded by the debtor's own marijuana business and rental income derived from other marijuana-related businesses. After an evidentiary hearing in which the Chapter 13 trustee objected, the court denied confirmation because the plan's reliance on income derived from the marijuana industry violated the good faith requirement under Section 1325(a)(3).[33] The court further concluded that because the contemplated marijuana operations were illegal under both federal and Oregon law,[34] debtor could not satisfy ***732** Section 1325(a)(6), which requires proof of a debtor's ability "to make all payments under the plan and to comply with the plan."[35] The court, however, expressed a willingness to consider confirmation of any amended plan that did not rely on funding from illegal sources of income. As a result, the court denied plan confirmation but permitted the debtor to file an amended plan. In the event a timely amended plan was not filed, the court indicated that it would issue an order to show cause for dismissal or conversion to Chapter 7. Id. at 773-74.[36]

In In re Johnson, 532 B.R. 53 (Bankr. W.D. Mich. 2015), the U.S. Trustee moved to dismiss a Chapter 13 case because part of the debtor's income came from the sale of medical marijuana permitted under Michigan law. The court credited the debtor's testimony that all plan payments made to the trustee came from his Social Security income but nevertheless concluded that the court could not, and would not, allow the debtor to remain in a bankruptcy case that assisted in the advancement of an illegal activity. The court, however, did not agree with the U.S. Trustee that dismissal was a foregone conclusion, but instead gave the debtor the option to remain in bankruptcy by ceasing his illegal business operations. Specifically, the court enjoined the debtor from continuing with his marijuana business, ordered him to destroy all marijuana plants, and scheduled a further evidentiary hearing to determine the debtor's compliance with these conditions. Id. at 59. The court also provided the debtor with the option

to terminate the injunction by moving to dismiss his own case under Section 1307(b). Id. [37]

In Olson v. Van Meter (In re Olson), 2018 WL 989263 (9th Cir. BAP Feb. 5, 2018), a Chapter 13 debtor obtained rental income from a marijuana dispensary on real property she proposed to sell under her plan. The bankruptcy court *sua sponte* dismissed the bankruptcy case because the debtor was accepting rental income during the post-petition period from a source engaged in a business that violated federal law. On appeal, the bankruptcy appellate panel vacated and remanded the case, stating that the bankruptcy court needed to make more findings of fact and conclusions of law to support dismissal. In her concurring opinion, Judge Tighe expressed her opinion that "[a]lthough 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." Id. at *7. Judge Tighe also provided additional clarification regarding the detail she believes to be necessary in future rulings involving similar cases:

> ***733** 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.

Id. at *6.

The common theme in all of these Chapter 13 cases is the willingness of the bankruptcy court to allow the voluntary debtor to propose a feasible plan that does not rely on income received through a violation of the Controlled Substances Act.

(2) Chapter 11 Cases.

[18] **[19]** Relief under Chapter 11 is available to both individuals and non-individuals, and may be initiated both voluntarily and involuntarily. For individual Chapter 11 debtors, a bankruptcy discharge is obtained only upon completion of payments of a confirmed plan. See 11 U.S.C. § 1141(d)(5). For non-individual Chapter 11 debtors, a bankruptcy discharge is obtained upon confirmation of a plan unless the plan does not provide for continued operations. See discussion at note 32, supra.

In In re Rent-Rite Super Kegs W. Ltd., 484 B.R. 799 (Bankr. D. Colo. 2012), creditors sought to dismiss a voluntary Chapter 11 case filed by the owner of a warehouse. Dismissal was sought because twenty-five percent of the non-individual debtor's revenues came from warehouse tenants engaged in the medical marijuana industry. Although the tenants' operations were authorized under Colorado law, the bankruptcy court found that the revenue source violated the Controlled Substances Act and subjected the secured creditor's real property collateral to potential criminal forfeiture proceedings under federal law. Id. at 805-06. The court, therefore, found that "cause" existed under Section 1112(b) due to gross mismanagement and application of the unclean hands doctrine. Id. at 809. Because the remaining seventy-five percent of the debtor's revenues were not derived from the marijuana tenants, however, the court scheduled a further hearing to determine whether conversion or dismissal would be in the best interests of creditors. Id. at 810-11. [38]

In In re Arm Ventures, LLC, 564 B.R. 77 (Bankr. S.D. Fla. 2017), the Chapter 11 debtor, which did not have any income derived from marijuana-related sources as of the petition date, proposed a plan that contemplated leasing real property to an affiliate that would generate income from medical marijuana as permitted by Florida law. The secured creditor sought dismissal based on a variety of factors, including the debtor's reliance on marijuana-related sources of income to fund its

plan. The court agreed that it could not confirm such a plan, but it provided the secured creditor with relief from the automatic stay in lieu of dismissal. Id. at 86-87. The court also ***734** gave the debtor two weeks to file an amended plan that did not rely on marijuana-related sources of income, absent which the court would convert the case to Chapter 7 and the secured creditor would be authorized to immediately proceed with its foreclosure sale. Id. at 86 & n.23. [39]

In In re Way to Grow, Inc., 597 B.R. 111 (Bankr. D. Colo. 2018), the Chapter 11 debtors' business

> involve[d] the sale of equipment for indoor hydroponic and gardening-related supplies. As to their customers' uses of their products, Debtors have represented "[w]hile the hydroponic gardening equipment may and is used for many types of crops, the Debtors' future business expansion plan is tied to the growing cannabis industry which is heavily reliant on hydroponic gardening."

Id. at 115. After discussing various bankruptcy decisions involving debtors engaged in illegal activities, including the decision in Rent-Rite, the court discussed "three basic propositions" gleaned from this caselaw:

> First, a party cannot seek equitable bankruptcy relief from a federal court while in continuing violation of federal law. Second, 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. And third, the focus of this inquiry should be on debtor's marijuana-related activities during the bankruptcy case, not necessarily before the bankruptcy case is filed.

Id. at 120. Utilizing these principles, the court found "cause" existed to dismiss the case under Section 1112(b) because the debtors' business violated the Controlled Substances Act. Specifically, after conducting a four-day evidentiary hearing, the court did not find credible the debtors' explanation that it would try to distance itself from selling its products to entities engaged in marijuana-related activities. The court further found that the reduction of debtors' revenue from marijuana-related sources would devastate the debtor's income stream, thereby making confirmation difficult, if not impossible. Finally, even if the court required the debtors to extricate themselves from the marijuana industry, the court concluded that the cost and effort of ensuring compliance would be inefficient, costly, and difficult to monitor:

> In any event, the Court does not believe such an order [requiring the debtor to extricate itself from marijuana-related sources of business], or the remediation it would require, would be effective in this case. The Court cannot simply order Debtors to cease all sales to customers known to be involved in marijuana cultivation, because the usefulness of Debtors' products in illegal grow operations will continue to attract marijuana horticulturalists to Debtors' business, including those growing marijuana solely for personal use. Debtors have already acquired a venerable reputation for expertise in hydroponic marijuana growing, and it is difficult to imagine how Debtors could prevent customers from continuing to patronize Debtors' stores because of this reputation. Indeed, the evidence does not show Debtors' essential business model has changed post-petition, which, of course, is the relevant time to determine whether Debtors may remain in bankruptcy. In any event, any such order would require the Court, and interested ***735** parties, to monitor the Debtors' sales and customers, which would be very difficult and inefficient. Further, in light of the acrimonious nature of [the relationship between the party-in-interest moving for dismissal] with the Debtors, the Court can be reasonably certain such an order would lead to costly and time-consuming future litigation over the Debtors' compliance.
>
> To prevent this Court from violating its oath to uphold federal law, under the specific facts of this case, the Court sees no practical alternative to dismissal.

Id. at 132. [40]

The common theme of these voluntary Chapter 11 cases is the bankruptcy court's consideration of whether the debtor in possession could propose a feasible plan that did not rely on income received through a violation of the Controlled Substances Act.

(3) Chapter 7 Cases.

[20] [21] [22] Relief under Chapter 7 is available to both individuals and non-individuals, and may be initiated both voluntarily and involuntarily. For individual Chapter 7 debtors, the property of the bankruptcy estate is administered by a bankruptcy trustee, see 11 U.S.C. § 704(a), and a bankruptcy discharge is obtained if no timely objections are filed by parties in interest. See 11 U.S.C. § 727(b). For non-individual Chapter 7 debtors, the property of the bankruptcy estate is administered by a bankruptcy trustee, but a discharge is not available. See 11 U.S.C. § 727(a)(1).

In Arenas v. U.S. Trustee (In re Arenas), 535 B.R. 845 (10th Cir. BAP 2015), the U.S. Trustee moved to dismiss a voluntary Chapter 7 case in which the individual debtors sold marijuana and obtained rental income from an entity engaged in the marijuana industry that was lawful under Colorado law. In response, the debtors sought to convert the case to Chapter 13. The bankruptcy court denied conversion and dismissed the case. The bankruptcy appellate panel for the Tenth Circuit affirmed and expressed their agreement "with the bankruptcy court that while debtors have not engaged in intrinsically evil conduct, the debtors cannot obtain bankruptcy relief because their marijuana business activities are federal crimes." Id. at 849-50. The appellate panel concluded that the debtors likely would be unable to satisfy the "good faith" requirement under Section 1325(a)(3) to confirm a Chapter 13 plan, and neither a Chapter 7 or 13 trustee could administer assets without violating federal law. Id. at 852. [41] It further observed that allowing the debtors to remain in Chapter 7 would prejudicially delay creditors, who would likely receive no distribution on their claims, while the debtors would receive a discharge and would be allowed to continue business operations that were illegal under the Controlled Substances Act. Id. at 853-54.

In In re Medpoint Mgmt., LLC, 528 B.R. 178 (Bankr. D. Ariz. 2015), vacated in part on other grounds, 2016 WL 3251581 (9th Cir. BAP June 3, 2016), an involuntary Chapter 7 case was filed against a non-individual entity that provided management services to medical marijuana ***736** businesses licensed under Arizona law. The alleged debtor stated "that all of its assets are marijuana-related," and counsel for the U.S. Trustee also expressed her belief that the alleged debtor did not have "any legal, non-marijuana assets that a trustee could lawfully administer." 528 B.R. at 184. The court dismissed the case because its continuation would require a Chapter 7 bankruptcy trustee to violate federal law and subject the bankruptcy estate to possible forfeiture of the alleged debtor's assets. Id. at 186. [42] The court also found that the petitioning creditors, who voluntarily conducted business with an entity engaged in illegal activities, were barred from seeking relief under the "unclean hands" doctrine. Id. at 186-87. [43]

[23] In Northbay Wellness Group, Inc. v. Beyries, 789 F.3d 956 (9th Cir. 2015), an attorney stole money from his client, i.e., a medical marijuana dispensary, and subsequently filed a personal, voluntary Chapter 7 bankruptcy. The dispensary instituted an adversary proceeding seeking to except its claim from discharge, but the bankruptcy court dismissed the adversary complaint under the "unclean hands" doctrine. The Ninth Circuit reversed and remanded, explaining that the bankruptcy court failed to balance the parties' respective wrongdoings as required under that doctrine:

> The Supreme Court has emphasized, however, that the doctrine of unclean hands "does not mean that courts must always permit a defendant wrongdoer to retain the profits of his wrongdoing merely because the plaintiff himself is possibly guilty of transgressing the law." [***737** *Johnson v.] Yellow Cab [Transit Co.]*, 321 U.S. [383, 387, 64 S.Ct. 622, 88 L.Ed. 814 (1944)]. Rather, determining whether the doctrine of unclean hands precludes relief requires balancing the alleged wrongdoing of the plaintiff against that of the defendant, and "weigh[ing] the substance of the right asserted by [the] plaintiff against the transgression which, it is contended, serves to foreclose that right." *Republic Molding Corp. v. B.W. Photo Utils.*, 319 F.2d 347, 350 (9th Cir. 1963). In addition, the "clean hands doctrine should not be strictly enforced when to do so would frustrate a substantial public interest." *EEOC v. Recruit U.S.A., Inc.*, 939 F.2d 746, 753 (9th Cir. 1991).

Id. at 960. The Ninth Circuit additionally observed "that the doctrine of unclean hands cannot prevent recovery of funds stolen from a client by his or her lawyer." Id. at 961. [44]

The common theme in all of these Chapter 7 cases is that the mere involvement of marijuana-related assets, income,

or connections to the debtor, is not dispositive of whether a particular case is permitted to proceed. [45]

***738 (4) Non-Bankruptcy Cases.**

Two of the other cases cited by the parties address the likelihood of prosecution under the Controlled Substances Act, rather than whether particular conduct is in fact illegal under federal law. The remaining case addresses the appointment of a receiver under Colorado law, but does not address the Controlled Substances Act at all. As previously discussed, there is no meaningful dispute that the Marijuana Business operated by the Debtor is not permitted by federal law.

In U.S. v. McIntosh, 833 F.3d 1163 (9th Cir. 2016), several defendants from California and Washington, which authorized the cultivation of medical marijuana, sought to enjoin their convictions for various marijuana-related violations of the Controlled Substances Act. They argued that Congress approved a rider to successive appropriations bills (referred to as "§ 542") [46] that prohibited the Justice Department from spending any of its funds "to prevent States [who have legalized medical marijuana] from implementing their own State laws that authorize the use, distribution, possession, or cultivation of medical marijuana." Id. at 1169-70. In examining its jurisdiction and appellants' standing, the Ninth Circuit found, among other things, that "[e]ven if Appellants cannot obtain injunctions of their prosecutions themselves, they can seek—and have sought—to enjoin [the Justice Department] from *spending funds* from the relevant appropriations acts on such prosecutions." Id. at 1172 (emphasis in original). Thereafter, the court held that § 542 only prohibits the Justice Department from utilizing funds to prosecute individuals who are in full compliance with applicable state medical marijuana laws:

> Individuals who do not strictly comply with all state-law conditions regarding the use, distribution, possession, and cultivation of medical marijuana have engaged in conduct that is unauthorized, and prosecuting such individuals does not violate § 542. Congress could easily have drafted § 542 to prohibit interference with laws that address medical marijuana, but it did not. Instead, it chose to proscribe preventing states from implementing laws that authorize the use, distribution, possession, and cultivation of medical marijuana.

Id. at 1178. The Ninth Circuit therefore vacated and remanded appellants' cases with instructions for the district courts to conduct evidentiary hearings to determine whether or not appellants' operations fully complied with their respective state's medical marijuana laws. Id. at 1179.

In U.S. v. Kleinman, 880 F.3d 1020 (9th Cir. 2017), an individual appealed his conviction of various marijuana-related offenses based, in part, on the Justice Department's prohibited use of funds under § 542. In affirming his conviction, the Ninth Circuit first found that appellant's conviction, which was entered prior to the passage of § 542, would not be vacated because § 542 did not change the illegality ***739** of marijuana-related offenses under federal law:

> § 542 does not require a court to vacate convictions that were obtained before the rider took effect. In other words, when a defendant's conviction was entered before § 542 became law, a determination that the charged conduct was wholly compliant with state law would *not* vacate that conviction. It would only mean that the [Justice Department's] continued expenditure of funds pertaining to that particular state-law-compliant conviction *after* § 542 took effect was unlawful. That is because, as we explained in *McIntosh*, § 542 did not change any substantive law; it merely placed a temporary hold on the expenditure of money for a certain purpose.

Id. at 1028 (emphasis in original).

In Yates v. Hartman, —— P.3d ——, 2018 WL 1247615 (Colo. App. Mar. 8, 2018), a spouse sought the appointment of a receiver over medical and recreational marijuana entities held in a marital dissolution proceeding. The entities were authorized to operate under Colorado law, and none of the parties asserted that their operations otherwise were illegal under the Controlled Substances Act. The appellate court concluded that any receiver must possess the proper licenses under Colorado law to operate the entities. Id. at ——–––, at *3-4. It therefore reversed the trial court's appointment of a receiver. Id. at ——, at *4.

The relevant theme of these non-bankruptcy cases[47] is that while Congress may act to deny funding for federal prosecution of marijuana offenses under the Controlled Substances Act, it has not acted to legalize the cultivation, production and distribution of marijuana.[48] Until it does so, all parties ***740** engaged in or having a significant connection with the marijuana industry face a creeping absurdity[49]: they can rely in good faith on more and more state laws to increasingly form new businesses, increasingly invest and loan millions of dollars,[50] and increasingly enter into occupations that expose all of them to possible federal criminal prosecution.[51] Moreover, state and local governments that derive tax revenues from medical and recreational marijuana businesses face continuous uncertainty.[52]

***741 3. The Evidence Presented by the Parties.**

[24] The burden of proof on this Dismissal Motion rests with 4Front as the party seeking relief. See, e.g., In re Rosenblum, 2019 Bankr. LEXIS 1160 (Bankr. D. Nev. Mar. 15, 2019) (order denying former spouse's alternative requests for dismissal, abstention, appointment of trustee, or relief from stay). The evidentiary record before the court consists of the written testimony offered by declarants Krane, Braddock, Malley, Miltenberger, Kanitz, and Padgett, the exhibits offered by the declarants, and the documents for which judicial notice has been requested. No objections have been raised as to any of the written testimony offered, the exhibits accompanying the declarations, or to the matters for which judicial notice was requested. Likewise, various documents have been attached as "exhibits" to the written legal arguments, some of which are not authenticated, but no objections have been raised to the inclusion of those documents as part of the record.

Among other things, Krane attests that 4Front entered into a consulting agreement with the Debtor in March 2014, for which it has not been paid under an arbitration award. See Krane Declaration at ¶¶ 6, 10, 11 and 12. As counsel for 4Front, Braddock attests, *inter alia*, that in May 2017, 4Front sued the Debtor in State Court to collect payments under the consulting agreement. See Braddock Declaration at ¶ 3. He also attests that prior to the Debtor's commencement of this Chapter 11 proceeding, 4Front took numerous steps to confirm and enforce an arbitration award in its favor, including prosecution of its Receivership Application and a request to hold the Debtor in contempt. Id. at ¶¶ 6 and 14. Braddock further attests that the State Court entered a judgment confirming the arbitration award, and the Debtor still refused to pay. Id. at ¶ 16.

As counsel for Highland Partners, and on behalf of both Highland Partners and Green Pastures, Malley attests that in July 2018, these parties commenced additional State Court actions against the Debtor for breach of a lease as well as certain loan agreements. See Malley Declaration at ¶ 5. He also attests that numerous other legal actions have been commenced in State Court by other parties. Id. at ¶ 8. As counsel for Green Pastures, Miltenberger attests that in May 2015, Green Pastures entered into an agreement with the Debtor to purchase certain promissory notes but that the Debtor has been in default since no later than June 2018. See Miltenberger Declaration at ¶¶ 5, 6 and 7. As the manager of an asset management firm, Kanitz attests that in May 2017, Highland Partners entered into a commercial lease with the Debtor for premises located at 3132 Highland Drive and 3152 Highland Drive, in Las Vegas. See Kanitz Declaration at ¶ 4. He also attests that between June and November 2016, certain members of Highland Partners entered into agreements with the Debtor to purchase certain promissory notes, and also to loan additional funds to the Debtor, all of which agreements ***742** have been breached. Id. at ¶ 5. Kanitz also attests that in September 2017 and January 2018, other members of Highland Partners entered into other transactions with the Debtor, including a secured line of credit, all of which have been breached. Id. at ¶ 6.

As the manager of BCP Holding, which is the manager of the Debtor, Padgett attests, *inter alia*, that on March 14, 2019, a judgment was entered by the State Court confirming an arbitration award in favor of 4Front in the amount of $ 4,987,092.29. See Padgett Declaration at ¶ 7. He also attests that the Debtor has workers compensation and liability

insurance coverage in place through April 26, 2020. Id. at ¶ 10. Padgett also attests that the Debtor has employee health insurance as well as automobile insurance in place as of April 8, 2019. Id. at ¶¶ 11 and 12. He attests that the Debtor made a payment of $ 81,850 to the Nevada Department of Taxation on April 23, 2019. Id. at ¶ 13. Padgett attests that an eviction proceeding has been commenced by "Renaissance one landlord" with respect to a commercial lease "which is critical to CWNevada's operations." Id. at ¶ 15. He also attests that the "Debtor is in the process of establishing banking relationships at the very same banks that 4Front has established its relationships with." Id. at ¶ 20.

In addition to the exhibits previously mentioned in this order, see discussion at 722–24, supra, the record encompasses copies of various documents submitted by 4Front, including: the Declaration of Anthony Imbimbo in Support of CWNevada's Opposition to Motion to Affirm Arbitration Award ("Imbimbo Declaration") filed in State Court on or about February 14, 2019, in Case No. A-17-755479-C (Ex. "4"); the final arbitration award in favor of 4Front in the amount of $ 3,741,803.92 (Ex. "8"); the State Court order and final judgment confirming the arbitration award (Ex. "9"); a preliminary injunction entered by the State Court on March 14, 2019, enjoining the Debtor from "selling, transferring, or otherwise disposing of any assets in their possession, custody, and/or control, including any Nevada cannabis license and cash received (except as needed for normal business operations) from the lawful sale of cannabis through their Nevada retail dispensaries until this court orders otherwise" (Ex. "11"); a State Court complaint entitled Maria Navarrete, et al. v. CWNevada, LLC, et al., Case No. A-19-792575-C, filed April 4, 2019, alleging, *inter alia*, that the Debtor was in default in payment of employees at three Nevada marijuana dispensaries operating under the name "Canopi" (Ex. "13"); email correspondence dated April 10, 2019, from a revenue officer at the Nevada Department of Taxation indicating that a balance of $ 388,890.45 was then-owing by the Debtor, along with various periodic statements of taxes due (Ex. "14"); an ex parte application for order to show cause why the Debtor should not be held in contempt, filed by 4Front in State Court on April 12, 2019 (Ex. "15"); an email dated April 13, 2019, from Padgett to Van Oyen and Kanitz ("Padgett Email") (Ex. 16); the U.S. Trustee's Guidelines for Region 17 as of December 16, 2016 ("UST Guidelines") (Ex. "A"); and the UST List of Authorized Depositories, District of Nevada, Fourth Quarter CY 2018 ("Approved Depository List") (Ex. "B").

Copies of various documents also were submitted by Highland Partners and Green Pastures, including: the Declaration of Brian Padgett dated September 5, 2018, filed in State Court in Case No. A-18-777270-B ("2018 Padgett Declaration") (Ex. "1" to Malley Declaration); the Convertible Note Purchase Agreement dated May 20, 2015, between various purchasers (including Green Pastures) and the Debtor ***743** (Ex. "1" to Miltenberger Declaration); a Commercial Lease dated May 24, 2017, for the Debtor's lease of premises from Highland Partners for an industrial building located at 3132 Highland Drive and 3135 Highland Drive in Las Vegas (Ex. "1" to Kanitz Declaration); a Series B Preferred Convertible Note Purchase Agreement dated November 7, 2016, between the Debtor and Appleseed Ventures Growth Opportunity Fund LLC, that includes, as Schedule 7(f), the CWNevada, LLC, Financial Statements for the Year Ended December 31, 2015 ("2015 Financial Statement") (Ex. "2" to Kanitz Declaration); and, a Promissory Note dated June 9, 2017, memorializing a loan to the Debtor in the amount of $ 161,802.81, obtained from Appleseed Ventures Growth Opportunity Fund LLC (Ex. "3" to Kanitz Declaration).

CIMA Group also submitted a number of documents, including the following: CIMA Group's emergency ex parte application for appointment of receiver and notice of suspension of registration, filed on April 13, 2019, in State Court in Case No. A-17-755479-C ("CIMA Group Application") (Ex. "1" to CIMA Joinder); the Notice of Verified Third-Party Claim and Demand for Surety, filed on February 15, 2019 on behalf of Brian Padgett, in State Court in Case No. A-18-773230-B ("Padgett Claim") (Ex. "2" to CIMA Joinder); and the Affidavit of Timothy Smits Van Oyen, a member of the Debtor [53], filed on May 13, 2019, in State Court in Case No. A-17-755479-C ("Van Oyen Affidavit") (Ex. "1" to CIMA Reply).

4. Dismissal Based on Abstention is Warranted under Section 305(a).

[25] The production and distribution of CBD products is not prohibited by the Controlled Substances Act if the THC concentrations in the particular hemp plant conform to the limitations prescribed under Title 7. See discussion at 727, supra. No one challenges Padgett's written testimony that a portion of the Debtor's operations includes a CBD Business. According to the Debtor's independent accountant, however, as of February 14, 2019, the Debtor's

> Current inventory on hand includes over [redacted] pounds of Cannabis Flower broken down into various sales weights (valued at $[redacted]), Cannabis Trim of [redacted]) valued at $[redacted]) pound for a total of $[redacted], Edible Products of [redacted] units (valued at $[redacted]), Concentrates of [redacted] units (valued at $[redacted]), and Work in Process inventory (valued at $[redacted]). The fair market value of this inventory totals $[redacted].

See Imbimbo Declaration at ¶ 7. Inasmuch as the recent inventory provided by its independent accountant may or may not include any CBD products, it is difficult to determine the significance of the Debtor's CBD Business. Moreover, there is no evidence of whether any portion of the Debtor's CBD Business includes the type of CBD products that are excluded from the Controlled Substances Act. [54]

***744** Upon the commencement of a Chapter 11 proceeding, a debtor in possession ordinarily is required to close its existing bank accounts "and establish new debtor in possession accounts to be used for all transactions during the pendency of the case." UST Guidelines at 4.4.6(b). The new accounts must be established at a depository institution meeting the requirements of Section 345(b). Those requirements are designed to ensure the safety of the funds held by a trustee or debtor in possession as a fiduciary of a bankruptcy estate. A list of approved depositories is maintained by the U.S. Trustee. See UST Guidelines at 4.4.6(a)(1). Padgett attests that the Debtor is attempting to establish debtor in possession accounts with the "very same banks that 4Front has established its relationships with." Padgett Declaration at ¶ 20. While 4Front has offered no evidence to the contrary, the Debtor's factual and legal position is a false equivalency: 4Front is not a debtor in possession and is not subject to the same requirement. The names of thirty-nine approved financial institutions, including Bank of Nevada, Bank of George, First Security Bank of Nevada, and Heritage Bank of Nevada, have been provided to the voluntary Chapter 11 debtor in possession. See Approved Depository List at 1. Because Debtor has never filed any Schedules nor a SOFA that would disclose any bank accounts that existed when it filed its voluntary Chapter 11 Petition, or which were closed prior to filing the Petition, the court does not know whether the Debtor even had any bank accounts to close. [55] At the very least, however, Debtor should be able to identify an approved depository institution in which it has attempted to open its required debtor in possession accounts. [56] It has not done so.

As a non-individual, fictitious legal entity, Debtor cannot proceed without legal counsel. See generally United States v. High Country Broadcasting Co. Inc., 3 F.3d 1244, 1245 (9th Cir. 1993). The voluntary Chapter 11 petition was signed by the Debtor's general counsel, and such counsel conceded at the hearing on the Dismissal Motion that the Debtor must obtain separate, disinterested, bankruptcy counsel. The record also reveals that Padgett holds the majority of the membership interests of the Debtor, see note 53, supra, and also is the manager of BCP Holding, which is the manager of the Debtor. The record further discloses that Padgett previously provided some nature of legal services to the Debtor. See 2015 Financial Statement ***745** at Note 3: Related Party Transactions. [57] The record also reveals that the Debtor's general counsel also represents Padgett personally and filed the Padgett Claim in one of the actions pending in State Court. [58] In that claim, Padgett represents that he "is the owner of all rights, title and interest" to funds that previously had been garnished by CIMA Group. See Padgett Claim at ¶¶ 3-4. Moreover, he also alleges that pursuant to a previously perfected security interest, he "has the right of possession, and owns all rights, title and interest in all of the assets of CWNevada, including but not limited to all personal property, accounts, money, deposit accounts, products and the proceeds therefrom that existed or acquired afterwards." (Additional emphasis added). Id. at ¶ 5. Assuming these representations are accurate, Padgett at one time, or perhaps continuously, has provided legal services to an entity whose operations have resulted in nine separate lawsuits that are pending in various stages in State Court. See Padgett Declaration at ¶¶ 8, 14 and 15. [59] More important, despite apparently perfecting only a security interest in the assets of the Debtor, he has made a verified claim in State Court that he actually owns all of the assets of the Debtor. In essence, the record before this court indicates that Padgett has taken positions that may be in actual and direct conflict with the interests of the Debtor, and that he also may be subject to claims by the Debtor that would be property of the bankruptcy estate.

The necessity of independent counsel to advise the Debtor is amply demonstrated by the record. While the Debtor is a limited liability company that, according to the Chapter 11 Petition, is managed by BCP Holding, as the managing member of the Debtor, see Resolution Authorizing Bankruptcy attached to Petition, it apparently is managed by a board of directors consisting of Padgett, Van Oyen, and Jennifer Lazovich. See 2018 Padgett Declaration at ¶ 3. Van Oyen had a twenty percent (20%) membership interest in the Debtor as of the end of 2015, see note 53, supra, and remains a member of the Debtor at this time. See Van Oyen Affidavit at ¶ 2. In addition to the board members he identifies, Padgett attests that the Debtor had two "shadow" directors, who apparently represented members of the Highland Partners and Green Pastures groups that purchased various promissory notes from the Debtor. See 2018 Padgett Declaration at ¶ 4. Whatever may be the validity or source of the alleged intrigue in the management of the Debtor, there is no dispute that Van Oyen joined in the Receivership Application brought in State Court by 4Front and also joins in the instant Dismissal Motion. Thus, there appears to be no consensus amongst the Debtor's management in favor of Chapter 11 relief. [60]

***746** Notwithstanding the significant issues concerning management, the record also suggests that the Debtor's financial woes have been understated by that management. No one disputes that the April 23, 2019 payment was made to NDOT in the amount of $ 81,850. See Padgett Declaration at ¶ 13. [61] That is a significant sum. The record also suggests, however, that as of May 3, 2019, the balance owing by the Debtor was $ 405,076.91. See Van Oyen Affidavit at ¶ 4. In other words, the tax payment made by the Debtor seven days after filing the Chapter 11 petition barely made a dent in the amount likely owed to the State of Nevada. Additionally, no one disputes that the Debtor is the subject of an eviction proceeding for "a commercial lease which is critical to the CWNevada's operations." Padgett Declaration at ¶ 15. The record also suggests that as of May 3, 2019, the Debtor was $ 117,500 in arrears as to that commercial lease of the dispensary premises located at 6540 Blue Diamond Road in Las Vegas, in addition to related obligations. See Van Oyen Affidavit at ¶¶ 5 and 6. Management simply ignores or apparently is unaware that a Chapter 11 debtor in possession is required to perform its obligations under any unexpired lease of commercial real property, particularly the payment of scheduled rent. See 11 U.S.C. § 365(d)(3).

[26] **[27]** The court has considered the role of the "unclean hands" doctrine in a bankruptcy case involving a marijuana-related debtor and the many parties that willingly do business with such an entity. It is clear that the Marijuana Business of this Debtor is not authorized under the Controlled Substances Act. It is equally clear that 4Front is a "national consultant in the cannabis industry," see note 6, supra, and therefore has potential legal exposure under the Controlled Substances Act. Compare Rent-Rite (voluntary Chapter 11 dismissed based on gross mismanagement and unclean hands of the debtor), with Medpoint Mgmt. (involuntary Chapter 11 dismissed based on, *inter alia*, unclean hands of petitioning creditors who did business with marijuana-related alleged debtor). Likewise, Highland Partners, Green Pastures, Van Oyen, MC Brands, and CIMA Group have potential legal exposure. See note 14, supra. When all sides to a pending dispute may be accused of wrongdoing, a court in equity may simply deny relief to all sides and dismiss the case. See, e.g., Green v. Higgins, 217 Kan. 217, 535 P.2d 446 (1975) (denial of both claims and counterclaims on finding that the conduct of both plaintiff and defendant had been willful, fraudulent, illegal, and unconscionable). But bankruptcy courts, like all courts, are required to consider the circumstances of each case rather than routinely dismissing entire swaths of petitions and requests filed by parties seeking ***747** legal relief. [62] Public confidence and the integrity of the court, see note 44, supra, require no less. Thus, the court is not convinced that the "unclean hands" doctrine has an appropriate role in this case.

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.

For the same reasons, the court instead concludes that the interests of creditors and the Debtor would be better served by dismissal of the case. See11 U.S.C. § 305(a)(1). The parties may return to State Court where the Receivership Application, among other matters, may be fully addressed. Having reached this conclusion, it is unnecessary to address 4Font's alternative request for dismissal under Section 1112(b), as well as the request for appointment of a Chapter 11 trustee under Section 1104(a). Because dismissal of the case results in a termination of the automatic stay under Section 362(c), it also is unnecessary to address 4Front's alternative request for relief from stay.

IT IS THEREFORE ORDERED that the Creditor 4Front Advisors LLC's Motion to Dismiss Bankruptcy Petition or, Alternatively, Motion for Relief from the Automatic Stay to Allow Receivership and Contempt Proceedings to Continue, Docket No. 18, be, and the same hereby is, **GRANTED**.

IT IS FURTHER ORDERED that the above-captioned Chapter 11 proceeding is **DISMISSED** pursuant to 11 U.S.C. § 305(a)(1).

IT IS FURTHER ORDERED that all pending hearings in connection with the above-captioned Chapter 11 proceeding are **VACATED**.

All Citations

602 B.R. 717

Footnotes

1 In this Order, all references to "ECF No." are to the number assigned to the documents filed in the instant case, or any other specifically identified case, as the documents appear on the dockets maintained by the clerk of court. All references to "Section" are to the provisions of the Bankruptcy Code, 11 U.S.C. §§ 101-1532. All references to "Local Rule" are to the Local Rules of Practice for this bankruptcy court. All references to "FRE" are to the Federal Rules of Evidence.

2 The absence of a creditor matrix is significant because bankruptcy relief depends on proper notice being given to creditors and other parties in interest. Moreover, a "creditor" under Section 101(10)(A) includes any entity that has a "claim" against the bankruptcy estate on the date the bankruptcy petition is filed. Under Section 101(5)(A), a claim includes any "right to payment, whether or not such right is reduced to judgment, liquidated, unliquidated, fixed, contingent, matured, unmatured, disputed, undisputed, secured, or unsecured..."

3 Local Rule 2004(c) provides as follows: "Production of documents may not be obtained via an order under Fed. R. Bankr. P. 2004. Production of documents may, however, be obtained via subpoena as provided by Fed. R. Civ. P. 45(a)(1)(C), as adopted by Fed. R. Bankr. P. 9016." (Emphasis added.) It appears that the 2004 Subpoena commands both testimony and production of documents based on the CIMA 2004 Order. The latter command appears to run afoul of Local Rule 2004(c). In addition, Local Rule 5075(a)(2) authorizes the clerk of the court to sign various orders on behalf of the court for certain matters, including 2004 Exam requests. That authorization applies to "[o]rders authorizing examinations to be taken under Fed. R. Bankr. P. 2004if the date set for examinations is set on not less than fourteen (14) days' notice and the request for examination does not include a request for production of documents. Orders that do not meet these requirements and orders under Fed. R. Bankr. P. 2004(d), must be signed by a judge..." Local Rule 5075(a)(2)(L) (emphasis added). The language of Local Rule 5075(a)(2)(L) is simply inconsistent with the language of Local Rule 2004(c) that precludes a production of documents from being obtained through an order authorizing a 2004 Exam. As a party in interest, CIMA Group is permitted to conduct a 2004 Exam of the Debtor's principal and should not be whipsawed, of course, between two poorly drafted local rules. CIMA Group has noticed a motion to be heard on June 19, 2019, if necessary, to address compliance with the CIMA 2004 Order and 2004 Subpoena. (ECF Nos. 70 and 74).

4 Section 305(a) provides that a bankruptcy court, after notice and a hearing, may dismiss a bankruptcy case at any time if "the interests of creditors and the debtor would be better served by such dismissal..." 11 U.S.C. § 305(a)(1).

5 Section 1112(b) provides that a bankruptcy court, after notice and a hearing, shall dismiss a Chapter 11 case, or convert it to Chapter 7, for cause, whichever is in the best of creditors and the estate. See 11

U.S.C. § 1112(b)(1). Examples of "cause" include "gross management of the estate." Id. at § 1112(b)(4)(B). To avoid dismissal or conversion, a party in interest must establish, *inter alia*, that there is a reasonable justification of the act or omission constituting cause, and that the act or omission will be cured within a reasonable amount of time. Id. at § 1112(b)(2)(B).

6 Through the written testimony of its co-founder, 4Front maintains that it is a "nationally recognized consultant in the legal cannabis industry." Krane Declaration at ¶ 5. 4Front apparently entered into an agreement with the Debtor on March 10, 2014, to provide consulting services "to assist [Debtor] in applying for highly valuable and competitive licenses to operate sate-legal marijuana facilities in Nevada." Id. at ¶ 6. In addition to that assistance, 4Front apparently provided "consulting services relating to the design and operation of successful retail cannabis dispensaries as permitted under Nevada state law." Id. at ¶ 7.

7 Through the written testimony of its legal counsel, 4Front maintains that it obtained an arbitration award against the Debtor that it seeks to confirm in an action pending in "Nevada state court." Braddock Declaration at ¶¶ 3, 4 and 5. Based on the arbitration award, 4Front apparently filed an application for the appointment of a receiver ("Receivership Application"), the hearing on which was continued by the Eighth Judicial District Court, Clark County, Nevada ("State Court") on several occasions and eventually set for April 17, 2019. Id. at ¶¶ 6 through 13. The State Court apparently entered an order requiring the Debtor to show cause on May 6, 2019, why it should not be held in contempt for violating a prior order. Id. at ¶ 14.

8 Paragraphs 17 through 39 of the Braddock Declaration offer authentication under FRE 901 of the twenty-four exhibits attached to the Dismissal Motion.

9 The court can take judicial notice under FRE 201 of the documents filed in the state court proceedings, as well as in this bankruptcy court. See U.S. v. Wilson, 631 F.2d 118, 119 (9th Cir. 1980); Conde v. Open Door Mktg., LLC, 223 F. Supp. 3d 949, 970 n.9 (N.D. Cal. 2017); Gree v. Williams, 2012 WL 3962458, at *1 n.1 (D. Nev. Sept. 7, 2012); Bank of Am., N.A. v. CD-04, Inc. (In re Owner Mgmt. Serv., LLC Trustee Corps.), 530 B.R. 711, 717 (Bankr. C.D. Cal. 2015).

10 Exhibits "K" through "N" appear to be authenticated under FRE 901 by paragraphs 13, 12, 11, and 10 of the Padgett Declaration. Exhibit "O" is a copy of a document entitled "Cannex Notice of Meeting and Management Information Circular Relating to the Special Meeting of Security Holders to be Held on April 18, 2019" ("Cannex Notice"), the source of which is not addressed by the Padgett Declaration.

11 The Office of the United States Trustee ("U.S. Trustee") is a component of the United States Department of Justice ("Justice Department") and exercises oversight responsibilities in bankruptcy cases through regional offices located throughout the United States. See 28 U.S.C. § 586. The U.S. Trustee has not joined in the instant Dismissal Motion, nor has it filed a statement expressing any view on the merits of this matter. Likewise, the U.S. Trustee did not enter an appearance at the hearing in this matter. Similarly, neither the Nevada Department of Taxation, Nevada Department of Health and Human Services, nor any other Nevada agency has joined in the Dismissal Motion, or expressed any view. Nor did any Nevada governmental agency enter an appearance at the hearing.

12 That exhibit is a photocopy that is obscured by a "sticky note" reflecting someone's handwriting and also what appears to be a receipt stapled to the original of the document. That receipt indicates that the NDOT received a total of $ 81,850 consisting of a check in the amount of $ 12,000, and cash in the amount of $ 69,850.00.

13 Nevada is one of many states that has enacted legislation to decriminalize marijuana. See generally NLJ Staff, *The Elephant in Nevada's Hotel Rooms: Social Consumption of Recreational Marijuana, A Survey of Law, Issues, and Solutions*, 2 Nev.L.J. Forum 99 (2018) [hereafter "NLJ Survey"].

14 Violations of the Controlled Substances Act are subject to criminal prosecution, with a range of penalties including incarceration and fines. See 21 U.S.C. §§ 841(b)(1)(A)(vii), 841(b)(1)(B)(vii), 841(b)(1)(C), and 841(b)(1)(D). See generally Brian T. Yeh, *Drug Offenses: Maximum Fines and Terms of Imprisonment for Violation of the Federal Controlled Substances Act and Related Laws*, Congressional Research Service, January 20, 2015, available at https://fas.org/sgp/crs/misc/RL30722.pdf (last visited May 31, 2019). Persons

who attempt or conspire in a violation of the Controlled Substances Act also may be subject to prosecution. See21 U.S.C. § 846. Compare18 U.S.C. § 2(a) (a person who aids, abets, counsels, commands, induces or procures the commission of an offense against the United States is punishable as a principal). The statute of limitations for the Justice Department to prosecute a violation of the Controlled Substances Act is five years. 18 U.S.C. § 3282. See, e.g., United States v. Mancuso, 718 F.3d 780, 787 n.1 (9th Cir. 2013) (five-year statute of limitations applies to federal prosecution under Controlled Substances Act).

15 See Statement from FDA Commissioner Scott Gottlieb, M.D., on new steps to advance agency's continued evaluation of potential regulatory pathways for cannabis-containing and cannabis-derived products, April 2, 2019, available at https://www.fda.gov/news-events/press-announcements/statement-fda-commissioner-scott-gottlieb (last visited May 31, 2019).

16 In Giampietro, the bankruptcy court determined that Nevada limited liability companies are subject to the alter ego doctrine that is applied to pierce the veil of Nevada corporations. 317 B.R. at 846-48. In 2017, the Nevada Supreme Court reached the same conclusion. SeeGardner v. Eighth Judicial District Court, 133 Nev. 730, 405 P.3d 651, 656 (2017).

17 The Bankruptcy Code makes clear that it is the commencement of a case under Sections 301, 302 and 303 that "creates an estate." 11 U.S.C. § 541(a). Prior to the commencement of a case, a debtor simply holds interests that may ultimately become property of the bankruptcy estate. After a bankruptcy estate comes into existence, it may thereafter acquire interests in additional property that also become property of the bankruptcy estate. See11 U.S.C. § 541(a)(7). Amongst the "legal or equitable interests of the debtor in property as of the commencement" of a bankruptcy case, see11 U.S.C. § 541(a)(1), are any claims or causes of action that the debtor may assert against any parties. SeeSierra Switchboard Co. v. Westinghouse Elec. Corp., 789 F.2d 705, 707 (9th Cir. 1986).

18 This includes taking possession of or exercising control over property of the bankruptcy estate, or enforcing a lien against property of the estate. See11 U.S.C. §§ 362(a)(3 and 4). Even if a party is not a creditor having a claim against the Debtor, it is still an "entity" to which the automatic stay applies. The automatic stay described in Sections 362(a)(1, 2, 3 and 6) does not apply to certain activity, such as an action by a governmental unit to enforce the unit's police and regulatory power. See11 U.S.C. § 362(b)(4).

19 "Cramdown" is simply a description of what is permitted in bankruptcy: if creditors and interest holders do not agree to the proposed treatment of their claims, the court may confirm a proposed plan over their objections if certain conditions are met.

20 Bankruptcy permits individuals and non-individuals to obtain a discharge of their personal liability to pay a debt. The Bankruptcy Code provides the statutory framework for which a discharge may be obtained. No one disputes, however, that a party that files for bankruptcy protection does not have a constitutional right to receive a discharge of debts. SeeU.S. v. Kras, 409 U.S. 434, 446, 93 S.Ct. 631, 638, 34 L.Ed.2d 626 (1973).

21 Although 4Front seeks dismissal of the case under Section 1112(b), it does not request appointment of a Chapter 11 trustee under Section 1104(a).

22 As previously mentioned, see discussion at 721–22, supra, 4Front seeks dismissal under Section 305(a), or, in the alternative, Section 1112(b). A decision on a motion to dismiss under Section 1112 must be rendered no later than fifteen days after a hearing commences, unless the moving party consents or compelling circumstances otherwise requires. See11 U.S.C. § 1112(b)(3).

23 Although CIMA Group's request for the appointment of a Chapter 11 trustee first appeared in its joinder filed the day before the Debtor's opposition was due, see CIMA Joinder at 6:16 to 12:2, Debtor's written opposition

to that joinder does not discuss whether appointment of a trustee is appropriate. See Additional Opposition at 2 ("Debtor hereby adopts all previous arguments made in their Opposition to 4Front Advisors, LLC's Motion as if fully set forth herein..."). In any event, the bankruptcy court may appoint a Chapter 11 trustee *sua sponte*, seeFukutomi v. U.S. Trustee (In re Bibo, Inc.), 76 F.3d 256 (9th Cir. 1996), if it determines the appointment of a Chapter 11 trustee to be in the interests of creditors, equity security holders, and other interests of the estate. See11 U.S.C. § 1104(a)(2).

24 Not surprisingly, a variety of cases have been filed in this court by individual or non-individual debtors that receive or propose to receive income from a source authorized under state law to cultivate or distribute marijuana. See, e.g., In re Warwick Properties, LLC, Case No. 17-15065-MKN (voluntary Chapter 11 limited liability company whose tenant cultivated marijuana on California real property as authorized by California law); In re Perez, Case No. 19-12284-MKN (voluntary individual Chapter 7 debtor apparently employed by a Nevada marijuana dispensary licensed under Nevada law); In re Misle, Case No. 18-15705-BTB (involuntary individual Chapter 7 debtor who receives income from an entity that manages marijuana cultivation facilities under Nevada law); In re Redrock Enterprises, LLC, Case No. 15-13493-ABL (voluntary Chapter 11 by debtor who proposed to lease property to a tenant engaged in marijuana operation under Nevada law); In re Olson, Case No. 17-50081-BTB (Chapter 13 debtor who received rental income from medical marijuana dispensary operating under Nevada law).

25 Cases involving marijuana-related individual and non-individual debtors have become the boogeyman of bankruptcy jurisprudence. Some courts have shied away, and other courts have approached such cases with caution. The bankruptcy debtor's actual connection to the potential illegal activity – whether direct, indirect, remote, or near – appears to be a significant consideration. It is worth noting, however, that bankruptcy courts have a long history of considering cases involving debtors whose activities and operations have included past, present and possibly ongoing violations of applicable non-bankruptcy, civil and criminal laws. See, e.g., Midlantic Nat'l Bank v. New Jersey Dept. of Envt'l Prot., 474 U.S. 494, 106 S.Ct. 755, 88 L.Ed.2d 859 (1986)(voluntary Chapter 11 of waste oil processor that possessed leaking containers of cancer-causing substances in violation of state and local law was converted to Chapter 7, rather than dismissed); In re Freedom Industries, Inc., Case No. 14-bk-20017 (Bankr. S.D. W.Va. Jan. 17, 2014)(voluntary Chapter 11 filed by chemical producer after chemical spill contaminated Elk River; Chapter 11 plan of reorganization confirmed even though the debtor and officers were subsequently sentenced for criminal violations of the federal Clean Water Act and federal Refuse Act). See also NCR Staff, *Catholic Dioceses and Orders that Filed for Bankruptcy and Other Major Settlements*, National Catholic Reporter (May 31, 2018), available at https://www.ncronline.org/news/accountability/catholic-diocesese-and-orders-filed-bankruptcy-and-other-major-settlements (last visited May 31, 2019) (listing all Catholic diocese bankruptcy proceedings filed from July 6, 2004 through approximately February 28, 2018, to address sexual abuse claims against clergy).

26 Although the debtors were the subject of a prior state court judgment that precipitated the Chapter 11 filing, id. at *1, the U.S. Trustee sought dismissal of the bankruptcy case solely under Section 1112(b), and not dismissal based on abstention under Section 305(a).

27 Section 1129(a) sets forth sixteen separate requirements that generally apply to all Chapter 11 plan proponents seeking to confirm a plan. Only individual Chapter 11 debtors, however, are subject to the requirements under Section 1129(a)(15).

28 In Chapter 11 and Chapter 13 proceedings, however, bankruptcy judges have been directed to make an independent determination of whether the statutory requirements for confirmation of a debtor's proposed plan have been met. See, e.g., Liberty Nat'l Enters. v. Ambanc La Mesa Ltd. P'Ship (In re Ambanc La Mesa Ltd. P'Ship), 115 F.3d 650, 653 (9th Cir. 1997) (Chapter 11 plan confirmation); United Student Aid Funds, Inc. v. Espinosa (In re Espinosa), 559 U.S. 260, 276-77, 130 S.Ct. 1367, 1380-81, 176 L.Ed.2d 158 (2010) (Chapter 13 plan confirmation). See alsoIn re Las Vegas Monorail Co., 462 B.R. 795, 798 (Bankr. D. Nev.

2011) (Chapter 11); In re Escarcega, 573 B.R. 219, 231 (9th Cir. BAP 2017) (Chapter 13). Moreover, federal judges are directed to report to the appropriate United States attorney all the facts and circumstances of a case in which the judge has reasonable grounds to believe that a bankruptcy crime or any violation of "other laws relating to insolvent debtors, receiverships or reorganization plans have been committed, or that an investigation should be had in connection therewith..." 18 U.S.C. § 3057(a).

29 If there are unusual circumstances establishing that conversion or dismissal of a Chapter 11 case is not in the best interests of creditors and the estate, such relief is prohibited if the debtor establishes a reasonable likelihood that a plan will be confirmed in a reasonable amount of time, and, *inter alia*, that any act constituting cause, including gross mismanagement, will be cured within a reasonable amount of time fixed by the court. See 11 U.S.C. § 1112(b)(2)(A and B).

30 Section 1129(a)(11) requires a Chapter 11 plan proponent to demonstrate that plan confirmation "is not likely to be followed by the liquidation, or the need for further financial reorganization, of the debtor or any successor to the debtor under the plan, unless such liquidation or reorganization is proposed in the plan." The Chapter 11 plan proponent must "demonstrate that any necessary financing or funding has been obtained, or is likely to be obtained." In re Trans Max Techs., Inc., 349 B.R. 80, 92 (Bankr. D. Nev. 2006). The Bankruptcy Code "...does not require the debtor to prove that success is inevitable, and a relatively low threshold of proof will satisfy § 1129(a)(11)...But the court must still have a reasonable and credible basis for making the necessary findings..." Id. (citations and quotations omitted).

31 See Garvin, 922 F.3d at 1035 ("Because it appears that [debtors' principal] continues to receive rent payments from [the marijuana producer], which provides at least indirect support for the Amended Plan, the [U.S.] Trustee asserts that [the Chapter 11] pan was 'proposed...by...means forbidden by law.' ").

32 A Chapter 11 plan may provide for the liquidation of the assets of the estate, see 11 U.S.C. § 1129(a)(11), but confirmation of a plan does not discharge the debtor if the plan provides for liquidation of all or substantially all property of the estate, the debtor does not engage in business after consummation of the plan, and the debtor would be denied a discharge if the case was a case under Chapter 7. See 11 U.S.C. § 1141(d)(3). A non-individual entity is not eligible for a discharge in Chapter 7. See discussion at 735, infra. A non-individual entity engaged solely in the cultivation, production and distribution of marijuana faces a difficult choice when seeking Chapter 11 relief: if it commits to disposing of its marijuana assets and to not engage in business, it will not receive a Chapter 11 discharge. If such a non-individual entity does not commit to ceasing operations that are in violation of the Controlled Substances Act, however, its Chapter 11 proceeding may well be subject to dismissal based on gross mismanagement established under Section 1112(b)(4)(B). The debtors in Garvin had substantial operations that did not violate the Controlled Substances Act and were able to engage in business even after rejecting the marijuana tenant's lease. Thus, a Chapter 11 discharge was available to the debtors in Garvin and occurred at the time their plan of reorganization was confirmed. See 11 U.S.C. § 1141(d)(1).

33 Section 1325(a)(3) parrots the language in Section 1129(a)(3), and requires the court to find that a proposed Chapter 13 plan "has been proposed in good faith and not by any means forbidden by law." 11 U.S.C. § 1325(a)(3).

34 Oregon law allowed a medical marijuana cultivation operation to be reimbursed for supplies and utility expenditures, but not to obtain a profit from the operation. 453 B.R. at 772-73. Oregon's non-profit requirement for medical marijuana cultivation businesses perhaps reflected a social policy to provide effective alternatives to traditional medicine, e.g., to address the side effects of chemotherapy, as a treatment for chronic pain, etc. A similar non-profit requirement for recreational marijuana presumably would not reflect

a similar social policy any more than a non-profit requirement for the liquor industry. With more states authorizing the cultivation, production and distribution of recreational marijuana products, it is clear that the marijuana industry increasingly is based on profit motivations rather than altruism.

35 Section 1325(a)(6) is the "feasibility" requirement in Chapter 13 that requires the individual debtor to demonstrate that he or she can actually perform the terms of the proposed payment plan. SeeKEITH M. LUNDIN & WILLIAM H. BROWN, CHAPTER 13 BANKRUPTCY, 4TH EDITION, § 198.1, at ¶ [2], Sec. Rev. June 15, 2004, www.Ch13*o*nline.com.

36 Because the debtor did not file an amended Chapter 13 plan, the case was dismissed after the court issued an order to show cause and the debtor filed a motion for voluntary dismissal. (McGinnis ECF No. 62).

37 The debtor confirmed a Chapter 13 plan, but his case ultimately was dismissed when he defaulted on his plan payments. (Johnson ECF No. 87).

38 According to the docket in the Rent-Rite case, approximately two years later (April 17, 2014), the bankruptcy court entered an order dismissing the Chapter 11 proceeding pursuant to a stipulation between the U.S. Trustee and the debtor in possession. (Rent-Rite ECF No. 175).

39 According to the docket in the Arm Ventures case, the debtor filed a proposed amended plan of reorganization (Arm Ventures ECF No. 149), but the plan was never confirmed. Instead, the Chapter 11 proceeding was later dismissed. (Arm Ventures ECF No. 261).

40 The debtors subsequently appealed the bankruptcy court's order, although the district court denied their request for a stay pending appeal. SeeWay to Grow, Inc. v. Inniss (In re Way to Grow, Inc.), 2019 WL 669795 (D. Colo. Jan. 18, 2019).

41 There is disagreement on whether a bankruptcy trustee who merely requests the disposal of marijuana-related assets is acting in violation of the Controlled Substances Act. See Steven J. Boyajian, "*Just Say No to Drugs? Creditors Not Getting a Fair Shake When Marijuana-Related Cases are Dismissed,"* XXXVI ABI Journal 9, 24-25, 74-75, September 2017.

42 Apparently, the authority of a bankruptcy trustee to waive the attorney-client privilege between a corporate debtor and its legal counsel was not raised. See Commodity Futures Trading Comm. v. Weintraub, 471 U.S. 343, 354, 105 S.Ct. 1986, 1994, 85 L.Ed.2d 372 (1985). When the activity of the corporate client is admittedly in violation of federal law, the criminal penalties for which extend to multiple parties and for many years, see discussion at note 14, supra, the potential legal consequences of a waiver may be extraordinary.

43 In Misle, see note 24, supra, an involuntary Chapter 7 case was filed against an individual. The alleged debtor sought dismissal of the case based on his representation that his entire income is derived from marijuana sources authorized under Nevada law, but which are in violation of the Controlled Substances Act. See Order Denying Motion for Dismissal on Involuntary Case, entered January 2, 2019 ("Misle Order"), at 2-3. (Misle ECF No. 57). The alleged debtor conceded, however, that (1) he had a 50% interest in a non-marijuana related entity, though he claimed that his ex-wife had exclusive control over that entity, (2) a Chapter 7 trustee could not legally take control of that entity, and (3) his ex-wife would likely not make any distributions to him. See Misle Order at 2-3 & n.5 and 5 n.11. The alleged debtor further relied on a letter and memo prepared by the Executive Office of the United States Trustee in arguing that trustees should not be put in the position to administer assets that would subject them to potential violations of federal law. Although the bankruptcy court agreed with this premise, the court found it premature to speculate as to the position of the U.S. Trustee, who had not yet entered an appearance. Id. at 4-5. The court further raised the possibility that a trustee might not be violating federal law if the marijuana-related assets were not property of the estate based on a non-marijuana-related, government forfeiture case entitled U.S. v. French, 822 F.Supp.2d 615 (E.D. Va. 2011). Id. at 4. Finally, the court opined that it did not have sufficient evidence from the alleged debtor that he did not have viable non-marijuana related assets that could be used to pay his creditors. For these reasons, the court declined to adopt a per se rule, as the alleged debtor urged, to dismiss the involuntary case based solely on the existence of marijuana-related business operations. Id. at 5-6. The individual alleged debtor appealed

the order denying dismissal of the involuntary case, and the bankruptcy court stayed the involuntary case pending the outcome of the appeal. (Misle ECF No. 104).

44 Proper application of the unclean hands doctrine is designed to preserve public confidence in, as well as the integrity of the court, by preventing it from becoming a participant in inequitable conduct. See Precision Instrument Mfg. Co. v. Automotive Maintenance Machinery Co., 324 U.S. 806, 814-15, 65 S.Ct. 993, 997-98, 89 L.Ed. 1381 (1945); In re Leeds, 589 B.R. 186, 200 (Bankr. D. Nev. 2018).

45 In Misle, the bankruptcy court raised the prospect under U.S. v. French that a debtor's interest in property may not become property of a bankruptcy estate if the property was acquired through an illegal act that would be subject to forfeiture under federal law. In French, creditors filed an involuntary Chapter 7 petition against an individual, and an order for relief was subsequently entered. Months prior to the bankruptcy filing, however, the debtor had pled guilty to wire fraud and money laundering, and the government obtained orders of forfeiture of the debtor's personal property assets that were involved and/or obtained through the commission of those crimes. The Chapter 7 trustee asserted an interest in the forfeited property as a bona fide purchaser under Section 544(a). In entering summary judgment against the trustee, the court recognized that the "relation back" doctrine under 21 U.S.C. § 853(c) "vests all forfeited property in the United States upon the commission of the act giving rise to forfeiture." 822 F.Supp.2d at 619. (Emphasis added). Therefore,

> by operation of the "relation back" doctrine, [the debtor's] forfeited property vested in the United States at the time of his criminal acts, *i.e.* in 2005—six years prior to the creation of the bankruptcy estate. Upon her appointment, the [Chapter 7] Trustee merely stands in the shoes of the debtor as a bona fide purchaser. Because [the debtor] lacked an ownership interest in the forfeited property at the creation of his bankruptcy estate, the Trustee also lacks an ownership interest and thus, lacks standing to challenge the forfeiture order.

Id. at 619. Although it did not rule on the issue, the district court in French acknowledged other caselaw holding that a similar result applies even when the forfeiture order is entered after the creation of the bankruptcy estate.Id. at n.3, citing, e.g., U.S. v. Zaccagnino, 2006 WL 1005042 (C.D. Ill. Apr. 18, 2006).

A more persuasive authority than French, however, is the decision by the bankruptcy appellate panel for the Ninth Circuit in U.S. v. Klein (In re Chapman), 264 B.R. 565 (9th Cir. BAP 2001). In Chapman, the appellate court concluded that a civil forfeiture action for assets used in the manufacture and distribution of marijuana is excepted from the automatic stay under Section 362(b)(4) as an exercise of the police and regulatory power of the federal government. Id. at 570-71. The court acknowledged that a civil forfeiture judgment may have the effect of retroactively eliminating property from the Chapter 7 bankruptcy estate because of the relation-back doctrine. Id. at 572. The appellate court concluded, however, that the federal government could complete its forfeiture action "even if the end result is that the Proceeds [from the sale of the assets] are not property of the estate." Id. (Emphasis added). The resulting uncertainty is that a bankruptcy case might be filed for a marijuana-related entity, but the assets held at the time of the bankruptcy petition might be forfeited in favor of the federal government retroactive to the date of the debtor's violation of the Controlled Substances Act. See generally Craig Peyton Gaumer, *When Two Worlds Collide: The Relationship and Conflicts between Asset Forfeiture and Bankruptcy Law*, 21-May Am.Bankr.Inst.J. 10 (May 2002).

46 Debtor refers to § 542 as the "Rohrbacher-Farr Amendment," see Opposition at 6:5 to 7:8, in arguing that the Justice Department may not expend funds to prosecute marijuana offences under the Controlled Substances Act. Although the Congressional appropriations process was once predictable, including the attachment of riders to spending bills, that may no longer be true.

47 The Yates v. Hartman decision raises a potential issue in any judicial proceeding that involves a party engaged in state-licensed activity: can a state court-appointed receiver, or an assigned bankruptcy trustee, continue to conduct operations of the subject entity without express approval of the licensing authority? In Nevada's long-established gaming industry, a temporary gaming license may be sought from the Nevada Gaming

Commission by a state-court receiver or bankruptcy trustee for continued operation of a casino or other gaming establishment. SeeNev. Gaming Reg. 9.030. The court is not aware of whether similar authority exists for Nevada's fledgling marijuana industry and the State of Nevada has not provided such information in this Chapter 11 proceeding.

48 Congress' efforts to criminalize the cultivation, production and distribution of marijuana, even if such activity occurs solely within the borders of a particular state, does not rule afoul of the U.S. Constitution. See Gonzales v. Raich, 545 U.S. 1, 22, 125 S.Ct. 2195, 2208-09, 162 L.Ed.2d 1 (2005). Under 21 U.S.C. § 811(h)(2), Congress appears to have delegated its authority over the substances included on the Schedules to the Controlled Substances Act to whomever currently serves as the Attorney General of the United States. See Touby v. United States, 500 U.S. 160, 165, 111 S.Ct. 1752, 1756, 114 L.Ed.2d 219 (1991); Washington v. Sessions, 2018 WL 1114758, at *3 (S.D.N.Y. Feb. 26, 2018). Unfortunately, recent occupants of the position have taken widely divergent views on the enforcement of the federal laws, including the Controlled Substances Act, pertaining to marijuana. See generally NLJ Survey, supra, at 115-120. See, e.g., Memorandum to All United States Attorneys, [former] Attorney General Jefferson B. Sessions, January 4, 2018, attached as Exhibit "E" to 4Front Reply ("Given the Department's well-established general principles, previous nationwide guidance specific to marijuana enforcement is unnecessary and is rescinded, effective immediately.")(Emphasis added); Sacramento Nonprofit Collective v. Holder, 552 Fed.Appx. 680, 683 (9th Cir. 2014) ("Appellants claim that the Government is judicially estopped from enforcing the CSA because in a prior lawsuit involving different plaintiffs, the parties entered into a joint stipulation to dismiss the sole remaining claim in that case – that the Tenth Amendment barred federal enforcement of the CSA with respect to medical marijuana use under California law – in light of the Ogden Memorandum. But the Appellants over-read the statements made in both the Ogden Memorandum and during the course of the prior litigation; at no point did the Government promise not to enforce the CSA. Appellants therefore identify no clear inconsistency between the Government's current and prior positions as is required to invoke the doctrine of judicial estoppel.")(Emphasis added).

49 See U.S. v. Lozoya, 920 F.3d 1231, 1242 (9th Cir. 2019) (acknowledging a "creeping absurdity" of the appellate court's holding as to proper venue for prosecution of federal crimes occurring on transcontinental air flights, i.e., in the federal judicial district over which the aircraft was flying when the alleged federal criminal act occurred).

50 Commercial actors who deal with marijuana-related businesses authorized under state law apparently acknowledge the risk that they may be parties to a violation of the Controlled Substances Act. See, e.g., January 9, 2018, $ 3,000,000 Line of Credit Facility, between MI-CW Holdings NV Fund 2 LLC and CWNevada, LLC, at Representations and Warranties, Paragraph 6(d) ("Borrower (i) has all necessary permits, approvals, authorizations, consents, licenses, franchises, registrations and other rights and privileges...to allow it to own and operate its business with any violation of law (excluding the federal Controlled Substances Act and related regulations) or the rights of others; (ii) is duly authorized, qualified and licensed under and in compliance with all applicable laws, regulations, authorizations and orders of public authorities (other than the federal Controlled Substances Act and related regulations);..."). (Emphasis added). (Ex. "5" to Kanitz Declaration).

51 In the Misle involuntary Chapter 7 case, the bankruptcy court expressed a version of this absurdity as follows: "As previously noted, recreational marijuana is legal in Nevada, and trustees in this district have presumably administered cases in which individual debtors possessed and/or used marijuana during the bankruptcy case. In such circumstances, is the court required to dismiss every individual bankruptcy case upon the debtor's admission that he or she possesses and/or uses marijuana for personal use? That is the natural progression of the Alleged Debtor's proposed per se rule and would only serve to invite abuse by opportunistic debtors who could simply use this mandatory 'get out of bankruptcy' card at any time they see fit." Misle Order at 3 n.6. While Misle was an involuntary proceeding filed against an individual, it illustrates the prospect of more voluntary bankruptcy petitions being filed under any chapter by individuals and non-individuals solely

for the purpose of triggering the automatic stay under Section 362(a). See discussion at 724–26, supra. If the disclosure of marijuana-related assets or activities requires a bankruptcy court to dismiss a case after a petition is filed, the debtor may have obtained temporary protection from creditors without any intention of obtaining a bankruptcy discharge of debts. While Congress has provided a partial solution for individuals who repeatedly file consumer bankruptcy petitions, see 11 U.S.C. §§ 362(c)(3) and (c)(4), it has provided no meaningful solution for non-individual debtors that repeatedly file Chapter 11 petitions.

52 See NLJ Survey, supra, at 118 ("Since Nevada legalized recreational marijuana, there have been an estimated $ 126 million in sales and $ 19 million in marijuana excise and wholesale taxes independent of sales tax and state and local licensing fees for marijuana dispensaries. With nearly 300 licensed businesses, the Nevada Dispensary Association estimates that the marijuana industry employs 8,700 people and invested $ 280 million in real estate. Further, the state awaits the funds from the 15 percent excise tax on marijuana sales, approximately $ 40 million, that it has earmarked for public education over the next biennium. Nevada, like other states, awaits the recreational marijuana industry's harvest."). Compare Candace Carlyon, "*We Don't Serve Your Kind Here: Federal Courts and Banks Don't Dance with Mary Jane*," 26 Nevada Lawyer, Issue 2, at 9 (February 2018) [hereafter "Nevada Lawyer"] ("The result of the conflict between state and federal law creates a dangerous situation in which businesses are booming but unable to deposit receipts without disguising the source of their funds. The case nature of the business, without any ability to deposit receipts, places the businesses, their employees and their customers in a dangerous situation. The ripple effect created by these successful businesses is huge. The receipts from marijuana-related businesses are paid over to vendors, landlords, employees and governmental agencies: all of these need to deposit those payments.").

53 As of December 31, 2015, Van Oyen had a twenty percent (20%) ownership interest in the Debtor while Padgett had a sixty percent (60%) ownership interest. See Statement of Equity set forth in 2015 Financial Statement.

54 A marijuana-related business that cultivates, produces and distributes products that are both illegal and legal, with some proceeds subject to forfeiture and other proceeds not, may create the type of "tracing" concern commonly associated with Ponzi schemes. See Cunningham v. Brown, 265 U.S. 1, 11-13, 44 S.Ct. 424, 426-27, 68 L.Ed. 873 (1924). CompareU.S. v. Gettel, 2017 WL 3966635 (S.D. Cal. Sep. 7, 2017)(resolution of competing claims to proceeds of real property that are the subject of government forfeiture). If the proceeds of a marijuana-related business are commingled, what test will be applied to determine which proceeds were subsequently used to acquire additional assets? Which of the subsequently acquired assets are subject to forfeiture and which of them are not? Which assets might be excluded from the bankruptcy estate, and which might not?

55 The difficulties that a marijuana business authorized under state law has in establishing bank accounts is often discussed. See Nevada Lawyer, supra, at 8-9. In this instance, it appears that the Debtor made a portion of its April 23, 2019 tax payment to NDOT using a check. See discussion at note 12, supra. Assuming the item referenced was a typical check from a checking account, rather than a check associated with a credit line, there should be information available as to the banking institution where the Debtor does business. That information does not appear in the record.

56 In its opposition to the Dismissal Motion, Debtor quotes from "Page 199" of the Cannex Notice referring to "banking relationships with 1st Bank of Colorado, Century Bank of Massachusetts, and Bank of Springfield in Illinois." See Opposition at 9:7-10. Unfortunately, there appears to be no part of the Cannex Notice that includes a page 199. More important, even if 4Front has relationships with those financial institutions, none of them appear on the Approved Depository List.

57 During 2015, Debtor paid $ 117,625.00 in legal and professional fees. See 2015 Financial Statement, Statement of Income. The document does not state whether any portion of the fees were paid to Padgett for legal services.

58 The Padgett Claim includes a verification executed under penalty of perjury by general counsel on behalf of Padgett. See Padgett Claim at 3.

59 As late as September 5, 2018, it appears that as the attorney for the Debtor, Padgett prepared his own declaration that was filed in State Court. See 2018 Padgett Declaration at ¶ 1.

60 Given the infighting amongst the Debtor's board of directors, including the alleged "shadow directors," it is not surprising that communications devolved into childishness immediately before the Chapter 11 petition was filed. See Padgett Email ("Since we are coming to the end of this clown convention, I'll tell you, smartest thing Jannotta did was not joining in on this one. I doubt any of you are fit to hold licenses. Heat's about to turn up boys."). Notwithstanding the churlish tone of the email, it is not clear whether it was sent on behalf of the Debtor, as counsel for the Debtor, or, on behalf of the author.

61 That payment was made seven days after the Debtor commenced this Chapter 11 proceeding. If Padgett owns all of the Debtor's money, as he claims, those funds must have been borrowed from Padgett, or was an additional capital contribution, either of which was subject to prior court approval under Section 364(b). If Padgett has only a security interest in the Debtor's assets, then the funds likely constitute "cash collateral" under Section 363(a) that cannot be used without consent or prior court approval under Section 363(c)(2). If other creditors assert a security interest or lien against the same assets, then the funds also cannot be used by the Debtor except with the consent of those creditors or prior court approval. A bankruptcy trustee, of course, can thoroughly investigate these assertions by waiving the attorney-client privilege of a non-individual debtor. See discussion at note 42, supra.

62 If there are 8,700 residents of Nevada employed by the marijuana industry, see discussion at note 52, supra, then the impact of automatically denying a bankruptcy fresh start to those residents and their dependents would be unconscionable.

End of Document

610 B.R. 338
United States District Court, D. Colorado.

IN RE: WAY TO GROW, INC., Pure Agrobusiness, Inc., Green Door Agro, Inc., Debtors.
Way to Grow, Inc., et al., Appellants,
v.
Corey Inniss, Appellee.

Civil Action No. 18-cv-3245-WJM
|
Bankruptcy Case Nos. 18-14330-MER, 18-14333-MER, and 18-14334-MER
|
Signed 09/18/2019

Synopsis

Background: Secured creditor who was former owner of debtors' business moved to dismiss their jointly administered Chapter 11 cases "for cause" based on illegality, under federal law, of some of debtors' business activity, which involved selling equipment and supplies to persons and entities growing marijuana. The Bankruptcy Court, Michael E. Romero, Chief Judge, 597 B.R. 111, granted motion. Debtors appealed, and their motion for stay pending appeal was denied, 2018 WL 7352930, 2019 WL 669795.

Holdings: The District Court, William J. Martinez, J., held that:

[1] dismissal for "cause" is appropriate when the Chapter 11 debtor runs a business dedicated to servicing the marijuana industry in violation of federal law;

[2] the federal statute which criminalizes selling goods with knowledge that they will be used to manufacture controlled substances is not void for vagueness;

[3] the bankruptcy court did not clearly err in finding that debtor whose business consisted of California-based marijuana-related operations knew that it was selling products that would be used to manufacture a controlled substance, in violation of federal statute;

[4] the bankruptcy court did not clearly err in finding that debtor which was a holding company that owned the other two debtors aided and abetted its subsidiaries' violations of federal law; and

[5] the bankruptcy court did not clearly err in applying to all three debtors its finding that, without revenue from marijuana-related customers, debtors lacked the ability to reorganize.

Affirmed.

Procedural Posture(s): On Appeal; Motion to Convert or Dismiss Case.

West Headnotes (17)

[1] **Bankruptcy** Conclusions of law; de novo review

Bankruptcy Clear error

In reviewing a bankruptcy court's decision, the district court normally functions as an appellate court, reviewing the bankruptcy court's legal conclusions de novo and its factual findings for clear error. 28 U.S.C.A. § 158(a).

[2] **Controlled Substances** Substances regulated; definitions and schedules

Under the Controlled Substances Act, marijuana is a Schedule I controlled substance. Comprehensive Drug Abuse Prevention and Control Act of 1970 § 202, 21 U.S.C.A. § 812.

1 Cases that cite this headnote

[3] **Criminal Law** Aiding, abetting, or other participation in offense

A party may be liable for aiding and abetting any federal crime. 18 U.S.C.A. § 2(a).

[4] **Criminal Law** Aiding, abetting, or other participation in offense

Aiding and abetting a federal crime requires proof that (1) someone else committed the

underlying crime, and (2) the alleged aider/abettor willfully associated himself with the criminal venture and sought to make the venture succeed through some action of his own. 18 U.S.C.A. § 2(a).

[5] **Bankruptcy** Dismissal or suspension

"Cause" exists to dismiss a Chapter 11 case when the debtor runs a business dedicated to servicing the marijuana industry in violation of federal law; marijuana is a Schedule I controlled substance, and although the Bankruptcy Code nowhere explicitly says that one of its purposes is to avoid facilitating commission of a federal crime, the Code is not blind to criminal behavior, it is inconceivable that Congress could have ever intended that federal judicial officials could, in the course of adjudicating disputes under the Code, approve a reorganization plan that relies on violations of federal criminal law, and so a debtor cannot propose a good-faith reorganization plan that relies on knowingly profiting from the marijuana industry. 11 U.S.C.A. §§ 1112(b)(1), 1129(a)(3); Comprehensive Drug Abuse Prevention and Control Act of 1970 §§ 202, 403, 21 U.S.C.A. §§ 812, 843(a)(7).

[6] **Bankruptcy** Construction and Operation

When used in the Bankruptcy Code, the words "includes" and "including" are not limiting. 11 U.S.C.A. § 102(3).

[7] **Bankruptcy** In General; Grounds in General

Congress's list of circumstances that count as "cause" to dismiss a Chapter 11 proceeding is not exclusive. 11 U.S.C.A. §§ 1112(b), 1112(b)(4).

[8] **Bankruptcy** Good faith and legality

Test of good faith, for confirmation purposes, focuses on whether a Chapter 11 plan is likely to achieve its goals and whether those goals are consistent with the Bankruptcy Code's purposes. 11 U.S.C.A. § 1129(a)(3).

[9] **Bankruptcy** Want or inadequacy of plan

Chapter 11 debtor's inability to propose a good-faith reorganization plan provides cause to dismiss debtor's case. 11 U.S.C.A. §§ 1112(b)(1), 1129(a)(3).

[10] **Constitutional Law** Drugs; controlled substances

Controlled Substances Validity

Federal statute which criminalizes selling goods with knowledge that they will be used to manufacture controlled substances is not void for vagueness in violation of due process; although statute mentions specific and unique items, it also encompasses "any equipment, chemical, product, or material which may be used to manufacture a controlled substance or listed chemical, knowing, intending, or having reasonable cause to believe, that it will be used to manufacture a controlled substance or listed chemical," which fairly provides notice to the ordinary person, and to the extent "reasonable cause to believe" might pose a problem, the "akin to actual knowledge" gloss given the language by controlling precedent overcame it. U.S. Const. Amend. 5; Comprehensive Drug Abuse Prevention and Control Act of 1970 § 403, 21 U.S.C.A. § 843(a)(7).

[11] **Bankruptcy** Dismissal or suspension

In determining, on motion to dismiss cases "for cause," whether business model and profitability of Chapter 11 debtors, which were involved in selling equipment and supplies to persons and entities growing marijuana, relied on actions that could be prosecuted as a violation of the federal statute criminalizing the selling

of goods with knowledge that they will be used to manufacture controlled substances, the bankruptcy court, unlike a prosecutor, needed no evidence of specific criminal transactions to sustain its findings; the court's inquiry was properly prospective, not retrospective. 11 U.S.C.A. § 1112(b)(1); Comprehensive Drug Abuse Prevention and Control Act of 1970 § 403, 21 U.S.C.A. § 843(a)(7).

[12] **Bankruptcy** Scope of review in general

District court may affirm the bankruptcy court on any basis supported by the record.

[13] **Bankruptcy** Proceedings

Bankruptcy court's finding, on motion to dismiss Chapter 11 debtors' cases "for cause," that particular debtor knew that it was selling products that would be used to manufacture a controlled substance, in violation of federal statute criminalizing such conduct, was supported by testimony of debtors' former owner that debtor in question, which was described as having "California marijuana-related operations," was operating the same type of business as second, Colorado-based debtor, and by debtors' concession that this debtor "operated in a similar manner" as second debtor, which concededly had at least "reasonable cause to believe" that the equipment it sold to at least some of its customers would be used to manufacture marijuana. 11 U.S.C.A. § 1112(b)(1); Comprehensive Drug Abuse Prevention and Control Act of 1970 § 403, 21 U.S.C.A. § 843(a)(7).

[14] **Bankruptcy** Proceedings

Bankruptcy court's finding, on motion to dismiss Chapter 11 debtors' cases "for cause," that debtor, a holding company that owned the other two debtors, aided and abetted its subsidiaries' violations of the federal statute criminalizing the selling of goods with knowledge that they will be used to manufacture controlled substances, was supported by evidence that, even though debtor itself sold nothing, debtor acquired one subsidiary to increase debtor's dominance in the cannabis industry, that debtor's website approvingly quoted another entity's characterization of the acquisition as resulting in debtor becoming "the leading one-stop solution for indoor plant, produce and cannabis growers in Colorado and California," and that debtor's founder knew that certain dispensaries and cannabis growers were customers of its subsidiaries. 11 U.S.C.A. § 1112(b)(1); 18 U.S.C.A. § 2(a); Comprehensive Drug Abuse Prevention and Control Act of 1970 § 403, 21 U.S.C.A. § 843(a)(7).

[15] **Criminal Law** Aiding, abetting, or other participation in offense

Liability under the federal aiding and abetting statute requires, first, an underlying crime and, second, willfully associating oneself with the criminal venture and seeking to make the venture succeed through some action of one's own. 18 U.S.C.A. § 2(a).

[16] **Bankruptcy** Dismissal or suspension

On motion to dismiss Chapter 11 debtors' cases "for cause" based on the illegality, under federal law, of some of debtors' business activity, which involved selling equipment and supplies to persons and entities growing marijuana, the bankruptcy court did not clearly err in applying to all three debtors its finding that, without revenue from marijuana-related customers, debtors lacked the ability to reorganize; although one debtor was a holding company and the court relied mostly on evidence from one subsidiary's managers, the evidence as a whole showed that all debtors developed their business specifically to service marijuana growers and that a substantial percentage of customers were marijuana cultivators. 11 U.S.C.A. § 1112(b)(1); 18 U.S.C.A. § 2(a); Comprehensive Drug

Abuse Prevention and Control Act of 1970 § 403, 21 U.S.C.A. § 843(a)(7).

[17] **Bankruptcy** Proceedings

In dismissing Chapter 11 debtors' cases "for cause," the bankruptcy court did not err, much less clearly err, by failing to address an argument which was never presented to it and could not have been a potential basis for relief until after the court issued its decision. 11 U.S.C.A. § 1112(b)(1).

Attorneys and Law Firms

***341** Keri Lynn Riley, Lee Moss Kutner, Kutner Brinen, P.C., Denver, CO, for Appellants.

Annette Wanlass Jarvis, Dorsey & Whitney, LLP-Salt Lake City, Salt Lake City, UT, Gregory Scot Tamkin, Andrea Ahn Wechter Dorsey & Whitney, LLP, Denver, CO, for Appellee.

ORDER AFFIRMING DECISION OF BANKRUPTCY COURT

William J. Martinez, United States District Judge

Way to Grow, Inc. ("Way to Grow"), Pure Agrobusiness, Inc. ("Pure Agro"), and Green Door Agro, Inc. ("Green Door") (together, "Debtors"), appeal the bankruptcy court's decision to dismiss their Chapter 11 petitions "for cause" given that Debtors' business relies on selling equipment and supplies to persons and entities growing marijuana, and Debtors know that the equipment and supplies will be used to grow marijuana. Such conduct is legal under the laws of Colorado and California, where Debtors operate, but remains illegal under federal law.

For the reasons explained below, this Court affirms the bankruptcy court as to Way to Grow and Green Door for the reasons explained by the bankruptcy court. As to Pure Agro, the Court also affirms, but for a slightly different reason evident in the record.

I. STANDARD OF REVIEW

[1] In reviewing a bankruptcy court's decision, the district court normally functions as an appellate court, reviewing the bankruptcy court's legal conclusions *de novo* and its factual findings for clear error. 28 U.S.C. § 158(a); *In re Warren*, 512 F.3d 1241, 1248 (10th Cir. 2008).

II. BACKGROUND [1]

A. Origins of the Dispute

Appellee Corey Inniss ("Inniss") founded Way to Grow in Fort Collins in 2002 and eventually opened six more retail stores throughout Colorado. *In re Way to Grow, Inc.*, 597 B.R. 111, 115 (Bnkr. D. Colo. 2018). In Debtors' words, Way to Grow's business model was "to market its stores as garden centers and carry high-end soil, nutrients, lights, and equipment to grow plants in both an indoor and outdoor setting." (ECF No. 27 at 7.)

***342** In 2014, a man named Richard Byrd (not a party here) founded and became CEO of Pure Agro, which operates as a holding company. (*Id.* at 8.) In 2015, Pure Agro "acquired [Green Door], a Los Angeles-based hydroponic and gardening retail store." (*Id.*)

In January 2016, Inniss sold Way to Grow to Pure Agro for $25 million, with $2.5 million paid upfront and the remaining $22.5 million coming by way of a promissory note in Inniss's favor, secured by each Debtor's property (then-existing and after-acquired), accounts receivable, and inventory. *Id.* Inniss also received 12,500 shares of Pure Agro's common stock, amounting to a little more than 21% of Pure Agro's outstanding shares. *Id.*

Way to Grow's "operations ... remained largely unchanged" after Pure Agro's acquisition, "continu[ing] to market and sell high-end nutrients, soil, and equipment for growing plants in a soil-based or water-based medium." (*Id.* at 10.) Green Door "operated in a similar manner, selling similar products and gardening supplies in a retail setting." (*Id.*)

Sometime in 2017, Debtors defaulted on the promissory note. (*Id.* at 10–11.) Debtors blame Inniss (who continued as a consultant) and his ex-father-in-law (who became CEO of Pure Agro) for this default, accusing them of "inappropriate

activities designed to strip the future cash flow away from [Way to Grow] and into their own pockets." (*Id.*) In any event, in April 2018, Inniss filed a lawsuit in Larimer County (Colorado) District Court on his own behalf, and derivatively on behalf of Pure Agro, to appoint a receiver over Debtors. *Way to Grow*, 597 B.R. at 115.

B. Bankruptcy Proceedings

Before the state court could rule on Inniss's request for a receiver, each Debtor filed a Chapter 11 bankruptcy petition, and the three petitions were jointly administered. *See Id.* at 114. Debtors soon moved the bankruptcy court for permission to spend cash collateral to meet ongoing business expenses, representing that they "generally sell equipment for indoor hydroponic gardening and related supplies.... While the hydroponic gardening equipment may [be] and is used for many types of crops, the Debtors' future business expansion plan is tied to the growing cannabis industry which is heavily reliant on hydroponic gardening." (ECF No. 23-1 at 53.) But Debtors were quick to add, somewhat inconsistently, that they "do not own or do business with cannabis." (*Id.*)

The bankruptcy court did not rule on this motion before Inniss, appearing as a secured creditor, filed a motion asking the bankruptcy court to abstain in favor of the Larimer County receivership action, or to dismiss the petitions altogether. (ECF No. 27-1 at 32.) Regarding dismissal, Inniss argued, among other things, that the bankruptcy court should dismiss Debtors' petitions "for cause" under 11 U.S.C. § 1112(b) (discussed in detail below in Part III.A) because there was

> no possibility of reorganization within a reasonable time as proceeds from the sale of the Debtors' products come from cannabis companies who violate federal law....
>
> * * *
>
> The Debtors' businesses are not the kind that can meet 11 U.S.C. § 1129(a)(3)'s good faith requirement [also discussed Part III.A] for confirming a plan because their sale of supplies and equipment to cannabis growers taints revenue and places assets at risk of forfeiture and seizure under federal law.

(ECF No. 27-1 at 56, 58.) Through later briefing, it became clear that the criminal ***343** prohibition Inniss believed Debtors were violating was the federal aiding and abetting statute, 18 U.S.C. § 2—more specifically, that Debtors were aiding and abetting the growing of marijuana, which is prohibited under the Controlled Substances Act (sometimes referred to in the record as the "CSA"). (ECF No. 27-1 at 287–94.)

The bankruptcy court eventually held a four-day evidentiary hearing on these allegations. *See Way to Grow*, 597 B.R. at 114. It rejected the argument that Debtors could be found guilty of aiding and abetting a Controlled Substances Act violation. *Id.* at 123–27. The court reasoned that the evidence did not show the proper *mens rea*, namely, "shar[ing] the same intent as their customers to violate the CSA and willfully associat[ing] themselves with their customers' criminal ventures." *Id.* at 126. But the bankruptcy court went on to examine whether Debtors could be found guilty of violating 21 U.S.C. § 843(a)(7). *See Id.* at 127–32. As described in more detail below, this statute criminalizes selling goods with knowledge that they will be used to manufacture controlled substances.

No party had raised § 843(a)(7) as a potential basis for criminal liability. Regardless, the bankruptcy court found "ample evidence" that Debtors—referred to collectively—knew they were selling products that their customers would use to grow marijuana, which would be a violation of the statute. *Id.* at 129. Accordingly, the court agreed with Inniss that cause existed to dismiss Debtors' bankruptcy proceedings.

The bankruptcy court then asked whether Debtors could change their business model "to sever all ties to their marijuana customers," and thereby avoid dismissal. *Id.* at 132. The court found that sales to marijuana growers were such an important part of Debtors' business that it was "inconceivable" Debtors could "still operate profitably" without selling to those customers. *Id.* Thus, "[t]o prevent this Court from violating its oath to uphold federal law, under the specific facts of this case, the Court sees no practical alternative to dismissal." *Id.*

Finally, the bankruptcy court concluded by showing its full understanding of the real-world consequences of its ruling:

> 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. As stated, even following those courts which have crafted alternatives to dismissal when debtors were violating the CSA would produce no practical or efficient alternative to dismissal in this case. At bottom, if the result in this case is unjust, Congress alone has power to legislate a solution.
>
> Ironically, if Inniss, as the party arguing Debtors are violating federal law, wrests control of the Debtors back from Byrd in the [Larimer County lawsuit], he will almost certainly continue, and perhaps expand, the Debtors' ongoing marijuana-related operations. This irony is not lost on the Court but provides no legal basis for an alternate outcome. The Court casts no aspersions upon the Debtors or their businesses. The result in this case is dictated by federal law, which this Court is bound to enforce.

Id. at 133.

C. Motion to Stay Pending Appeal

Debtors immediately appealed to this Court and moved to stay the bankruptcy ***344** court's judgment pending appeal. (ECF No. 9.) Among Debtors' arguments was that the bankruptcy court improperly imputed the activities of Way to Grow to the other two Debtors, which was particularly problematic as to Pure Agro because it is a holding company that does not sell anything, so it arguably could not violate § 843(a)(7). (*Id.* ¶¶ 19–21.)

The Court denied the motion to stay pending appeal, for various reasons. (ECF No. 20.) As to Debtors' argument that the bankruptcy court erred by not distinguishing between Debtors for purposes of § 843(a)(7), the Court held that Debtors were not likely to succeed on the merits of this argument because nothing in the record showed that they argued to the bankruptcy court that the evidence was insufficient as to any particular one of them. (*Id.* at 6–7.) Moreover, Debtors had not argued that the bankruptcy court's alleged error could be reviewed under the plain error doctrine. (*Id.* at 7.)

The parties then proceeded to merits briefing, and the dispute is now ripe for a final disposition.

III. ANALYSIS

As aptly stated by the bankruptcy court, there are many potential disputes here, but "the main event" in this lawsuit is threefold: (i) "Debtors' connections to the marijuana industry," (ii) whether "those connections constitute continuing violations of federal law," and (iii) whether that restricts a bankruptcy court's ability to provide relief to Debtors under the Bankruptcy Code. *Way to Grow*, 597 B.R. at 116. The Court will first address the broader questions about the availability of bankruptcy protection to businesses that depend on the marijuana industry, and then address whether Debtors run such businesses.

A. Bankruptcy Courts' Authority to Dismiss a Chapter 11 Proceeding Where the Debtor's Business Violates Federal Law

1. Federal Crimes Related to Marijuana

[2] The Controlled Substances Act, 21 U.S.C. §§ 101 *et seq.*, declares marijuana to be a Schedule I controlled substance. *See* 21 U.S.C. § 812, Schedule I(c)(10). It is a federal crime "to manufacture, distribute, or dispense, or possess with intent to manufacture, distribute, or dispense, a controlled substance." *Id.* § 841(a)(1). It is also a federal crime "to manufacture, distribute, export, or import ... any equipment, chemical, product, or material which may be used to manufacture a controlled substance or listed chemical, knowing, intending, or having reasonable cause to believe, that it will be used to manufacture a controlled substance." *Id.* § 843(a)(7).

[3] **[4]** Finally, a party can be liable for aiding and abetting any federal crime. *See* 18 U.S.C. § 2(a) ("Whoever commits an offense against the United States or aids, abets, counsels, commands, induces or procures its commission, is punishable as a principal."). Aiding and abetting requires proof that (i) someone else committed the underlying crime and (ii) the alleged aider/abettor "willfully associate[d] himself with the criminal venture and [sought] to make the venture succeed through some action of his own." *United States v. Leos-Quijada*, 107 F.3d 786, 794 (10th Cir. 1997); *see also* Tenth Circuit Criminal Pattern Jury Instructions § 2.06 (2011 ed., Feb. 2018 update), *available at* https://www.ca10.uscourts.gov/sites/default/files/clerk/Jury% 20Instructions% 20Update %202018.pdf (last accessed Sept. 16, 2019).

2. Dismissal for Cause (11 U.S.C. § 1112(b))

Based on the evidence developed through the evidentiary hearing, the ***345** bankruptcy court concluded that most of Debtors' business comprised, and would continue to comprise, selling supplies to marijuana growers while knowing that the supplies would be used to grow marijuana. In other words, the bankruptcy court found that the Debtors' primary business was a violation of 21 U.S.C. § 843(a)(7).

In this light, the bankruptcy court held that there was "cause to dismiss this bankruptcy case under 11 U.S.C. § 1112(b)." *Way to Grow*, 597 B.R. at 132. In relevant part, the statute cited by the bankruptcy court reads as follows:

> [O]n request of a party in interest, and after notice and a hearing, 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, for cause unless the court determines that the appointment under section 1104(a) of a trustee or an examiner is in the best interests of creditors and the estate.

11 U.S.C. § 1112(b)(1).[2]

[5] The first question, then, is whether "cause" exists under this statute when the debtor runs a business dedicated to servicing the marijuana industry. If the answer is "no," the Court need not address Debtors' arguments about the application of this principle to them under the facts of this case. For the reasons explained below, however, the Court finds that the answer is "yes."

[6] **[7]** Congress provided a list of circumstances that count as "cause" to dismiss a Chapter 11 proceeding. *See Id.* § 1112(b)(4). It says nothing about reorganization plans that rely on violations of federal law. However, Congress prefaced this list as follows: "For purposes of [§ 1112(b)], the term 'cause' includes ...." *Id.* The words " 'includes' and 'including' are not limiting" when used in the Bankruptcy Code. *Id.* § 102(3). Therefore, Congress's list is not exclusive, as further confirmed by legislative history: "The list [in § 1112(b)(4)] is not exhaustive. The court will be able to consider other factors as they arise, and to use its equitable powers to reach an appropriate result in individual cases." H.R. Rep. 95-595, 406, 1978 U.S.C.C.A.N. 5963, 6362.

In an oft-cited decision on bankruptcy law as it relates to marijuana-based businesses, Judge Howard R. Tallman of the United States Bankruptcy Court for the District of Colorado held that a marijuana-based business intending to continue to operate as such cannot propose a Chapter 11 reorganization plan in good faith—and, in turn, the inability to propose a reorganization plan in good faith is "cause" to dismiss a Chapter 11 proceeding. *See In re Rent-Rite Super Kegs W. Ltd.*, 484 B.R. 799, 809 (Bankr. D. Colo. 2012). This Court agrees.

[8] The relevant statute is 11 U.S.C. § 1129(a)(3), which reads in relevant part, "The court shall confirm a plan only if * * * [t]he plan has been proposed in good faith." "[T]he test of good faith under § 1129(a)(3) focuses on whether a plan is likely to achieve its goals and whether those goals are consistent with the [Bankruptcy] Code's purposes." *In re Paige*, 685 F.3d 1160, 1179 (10th Cir. 2012).

The Bankruptcy Code nowhere explicitly says that one of its purposes is to avoid ***346** facilitating commission of a federal crime. One could therefore take a narrow view and conclude that the Bankruptcy Code is blind to the lawfulness of the debtor's activities under a reorganization plan. However, the Tenth Circuit has "not rule[d] out the possibility that a plan could be unconfirmable under § 1129(a)(3) because of the proponent's ... improper conduct." *Id.* Moreover, the Bankruptcy Code *does* provide that the automatic stay does not extend to "proceeding[s] by a governmental unit ... to enforce such governmental unit's ... police and regulatory power," 11 U.S.C. § 362(b)(4), and that a bankruptcy discharge cannot extend to "a fine, penalty, or forfeiture payable to and for the benefit of a governmental unit, and is not compensation for actual pecuniary loss," *Id.* § 523(a)(7). In other words, the Code is not blind to criminal behavior. Finally, it is frankly inconceivable that Congress could have ever intended that federal judicial officials could, in the course of adjudicating disputes under the Bankruptcy

Code, approve a reorganization plan that relies on violations of federal criminal law.

[9] For all these reasons, the Court holds that, as long as marijuana remains a Schedule I controlled substance, a Chapter 11 debtor cannot propose a good-faith reorganization plan that relies on knowingly profiting from the marijuana industry. And, in turn, inability to propose a good-faith reorganization plan is cause for dismissal under 11 U.S.C. § 1112(b)(1). [3]

3. A Clarification Regarding § 1129(a)(3)

For clarity, the Court notes the following about the requirement that a reorganization plan be proposed in good faith. Section 1129(a)(3) states that "[t]he court shall confirm a plan only if * * * [t]he plan has been proposed in good faith," but then goes on to add "and not by any means forbidden by law." Judge Tallman's decision in *Rent-Rite* (*i.e.*, that an inability to satisfy § 1129(a)(3) is cause for dismissal under § 1112(b)(1)) has recently been criticized by the Ninth Circuit in *Garvin v. Cook Investments NW, SPNWY, LLC*, 922 F.3d 1031, 1035 (9th Cir. 2019), based on —as it turns out—a mistaken perception that Judge Tallman was relying on the "means forbidden by law" clause, not the "good faith" clause.

In *Garvin*, the bankruptcy court, over the trustee's objection, confirmed a reorganization plan that included a continuing lease to an entity growing marijuana. *Id.* at 1033–34. The trustee argued that the reorganization plan contained a "means forbidden by law," as proscribed by § 1129(a)(3), but the Ninth Circuit said that the trustee was misreading the statute ***347** because it forbids only a "plan ... proposed ... by any means forbidden by law." *Id.* at 1035. In other words, the Ninth Circuit emphasized that the statute focuses on the means of proposing the plan, not on the means of carrying it out.

Having held as much, *Garvin* then characterized *Rent-Rite* as a decision that misreads the "means forbidden by law" clause, *see id.*, but *Garvin* itself misunderstood *Rent-Rite*. The entire relevant passage from *Rent-Rite* shows that Judge Tallman was not interpreting on the "means forbidden by law" clause, but only the "good faith" clause:

> Title 11 U.S.C. § 1129(a)(3) provides that a plan may only be confirmed if it is "proposed in good faith and not by any means forbidden by law." Because a significant portion of the Debtor's income is derived from an illegal activity, § 1129(a)(3) forecloses any possibility of this Debtor obtaining confirmation of a plan that relies in any part on income derived from a criminal activity. This Debtor has no reasonable prospect of getting its plan confirmed. *Even if § 1129 contained no such **good faith** requirement*, under no circumstance can the Court place itself in the position of condoning the Debtor's criminal activity by allowing it to utilize the shelter of the Bankruptcy Code while continuing its unlawful practice of leasing space to those who are engaged in the business of cultivating a Schedule I controlled substance.

484 B.R. at 809 (footnote omitted; emphasis added).

Likewise, this Court grounds its holding in § 1129(a)(3)'s requirement that a Chapter 11 plan is unconfirmable unless "proposed in good faith." This is what Inniss argued below. (ECF No. 27-1 at 58.) The Court need not and does not opine on what it means for a plan to be "proposed ... not by any means forbidden by law."

4. "Shock[ing to] the General Moral or Common Sense"

Debtors argue that interpreting 21 U.S.C. § 843(a)(7) to be a basis for lack of good faith under 11. U.S.C. § 1129(a)(3) "causes results that are 'so gross as to shock the general moral or common sense.' " (ECF No. 27 at 24 (citing *Crooks v. Harrelson*, 28[2] U.S. 55, 60, 51 S.Ct. 49, 75 L.Ed. 156 (1930)).) Debtors' citation to *Crooks* is instructive but ultimately inapt.

The defendant in *Crooks* sought to avoid the application of a tax statute. 282 U.S. at 57–58, 51 S.Ct. 49. The Supreme Court said that "[t]he meaning of the provision in question, considered by itself, does not seem to us to be doubtful." *Id.* at 58, 51 S.Ct. 49. The defendant nonetheless argued that "the literal meaning of the statute ... should be rejected as leading to absurd results, and a construction adopted in harmony with what is thought to be the spirit and purpose

of the act in order to give effect to the intent of Congress." *Id.* at 59, 51 S.Ct. 49. The defendant cited a case in which the Supreme Court appeared to have taken such an approach, and, in that context, the Supreme Court in *Crooks* said the following:

> [A] consideration of [the prior case] will disclose that the principle is to be applied to override the literal terms of a statute only under rare and exceptional circumstances. The illustrative cases cited in [the prior case] demonstrate that, to justify a departure from the letter of the law upon that ground, the absurdity must be so gross as to shock the general moral or common sense. And there must be something to make plain the intent of Congress ***348** that the letter of the statute is not to prevail.

Id. at 60, 51 S.Ct. 49 (citation omitted).

Following *Crooks*, then, the question is, first, whether 21 U.S.C. § 843(a)(7), as applied to businesses such as Debtors', leads to an "absurdity ... so gross as to shock the general moral or common sense"; and second, whether there is "plain" evidence of "the intent of Congress that the letter of the statute is not to prevail." For context, the full text of § 843(a)(7) is as follows:

> It shall be unlawful for any person knowingly or intentionally * * * to manufacture, distribute, export, or import any three-neck round-bottom flask, tableting machine, encapsulating machine, or gelatin capsule, or any equipment, chemical, product, or material which may be used to manufacture a controlled substance or listed chemical, knowing, intending, or having reasonable cause to believe, that it will be used to manufacture a controlled substance or listed chemical in violation of this subchapter or subchapter II or, in the case of an exportation, in violation of this subchapter or subchapter II or of the laws of the country to which it is exported[.]

Turning to the first *Crooks* inquiry—shockingly gross absurdity—Debtors note that the bankruptcy court "did not point to any specific transaction in which [they] sold equipment to a customer." (ECF No. 27 at 25.) Debtors seem to be saying § 843(a)(7) must be construed to require proof that the person who bought, *e.g.*, hydroponic equipment, used it to grow marijuana. Without such a requirement, Debtors say,

> section 843(a)(7) could serve to turn any business into a criminal with a single transaction. If an individual walked into a Home Depot and the cashier had reasonable cause to believe the shovel would be used in a marijuana growing operation based on statements by the customer, by virtue of selling that individual a shovel, the Home Depot will have committed a criminal act. The cashier, acting as an agent of the store, knew that he was distributing a shovel to the marijuana grower, and sold the shovel having reasonable cause to believe that it would be used grow marijuana. The Home Depot would not even need to know the customer's name, nor whether the shovel was actually used to grow marijuana.

(*Id.* at 26.)

It would be an absurd use of prosecutorial discretion to charge The Home Depot with a crime based on this fact pattern, but such fact patterns can be imagined under many criminal statutes. The ability to imagine that a prosecutor with poor judgment might institute an absurd prosecution is not a basis to declare that the statute's plain language must be disregarded. The bankruptcy court had before it evidence that Debtors derive from 65% to 95% of their business from marijuana growers. (*See* Parts III.B & III.C, below.) Notably, Debtors do *not* argue that it would be absurd to prosecute a business if it *knows* that 65% to 95% of its sales will go toward manufacturing a controlled substance.

As for the second *Crooks* inquiry—evidence of Congress's obviously contrary intent—Debtors offer nothing. However, in a separate context that the Court will address below (Part III.A.5), Debtors argue that the statute's specific mention of equipment such as a three-neck round-bottom flask, and its use of verbs such as "distribute" and "manufacture," "denote[ ] Congress'[s] intent to target persons selling equipment, materials, and listed chemicals ***349** to methamphetamine manufacturers." (*Id.* at 28.) Debtors say this is "supported by the legislative history," but they cite none. (*Id.*) In any event, to the extent this can be construed as a *Crooks* argument, the alleged focus on methamphetamine is not "something to make plain the intent of Congress that the letter of the statute is not to prevail." 282 U.S. at 60, 51 S.Ct. 49.

Finally, the *mens rea* of § 843(a)(7) is "knowing, intending, or having reasonable cause to believe, that [the equipment, chemical, product, or material in question] will be used to manufacture a controlled substance." The Tenth Circuit has construed identical language in the statute's immediately preceding paragraph, 21 U.S.C. § 843(a)(6), which makes it a crime

> to possess any three-neck round-bottom flask, tableting machine, encapsulating machine, or gelatin capsule, or any equipment, chemical, product, or material which may be used to manufacture a controlled substance or listed chemical, knowing, intending, or having reasonable cause to believe, that it will be used to manufacture a controlled substance or listed chemical in violation of this subchapter or subchapter II.

In that context, the Tenth Circuit held that all three mental states—knowing, intending, or having reasonable cause to believe—are subjective, with "reasonable cause to believe" meaning something "akin to actual knowledge." *United States v. Truong*, 425 F.3d 1282, 1289 (10th Cir. 2005) (internal quotation marks omitted).

As the bankruptcy court recognized, there is no reason to believe that the Tenth Circuit's interpretation of § 843(a)(6) would not also apply to § 843(a)(7). *See Way to Grow*, 597 B.R. at 127 & n.137. In this light, the Court finds nothing "shock[ing to] the general moral or common sense," *Crooks*, 282 U.S. at 60, 51 S.Ct. 49, that an individual or business could be prosecuted for selling an item, knowing it will be used to commit a criminal act—whether or not the criminal act happened.

The lack of "moral shock" is fairly obvious in other contexts. For example, it is

> unlawful for any person to sell or otherwise dispose of any firearm or ammunition to any person knowing or having reasonable cause to believe that such person * * * is subject to a court order that restrains such person from harassing, stalking, or threatening an intimate partner of such person or child of such intimate partner or person, or engaging in other conduct that would place an intimate partner in reasonable fear of bodily injury to the partner or child.

18 U.S.C. § 922(d)(8). The legitimate interest in prohibiting (and therefore dissuading) the mere sale or transfer of firearms in such circumstances is beyond question, without any need to wait and see if the firearm gets used.

The difference in this case, of course, is that a majority of voters in Colorado (and several other states) have decided that one among many Schedule I controlled substances—marijuana—poses no threat worthy of criminal prohibition. Reasonable minds may differ on that question, but the fact that the federal government can enforce the Controlled Substances Act in a manner that many Coloradans would disagree with does not "shock the general moral or common sense." *Crooks*, 282 U.S. at 60, 51 S.Ct. 49.

5. Vagueness

[10] Debtors further argue that "[s]ection 843(a)(7) is so vague as to fail to put a person of ordinary intelligence on notice that his otherwise lawful conduct, such as ***350** selling gardening supplies, is illegal." (ECF No. 27 at 28.) *See also* *Johnson v. United States*, —— U.S. ——, 135 S. Ct. 2551, 2556, 192 L.Ed.2d 569 (2015) ("Our cases establish that the Government violates [the Fifth Amendment due process clause] by taking away someone's life, liberty, or property under a criminal law so vague that it fails to give ordinary people fair notice of the conduct it punishes ...."). In this context, Debtors note that some of the statute's language appears directed at methamphetamine manufacture. (ECF No. 27 at 28.)[4]

The Court disagrees that § 843(a)(7) is void for vagueness. Its language indeed mentions specific and unique items, but it also encompasses "*any* equipment, chemical, product, or material which may be used to manufacture a controlled substance or listed chemical, knowing, intending, or having reasonable cause to believe, that it will be used to manufacture a controlled substance or listed chemical" (emphasis added). This fairly provides notice to the ordinary person. To the extent "reasonable cause to believe" might pose a problem (and the Court expresses no opinion about that), the Tenth Circuit's "akin to actual knowledge" gloss overcomes it. *Truong*, 425 F.3d at 1289. Accordingly, Debtors' vagueness argument fails.

6. Proof of Specific Transactions

Finally, Debtors argue that a § 843(a)(7) violation can only be proven through "evidence of specific transactions" in which the defendant knew that the item being sold would be used to manufacture a controlled substance. (ECF No. 27 at 29–36.) The bankruptcy court cited no such evidence, but this Court disagrees with Debtors that such evidence was required under the circumstances.

[11] The question before the bankruptcy court was whether Debtors' business model and profitability relied on actions that could be prosecuted as a violation of § 843(a)(7). In other words, the bankruptcy court's inquiry was ultimately prospective, not retrospective. That is why the bankruptcy court first asked whether Debtors' business model necessarily placed it in a position of violating federal law, *see Way to Grow*, 597 B.R. at 123–32, and then asked whether bankruptcy proceedings could nonetheless be saved by Debtors "sever[ing] all ties to their marijuana customers," *Id.* at 132. Unlike a prosecutor, the bankruptcy court needed no evidence of specific criminal transactions to sustain its findings on these matters.

B. Evidence as to Each Debtor

1. Bankruptcy Court's Treatment of "Debtors" as a Group

Debtors argue that, even if the bankruptcy court correctly found that § 843(a)(7) might be a basis for cause to dismiss bankruptcy proceedings, the bankruptcy court erroneously lumped all three Debtors together when the evidence almost exclusively focused on Way to Grow's activities. Thus, say Debtors, at least Pure Agro's and Green Door's bankruptcy petitions should not have been dismissed because the evidence that they are violating § 843(a)(7) is insufficient. (ECF No. 27 at 18–24.)[5]

***351** As noted above (Part II.C), the Court rejected this argument as a basis to grant a stay pending appeal because nothing in the record showed that Debtors had argued below for separate treatment. In their opening merits brief, Debtors attempt to explain this by arguing that the focus of the evidentiary hearing, as they saw it, was aiding and abetting under 18 U.S.C. § 2, while 21 U.S.C. § 843(a)(7) was raised for the first time by the bankruptcy court in its dismissal order. (ECF No. 27 at 18.)

> Had the Debtors been provided with notice that Inniss intended to argue that section 843(a)(7) applied, each Debtor could have

> presented additional legal argument regarding how and why section 843(a)(7) does not apply. The Debtors could also have presented evidence including testimony from customers about the use to which the equipment and materials purchased at [Way to Grow] stores was put, the use of hydroponic equipment, and the legal crops grown by customers. The Debtors could also have presented additional evidence to further emphasize the fact that Pure [Agro] is a holding company and does not distribute any equipment.

(*Id.* at 18.)

As presented in the opening brief, this is still not an argument for plain error review, even though the Court previously called Debtors out for failing to argue as much. (*See* ECF No. 20 at 7.) Debtors' first mention of plain error review comes in their reply brief (ECF No. 32 at 12–14), and therefore could be deemed forfeited.

In sum, Debtors are treading on thin ice. Debtors refused to argue for plain error until it was too late for Inniss to respond. Moreover, the Court is not convinced that Debtors would have tailored their evidentiary presentations any differently had they known that § 843(a)(7) would be at issue, not just aiding and abetting. The aiding and abetting accusation gave Debtors every incentive to present all the same evidence they now say they were precluded from presenting. And, from the Court's review of the hearing transcripts, the parties continually focused on the questions of what Debtors sell and what they know about how their customers use their products. These are the same questions the parties would have explored if § 843(a)(7) had been part of their preparations.

However, viewed generously, the Court can see how looking at the case through an aiding and abetting lens might have caused Pure Agro to think less about its separateness from its subsidiaries than it might have if it had known ahead of time that the bankruptcy court would be considering § 843(a)(7), which requires manufacturing, distributing, exporting, or importing tangible items—activities that a holding company like Pure Agro usually does not perform. From that perspective, there is slightly more merit to Debtors' argument, at least as applied to Pure Agro, although there is still the question of whether Debtors forfeited their opportunity to argue for plain error.

[12] Ultimately, the Court finds that it need not decide whether the bankruptcy court erred by failing to discuss the three Debtors separately, nor whether Debtors forfeited that argument. The Court can affirm on any basis supported by the record. *See* *SEC v. Chenery Corp.*, 318 U.S. 80, 88, 63 S.Ct. 454, 87 L.Ed. 626 (1943) ("[I]n reviewing the decision of a lower court, it must be affirmed if the result is correct although the lower court relied ***352** upon a wrong ground or gave a wrong reason." (internal quotation marks omitted)). There is ample basis in the record that Way to Grow's and Green Door's business models depend on activities that could be prosecuted under § 843(a)(7), and there is likewise ample evidence that Pure Agro involves itself in Way to Grow's and Green Door's business in a manner that could subject it to prosecution for aiding and abetting their criminal activities.

2. Way to Grow

At least as to Way to Grow, Debtors do not challenge the bankruptcy court's conclusion that there was "ample evidence" that, in the language of § 843(a)(7), Way to Grow at least had " 'reasonable cause to believe' the equipment [it] sell[s] to at least some of [its] customers will be used to manufacture marijuana." *Way to Grow*, 597 B.R. at 129. And the evidence before the bankruptcy court was otherwise overwhelming. For example:

- Inniss testified that: (i) he built up Way to Grow to service the marijuana industry; (ii) the "whole thesis" of Pure Agro's acquisition of Way to Grow "was to combine Byrd's California marijuana-related operations with [Way to Grow's] operations in Colorado"; (iii) Way to Grow sells products that "would be cost-prohibitive for use in cultivating any crop except marijuana, because marijuana is the highest yielding cash crop which can be grown"; (iv) Way to Grow "sell[s] so-called 'bubble bags' which are specifically used to make 'water hash,' a concentrated marijuana derivative"; and (v) he knew the real names of customers that used aliases when buying products from Way to Grow, and he further knew that those customers were dispensaries and grow operations. *Id.* at 129–30.

- Since at least 2016, Way to Grow participated in the Cannabis Cup, "a cannabis industry trade show and the world's biggest marijuana grow competition." *Id.* at 130.

- At the Cannabis Cup and similar events, Way to Grow has distributed self-branded swag such as "lighters and rolling papers," and has contributed prize money to be awarded to the winner of the grow-off competition. *Id.*

- The manager of Way to Grow's Boulder store testified that: (i) "he, and all of his co-workers, were themselves marijuana growers who bought supplies from [Way to Grow] before becoming employees"; (ii) "[mo]st of [his] interactions with customers have been about cannabis"; (iii) Way to Grow "choose[s] products based on favorability of use in marijuana cultivation"; (iv) "the 'trim bags' and 'bubble bags' sold by [Way to Grow] are specifically intended for use with cannabis"; (v) "[a]s recently as August 2018, [Way to Grow] engaged in cross-promotions with dispensaries at local grow-offs"; and (vi) "as much as 95% of customers in his store are using [its] products to grow marijuana." *Id.*

- The manager of Way to Grow's Fort Collins store testified that: (i) " 'everybody just assumes' customers talking generally about help with plants are talking about marijuana plants"; (ii) Way to Grow has a reputation for being an expert in cannabis growing; (iii) he has visited customers' cannabis growing facilities; (iv) "[a] list of approved products for use in cannabis cultivation is made available in the store"; (v) "[c]ustomers sometimes bring marijuana plants, or, more commonly, photographs ***353** of marijuana grow operations, to [Way to Grow's] stores, and [its] employees 'typically' offer products to those customers based on those photographs"; and (vi) "the 'vast majority' of [Way to Grow's] customers" grow cannabis. *Id.*

- In an e-mail dated June 28, 2018 (three days after Inniss filed his motion to dismiss), Way to Grow's vice president of operations instructed store managers to remove "anything 'MJ related in your stores' " and "to 'not discuss MJ directly with any customers [or] allow customers to bring anything plant related into your stores.' " *Id.* at 131.

Accordingly, the bankruptcy court did not err, much less clearly err, in finding as a matter of fact that Way to Grow "know[s] .. that it [is selling products that] will be used to manufacture a controlled substance." 21 U.S.C. § 843(a)(7).

3. Green Door

[13] The evidence specifically as to Green Door was not as fully developed. However, the bankruptcy court credited Inniss's testimony that Green Door—described as "Byrd's California marijuana-related operations"—was operating the same type of business as Way to Grow. *Way to Grow*, 597 B.R. at 129. Moreover, Debtors' opening merits brief before this Court admits that Green Door "operated in a similar manner" to Way to Grow. (ECF No. 27 at 10.) Accordingly, given the evidence before the bankruptcy court about Way to Grow and the evidence that Green Door was simply a California-based iteration of the same type of business, the bankruptcy court did not clearly err in finding as a matter of fact that Green Door "know[s] .. that it [is selling products that] will be used to manufacture a controlled substance." 21 U.S.C. § 843(a)(7).

4. Pure Agro

[14] **[15]** Pure Agro is a holding company that owns Way to Grow, Green Door, and another (non-debtor) entity called Crop Supply. Although Inniss points to hearing testimony in which Byrd speaks of Pure Agro "sell[ing]" things such as dirt and hydroponic gardening supplies (*see* ECF No. 31 at 26), there appears to be no serious dispute that Byrd was speaking loosely and that Pure Agro, of itself, sells nothing. But that does not mean that Pure Agro is insulated from potential prosecution. Again, "Whoever commits an offense against the United States or aids, abets, counsels, commands, induces or procures its commission, is punishable as a principal." 18 U.S.C. § 2(a). Liability requires an underlying crime (supplied here by the subsidiary Debtors' actions) and "willfully associat[ing] [oneself] with the criminal venture and seek[ing] to make the venture succeed through some action of [one's] own." *Leos-Quijada*, 107 F.3d at 794.

The evidence before the bankruptcy court was enough to support a finding that Pure Agro aids and abets its subsidiaries' violations of federal law. For example:

- Inniss testified that Pure Agro acquired Way to Grow to increase Pure Agro's dominance in the cannabis industry. *Way to Grow*, 597 B.R. at 129.

- Pure Agro's website quotes Byrd as follows: "We are the picks and shovels play for what we're calling the Green Rush."[6] (ECF No. 31-1 at 10.)

***354** • Pure Agro's website approvingly quotes a BusinessWire characterization of the Way to Grow acquisition as follows: "With the merger of Way to Grow completed in January 2016, PureAgro is now the leading one-stop solution for indoor plant, produce and cannabis growers in Colorado and California." (*Id.* at 9; *see also* ECF No. 23-4 at 372 (Byrd's endorsement of this quote as "a true statement").)

- Pure Agro's website quotes a characterization of itself published in the Cannabis Business Times as a "pioneer[ ] of the hydroponics and indoor agriculture industry for the past 20 years." (ECF No. 31-1 at 12.)

- Pure Agro issued a press release on November 1, 2016, datelined "Los Angeles & Fort Collins, Colo." The press release describes Way to Grow and Crop Supply—the latter of which was "[s]pun out of Way to Grow's operations" as a "wholesale operating division, selling directly and exclusively to large commercial growers." The press release quotes Byrd as saying, "Our current focus and primary growth initiatives are aligned with serving the fast-growing legal cannabis industry." The press release goes on to describe the business opportunity in light of the many states legalizing cannabis. (*Id.* at 25–27.)

- At the evidentiary hearing, Byrd confirmed his knowledge that certain dispensaries and cannabis growers were customers of Pure Agro's subsidiaries. (ECF No. 23-4 at 418–19.)

- Byrd testified that Crop Supply was losing money but "it's all a rollup so we can have a profit on one sub entity and a loss on another." (*Id.* at 361–62.) Elaborating, John Thompson, Pure Agro's head of finance, testified that Pure Agro, Crop Supply, and Way to Grow shared a single bank account that allowed for transfers between the companies. (*Id.* at 497.)

Finally, the Court notes that Debtors' failure to argue for distinct treatment in the bankruptcy court is further evidence that they view themselves as distinct on paper but not in purpose.

In sum, Pure Agro "willfully associat[es] [itself] with the criminal venture and seek[s] to make the venture succeed through some action of [its] own." *Leos-Quijada*, 107 F.3d at 794. Indeed, Pure Agro's *purpose* is to support its subsidiaries in their efforts to sell to customers whom the subsidiaries and Pure Agro know to be using the products to grow marijuana. For this reason, the bankruptcy court's decision as to Pure Agro is affirmed.

C. Ability to Reorganize

[16] The bankruptcy court heard testimony from one Way to Grow manager that 95% of his store's customers were using Way to Grow's products to grow marijuana, and from another store manager that the "vast majority" of his customers were doing likewise. *Way to Grow*, 597 B.R. at 130. The bankruptcy court heard testimony from Byrd that "this figure [was] closer to 65%." *Id.* at 130 n.154. Weighing this evidence, the bankruptcy court concluded, "Whether marijuana-related customers account ***355** for 65% or 95% of Debtors' revenue, eliminating all such revenue would be devastating to the Debtors. It is inconceivable Debtors could terminate any sales to known marijuana cultivators and still operate profitably." *Id.* at 132.

Debtors challenge this finding. Debtors' first argue that the bankruptcy court relied mostly on evidence from Way to Grow managers (and not witnesses from Pure Agro or Green Door) about the centrality of marijuana to Way to Grow's business. (*Id.* at 36.) But the evidence as a whole shows that all three Debtors developed their business specifically to service marijuana growers and, tellingly, Debtors failed to introduce any evidence to the contrary during the four-day hearing. The bankruptcy court did not clearly err in applying its finding to all three Debtors.

Debtors next argue that the store managers merely offered "guesses" of how many customers used store products to grow marijuana, and that "the managers acknowledged that this conclusion was speculation, and that they had no personal knowledge of what their customers were growing." (ECF No. 27 at 36–37.) Debtors cite nothing in the record to support these characterizations of the managers' testimony, and they are otherwise inconsistent with the testimony summarized by the bankruptcy court that the managers knew their stores were selling products for use by marijuana growers to grow marijuana. *See Way to Grow*, 597 B.R. at 130. Thus, the bankruptcy court did not clearly err in relying on the managers' estimates.

Debtors further argue that the bankruptcy court inappropriately fixated on Debtors' sales of hydroponic equipment, whereas "soil, containers, and nutrients were and are the principal items sold in terms of product volume and revenue." (ECF No. 27 at 37.) Debtors request that the case be remanded for the bankruptcy court to consider the "actual mix of products" sold. (*Id.*)

It is true that, at one point, the bankruptcy court stated, "Debtors have already acquired a venerable reputation for expertise in hydroponic marijuana growing, and it is difficult to imagine how Debtors could prevent customers from continuing to patronize Debtors' stores because of this reputation." *Way to Grow*, 597 B.R. at 132. But this was part of the bankruptcy court's alternative reason for finding no reasonable prospect of reorganization, *i.e.*, that it would be difficult to stop marijuana growers from returning to Debtors' stores. The Court need not opine on this alternative reason because the primary reason—the percentage of customers that seek out Debtors for marijuana-growing supplies—is enough by itself to support the bankruptcy court's finding.

Finally, Debtors say that the bankruptcy court "never made any determination as to whether any customer was growing" a cannabis plant for purposes of human consumption, as compared to the now-legal purpose of producing hemp. (ECF No. 27 at 38.) This argument relies on the Agriculture Improvement Act of 2018, Pub. L. No. 115-334, which the President signed into law on December 20, 2018—shortly after Appellants filed this appeal. Among many other changes, this law lifted the federal ban on commercial and industrial hemp production and removed hemp from Schedule I so long as it contains no more than 0.3% of THC (the active ingredient in marijuana) by dry weight. *See id.* §§ 10113, 12619. Debtors say that "[t]he legalization of hemp means that [they] could reorganize based upon the hemp market." (ECF No. 27 at 39.)

[17] Debtors cite nothing in the record to support this contention. Apparently this argument was never advanced to the bankruptcy ***356** court. This Court does not opine on whether the timing of the Agriculture Improvement Act's passage excuses Debtors' failure to develop a proper record or to advance the argument. The Court only holds that the bankruptcy court did not err, much less clearly err, by failing to address this argument, which was never presented to it and could not have been a potential basis for relief until after the bankruptcy court issued its decision.

IV. CONCLUSION

For the reasons set forth above, the Court ORDERS as follows:

1. The judgment of the bankruptcy court is AFFIRMED;
2. The Clerk shall enter judgment in favor of Appellee and against Appellants, and shall terminate this case; and
3. Appellee shall have his costs incurred in this Court, if any, upon compliance with D.C.COLO.LCivR 54.1.

All Citations

610 B.R. 338

Footnotes

1 The record on appeal has been filed in a disorganized fashion. (*See* ECF Nos. 23, 26.) Also, attached to their merits briefs, the parties have filed separate appendices of record excerpts, each with a set of page numbers that differs from the record—while sometimes still citing the record, rather than their appendices, in their briefs. For simplicity when citing to the record in these circumstances, the Court will cite directly to the CM/ECF docket number and page number where the cited material can be found, regardless of whether it is characterized as a part of the record or an appendix. Also, for matters not in dispute, the Court will cite to the parties' briefs where the appropriate record citations may be found. *All* ECF page citations, whether to the record or to a brief, are to the page number in the CM/ECF header, which rarely matches the document's internal pagination.

2 No party makes any argument about the possibility of converting the jointly administered Chapter 11 cases to a Chapter 7 proceeding, nor the possibility of appointing a trustee or examiner. Accordingly, like the parties,

the Court will ignore these portions of § 1112(b)(1). For purposes of this dispute, the only relevant portion of § 1112(b)(1) is its authorization to "dismiss a case ... for cause."

3 Some courts have held that lack of good faith is grounds for dismissal independent from a dismissal for "cause" under § 1112(b)(1). *See* 7 *Collier on Bankruptcy* ¶ 1112.07[1] (Richard Levin & Henry J. Sommer eds., 16th ed.). But, "[i]n general, the requirements of good faith and cause do overlap, and what is sufficient to demonstrate a lack of good faith is also probably sufficient to demonstrate cause." *Id.* ¶ 1112.07[5]. Accordingly, the Court need not explore whether its holding is justified independent of §§ 1112(b)(1) and 1129(a)(3).

Furthermore, bankruptcy decisions throughout the country have explored other potential bases for holding that a bankruptcy court cannot grant relief to a marijuana-based business. *See, e.g.*, *Garvin*, 922 F.3d at 1036 (suggesting that operating a marijuana-based business could be cause for dismissal as "gross mismanagement of the [bankruptcy] estate" under 11 U.S.C. § 1112(b)(4)(B)); *In re Olson*, 2018 WL 989263, at *4–6 (9th Cir. BAP Feb. 5, 2018) (surveying various approaches); *Way to Grow*, 597 B.R. at 120–23 (same). The Court finds that inability to propose a good-faith reorganization plan provides cause to dismiss under § 1112(b)(1), and so the Court need not express any opinion about alternative bases for dismissal.

4 Debtors further note that hydroponic equipment is not on a Drug Enforcement Administration list of products and materials specifically associated with clandestine drug manufacturing. (*Id.*) It is not clear what relevance this has to whether § 843(a)(7) is too vague to be understood by the ordinary person.

5 Save for their argument that there must be evidence of specific transactions, which the Court has rejected immediately above, Debtors do not argue that the evidence against Way to Grow was insufficient.

6 As aptly explained by Investopedia, "pick and shovel play" is a metaphor derived from the persons who sold equipment to gold diggers during the California gold rush. It is "an investment strategy that invests in the underlying technology needed to produce a good or service instead of in the final output. It is a way to invest in an industry without having to endure the risks of the market for the final product." Investopedia, "Pick-And-Shovel Play," *at* https://www.investopedia.com/terms/p/pick-and-shovel-play.asp (last accessed Sept. 16, 2019).

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Faculty

William (Bill) A. Brandt, Jr. is the founder and executive chairman of Development Specialists, Inc. in New York and has been involved in thousands of insolvency and restructuring cases over his long career. He has often advised members of Congress on insolvency policy and was the principal author of the amendment to the Bankruptcy Code which permits the election of trustees in chapter 11 cases. Mr. Brandt currently serves as the chapter 11 trustee in the largest cross-national insolvency pending in the U.S., China Fishery Group, and serves as a chapter 11 trustee for the San Luis & Rio Grande Railroad in southern Colorado. He served on ABI's Commission for the Reform of Chapter 11, and in 2015 he completed serving his third and final consecutive term as chair of the Illinois Finance Authority, having first been appointed by the governor in 2008 and confirmed unanimously by the Illinois Senate that same year, then subsequently reappointed as chair in 2010 and 2012. He is also part of the ownership group that controls Chicago's second-largest daily newspaper, *The Chicago Sun-Times*. More recently, in the political realm Mr. Brandt was a member of the U.S. Electoral College for the 2016 presidential election, serving as an elector from the State of Illinois. Mr. Brandt has written for a number of publications spanning a broad spectrum of thought, including *Maclean's*, *Canada's Weekly Newsmagazine*, *Corporate Board Member* and *Urban Land*. He is a frequent commentator on topics of corporate restructuring, bankruptcy, municipal insolvency and related public policy issues, and regularly appears on a host of both cable and broadcast outlets. Mr. Brandt was a member of the National Advisory Council for the Institute of Governmental Studies at the University of California at Berkeley from 2006-18, serving as chair for the last two years. Mr. Brandt served several terms as a member of ABI's Board of Directors and as a member of the Advisory Board for the *ABI Law Review*. He is an advisory board member of ABI's annual New York City Bankruptcy Conference, having earlier served for 15 years in a similar capacity for ABI's Bankruptcy Battleground West program. In 2020, he received the New York Institute of Credit's 46th Annual Leadership in Credit Education Award for Dedication and Commitment to NYIC and the Credit Industry. Mr. Brandt received his B.A. from St. Louis University and his M.A. from the University of Chicago, where he also completed further post-graduate work toward a doctoral degree.

Gerard DiConza is a partner in the Bankruptcy, Restructuring and Insolvency Litigation Group at Archer & Greiner in New York and has more than 25 years of experience in chapter 11 restructurings and representing estate fiduciaries in complex bankruptcy litigation involving issues of fraud, alter ego, breach of fiduciary duties, bad faith and avoidable transfers. He represents debtors, trustees, foreign liquidators, distressed buyers in § 363 sales, chapter 11 plan fiduciaries and creditors, both in and out of court. Mr. DiConza has represented companies liquidating and winding down their affairs through chapter 11, ABCs and federal and state receiverships. Following law school, he clerked for Hon. Jeremiah E. Berk, U.S. Bankruptcy Judge for the Southern District of New York. Mr. DiConza frequently speaks on bankruptcy topics and is currently a lecturer on restructurings at the New York University School of Professional Studies. He received his B.B.A. in 1991 from Hofstra University; his J.D. in 1994 from St. John's Law School, where he was editor-in-chief of the *ABI Law Review*; and his LL.M. in corporate law from New York University School of Law in 1998.

Hon. Rosemary Gambardella was sworn in as a U.S. Bankruptcy Judge on May 3, 1985, in the District of New Jersey in Newark, becoming the first woman to serve on its bankruptcy court. From

1980-85, she was senior staff counsel to Hugh M. Leonard, then U.S. Trustee for the Districts of New Jersey and Delaware. Judge Gambardella served as Chief Judge of the U.S. Bankruptcy Court for the District of New Jersey from Aug. 12, 1998, to Aug. 11, 2005. She is a member of the Lawyers Advisory Committee of the U.S. Bankruptcy Court for the District of New Jersey, a member and former president of the New Jersey Bankruptcy Inn of Court, and a member of the Bankruptcy Committee of the Third Circuit Task Force on Equal Treatment in the Courts - Gender Commission. In addition, she is a member of the National Association of Women Judges, the National Conference of Bankruptcy Judges, ABI and the Turnaround Management Association, and is a former member of the Bankruptcy Judges Advisory Group for the Administrative Office of the U.S. Courts. Judge Gambardella was the bankruptcy judge representative to the Judicial Conference of the United States (2009-11) and is a Fellow of the American College of Bankruptcy. She received the Rutgers School of Law – Newark Distinguished Alumni Award in 2012, the New York Institute of Credit Women's Division Judge Cecelia H. Goetz Award, the William J. Brennan, Jr. Award in 2013 and the Conrad B. Duberstein Memorial Award in 2015. Judge Gambardella earned her B.A. in history in 1976 from Rutgers University, where she was elected to Phi Beta Kappa. After receiving her J.D. from Rutgers Law School-Newark in 1979, Judge Gambardella served as law clerk to the late Chief Bankruptcy Judge Vincent J. Commisa from 1979-80.

Marc E. Hirschfield is a partner with Royer Cooper Cohen Braunfeld LLC in New York, where he leads its Business Restructuring & Bankruptcy practice and is a member of the firm's corporate and litigation departments. He regularly represents debtors, committees, DIP lenders, secured and unsecured creditors and acquirers of assets in both out-of-court workouts and bankruptcy cases. Mr. Hirschfield has served as an expert witness on bankruptcy matters. He also is an experienced mediator and is on the mediation panels for the Southern and Eastern Districts of New York and the District of Delaware. Having served as one of the lead counsel to the trustee in the Madoff liquidation and in other Ponzi scheme cases, he has specialized expertise in financial fraud matters. Mr. Hirschfield has been included *Chambers USA: America's Leading Lawyers for Business* and is a *New York Super Lawyer*. He received his B.A. with honors and Phi Beta Kappa in 1989 from the State University of New York at Binghamton, and his J.D. *magna cum laude* in 1992 from the State University of New York at Buffalo School of Law, where he was editor of the *Buffalo Law Review* and a member of the Moot Court Board.

Jennifer L. Rodburg is a Restructuring and Insolvency partner with Fried, Frank, Harris, Shriver & Jacobson LLP in New York, where she focuses her practice on the representation of creditors and investors in corporate restructurings both in and out of court. She represents hedge funds, private-equity funds, banks, property owners, asset-acquirers and other strategic parties in connection with prepackaged and traditional bankruptcy proceedings, DIP and exit financings, § 363 sales and other distressed situations. Ms. Rodburg has a broad range of experience in representing official and unofficial creditors' committees and equity committees in connection with chapter 11 cases and out-of-court restructuring situations. She also counsels investment funds, financial institutions and other clients on issues involved in trading distressed debt, analyzing the risks associated with potential investments and acquiring financially distressed companies. Ms. Rodburg is consistently recognized by *Chambers USA: America's Leading Lawyers for Business* as a leading individual in Bankruptcy/Restructuring and by *Legal 500* in Corporate Restructuring. She also was named an "Outstanding Young Restructuring Lawyer" in the April 2009 issue of *Turnarounds & Workouts*. Ms. Rodburg lectures on bankruptcy-related matters for seminars and panels sponsored by the Association of

the Bar of the City of New York and other professional organizations. She is a member of ABI, the American Bar Association, the New York State Bar Association and the New York City Bar, and she is admitted to the bar in New York, New Jersey, the District of Columbia and the U.S. District Court for the Southern District of New York. Ms. Rodburg received her B.A. *magna cum laude* from the University of Pennsylvania in 1997 and her J.D. in 2000 from New York University School of Law.

Suzzanne Uhland is a partner in the New York office of Latham & Watkins and represents companies, creditors and investors in chapter 11 reorganizations and out-of-court restructurings. She has represented debtors-in-possession, creditors, and DIP lenders in chapter 11 cases of public and private companies; businesses in connection with out-of-court restructurings and debt-renegotiations; private-equity and hedge fund clients in distressed investments and portfolio company restructurings; and financial institutions and public and private companies in connection with credit financing transactions. In addition, she has also represented licensors and licensees of intellectual property in connection with preserving or acquiring intellectual property rights in distressed situations. Ms. Uhland has been listed in *Benchmark Litigation* as a Local Litigation Star for Bankruptcy (2019-21) and a National Litigation Star (2021), and in *Lawdragon* as one of the 500 Leading Global & Insolvency Lawyers (2020), *Chambers USA* (2019). She also received the Global M&A Network's Top USA Woman Dealmakers Award in 2019 and has been listed in *The Best Lawyers in America* for 2020 in Bankruptcy & Creditor/Debtor Rights/Insolvency & Reorganization Law. Ms. Uhland received her A.B. in 1984 with distinction and Phi Beta Kappa, and her M.A. in 1986, from Stanford University, and her J.D. from Yale University in 1988, where she was co-editor-in-chief of the *Yale Journal on Regulation*.