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CAITLYN CULLEN*

A new marijuana industry has emerged in the United States in the wake of state-by-state legalization of marijuana, and entrepreneurs, investors, and other advisory services are increasingly viewing the marijuana industry as an area of legitimate business opportunity. However, potential investors have been hesitant to establish formal relationships with marijuana businesses that operate legitimately in the eyes of the state but in a cloud of legal uncertainty at the federal level because the Controlled Substances Act criminalizes marijuana. This Note identifies two economic consequences of the conflicts of state and federal law and suggests a temporary solution that would allow states to capture the financial benefits of this industry while the federal government works towards a more permanent, nation-wide solution.

The first economic consequence that this Note identifies is that foreign marijuana companies have strategic advantages over U.S. marijuana companies. Investors prefer foreign marijuana companies, particularly those in Canada, instead of the U.S. companies operating in a similar manner. Further, some of these foreign marijuana companies have successfully listed on public U.S. stock exchanges while their domestic counterparts have not been able to, giving foreign competitors greater access to U.S. capital markets than U.S. marijuana companies.
The second economic consequence this Note discusses is that marijuana companies have been precluded from seeking the protections of bankruptcy law. This Note also suggests that federal bankruptcy courts are equipped to address some of the financial consequences created by this legal disparity. In doing so, they could provide a greater level of comfort to investors and encourage legitimate business development, thus allowing states that have chosen to legalize marijuana to realize the economic benefits of the industry while the federal government navigates the broader issue of federal policy on marijuana.

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INTRODUCTION

The “legal” marijuana industry in the United States was estimated to be worth $8.5 billion in 2017, based solely on revenue from the states that legalized marijuana for medicinal or recreational sales at the time.1 Despite federal prohibition of marijuana use, distribution, and sales under the Controlled Substances Act,2 many states

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have forged ahead with their own laws legalizing medicinal marijuana and, increasingly, recreational marijuana for adults. With the state legalization trend expected to continue, the legal marijuana market in the United States is projected to be worth $23 billion by 2022, and U.S. investors are taking note.

In 2018, Canada legalized recreational marijuana use nationwide. Not only did this ignite reactions in Canadian markets, but it also sparked reactions from U.S. entrepreneurs, businesses, and

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5 Arcview Group, supra note 1; see also Pellechia, supra note 1.

6 See infra Part II.A; see also Lewis, supra note 4 (“Corporate behemoths like Altria (parent company of Marlboro cigarettes) and Constellation Brands (parent of Corona beer and Svedka vodka) made multi-billion dollar weed investments.”).


financial markets in the United States. In August 2018, after Canada’s legalization, U.S. company Constellation Brands announced a $4 billion investment in Canadian cannabis company Canopy Growth Corporation. This was the “first multi-billion dollar deal in the [marijuana] space” and it drew support from top U.S. investment banks. The deal was advised by Goldman Sachs and financed by Bank of America, signifying that “the top-tier bankers have made their presence known at the cannabis deal-making table.” As states across America continue to liberalize their marijuana laws, marijuana is shifting “to the mainstream investment sector” and is increasingly being viewed as a legitimate and lucrative business opportunity. Constellation, which prides itself on being “at the forefront of consumer trends,” sees its investment in the Canadian marijuana company as a way to ensure that it is poised for growth in medicinal marijuana markets around the world, as well as a first-mover advantage in the anticipated recreational marijuana market in the United States.

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12 Gelsi, supra note 9.

13 Id.

14 See supra note 3 and accompanying text.

15 Gelsi, supra note 9.

16 See Lewis, supra note 4.

17 CONSTELLATION COMPANY PROFILE, supra note 10, at 5.

18 See Constellation to Invest $4 Billion in Canopy Growth, supra note 11. (The funds will be used to “establish global scale in the nearly 30 countries pursuing a federally permissible medical cannabis program, while also rap-
Regardless of the arguments for and against federal legalization of marijuana, the current reality is that a new marijuana industry has emerged in the United States in the wake of state-by-state legalization, bringing with it economic opportunities. Ironically, at a time when the national conversation is so often focused on strengthening the domestic economy, conflicts of state and federal law prevent this industry from realizing its full economic potential. Because marijuana is illegal under federal law, institutional investors and banks have been hesitant to provide services to U.S. marijuana businesses, and these marijuana businesses have been precluded from seeking the protection of bankruptcy law. While the legal conflicts are constraining the potential economic benefits from these

idly laying the global foundation needed for new recreational cannabis markets. . . . [M]anagement views other jurisdictions, including the United States, as strategic priorities requiring significant capital.”

19 See supra note 3 and accompanying text.

20 While the terms “marijuana industry” and “marijuana business” may encompass ancillary services like medical research, pesticide and agricultural services, and marketing services, this Note uses those terms to refer solely to the cultivators, distributors, and dispensaries of medical and recreational marijuana in state-sanctioned industries, unless noted otherwise.

21 See generally Proclamation No. 9816, 83 Fed. Reg. 55,457 (Nov. 6, 2018). [W]e celebrate the Americans who forge new frontiers of possibility and prosperity, and we reaffirm our commitment to creating an environment in which they can continue to drive our country’s economic success . . . . My Administration is committed to policies that foster entrepreneurship and create jobs . . . . Americans have experienced an overall decrease in regulatory burdens. We will not let up. Americans deserve a regulatory environment that facilitates innovation, rewards creativity, and allows the skills and dexterity of our entrepreneurs to shine.

Id. at 55,457.


23 See infra Part II.


businesses, they are not stifling demand or investment interest in the industry in the same way, which is giving foreign competitors a strategic advantage.26

Despite these challenges, the U.S. state-legalized marijuana industry has a strong growth trajectory and continues to gain social, political, and financial interest.27 Consequently, there are economic incentives for the legal system to address some of the conflicts between state and federal law to allow the existing industry to access the nation’s financial resources and encourage economic growth, development, and stability.28 This Note explores how the disparity between state and federal marijuana laws creates financial hurdles to industry growth and, without taking a stance on federal legaliza-

27 See Bricken, Funding and Financing, supra note 25, at 6 (“Though marijuana remains federally illegal, more than half of the states have various versions of legalized marijuana, with at least a half dozen more states expected to legalize within the next two years. With the growth in legalization, the potential for profits in the cannabis industry continues to increase at an exponential pace. The 2016 Marijuana Business Factbook predicts the cannabis industry will grow from a $14–$16 billion market in 2016 to a $44 billion market by 2020—an approximate 300 percent increase in just four years.”).
28 See John Horn & Darren Pleasance, Restarting the US Small-Business Growth Engine, MCKINSEY & CO. (Nov. 2012), https://www.mckinsey.com/featured-insights/employment-and-growth/restarting-the-us-small-business-growth-engine/0 (“While the small-business universe is vast, its real economic impact comes disproportionately from a much smaller subset of high-growth firms. . . . [A] subset of small businesses—high-growth ones—creates the vast majority of new jobs. . . . The 1 percent of all firms that are growing most quickly (fewer than 60,000 in all) account for 40 percent of economy-wide net new job creation. To provide a sense of magnitude, high-growth firms add an average of 88 employees a year, while the average non-high-growth company only adds 2 to 3.”); see also Asli Demirgüç-Kunt et al., WORLD BANK, FINANCE FOR ALL? POLICIES AND PITFALLS IN EXPANDING ACCESS 55 (2008), https://siteresources.worldbank.org/INTFINFORALL/Resources/4099583-1194373512632/FFA_book.pdf (“It is by providing financial services to any and all firms with good growth opportunities that the financial sector helps developing economies to grow and to converge on the high-income levels of advanced economies. This is not just a matter of the overall volume of lending: it matters crucially which firms get finance and on what terms, that is, on whether creditworthy firms of all sizes, both incumbent ones and those that seek entry, have broad access to finance at reasonable costs.”).
tion of marijuana, proposes other ways that the legal system can foster a business environment for this nascent industry to flourish, allowing states to benefit from the full economic potential of the market. Recognizing that there are certain objections to the use of marijuana, this Note does not address the moral and health arguments for its criminalization. Notwithstanding the highly contested nature of the moral and health objections to nationwide legalization, this Note assumes those objections will ultimately be overcome and solely focuses on the business opportunity of the state-sanctioned marijuana industry and how the legal system can support the realization of its economic potential.

This Note examines the relationship between institutional investors and the U.S. marijuana industry and identifies access to capital markets and bankruptcy as challenges that strain the relationship. This strained relationship creates financial hurdles to growth for the marijuana industry by (1) diverting available capital of investors interested in the marijuana market from domestic marijuana industry to foreign marijuana operations, 29 and (2) preventing marijuana businesses from accessing the federal bankruptcy system, which creates uncertainty for the already-limited pool of lenders and discourages an influx of new capital. 30 While bankruptcy is typically associated with failing businesses, the bankruptcy system lends stability to markets by providing insolvent businesses and their creditors with a predictable process to obtain the best possible value in a worst-case scenario. 31 The state-sanctioned marijuana industry is still a young industry and has yet to exhibit large-scale financial downturns, but no industry is completely immune to the peaks and pitfalls of macroeconomic cycles 32 or the risks of new businesses. 33 The risks are even higher if the industry is precluded from federal

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29 See infra Part II.A.
30 See infra Part II.B.
32 Cf. Eric Rosenberg, 5 Recession Resistant Industries, INVESTOPEDIA (Sept. 27, 2018), https://www.investopedia.com/articles/investing/100115/5-recession-resistant-industries.asp (describing certain industries that, while not completely recession-proof, feel less dramatic effects of economic swings).
33 See Bricken, Funding and Financing, supra note 25, at 7.
bankruptcy protection because businesses and their creditors will not be able to predict the process and legal remedies available in the case of a business’s failure.  

Part I of this Note provides an overview of the Controlled Substances Act and other federal laws relevant to investments in the marijuana industry. It also briefly summarizes the process of marijuana legalization in the United States and factors contributing to the confusion surrounding liability. In the discussion of liability, this Note focuses on the legal risks to the financial industry born out of the tension between state and federal laws. Part II explores how these liability risks affect the relationship between institutional investors and the marijuana industry. After exploring the industry’s ability to raise capital in Part II, this Note then discusses the industry’s ability (more accurately, lack of ability) to access the federal bankruptcy system when capital becomes too sparse. Part III of this Note proposes that courts create a business environment more favorable to industry growth by allowing state-sanctioned marijuana businesses access to federal bankruptcy protection. The proposal is divided into two parts. The first part argues that marijuana businesses that are considered legitimate by the state should be eligible for federal bankruptcy protection because that approach is more consistent with the goals of bankruptcy. The second part explores how bankruptcy eligibility could address some of the problems presented by the disconnect between state and federal laws, thus achieving an economically desirable objective without requiring Congress to confront the larger, more contentious issue of federal marijuana legalization.

I. CONFLICTING LEGAL STATUS OF THE MARIJUANA INDUSTRY

Following the November 2018 midterm elections, thirty-three states and Washington D.C. have legalized medical marijuana, and, of those, ten states and Washington D.C. have legalized marijuana for recreational use by adults. While legalization at the state level

35 See State Marijuana Laws, supra note 3; see also Marijuana Overview, supra note 3. Under the Supremacy clause of the U.S. Constitution, federal law preempt state laws whenever there is a direct conflict between the two, but there remains unsettled debate regarding the preemptive reach of the federal Controlled Substances Act over state laws that regulate the use, production, and distribution
has gained momentum and public support, federal law prohibits marijuana for both medical and recreational purposes. The Obama and Trump Administrations have expressed conflicting views on the federal legalization of marijuana, however neither has demonstrated clear efforts to protect or prosecute state-sanctioned marijuana businesses. Although the momentum of state law is encouraging the economic development of the marijuana industry, the inconsistent stance of federal administrations and lack of clear policy regarding the legitimacy of state-sanctioned marijuana businesses has created apprehension about the criminal liability that may result from transacting with marijuana businesses, and consequently has a dampening effect on that development.

of marijuana within their borders. See U.S. CONST. art. VI, cl. 2; see also Scott Bomboy, Federal Marijuana Policy Change Raises Significant Questions, NATIONAL CONSTITUTION CENTER (Jan. 4, 2018), https://constitution-center.org/blog/federal-marijuana-policy-change-raises-significant-questions. While some believe there is a direct conflict that would allow the federal law to invalidate state laws legalizing marijuana, others look to the Tenth Amendment’s preservation of states’ rights to create and enforce laws on all issues not expressly reserved to the federal government. See U.S. CONST. amend. X; see also Erwin Chemerinsky et al., Cooperative Federalism and Marijuana, 62 UCLA L. REV. 74, 100–04 (2015); Bomboy, supra. Furthermore, the Tenth Amendment’s anti-commandeering clause provides that the federal government cannot force states to pass certain laws or require state and local officials to enforce the laws of the federal government. See id. The preemption question that the Supreme Court has declined to address on multiple occasions is whether states’ laws legalizing and regulating marijuana within their borders create a direct and impermissible conflict with federal Controlled Substances Act. See, e.g., Nebraska v. Colorado, 136 S. Ct. 1034 (2016); see also Chemerinsky et al., supra, at 101.


38 See infra Part I.C.

39 See State Marijuana Laws, supra note 3; see also Marijuana Overview, supra note 3.

40 See infra Part I.C.
A. Criminal Liability Under the Controlled Substances Act

Under the Controlled Substances Act (“CSA”), it is illegal to “manufacture, distribute, or dispense” marijuana, which is classified as a Schedule I substance. Schedule I substances carry the most severe legal penalties and are characterized as follows:

(1) Schedule I.—

(A) The drug or other substance has a high potential for abuse.

(B) The drug or other substance has no currently accepted medical use in treatment in the United States.

(C) There is a lack of accepted safety for use of the drug or other substance under medical supervision.

Depending on the weight or amount of a Schedule I substance, penalties for manufacturing, distributing, or dispensing marijuana can range from a probationary period for first time offenders found with small amounts, to a minimum sentence of ten years imprisonment with a fine of up to $10 million for first time offenders found with 1,000 kilograms of any substance containing marijuana or 1,000 marijuana plants. The CSA directly implicates marijuana cultivation, distribution, and dispensary businesses, but the potential federal criminal liability does not seem to have dissuaded these businesses from entering the thriving state-legitimized markets. In fact, with 1,025 licensed dispensaries in Colorado as of August 1, 2019.

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42 Id. § 812 Schedule I(c)(10).
43 Id. § 812(b)(1).
44 See id. § 841; see also 18 U.S.C. § 3607(a)(2012).
45 Marijuana cultivation, distribution, and dispensary businesses are engaged in the three specific activities that the CSA criminalized. 21 U.S.C. § 841(a).
there are now over three times more marijuana dispensaries than Starbucks stores in the state.\textsuperscript{48}

Criminal liability under the CSA extends beyond those directly engaged in the business to stakeholders that support or benefit from the business in a number of ways.\textsuperscript{49} Leasing or mortgaging property to marijuana cultivators and dispensaries, for example, could result in up to twenty years in prison and a $2 million dollar fine under the CSA.\textsuperscript{50} It is also illegal to use income derived from illegal drug activities in any business that directly or indirectly affects interstate or foreign commerce.\textsuperscript{51} In today’s technology-dependent economy, it is a rarity to find a company that does not affect interstate or foreign commerce through internet usage in some way.\textsuperscript{52} If the marijuana cultivators or dispensaries were, in fact, prosecuted and convicted

\textsuperscript{47} See id.
\textsuperscript{48} There are 322 Starbucks stores in Colorado. \textit{Lifestyle Statistics: Starbucks Stores (Most Recent) by State}, STATEMASTER, http://www.statemaster.com/graph/lif_sta_sto-lifestyle-starbucks-stores (last visited July 13, 2019); see also Scheuer, supra note 26, at 521–22 (noting the rapid growth of the marijuana industry, evidenced by the greater number of dispensaries than Starbucks stores in a handful of states with legalized marijuana); see also \textit{How Many Dispensaries Are in Denver, Colorado?}, 420 TOURS (Feb. 28, 2018), https://my420tours.com/many-dispensaries-denver-colorado/ (finding the number of dispensaries in Denver outnumbers the amount of Starbucks stores and McDonalds stores in the city, combined, but this comparison may be slightly skewed because differing town ordinances on possession lead to a concentration of dispensaries in possession-friendly towns.).
\textsuperscript{49} See, e.g., 21 U.S.C. § 856 (a)–(b).
\textsuperscript{50} Id.; see also \textit{In re Rent-Rite Super Kegs W. Ltd.}, 484 B.R. 799, 803–07 (Bankr. D. Colo. 2012) (holding that a property manager who leased a warehouse to a marijuana cultivator was engaged in conduct that violated the CSA, which therefore provided cause to dismiss the property manager’s Chapter 11 claim for Bankruptcy relief).
\textsuperscript{51} 21 U.S.C. § 854(a).
\textsuperscript{52} See Brittany Yantis et al., \textit{Money Laundering}, 55 AM. CRIM. L. REV. 1469, 1485–86 (2018). Both financial transaction and proceeds of illegal activity are defined very broadly. Id.; see also JAMES KILICK ET AL., \textit{WHITE & CASE, GLOBAL INVESTIGATIONS: READING THE SIGNALS} 9 (2014), https://www.whitecase.com/sites/whitecase/files/files/download/publications/whitecase_globalinvestigations_readingthesignals.pdf (“Many US laws . . . may establish jurisdiction over a crime whenever it involves the use of any ‘means or instrumentality of interstate or foreign commerce.’ The term is broadly defined by US authorities and may cover any communication or movement that crosses state or international borders, including wire transfers, emails, phone calls, mail and travel.”).
for violating the CSA, all of the assets of the business—not just the plants or related products—could be subject to government forfeiture, leaving creditors and entrepreneurs without any collateral or residual value. This potential confiscation of assets decreases their value as collateral to lenders. Furthermore, the financial risk of asset forfeiture may be compounded with criminal liability under the continuing criminal enterprise provision of the CSA. If the nature of a relationship between a stakeholder and marijuana business is criminalized under the CSA, the actions of the stakeholder could be seen as a continuing series of violations which would render the stakeholder as one “engag[ed] in a continuing criminal enterprise.” Such a finding could severely increase criminal penalties beyond what could have been imposed for the underlying violation, adding criminal liability risks on top of the financial risk of collateral seizure.

B. Investors’ Criminal Liability Under Anti-Money Laundering Laws

In addition to the array of activities criminalized by the CSA, marijuana business stakeholders, like investors and financial service providers, may encounter risks with other federal laws because of the federal prohibition of marijuana. The federal anti-money laundering statutes impose criminal liability on anyone who engages in

54 See Befort, supra note 34; see also Bricken, Funding and Financing, supra note 25, at 7.
55 See Bricken, Funding and Financing, supra note 25, at 7 (describing how marijuana businesses are vulnerable to asset forfeiture, creating financial, as well as criminal risks for lenders).
56 See 21 U.S.C. § 848(c). An individual found to be in violation of the continuing criminal enterprise statute will be subject to both asset forfeiture and increased prison and fines sentences. Id.
57 Id. An action is considered part of the continuing series of violations if (1) the action itself is a felony, (2) it is undertaken with at least five other people with whom the defendant has a managerial or supervisory relationship, and (3) a substantial amount of income is derived from the action. Id.
58 See id.; see also Bricken, Funding and Financing, supra note 25, at 7.
60 See Befort, supra note 34, at 32.
a financial transaction knowing that the money involved is the “proceeds of some form of unlawful activity.” Since the growing and selling of marijuana is illegal under federal law, any bank, investor, or supplier who accepts money from such a business could be liable for money laundering. While the initial act of a bank lending or investing in a marijuana business might not trigger money laundering laws because the funds flowing from the bank to the businesses are presumably still untainted, a bank’s subsequent acceptance of loan repayments reverses the flow of funds. Once the funds flow from the marijuana business (that is illegal in the eyes of federal law) to the bank, the payment could be seen as a financial transaction with illegally derived funds. Thus, under money laundering statutes, banks may loan out money but not get repaid. Such

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61 18 U.S.C. § 1956(a)(1) (2012). Under 18 U.S.C. §§ 1956–57, parties on both sides of the transaction are liable for money laundering, so the legal party beings used to “clean” the illegal proceeds (financial institutions, for the purpose of this Note) can be liable separately from the criminal enterprise. See id. §§ 1956–57.


64 See Yantis, supra note 52, at 1478–82. The four elements required to prove money laundering under 18 U.S.C. § 1956 are (1) knowledge that the transaction included illegally derived funds (even if the specific type of illegal activity is unknown); (2) the money involved must be proceeds derived from illegal activity; (3) an attempted or completed financial transaction; and (4) intent either to promote the underlying activity, evade taxes, or conceal the illegal nature of the funds in some way. See 18 U.S.C. § 1956(a).

65 See Yantis, supra note 52, at 1478–82. While the movement of money through a wire transfer or other means or any transaction with a bank engaged in interstate commerce constitutes the requisite type of financial transaction for money laundering, the funds are clean until they cross over to the marijuana business. Once the marijuana business has handled the funds, however, they can be tied directly or indirectly to illegal activities. See id. Even if the marijuana business uses money from a federally legal source to pay its obligations to the bank, a comingling of clean and illegal assets is sufficient to jeopardize the validity of the business’s entire asset pool and, therefore, any transactions it tries to initiate with a bank. See id. at 1480–83.

66 See Befort, supra note 34, at 33–34.
a transaction is typically considered a gift, not a loan, and is insufficient to attract the capital resources necessary for industry growth.

Furthermore, a violation of anti-money laundering laws is also considered a violation of Federal Deposit Insurance Corporation (“FDIC”) laws. In the most extreme cases, such a violation “could ultimately lead to termination of FDIC insurance” for the violating

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67 A gift is defined as “[t]he voluntary transfer of property to another without compensation,” or “[a] thing so transferred” while a loan is defined as “[a] thing lent for the borrower’s temporary use; esp., a sum of money lent at interest.” Compare Gift, BLACK'S LAW DICTIONARY (11th ed. 2019), with Loan, BLACK'S LAW DICTIONARY (11th ed. 2019).


69 See Scheick, supra note 68, at 462. The FDIC is a government agency that provides stability to the United States financial system by insuring bank deposits of $250,000 per customer per bank. Insurance Program, FED. DEPOSIT INS. CORP., https://www.fdic.gov/about/strategic/strategic/insurance.html (last updated Jan. 29, 2018). Even if a bank fails, customers’ savings and checking account balances are still protected by the U.S. government through the FDIC. Id. FDIC insurance is a crucial consumer protection tool and has become very common at banks across the nation. See Chizoba Mora, Are All Bank Accounts Insured by the FDIC?, INVESTOPEDIA (last updated May 27, 2019), https://www.investopedia.com/ask/answers/08/fdic-insured-bank-account.asp. Almost all consumer banks are FDIC insured, but cash transfer apps like Venmo are not. See id.; Lauren Lyons Cole, Venmo Just Settled with the FTC Over Allegations It Misled Users—And I Found the Little-Known App That Will Replace It Once and for All, BUSINESS INSIDER (Mar. 5, 2018, 1:44 PM), https://www.businessinsider.com/venmo-apple-pay-cash-vs-zelle-2017-12. Highlighting the problems of keeping cash in a non-FDIC insured account, Venmo recently settled a lawsuit alleging that it misled consumers by claiming it had “bank-grade security systems” but was not actually FDIC insured, and, on multiple occasions, prevented customers from cashing-out and caused them to lose money they thought they actually had. Id.
financial institution, a fate akin to financial suicide for banks. Unlike the cultivation, distribution, and dispensary businesses directly engaged in the marijuana market, stakeholders like financial institutions seem hesitant to enter the lucrative marijuana industry.

C. Hazy Enforcement Policies of Federal Administrations

Because of the array of risks the marijuana industry presents to a growing population of stakeholders, different presidential administrations have made efforts to provide legal clarity on enforcement policies in the industry. While medical marijuana programs have existed in states since the late 1990s, state legalization of recreational marijuana did not begin until 2012, with Colorado and Washington being the first. With the momentum of recreational legalization drastically increasing the number of individuals who could violate the CSA as business owners and consumers, the ability to criminalize this growing population rests squarely on the shoulders of federal prosecutors. As the need for federal clarification on the enforcement of the CSA becomes increasingly apparent, the federal government’s response has been inconsistent, adding uncertainty to the risk of prosecution.

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71 See Scheick, supra note 68, at 462.
72 See Murphy, supra note 25; infra Part II.
73 See infra Part I.C.
74 See State Medical Marijuana Laws, supra note 3.
75 See Marijuana Overview, supra note 3.
76 See supra note 3 and accompanying text.
77 Cf. Scheuer, supra note 26, at 527–28 (“it is probably safe to say that if medical marijuana dispensaries are still considered illegal and an option for prosecution by the federal government exists, then a recreational marijuana dispensary would be at even more risk. In November 2013, one month before the law went into effect, federal agents raided numerous marijuana dispensaries in Colorado in what may have been a warning to marijuana businesses set to start selling marijuana to recreational users in January 2014.”).
1. THE OBAMA ADMINISTRATION’S LAISSEZ-FAIRE APPROACH

Without directly endorsing the legalization of marijuana, the Obama administration supported states’ efforts to legitimize the marijuana industry by clarifying that it would not prevent or undo those efforts.78 In 2009, the Department of Justice announced new enforcement guidelines for states that had authorized medical marijuana.79 The memorandum acknowledged the federal government’s continued commitment to fighting the dangers of marijuana posed by its illegal distribution and association with violent criminal enterprises, but clarified that U.S. Attorneys “should not focus federal resources in [their] States on individuals whose actions are in clear and unambiguous compliance with existing state laws providing for the medical use of marijuana.”80 This enforcement policy echoed Obama’s campaign trail promises to respect state laws on marijuana.81

The Obama Administration reiterated its support for states’ thoughtful implementation of their laws legalizing both medical and recreational marijuana in its 2013 policy memorandum released by former Deputy Attorney General James Cole (“Cole Memo”).82 The Cole Memo attempted to provide clarity in an environment riddled with confusion by allocating enforcement responsibility between state and federal authorities.83 The memo enumerated a list of specific harms to public health, safety, and welfare and provided that federal resources would be committed only to the “most significant [marijuana] threats,” while “enforcement of state law by state and

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78 Id. at 524–25.
80 Id.
81 See Scheuer, supra note 26, at 524 n.21.
83 See id.
local law enforcement and regulatory bodies should remain the primary means of addressing marijuana-related activity. The federal priorities included the following:

- Preventing the distribution of marijuana to minors;
- Preventing revenue from the sale of marijuana from going to criminal enterprises, gangs, and cartels;
- Preventing the diversion of marijuana from states where it is legal under state law in some form to other states;
- Preventing state-authorized marijuana activity from being used as a cover or pretext for the trafficking of other illegal drugs or other illegal activity;
- Preventing violence and the use of firearms in the cultivation and distribution of marijuana;
- Preventing drugged driving and the exacerbation of other adverse public health consequences associated with marijuana use;
- Preventing the growing of marijuana on public lands and the attendant public safety and environmental dangers posed by marijuana production on public lands; and
- Preventing marijuana possession or use on federal property.

Though not as robust as a federal legislative change, the Cole Memo was perceived as providing assurance that industry participants would not be prosecuted as long as they were compliant with the respective state’s laws on the matter, thus providing enough certainty to allow the industry to flourish.86

Following the Department of Justice guidance, the Financial Crimes Enforcement Network (“FinCEN”)87 released its own guidance, outlining proper procedures for financial institutions to follow.
when lending or providing banking services to the marijuana industry.\footnote{FinCEN 2014 Banking Guidance, supra note 63 at 2.} After diligently verifying that the business is compliant with state laws and does not implicate one of the eight priorities of the Cole Memo, FinCEN recommends that the “financial institution[s] that decide[] to provide services to a marijuana-related business . . . file suspicious activity reports (“SARs”).”\footnote{Id. at 3.} Since a bank that knowingly conducts transactions with illegally derived funds is engaged in illegal money laundering under the Bank Secrecy Act,\footnote{Bank Secrecy Act, 31 U.S.C. § 5311 et. seq. (2012).} banks are required to file an SAR any time they believe such a transaction has occurred.\footnote{Id.; see also FinCEN 2014 Banking Guidance, supra note 63, at 4 n.7.} In doing so, the bank assists law enforcement in investigating the criminal activity and mitigates its own liability for money laundering.\footnote{Gerald L. Blanchard, Reports of Suspicious Activity in Bank Secrecy Act, in 2 LENDER LIABILITY: LAW, PRACTICE, AND PREVENTION § 21:6. (2018).} However, a high number of SARs filed for the same customer could indicate a bank’s controls are too lax and could subject the bank to increased regulatory scrutiny and penalties.\footnote{See James DeFrantz, When to Hold ‘Em and When to File ‘Em—A Two Part Series on SAR Filings, LINKEDIN (Feb. 7, 2016), https://www.linkedin.com/pulse/when-hold-em-file-em-two-part-series-sar-filings-james-defrantz?trk=prof-post.}

To differentiate SARs arising from state-legitimized marijuana businesses from SARs for traditional criminal enterprises, FinCEN created a three-category system.\footnote{FinCEN 2014 Banking Guidance, supra note 63 at 3–5.} A “marijuana limited” filing acknowledges that marijuana is federally prohibited, but the bank has no other reason to believe the business is engaged in illegal activity.\footnote{Id. at 3.} A “marijuana priority” filing acts as a red flag, indicating that a bank believes the business is not fully compliant with the relevant state laws or that the business might implicate the Cole Memo priorities.\footnote{Id. at 4.} The third category is “marijuana termination,” which indicates that the bank no longer believes it can remain compliant with anti-money laundering statutes if it continues the relationship with
the marijuana client because it would be supporting illegal activity of a company that is not compliant with state laws.97

On one hand, the Cole Memo and FinCEN memo together demonstrate the Obama administration’s earnest attempt to ensure its laws did not stifle the growth of marijuana industries that states chose to legitimize.98 On the other, the three-category reporting system requires banks to file continuing SARs throughout the year and constantly monitor the client to determine if it has switched categories, which comes with significant administrative burdens and costs that, in actuality, may be prohibitively high.99 The high regulatory burden may either dissuade banks from working with the marijuana industry, or the increased costs of compliance could be passed along to the customer, increasing the cost of banking for the marijuana industry.100 Furthermore, while the Cole Memo was more permissive of transactions with state-sanctioned marijuana industries, the memo was not a law, and did not decriminalize transacting with the industry.101 Instead, it merely changed whether or not banks were likely to be prosecuted for those transactions, which, ultimately, was subject to change by the subsequent administration.102

2. THE TRUMP ADMINISTRATION’S OPPOSITE STANCE

Though certain banks have hesitantly begun to enter the marijuana business arena, there is still great uncertainty in the industry, keeping otherwise ready and willing investors watching from the sidelines instead of contributing to the economic prosperity of a nascent industry with high growth potential.103 On the campaign trail, then-candidate Donald Trump took the position that “enforcement

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97 Id. at 4–5.
99 See DeFrantz, supra note 93; Hilary V. Bricken, Navigating the Hazy Status of Marijuana Banking, BUS. L. TODAY, Aug. 2017, at 1, 2 [hereinafter Bricken, Navigating the Hazy Status of Marijuana Banking].
100 See Bricken, Navigating the Hazy Status of Marijuana Banking, supra note 99, at 2.
101 See Bricken, Funding and Financing, supra note 25, at 7.
102 Id.
103 See id. (“Though the federal government’s Financial Crimes Enforcement Network in 2014 produced guidelines for financial institutions to bank the marijuana industry, most financial institutions have elected not to participate.”).
of marijuana laws was a state issue.**104 However, following the 2016 presidential elections,105 federal agencies under the Trump administration seemed keen to abandon the Obama-era’s *laissez-faire* enforcement policies,106 resulting in a heightened awareness of the risks of entering an industry that is criminalized by the federal government.107 In 2017, the director of the U.S. Trustee Program, who is responsible for overseeing federal bankruptcy courts,108 stated, “debtors with assets or income derived from marijuana may not proceed through the bankruptcy system.”109 This is consistent with federal bankruptcy judges’ treatment of bankruptcy petitions in the marijuana industry so far, which have almost exclusively been dismissed.110 Further adding to the cloud of uncertainty in the industry, then-Attorney General Jeff Sessions rescinded the Cole Memo in 2018, announcing a “return to the rule of law.”111 In his memo, Sessions reminded prosecutors that violations of the CSA may also

110 See infra Part II.
111 Dep’t of Justice, Office of Public Affairs, Press Release No. 18-8, Justice Department Issues Memo on Marijuana Enforcement (Jan. 4, 2018), https://www.justice.gov/opa/pr/justice-department-issues-memo-marijuana-enforcement; see also JEFFERSON B. SESSIONS, III, ATT’Y GEN., MEMORANDUM FOR ALL UNITED STATES ATTORNEYS ON MARIJUANA ENFORCEMENT (Jan. 4, 2018),
serve as the basis for prosecuting crimes under money laundering statutes and the Bank Secrecy Act, confirming a main concern among financial institutions.

Despite Sessions’ notorious opposition to the legalization of marijuana, the actual effects of the rescission may not be so dramatic. Sessions’ one page memo altered national policy on marijuana and restored prosecutorial discretion to U.S. Attorneys, directing them to “disrupt criminal organizations, tackle the growing drug crisis, and thwart violent crime across our country.” Curiously, this “new” directive outlines goals similar to those in the Cole Memo, which stated that U.S. Attorneys should remain vigilant in pursuit of violent drug cartels and illegal drug trafficking, so prosecutors may choose to act no differently than they did under the Cole Memo. Additionally, an appropriations bill dictates that the Department of Justice may not use federal funds to prosecute individuals in the medical marijuana businesses who are fully compliant with their state’s marijuana laws and regulations. Furthermore,
FinCEN’s marijuana banking guidance remains valid and continues to report a steady increase in the number of banks serving the marijuana industry, but, like the Cole Memo, it is merely guidance, not law, and cannot eliminate liability.

Shortly after rescinding the Cole Memo, Sessions was replaced by William Barr as Attorney General. Barr has stated that he favors a uniform, national prohibition of marijuana, but also acknowledges that obtaining such a national consensus on marijuana may not be feasible. He adopts a less aggressive stance than Sessions by taking the position that a new law that allows states to create and enforce marijuana laws within their borders while maintaining harmony with the federal laws is preferable to the status quo, which simply ignores the enforcement of certain aspects of federal laws. This is, in fact, exactly what the proposed STATES Act hopes to achieve by creating a carve-out of criminal liability under the CSA for marijuana businesses that are compliant with state laws.

implementation of their medical marijuana laws. Id.; see also Julie Hamill, Protection of Adult-Use Cannabis From Federal Enforcement Passes House in Resounding Bipartisan Vote, CANNALAW BLOG (Jun. 22, 2019), https://www.cannalawblog.com/protection-of-adult-use-cannabis-from-federal-enforcement-passes-house-in-resounding-bipartisan-vote/. This no-interference has been interpreted to prohibit the Department of Justice from using appropriated funds to prosecute individuals in the medical marijuana business who fully comply with their state’s laws. Id. This appropriations bill has been renewed each year since 2014, and the proposed amendment to the 2020 appropriations bill would, if passed, extend this protection to recreations/adult-use state marijuana laws. Id.

FIN. CRIMES ENF’T NETWORK, MARIJUANA BANKING UPDATE 1 (2018), https://www.fincen.gov/sites/default/files/shared/Marijuana_Banking_Update_Sep
tember_2018.pdf. While the first quarter of 2018 saw a drop in the number of banks serving the industry, likely in response to the Sessions memo, the market rebounded in the second and third quarters, with the number of banks serving the marijuana industry climbing to 486. Id. at 2.

Scheick, supra note 68, at 465–66.


Id.

Bill, which was originally proposed by Senators Cory Gardner and Elizabeth Warren, is one that President Trump has said he “probably will end up supporting.”

Marijuana businesses and their associated financial institutions might operate legally in the eyes of the state, but nonetheless risk federal prosecution for violating the CSA, anti-money laundering statutes, and the Bank Secrecy Act. The disparity of marijuana treatment between state and federal laws is compounded by inconsistent views between presidential administrations and agencies on whether compliance with state marijuana laws shields marijuana businesses and their stakeholders from federal enforcement.

II. THE FINANCIAL CONSEQUENCES OF LEGAL DISPARITIES

As a consequence of the tension between state and federal law and the confusion generated by successive administrations’ disparate views on enforcement policies, the marijuana industry’s access to financial resources has been stifled. The legal uncertainties that prevent the marijuana industry from realizing its full economic potential manifest themselves in opposite ends of a business’s financial life-cycle: marijuana businesses have limited access to U.S. capital markets, where businesses often raise the funding to grow, and to bankruptcy, where businesses in distress typically turn for help. As a result, foreign marijuana businesses are gaining an advantage over similarly-situated domestic marijuana businesses, and lenders and marijuana businesses operate beyond the reach of legal enforcement mechanisms for financial obligations, in the capital markets and bankruptcy realms, respectively.

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125 Sullivan, supra note 104.
126 Scheick, supra note 68, at 465–66
127 Id.
128 See supra Part I.
129 See Scheuer, supra note 26, at 529 n.100.
130 See infra Part II.A
131 See infra Part II.B
132 See infra Part II.A
133 See infra Part II.B
A. Grass is Greener on the Other Side of the Border

1. U.S. Capital Is Invested in Foreign Marijuana Businesses Instead of Domestic Businesses

First, capital that is ready to be invested in the industry is not being deployed efficiently. Shortly after the Constellation Brands-Canopy Growth deal closed in November 2018, the Altria Group announced a $1.8 billion investment in the Cronos Group, a Canadian cannabis company. This deal was financed by JPMorgan Chase Bank. The parallel Constellation and Altria deals both demonstrate the interest in and issues arising out of investing in the marijuana industry. In both, publicly traded U.S. companies made investments in the marijuana industry with the support of major U.S. investment banks—but the investments were both in foreign entities.

These deals illustrate the abundance of available capital and a desire by U.S. investors to put capital to use in the marijuana industry. With such high growth rates anticipated from increased state legalization and large U.S. companies willing to provide bullish endorsements for the product, the natural assumption would be that

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136 Id.


138 See Scheuer, supra note 26, at 530.

139 See Lewis, supra note 4.
the industry is ripe for investment and prosperity. But willing investors have not been able to capitalize on that opportunity because both the FinCEN Guidance and Department of Justice enforcement memoranda merely diminish the likelihood banks will suffer consequences for violating federal law. They do not alter the substantive law to eliminate the criminality altogether. The uncertain legal environment has forced many banks and otherwise eager investors to remain on the sidelines grappling with the risk of being prosecuted or searching for an alternative, less risky way to invest in the marijuana industry. Currently, that means investing in foreign operations.


141 See Scheuer, supra note 26, at 529–30.


143 Id.


145 See Lewis, supra note 4.

... And, since they’re attracting so many American investors, some major Canadian cannabis companies are now listed on the more prominent U.S. stock exchanges. These Canadian operators are the companies taking on multi-billion dollar investments from the alcohol and tobacco industries. These are the companies that small businesses fear, resent, or hope will see them as an acquisition target. These are the companies that are already exporting to Germany and Israel, laying the groundwork to dominate the global marijuana industry for years to come.

Id.
2. FOREIGN MARIJUANA BUSINESSES CAN BE PUBLICLY TRADED ON U.S. STOCK EXCHANGES, BUT SIMILARLY-SITUATED DOMESTIC BUSINESSES CANNOT

Second, because of the inconsistencies between state and federal marijuana laws in the United States, foreign marijuana growers and retailers have greater access to U.S. capital markets than domestic companies engaged in the exact same business activities. For example, to list on a major U.S. stock exchange like the New York Stock Exchange (“NYSE”) or the Nasdaq, a company must be legal in the jurisdiction where it operates. The NYSE is a self-regulating entity that requires certain approvals and documentation from companies wishing to list, including a certificate of good standing from the jurisdiction of incorporation, a statement of legal fitness from the advising law firm, and a statement of financial fitness from the financial auditing firm. State law governs business incorporation and states that have legalized marijuana that have licensing and registration requirements can, in fact, provide a statement of good standing. The realistic roadblock, however, may be obtaining the credibility certifications from the law firm and accounting firm, which jeopardize their own reputation and liability by endorsing a

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146 See Gene Johnson, Canadian Marijuana Company Tilray Has First US Pot IPO, U.S. NEWS (Jul. 19, 2018), https://www.usnews.com/news/us/articles/2018-07-19/canadian-marijuana-company-tilray-has-first-us-pot-ipo (noting that the presence of institutional investors is required for such a large IPO and “[t]he lesson is that the institutions will be there if you have a good business plan and your business is 100 percent legal in the jurisdiction you’re in.”); see also Jeremy Burke, One of the Largest Cannabis Companies Is Going Public on the New York Stock Exchange, BUSINESS INSIDER (Oct. 23, 2018, 6:01 AM), https://www.businessinsider.com/aurora-cannabis-going-public-on-new-york-stock-exchange-2018-10 (“To get listed on a US exchange like the NYSE, cannabis producers have to prove they are not violating any federal laws by shipping cannabis into the U.S . . .”).


company that they know is violating federal laws. If all the documents are obtained, the company would need to surmount the additional legal roadblocks of U.S. Securities and Exchange Commission (“SEC”) approval to make a public offering before it can seek approval from the NYSE to list.

As of October 17, 2018, recreational sales of marijuana are legal in Canada, so Canadian marijuana growers and retailers can, and, in fact have, successfully listed on U.S. stock exchanges. In contrast, U.S. marijuana growers and retailers that comply with state laws find themselves in legal purgatory where they may not be prosecuted for violating the CSA, but are also not considered federally legal and will therefore not pass the rigorous approval process for listing on the major U.S. stock exchanges. In a political climate colored by protectionist policies intended to bolster the domestic economy, the laws governing the marijuana industry result in an


See id. at 27–30.

See Canada Dep’t of Justice, supra note 7.

Sean Williams, These 5 Pot Stocks Are Now Listed on the NYSE or Nasdaq, Motley Fool (Nov. 7, 2018, 9:21 AM), https://www.fool.com/investing/2018/11/07/these-5-pot-stocks-are-now-listed-on-the-nyse-or-nasdaq.aspx. Canopy Growth, Aurora Cannabis, and Aphria are Canadian marijuana companies listed on the NYSE. Id. Similarly, Cronos and Tilray are both Canadian marijuana businesses listed on the Nasdaq. Id.

See Chloe Aiello & Kellie Ell, Tilray Joins Nasdaq in First US Cannabis IPO, CNBC (July 19, 2018, 10:39 AM), https://www.cnbc.com/2018/07/18/tilray-joins-nasdaq-in-first-us-cannabis-ipo-.html. The Nasdaq and NYSE are the major organized stock exchanges in the United States that require companies to meet certain requirements to be listed. See id. In contrast, the OTC market is the alternative to these more reputable exchanges. See id. They have fewer listing requirements, are not as closely regulated, and are not as transparent as the major exchanges, so they are typically less desirable. Williams, supra note 153. There are some U.S.-based marijuana companies listed on OTC markets. See Mrinalini Krishna, Top Marijuana Stocks to Watch, Investopedia, https://www.investopedia.com/investing/top-marijuana-stocks/ (last updated June 25, 2019).
ironic allocation of financial resources where U.S. assets can be invested in foreign companies but cannot be invested in domestic companies engaged in the same activities.\textsuperscript{155} Furthermore, U.S. marijuana growers and retailers must look to foreign markets to publicly list, and in doing so, may be required to merge into a foreign company.\textsuperscript{156} In either case, U.S. assets are drained from the domestic economy.

B. \textit{If It All Goes Up In Smoke, Investors and State-Sanctioned Marijuana Businesses Cannot Turn to the Bankruptcy Courts}

In the few instances where state-sanctioned marijuana businesses have filed for bankruptcy, their claims have been dismissed.\textsuperscript{157} The bankruptcy code does not explicitly prohibit state-legalized marijuana businesses from filing a petition for bankruptcy,\textsuperscript{158} but it has been interpreted by courts to prevent these businesses and their creditors from proceeding due to bad faith, for proposing an illegal or infeasible plan of reorganization under Chapter 11, for the inability of the bankruptcy trustee to legally liquidate the business’s assets under Chapter 7, or under the equitable doctrine of unclean hands.\textsuperscript{159} As bankruptcy courts navigate an environment in which businesses are legal within their state, are federally recognized for the purpose of tax collection, but are neither federally recognized as legal nor prosecuted for being illegal, these courts are uniquely positioned to define the ambiguous rights of and relationships between investors and these businesses.

Coextensive with the difficulty of raising capital in the domestic marijuana industry is the uncertainty of remedies and procedures if

\textsuperscript{155} See Aiello & Ell, \textit{supra} note 154.


\textsuperscript{159} See id. at 113–19.
a business becomes insolvent.\textsuperscript{160} As the industry grows, the inevitability that some businesses will not succeed requires lenders to examine their remedies in the event of a business’s failure.\textsuperscript{161} Under normal circumstances, these remedies are governed by federal bankruptcy law.\textsuperscript{162} Once it has been proven that a business is not viable in its current state and has no realistic hope of surmounting its debts, bankruptcy allows the business to stop, evaluate its assets and what value it can offer to its creditors, and then move forward free of the weight of its past financial mistakes.\textsuperscript{163} However, the bankruptcy system is a creation of federal law,\textsuperscript{164} and as such, marijuana businesses have not been able to proceed with claims for relief.\textsuperscript{165} Chapter 11 and Chapter 7 are the two forms most commonly used for businesses\textsuperscript{166} and a brief overview of each process is warranted to explain why neither avenue has been open to state-sanctioned marijuana businesses.

1. \textbf{The Chapter 11 and Chapter 7 Bankruptcy Processes}

The goal of Chapter 11 bankruptcy is to form a plan of reorganization with the understanding that creditors will ultimately be paid back more of their debt if they allow the business to cut some losses,

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\textsuperscript{160} See Todd Plummer, Research Memo, \textit{Smoke & Mirrors: Bankruptcy Relief Remains Elusive for Marijuana Businesses and their Creditors}, 8 ST. JOHN’S BANKR. RESEARCH LIBR. No 21 (2016), https://www.stjohns.edu/sites/default/files/uploads/2016-plummer_todd_research_memo_.pdf (“A corollary of this bloom in industry is the inevitability that sooner or later, some of these companies will seek bankruptcy relief. So as public opinion evolves, laws change, and jurisprudence develops, one question emerges: can a medical marijuana company legal under state law seek relief under Title 11 of the United States Code . . . ?”).

\textsuperscript{161} See id.


\textsuperscript{163} See id; see also \textit{Bankruptcy: Overview}, Practical Law Practice Note 1-380-9908, \textit{Westlaw} (last visited July 22, 2019) [hereinafter \textit{Bankruptcy Practice Note}].

\textsuperscript{164} \textit{Bankruptcy Basics}, supra note 162, at 5. Congress has the authority to enact nationwide bankruptcy laws under Article 1, Section 8 of the U.S. Constitution. Id. The Federal Bankruptcy Code, codified in Title 11 of the U.S. Code, and the Federal Rules of Bankruptcy Procedure govern all bankruptcy proceedings. Id.

\textsuperscript{165} See Plummer, supra note 160; see also infra Part II.B.

\textsuperscript{166} See \textit{Bankruptcy Practice Note}, supra note 162.
pursue a new strategy to continue operating, and pay back loans over a longer period of time.  

A debtor can file for Chapter 11 bankruptcy voluntarily or creditors wishing to enforce payment of the debtor’s obligations can force the debtor into involuntary Chapter 11 bankruptcy. Often, the debtor itself, or the debtor with the help of a plan sponsor, will manage the process as the “Debtor in Possession.” This allows the business to both remain in possession of its assets and remain functional while it forms a plan of reorganization. After filing the bankruptcy petition, the debtor has sixty days to file a disclosure statement including a description of the business, its financial information, its reasons for filing for bankruptcy, a liquidation analysis, and an initial description of the Chapter 11 plan, essentially justifying why the business seeks the dismissal of certain debts under bankruptcy laws. The Debtor in Possession has 120 days after filing the petition to present the reorganization plan outlining revenue streams, sources and uses of capital, and the repayment plan for each creditor, including sacrifices it requires them to accept. After creditor approval, the reorganization plan is presented to the bankruptcy court judge for approval. If it is approved, the debtor can successfully emerge from bankruptcy and continue its operations as a re-organized, recapitalized entity with new repayment plans for its secured lenders and all remaining debts extinguished. However, if the court does not approve the plan, the case may be dismissed or converted into a Chapter 7 liquidation.

Chapter 7 bankruptcy provides a court-managed process for liquidating all of the business’s assets when there is no viable way for the business to continue. The key distinction between Chapter 11 and Chapter 7 processes, for the purposes of this Note, is that all of

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167 See id.
168 11 U.S.C. §§ 301, 303 (2012); see also BANKRUPTCY BASICS, supra note 162, at 29.
169 11 U.S.C. §§ 1101–07; see also Christopher R. Kaup & J. Daryl Dorsey, Chapter 11 Bankruptcy: A Primer, GPSolo, July/August 2011, at 49.
170 11 U.S.C. § 1125; see also Kaup & Dorsey, supra note 169, at 50.
171 11 U.S.C. § 1121; see also Kaup & Dorsey, supra note 169, at 50–51.
173 BANKRUPTCY BASICS, supra note 162, at 39–40.
174 See id. at 38.
175 See id. at 6–7.
the debtor’s assets come under the control of the U.S. Trustee in the event of Chapter 7 bankruptcy. The assets of the business are sold at auction and the money is used to provide as much value to the creditors as possible. While individuals’ debts are discharged in personal Chapter 7 bankruptcy proceedings, corporations and partnerships that are liquidated under Chapter 7 do not receive a discharge of their debts. The Trustee simply liquidates all of the business’s assets and pays creditors to the extent possible. At that point, the unpaid creditors will only be able to recover from the business’s managers and individuals, if the managers are personally liable for the company’s remaining debts.

2. DISMISSAL FOR BAD FAITH

Under Chapter 11, the first challenge marijuana businesses face is surviving dismissal for a lack of good faith bankruptcy filing under 11 U.S.C. § 1112(b). Section 1112(b) enumerates a list of grounds for a “for cause” dismissal of bankruptcy and, while good faith is not explicitly stated, courts have widely read a lack of good faith in filing a petition as cause for dismissal. In In re CGO Enterprises, a Colorado dispensary petition for Chapter 11 bankruptcy was challenged by the U.S. Trustee on several good faith grounds. The Trustee argued that the debtor initiated the petition in bad faith, knowing that it could not produce a confirmable reorganization

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177 See id. at 18 (“The primary role of a chapter 7 trustee in an asset case is to liquidate the debtor’s nonexempt assets in a manner that maximizes the return to the debtor’s unsecured creditors. The trustee accomplishes this by selling the debtor’s property . . .”).

178 Id. at 15, 18.


181 See id.


183 11 U.S.C. § 1112(b); see also Cheng, supra note 158, at 108–09, 113–16.

184 United States Trustee’s Motion to Dismiss This Chapter 11 Case Pursuant to 11 U.S.C. § 1112(b) at 2–3, In re CGO Enterprise L.L.C., No. 12-19010 (Bankr. D. Colo. May 16, 2012), 2012 WL 1962267 [hereinafter CGO Motion to Dismiss].
plan. To confirm a plan, the court must find it is a viable plan for continuing operations that is “not by any means forbidden by law.” As the plan would have to be funded by the illegal sale of marijuana under the CSA, the Trustee argued that the plan could not be confirmed. The second argument was that CGO failed to file timely documents, which was grounds for dismissal. CGO withdrew its petition, conceding to the failure to file timely documents, but rejected the notion that any plan would have been illegal. Curiously, the debtor’s withdrawal was driven by its own concerns about the feasibility of its reorganization plan due to complications regarding the ownership of the cannabis plants and ability to include them in the estate. While “CGO legally ‘owned’ all medical marijuana plants it produced, the applicable state regulators believe[d] individual plants are only owned for the ‘benefit of’ or on ‘behalf of’ named individual patients, and the applicable state regulators [did] not believe that a trustee could exercise any control or dominion over medical marijuana plants.”

3. DISMISSAL FOR ILLEGAL OR INFEASIBLE REORGANIZATION PLANS

While 11 U.S.C. § 1112(b) requires bankruptcy petitions to be filed in good faith in order to seek financial relief and repayment for creditors, 11 U.S.C. § 1129 requires a reorganization plan to be financially viable. In California, Mother Earth’s Alternative Healing Cooperative’s Chapter 11 bankruptcy petition illustrates

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185 See id. at 3.
187 CGO Motion to Dismiss, supra note 184, at 3.
188 Id.
190 See id. at 1.
191 Id.
the challenges of surmounting the good faith hurdle under Section 1112(b), as well as two key factors a court must find to confirm the plan under 11 U.S.C. § 1129.\textsuperscript{195} Mother Earth openly admitted its goal in seeking bankruptcy protection was to avoid eviction.\textsuperscript{196} The southern California medical marijuana dispensary was fully compliant with California state laws, but alleged that its landlord had been receiving pressure from the federal government to evict the business.\textsuperscript{197} The judge noted that the “[d]ebtor fil[ing] this bankruptcy solely to preserve a lease” was grounds for dismissal.\textsuperscript{198} Furthermore, to win court approval, a plan must “not [be] by any means forbidden by law”\textsuperscript{199} and must be feasible.\textsuperscript{200} The judge found the only means of funding a plan would have been “by criminally illegal means,” and the viability of the plan was further compromised because any proceeds the business received under the plan “would have been subject to forfeiture and, therefore, [were] illusory.”\textsuperscript{201}

4. DISMISSAL FOR INABILITY OF THE TRUSTEE TO LEGALLY LIQUIDATE ASSETS

Chapter 7 bankruptcy cases have been dismissed primarily because of the inability of the Trustee to legally sell the marijuana assets.\textsuperscript{202} Because the bankruptcy trustee manages the liquidation process of Chapter 7 bankruptcy, a bankruptcy court in Colorado held that “the trustee could neither ‘take control of the Debtor’s Property . . . ’ nor ‘liquidate the inventory of marijuana plants . . . ’ without violating § 841(a) of the CSA.”\textsuperscript{203} The court’s dismissal in Mother Earth similarly refused to convert the Chapter 11 petition to

\textsuperscript{197} Id.
\textsuperscript{198} Mother Earth Order, supra note 195, at 2.
\textsuperscript{200} See id. § 1129(a)(11).
\textsuperscript{201} Mother Earth Order, supra note 195, at 2.
\textsuperscript{202} See, e.g., id. at 3.
\textsuperscript{203} Plummer, supra note 160 (quoting In re Arenas, 514 B.R. 887, 892 (Bankr. D. Colo. 2014)).
a Chapter 7 bankruptcy proceeding because the bankruptcy “trustee cannot be forced to engage in illegal activity.” 204

5. DISMISSAL FOR “UNCLEAN HANDS”

In addition to the debtor’s inability to proceed with bankruptcy claims, courts have also denied creditors of marijuana businesses access to bankruptcy courts under the unclean hands doctrine. As a court of equity, the bankruptcy court’s available remedies are informed by the notion that “a plaintiff asking a court for equitable relief ‘must come with clean hands.’” 205 When creditors brought an involuntary Chapter 7 petition to force an Arizona medical marijuana dispensary into bankruptcy, they were met with little sympathy from the bankruptcy court. 206 Illustrating a key danger of the continued tension between federal and state law for investors, the dispensary was able to escape liability for its debts by using its own federal illegality as a defense. 207 It used the unclean hands doctrine to argue that its creditors “knew or should have known that Medpoint’s activities were illegal under federal law” and therefore the creditors were not eligible to seek relief under the federal bankruptcy laws. 208 Reluctantly persuaded by Medpoint’s argument, the court ruled in favor of the debtor, finding both unclean hands of the petitioner and risk for the trustee who would have had to liquidate the marijuana assets if the Chapter 7 liquidation were allowed to proceed. 209

204 Mother Earth Order, supra note 195, at 3.
205 Northbay Wellness Grp., Inc. v. Beyries, 789 F.3d 956, 959 (9th Cir. 2015) (quoting Johnson v. Yellow Cab Transit Co., 321 U.S. 383, 387 (1944)).
206 See In re Medpoint Management, LLC, 528 B.R. 178, 186–88 (Bankr. D. Ariz. 2015), vacated on other grounds, 2016 WL 3251581 (B.A.P. 9th Cir. June 3, 2016) (“Medpoint did not dupe [the creditors] into entering the medical marijuana business. . . . Petitioning Creditors may themselves have also violated the CSA and attempted to profit from those violations.”).
207 See id. at 188 (“The Court has neither the authority nor the will to enter an order for relief or endanger a trustee who might be assigned to administer drug tainted assets for the benefit of creditors who assumed the risk of doing business with an enterprise engaged in violations of federal law.”).
208 Id. at 186–87.
III. Bankruptcy Courts are Uniquely Positioned to Remedy Certain Financial Consequences by Allowing State-Sanctioned Marijuana Businesses Access to the Federal Bankruptcy System

As social acceptance of marijuana broadens, the business and legal arenas must work together to create stability. While insolvency is a fate debtors and creditors alike hope to avoid, the bankruptcy system has a stabilizing effect on markets by identifying the best outcome in a bad situation. “The Bankruptcy Code [] does not explicitly prohibit [marijuana businesses] from filing for bankruptcy” and should therefore be made accessible to the state-legitimized marijuana industry.

A. Better Alignment with the Goals of Bankruptcy

There are many instances in which discrepancies between state and federal marijuana laws have created confusion, including issues of tax violations and employee terminations for positive marijuana tests. For example, tax violations and employee terminations for testing positive for marijuana illuminate tension between state and federal laws. Alterman v. Comm’r of Internal Revenue, 115 T.C.M. (CCH) 1452, (T.C. 2018) (finding tax penalties for under-reporting income valid when the business deducted business expenses from its gross income—a standard practice for most businesses, but not allowed for marijuana businesses); see also Canna Care, Inc. v. Comm’r, 110 T.C.M. (CCH) 408 (T.C. 2015), aff’d sub nom. Canna Care, Inc. v. Comm’r of
however, is that the law in those cases was used to prosecute violations within its reach, while bankruptcy laws are voluntarily sought out by those who seek to benefit from its financial forgiveness.\textsuperscript{215} Even in circumstances where the creditor forces the debtor into involuntary bankruptcy, the bankruptcy court does not weigh criminal issues, but rather equitable issues of financial misfortunes or mismanagement.\textsuperscript{216} Bankruptcy courts serve an economic purpose rather than a criminal purpose, so whether a business can or cannot access the bankruptcy framework should be a question of economic benefit rather than a question of legal harmony under the preemption doctrine.\textsuperscript{217} Both Congress and bankruptcy judges have noted that the bankruptcy courts are courts of limited jurisdiction to address financial affairs.\textsuperscript{218} Bankruptcy courts in the past have limited their

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Internal Revenue, 694 F. App’x 570 (9th Cir. 2017) (“we find that petitioner was involved in the trade or business of trafficking in a controlled substance within the meaning of the CSA that was prohibited by law during the years at issue. We hold that section 280E prohibits petitioner from deducting any amounts paid or incurred during the years at issue in connection with its trade or business that respondent disallowed”); Coats v. Dish Network, L.L.C., 303 P.3d 147, 150–52 (COA 2013) (holding plaintiff’s medical marijuana use, though legal in Colorado, illegal under the federal CSA, and therefore reasonable grounds for employment termination); see Chemerinsky et al., supra note 35, at 98 n.88 (detailing a number of cases addressing employment termination after failing a marijuana drug test).
\textsuperscript{215} “One of the primary purposes of [the federal bankruptcy law] is to ‘relieve the honest debtor from the weight of oppressive indebtedness, and permit him to start afresh free from the obligations and responsibilities consequent upon business misfortunes.’” \textit{In re Perrotta}, 406 B.R. 1, 7 (Bankr. D.N.H. 2009) (quoting \textit{Local Loan Co. v. Hunt}, 292 U.S. 234, 244 (1934)) (internal quotation marks omitted) (alterations in original).
\textsuperscript{216} \textit{See} Cheng, \textit{supra} note 158, at 118–20.
\textsuperscript{217} \textit{See id.} at 119–21.
\textsuperscript{218} \textit{See} Stern v. Marshall, 564 U.S. 462, 486–501 (2011). The Court held that bankruptcy courts are not mere adjuncts of Article III Courts and, therefore, the bankruptcy court’s entry of final judgement on a non-bankruptcy issue was unconstitutional. \textit{See id.} This is because Bankruptcy Courts are not Article III courts under the constitution, but rather, courts whose authority is derived from an act of Congress. \textit{See id.} As a result, the judges do not have the same salary and tenure protections as Article III judges meant to protect them from political influence in their decision-making. \textit{See id.} To allow a bankruptcy court to decide matters that are not related to bankruptcy, but are civil rights or criminal in nature, would allow such crucial rights to be “taken from the Article III Judiciary . . . [and] Article III would be transformed from the guardian of individual liberty and separation of powers we have long recognized.” \textit{Id.} at 495.
\end{quote}
analysis of reorganization plans to its financial feasibility of the plan
and the interests of its creditors, declining to opine on questionable
legalities and suggesting that such an inquiry would be “contrary to
the ‘basic function of bankruptcy judges in bankruptcy proceed-
ings.’”219 This Note by no means suggests that bankruptcy courts
should open their doors to the black market; rather, it proposes that
where one governing body—in this case, the state—has determined
that it is in the public interest to legitimize an industry, and the con-
flicting governing body—the federal government—has demon-
strated it is not in the public interest to cripple the states’ efforts,
bankruptcy courts should fulfill their economic role by providing a
predictable and organized process for businesses and lenders alike.220

Furthermore, the tests applied in each bankruptcy process to de-
termine whether a petition should survive dismissal are concerned
with detecting abuse of the bankruptcy system to hide value or
fraudulently escape liability for debts, not “abuses” directed at de-
termining the criminality of state-approved actions.221 While CGO
and Mother Earth’s Healing Cooperative’s dismissals both noted a
good faith violation because of the marijuana in the reorganization
plan, neither one was dismissed exclusively on a finding that any
reorganization plan based on the sale of marijuana is unconfirm-
able.222 Rather, both cases included additional reasoning that would
have been grounds for dismissal regardless of the marijuana, so it is
not clear that a debtor’s characterization as a marijuana business
alone precludes it from proceeding with bankruptcy.223 Under a

219 Cheng, supra note 158, at 120–21 (2013) (quoting In Re Food City Hall at
812).
220 See Gamble, supra note 31 (“To accurately determine the risk of these in-
vestments, it is important to look beyond the numbers to the legal institutions
that provide transparency and consistency, because when things go sour, they are your
only protection.”).
221 See Cheng, supra note 158, at 110.
222 See CGO Motion to Dismiss, supra note 184, at 2–3; Mother Earth Order,
supra note 195, at 2–3.
223 Mother Earth had an improper purpose for filing because it was trying to
escape eviction rather than accomplish the goals of bankruptcy, which are to pro-
vide as much value as possible to creditors before making a fresh start. See Mother
Earth Order, supra note 195, at 2; see also Debtor’s Response to Motion to Dis-
miss, supra note 189, at 1.
Chapter 11 reorganization, the court has a fiduciary duty to apply the best interest of the creditors test.224 The test considers which assets to pay the business’s creditors with and whether it is in the best interest of the creditors for the business to continue so it could potentially repay some on an extended timeline or whether the creditors would be better served by liquidating the company’s assets.225 CGO openly admitted it did not have enough assets to proceed further with Chapter 11 bankruptcy and unilaterally determined it would not pass the best interest test.226 However, if a marijuana business’s reorganization plan is compliant with state laws and survives the best interest test, the creditors should be allowed to benefit from that plan.

In determining the validity of a creditor’s claim in bankruptcy proceedings, the Supreme Court has “long recognized that the basic federal rule in bankruptcy is that state law governs the substance of claims” because the debtor’s obligation to pay stems from a contract.227 The creditor’s right to enforce payment is determined by the contract between the debtor and the creditor, which is a matter of state law since “[p]roperty interests are created and defined by state law.”228 A contract that is illegal is unenforceable,229 but the federal prohibition of marijuana under the CSA that renders the contract illegal is in direct conflict with the state law that is determinative of the contract’s validity.230 Assuming the business is compliant with state marijuana laws, the contract is valid in the eyes of the state and “[u]nless some federal interest requires a different outcome, there is no reason why such interests should be analyzed differently simply

226 See Debtor’s Response to Motion to Dismiss, supra note 189, at 1.
228 Id. at 451 (quoting Butner v. United States, 440 U.S. 48, 55 (1979)) (alterations in original).
229 George A. Strong, The Enforceability of Illegal Contracts, 12 Hastings L.J. 347, 357 (1961) (“an illegal contract is one that is unenforceable as a matter of policy because enforcement would be injurious to the best interest of the public.”).
because an interested party is involved in a bankruptcy proceeding.\footnote{Travelers Cas., 549 U.S. at 451 (quoting \textit{Butner}, 440 U.S. at 55).} Not only does the federal government have an interest in enforcing the CSA, but it also has an interest in the economic prosperity of its citizens in every state.\footnote{See generally Proclamation No. 9816, 83 Fed. Reg. 55,457 (Nov. 6, 2018).} While a traditional federal court might weigh the legal harmony interests of preemption higher than the economic interest, as discussed, it is more consistent with the bankruptcy courts’ role to focus on the economic interests.

B. \textit{Benefits to Industry and Investors Outweigh the Risks to the Bankruptcy System}

Bankruptcy access alone cannot address all of the burning questions of financial institutions evaluating an investment in the domestic marijuana market, but it is one necessary component of creating a business environment positioned for growth.\footnote{See Gamble, \textit{supra} note 31 (“[C]redit is essential to economic growth. In game theory, a debtor’s best move is not to repay the debt. Creditors know this and their best move is not to lend. So without adequate legal protections, economic growth can come to an end.”).} A major goal of the states’ legalization programs is to eliminate the harms caused by the illegal marijuana trade.\footnote{See, e.g., Cheng, \textit{supra} note 158, at 140.} If the states hope to drive business away from the illegal market, the legitimate market needs to be large enough to absorb demand and to offer prices that consumers are willing to pay.\footnote{ADAM ORENS ET AL., MARIJUANA POLICY GROUP \& UNIV. COLO. BOULDER, COLORADO DEPARTMENT OF REVENUE, \textit{MARKET SIZE AND DEMAND FOR MARIJUANA IN COLORADO: 2017 MARKET UPDATE} 14 –15 (2018), https://www.colorado.gov/pacific/sites/default/files/MED%20Demand%20and%20Market%20Study%20%20082018.pdf.} Otherwise, states’ efforts may be thwarted by consumers turning to the black market for cheaper or more accessible products.\footnote{\textit{Id.}; see also Jeff Desjardins, \textit{California’s Recreational Cannabis Industry Is Booming—But Regulations Are Posing a Unique Threat}, \textit{BUSINESS INSIDER} (Aug. 28, 2018, 6:45 PM), https://www.businessinsider.com/californias-recreational-cannabis-industry-is-booming-but-regulations-are-posing-a-unique-threat-2018-8.} If investors have assurance that they will be able to enforce their loans and obtain their collateral through bankruptcy proceedings, they will be more likely to lend to the industry. As the
availability of funding for the industry grows, so too will the industry’s competition and its ability to fully address demand.\textsuperscript{237} Increased competition improves quality and drives down prices, which ultimately benefits consumers, the economy, and states’ efforts to drive business away from the illegal drug trade.\textsuperscript{238}

Even if the legislature were to make an exception to legal liability for banks that lend to marijuana industries, lenders still face the risk of being left with no way to enforce their loans through bankruptcy proceedings if the business fails.\textsuperscript{239} Access to the bankruptcy system adds security to the market and increases growth by providing a predictable, navigable process for debtors and creditors, thus allowing the industry to achieve greater scale by encouraging more lending. It allows debtors in financial distress to start fresh, hopefully bringing some financial management lessons to future pursuits.\textsuperscript{240} Further, bankruptcy proceedings allow creditors a legal means of enforcing their unpaid loans and maximizing the value of their recovery in the event of insolvency.\textsuperscript{241} The continuing recovery of the U.S. economy in the wake of the 2008 financial crisis is a

\textsuperscript{237} See Desjardins, supra note 236; see also ORENS ET AL., supra note 235, at 14–15.
\textsuperscript{238} Cf. ORENS ET AL., supra note 235, at 14–15.
\textsuperscript{239} For an illustration of forfeiture and of how mere promises of safe-harbor from criminal liability alone are insufficient to encourage meaningful banking activity in the industry, see Chemerinsky et al., supra note 35, at 93.
\textsuperscript{240} Even if the federal government were to promise never to pursue money laundering charges against those banks doing business with the marijuana industry, it is not at all clear that banks would actually begin to treat marijuana businesses the way they treat other businesses. Because the CSA and its forfeiture provisions remain good law, the assets of a marijuana business remain subject to forfeiture even in the face of a federal promise not to pursue such actions, and it is difficult to see how those assets could be seen by a bank as sufficiently secure against government seizure to be worth the risk. It was for this reason that the reaction of the marijuana industry to the new banking guidelines was decidedly tepid.
\textsuperscript{241} Id. (citing Evan Perez, Banks Cleared to Accept Marijuana Business, CNN (Feb. 17, 8:39 AM), http://www.cnn.com/2014/02/14/politics/u-s-marijuana-banks).
salient illustration of the economic function of the bankruptcy system. More than ten years after Lehman Brothers declared Chapter 11 bankruptcy, launching the tailspin of the U.S. stock market, the deal negotiated during the bankruptcy process is credited as one that “helped avert ‘an even greater economic calamity.’” Over $130 billion in claim settlements have been paid and the process is still ongoing. It is unclear what, if any, recovery creditors would have had without bankruptcy.

The federal government has not actively condoned state-legalized marijuana businesses, nor has it condemned businesses that openly seek to expand in compliance with states’ laws. If federal bankruptcy courts were to start allowing marijuana businesses or their creditors to proceed with bankruptcy claims as regular businesses, there are, of course, inherent risks. Broadly speaking, decisions may be overturned or a circuit split may emerge as bankruptcy petitions make their way through the courts in each legalized state. A circuit split would detract from the market-stabilizing investment security that bankruptcy can provide. However, this would likely encourage forum-shopping behavior and consequential migration of funding and the associated growth to states in jurisdictions that provide security in bankruptcy procedures. Furthermore, in finding that the personal mandate of the Affordable Care Act was a legal tax, not an illegal penalty, the Supreme Court “estimated that four million people each year will choose to pay the IRS rather than buy insurance” and reasoned “that Congress regards such extensive failure to comply with the mandate as tolerable suggests that Congress did

245 See id.
246 There has certainly been verbal political condemnation, but to date, there seems to have been little condemnation actions against those in compliance with state marijuana laws and federal tax reporting requirements. See infra Part I.B.
not think it was creating four million outlaws.” 248 Similarly, there are currently over 1.2 million registered medical marijuana users in California and thirty-nine million consumers. 249 Recreational marijuana is now legalized in California, and therefore available to more than thirty-nine million people. 250 With nine other recreational states and thirty-two other medical states’ populations, 251 the number of people exposed to the risk of violations under the CSA as consumers and business owners far exceeds the four million people the Supreme Court was concerned with criminalizing in NFIB v. Sebelius. 252 With such a large number of people at risk, it is unlikely that the federal government would remain fairly passive in the face of a growing population if it intended for all these people to be considered outlaws.

Additionally, the individual bankruptcy trustees who take control of assets may be exposed to criminal liability for selling marijuana in a Chapter 7 liquidation or for supporting the sale of marijuana in the event of approval of a reorganization plan. 253 However, there are a few reassurances that these individuals are unlikely to suffer the consequences of that risk. A federal appropriations bill does not allow the use of federal funds to prosecute medical marijuana businesses that are in compliance with their state laws. 254 If the federal government has determined it would be a waste of money to go after state-compliant businesses, it would likely be an even more egregious waste of federal resources to prosecute the U.S. Trustees performing the debt distributing functions of the bankruptcy court. In fact, the Ninth Circuit in United State v. McIntosh allowed a group of ten marijuana dispensaries to enjoin the Department of Justice’s

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248 Id.
250 See Desjardins, supra note 236.
251 See supra note 3 and accompanying text.
prosecution efforts, finding that the prosecution under the CSA violated the appropriations bill.255

CONCLUSION

The reality of state-by-state marijuana legalization is that a quasi-legal marijuana industry now exists in the United States. Legal uncertainties regarding federal liability and enforcement, however, have limited the industry’s access to resources, thus limiting the economic benefits that states can realize from a prospering and expanding industry. As the wave of state recreational marijuana legalization gains momentum, the importance of legal clarity on the issue grows because the missed business opportunities are that much larger. Federal and state views on the legality of marijuana remain divergent, but the belief that corporate bankruptcy is an important strategic business tool is a view upon which the government stands united.256 By granting state-legitimized marijuana businesses access

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255 United States v. McIntosh, 833 F.3d 1163, 1177 (9th Cir. 2016).
to the federal bankruptcy system, the government can bolster the industry’s access to capital and access to remedies when the capital runs out. Doing so certainly does not address all the qualms facing the industry but increases the likelihood that marijuana businesses and U.S. investors can capitalize on opportunities of the domestic marijuana industry, regardless of when or how the federal government confronts the increasing divide between state and federal marijuana laws.

fourth-times-a-charm-how-donald-trump-made-bankruptcy-work-for-him/#6cc9f7007ffa. For the judicial branch, see Local Loan Co. v. Hunt, 292 U.S. 234, 244 (1934).