

11-22-2019

## Nipped in the Bud: How Legal Disparities Create Financial Growth Hurdles in the State-Sanctioned Marijuana Industry and Why Bankruptcy Courts Can Provide a Remedy

Caitlyn Cullen

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# **Nipped in the Bud: How Legal Disparities Create Financial Growth Hurdles in the State-Sanctioned Marijuana Industry and Why Bankruptcy Courts Can Provide a Remedy**

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.<sup>1</sup> Despite federal prohibition of marijuana use, distribution, and sales under the Controlled Substances Act,<sup>2</sup> many states

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\* J.D. Candidate 2020, University of Miami School of Law. I would like to thank Professor Kathleen Claussen for her guidance and invaluable feedback throughout the process of writing this Note. I would also like to thank the *University of Miami Law Review* for introducing me to such a wonderful group of people to work with, and the *University of Miami Law Review* Editors, in particular, for their dedication and insightful edits. Finally, this Note would not be complete without expressing my sincerest thanks to my family and friends. They are my sounding board and constant source of encouragement, and I am forever grateful for their love, humor, and support.

<sup>1</sup> Thomas Pellechia, *In 2017 and Beyond, U.S. Enjoys The Highest Legal Cannabis Market Share Worldwide*, FORBES (June 26, 2018, 10:24 AM), <https://www.forbes.com/sites/thomaspellechia/2018/06/26/in-2017-beyond-u-s-enjoys-the-highest-legal-cannabis-market-share-worldwide/#15ef8a892d20>; see also Arcview Group, *Legal Marijuana Markets Projected to Reach \$23.4 Billion, Employ Nearly a Half-Million Americans by 2022; Effective End of Federal Prohibition is in Sight*, GLOBE NEWSWIRE (June 28, 2018, 9:00 AM), <https://globenewswire.com/news-release/2018/06/28/1531033/0/en/NEW-REPORT-Legal-Marijuana-Markets-Projected-to-Reach-23-4-Billion-Employ-Nearly-a-Half-Million-Americans-by-2022-Effective-End-of-Federal-Prohibition-is-in-Sight.html>.

<sup>2</sup> See Controlled Substances Act, 21 U.S.C. §§ 801, 812 (2012).

have forged ahead with their own laws legalizing medicinal marijuana and, increasingly, recreational marijuana for adults.<sup>3</sup> With the state legalization trend expected to continue,<sup>4</sup> the legal marijuana market in the United States is projected to be worth \$23 billion by 2022,<sup>5</sup> and U.S. investors are taking note.<sup>6</sup>

In 2018, Canada legalized recreational marijuana use nationwide.<sup>7</sup> Not only did this ignite reactions in Canadian markets,<sup>8</sup> but it also sparked reactions from U.S. entrepreneurs, businesses, and

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<sup>3</sup> As of October 2019, marijuana is legal for adult recreational use in ten states plus Washington D.C. *Marijuana Overview*, NAT'L CONF. OF ST. LEGISLATURES, <http://www.ncsl.org/research/civil-and-criminal-justice/marijuana-overview.aspx> (last updated July 26, 2019). These states include: Alaska (2014), California (2016), Colorado (2012), Maine (2016), Massachusetts (2016), Michigan (2018), Nevada (2016), Oregon (2014), Vermont (2018), and Washington (2012). *Id.* In May 2019, Illinois passed the Cannabis Regulation and Tax Act, which will allow legal sales of adult-use marijuana to begin in January 2020. *Id.* Marijuana is legal for medical use in thirty-three states plus Washington D.C. (inclusive of the ten recreational use states). *See State Medical Marijuana Laws*, NAT'L CONFERENCE OF ST. LEGISLATURES, <http://www.ncsl.org/research/health/state-medical-marijuana-laws.aspx> (last updated July 2, 2019). These states are: Alaska, Arizona, Arkansas, California, Colorado, Connecticut, Delaware, Washington D.C., Florida, Hawaii, Illinois, Louisiana, Maine, Maryland, Massachusetts, Michigan, Minnesota, Missouri, Montana, Nevada, New Hampshire, New Jersey, New Mexico, New York, North Dakota, Ohio, Oklahoma, Oregon, Pennsylvania, Rhode Island, Utah, Vermont, Washington, and West Virginia. *Id.* In addition to these thirty-three states with comprehensive medical marijuana regulations, thirteen states allow for the use of low-THC/high-CBD products in a limited number of medical situations or as a legal defense. *Id.* In total, forty-six of the fifty United States permit some form of marijuana use or distribution. *See id.*

<sup>4</sup> *See* Amanda Chicago Lewis, *Why 2019 Will Be the Year of Weed*, ROLLING STONE (Jan. 2, 2019, 4:27 PM), <https://www.rollingstone.com/culture/culture-features/2019-weed-marijuana-cannabis-what-to-expect-774035/>.

<sup>5</sup> Arcview Group, *supra* note 1; *see also* Pellechia, *supra* note 1.

<sup>6</sup> *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.”).

<sup>7</sup> *Cannabis Legalization and Regulation*, CAN. DEP'T OF JUSTICE, <https://www.justice.gc.ca/eng/cj-jp/cannabis/> (last visited July 13, 2019).

<sup>8</sup> *See Big Bongs, Little Bang*, ECONOMIST (Oct. 13, 2018) <https://www.economist.com/the-americas/2018/10/13/the-main-high-from-canadas-cannabis-legalisation-is-financial>.

financial markets in the United States.<sup>9</sup> In August 2018, after Canada's legalization, U.S. company Constellation Brands<sup>10</sup> announced a \$4 billion investment in Canadian cannabis company Canopy Growth Corporation.<sup>11</sup> This was the “first multi-billion dollar deal in the [marijuana] space” and it drew support from top U.S. investment banks.<sup>12</sup> 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.”<sup>13</sup> As states across America continue to liberalize their marijuana laws,<sup>14</sup> marijuana is shifting “to the mainstream investment sector”<sup>15</sup> and is increasingly being viewed as a legitimate and lucrative business opportunity.<sup>16</sup> Constellation, which prides itself on being “at the forefront of consumer trends,”<sup>17</sup> 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.<sup>18</sup>

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<sup>9</sup> See, e.g., Steve Gelsi, *Bank of America, Goldman Sachs Get Behind Constellation Brands' Cannabis Play*, REAL MONEY (Aug. 15, 2018, 2:05 PM), <https://realmoney.thestreet.com/articles/08/15/2018/bank-america-goldman-sachs-get-behind-constellation-brands-cannabis-play>.

<sup>10</sup> Constellation Brands is a Fortune 500 company best known for its iconic beverage brands including Corona, Funky Buddha Brewery, Kim Crawford Wines, and Svedka. See generally CONSTELLATION BRANDS, COMPANY PROFILE 1–22 (2019), <https://companyprofile.cbrands.com/assets/dist/CBI-2019-Company-Profile.pdf> [hereinafter CONSTELLATION COMPANY PROFILE].

<sup>11</sup> See *Constellation Brands to Invest \$5 Billion CAD (\$4 Billion USD) in Canopy Growth to Establish Transformative Global Position and Alignment*, CONSTELLATION BRANDS (Aug. 15, 2018), <https://www.cbrands.com/news/articles/constellation-brands-to-invest-5-billion-cad-4-billion-usd-in-canopy-growth-to-establish-transformative-global-position-and-alignment> [hereinafter *Constellation to Invest \$4 Billion in Canopy Growth*].

<sup>12</sup> Gelsi, *supra* note 9.

<sup>13</sup> *Id.*

<sup>14</sup> See *supra* note 3 and accompanying text.

<sup>15</sup> Gelsi, *supra* note 9.

<sup>16</sup> See Lewis, *supra* note 4.

<sup>17</sup> CONSTELLATION COMPANY PROFILE, *supra* note 10, at 5.

<sup>18</sup> 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,<sup>19</sup> bringing with it economic opportunities.<sup>20</sup> Ironically, at a time when the national conversation is so often focused on strengthening the domestic economy,<sup>21</sup> conflicts of state and federal law<sup>22</sup> prevent this industry from realizing its full economic potential.<sup>23</sup> Because marijuana is illegal under federal law,<sup>24</sup> institutional investors and banks have been hesitant to provide services to U.S. marijuana businesses,<sup>25</sup> 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

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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.”).

<sup>19</sup> See *supra* note 3 and accompanying text.

<sup>20</sup> 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.

<sup>21</sup> 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.

<sup>22</sup> Compare Controlled Substances Act, 21 U.S.C. §§ 812 Schedule I(c)(10), 841 (2012), with CAL. BUS. & PROF. § 26000(b) (2016).

<sup>23</sup> See *infra* Part II.

<sup>24</sup> 21 U.S.C. §§ 812, 841.

<sup>25</sup> See *infra* Part II.A; see also Hilary Bricken, *Funding and Financing a Marijuana Business*, SCITECH LAW, Spring 2017, at 6–7 [hereinafter Bricken, *Funding and Financing*]; Kevin Murphy, *Legal Marijuana: The \$9 Billion Industry That Most Banks Won’t Touch*, FORBES (Sept. 6, 2018, 10:07 AM), <https://www.forbes.com/sites/kevinmurphy/2018/09/06/legal-marijuana-the-9-billion-industry-that-most-banks-wont-touch/#4466e4263c68>.

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

Despite these challenges, the U.S. state-legalized marijuana industry has a strong growth trajectory and continues to gain social, political, and financial interest.<sup>27</sup> 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.<sup>28</sup> 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-

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<sup>26</sup> See *infra* Part II.B; see also Luke Scheuer, *The "Legal" Marijuana Industry's Challenge for Business Entity Law*, 6 WM. & MARY BUS. L. REV. 511, 545–47 (2015).

<sup>27</sup> 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.”).

<sup>28</sup> 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](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,<sup>29</sup> 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.<sup>30</sup> 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.<sup>31</sup> 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<sup>32</sup> or the risks of new businesses.<sup>33</sup> The risks are even higher if the industry is precluded from federal

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<sup>29</sup> See *infra* Part II.A.

<sup>30</sup> See *infra* Part II.B.

<sup>31</sup> See Scheuer, *supra* note 26, at 545–46; see also William Gamble, *Significance of Bankruptcy and Economic Growth*, SEEKING ALPHA (Mar. 4, 2010, 6:39 AM), <https://seekingalpha.com/article/191890-significance-of-bankruptcy-and-economic-growth>.

<sup>32</sup> 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).

<sup>33</sup> 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.<sup>34</sup>

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.<sup>35</sup> While legalization at the state level

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<sup>34</sup> Jay D. Befort, *Ongoing Saga of Medical Marijuana: What's A Bank and A Debtor to Do?*, 35 AM. BANKR. INST. J., Mar. 2016, at 32, 33–34.

<sup>35</sup> 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 preempts 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,<sup>36</sup> federal law prohibits marijuana for both medical and recreational purposes.<sup>37</sup> 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.<sup>38</sup> Although the momentum of state law is encouraging the economic development of the marijuana industry,<sup>39</sup> the inconsistent stance of federal administrations and lack of clear policy regarding the legitimacy of state-sanctioned marijuana businesses<sup>40</sup> has created apprehension about the criminal liability that may result from transacting with marijuana businesses, and consequently has a dampening effect on that development.

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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* Chemerinsky et al., *supra*, at 102–03. Thus, while states' laws decriminalizing marijuana cannot prevent the federal government from prosecuting offenders of federal laws within those states' territories, the federal government cannot require the states to pass and enforce their own laws criminalizing marijuana. *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.

<sup>36</sup> A recent Gallup poll estimates that “[s]ixty-six percent of Americans now support legalizing marijuana.” Justin McCarthy, *Two in Three Americans Now Support Legalizing Marijuana*, GALLUP (Oct. 22, 2018), <https://news.gallup.com/poll/243908/two-three-americans-support-legalizing-marijuana.aspx>.

<sup>37</sup> *See* Controlled Substances Act, 21 U.S.C. §§ 801, 812 (2012).

<sup>38</sup> *See infra* Part I.C.

<sup>39</sup> *See State Marijuana Laws, supra* note 3; *see also Marijuana Overview, supra* note 3.

<sup>40</sup> *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”<sup>41</sup> marijuana, which is classified as a Schedule I substance.<sup>42</sup> 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.<sup>43</sup>

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.<sup>44</sup> The CSA directly implicates marijuana cultivation, distribution, and dispensary businesses,<sup>45</sup> but the potential federal criminal liability does not seem to have dissuaded these businesses from entering the thriving state-legitimized markets.<sup>46</sup> In fact, with 1,025 licensed dispensaries in Colorado as of August 1,

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<sup>41</sup> Controlled Substances Act, 21 U.S.C. § 841(a).

<sup>42</sup> *Id.* § 812 Schedule I(c)(10).

<sup>43</sup> *Id.* § 812(b)(1).

<sup>44</sup> *See id.* § 841; *see also* 18 U.S.C. § 3607(a)(2012).

<sup>45</sup> Marijuana cultivation, distribution, and dispensary businesses are engaged in the three specific activities that the CSA criminalized. 21 U.S.C. § 841(a).

<sup>46</sup> *See MED Resources and Statistics*, COLO. DEP’T OF REVENUE, <https://www.colorado.gov/pacific/enforcement/med-resources-and-statistics> (last updated Aug. 1, 2019).

2019,<sup>47</sup> there are now over three times more marijuana dispensaries than Starbucks stores in the state.<sup>48</sup>

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.<sup>49</sup> 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.<sup>50</sup> It is also illegal to use income derived from illegal drug activities in any business that directly or indirectly affects interstate or foreign commerce.<sup>51</sup> 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.<sup>52</sup> If the marijuana cultivators or dispensaries were, in fact, prosecuted and convicted

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<sup>47</sup> *See id.*

<sup>48</sup> There are 322 Starbucks stores in Colorado. *Lifestyle Statistics: Starbucks Stores (Most Recent) by State*, STATEMASTER, [http://www.statemaster.com/graph/lif\\_sta\\_sto-lifestyle-starbucks-stores](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 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.).

<sup>49</sup> *See, e.g.*, 21 U.S.C. § 856 (a)–(b).

<sup>50</sup> *Id.*; *see also 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).

<sup>51</sup> 21 U.S.C. § 854(a).

<sup>52</sup> *See* Brittany Yantis et al., *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 KILLICK ET AL., WHITE & CASE, GLOBAL INVESTIGATIONS: READING THE SIGNALS 9 (2014), [https://www.whitecase.com/sites/whitecase/files/files/download/publications/whitecase\\_globalinvestigations\\_readingthesignals.pdf](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,<sup>53</sup> leaving creditors and entrepreneurs without any collateral or residual value.<sup>54</sup> This potential confiscation of assets decreases their value as collateral to lenders.<sup>55</sup> Furthermore, the financial risk of asset forfeiture may be compounded with criminal liability under the continuing criminal enterprise provision of the CSA.<sup>56</sup> 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.”<sup>57</sup> 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.<sup>58</sup>

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

In addition to the array of activities criminalized by the CSA,<sup>59</sup> marijuana business stakeholders, like investors and financial service providers, may encounter risks with other federal laws because of the federal prohibition of marijuana.<sup>60</sup> The federal anti-money laundering statutes impose criminal liability on anyone who engages in

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<sup>53</sup> See 21 U.S.C. § 853.

<sup>54</sup> See Befort, *supra* note 34, at 33; see also Bricken, *Funding and Financing*, *supra* note 25, at 7.

<sup>55</sup> 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).

<sup>56</sup> 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.*

<sup>57</sup> *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.*

<sup>58</sup> See *id.*; see also Bricken, *Funding and Financing*, *supra* note 25, at 7.

<sup>59</sup> See, e.g., 21 U.S.C. § 848.

<sup>60</sup> See Befort, *supra* note 34, at 32.

a financial transaction knowing that the money involved is the “proceeds of some form of unlawful activity.”<sup>61</sup> Since the growing and selling of marijuana is illegal under federal law,<sup>62</sup> any bank, investor, or supplier who accepts money from such a business could be liable for money laundering.<sup>63</sup> 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.<sup>64</sup> 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.<sup>65</sup> Thus, under money laundering statutes, banks may loan out money but not get repaid.<sup>66</sup> Such

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<sup>61</sup> 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.

<sup>62</sup> 21 U.S.C. § 841(a).

<sup>63</sup> *See* 18 U.S.C. § 1956(c)(7); *see also* FIN. CRIMES ENF’T NETWORK, DEP’T OF THE TREASURY, FIN–2014–G001, BSA EXPECTATIONS REGARDING MARIJUANA-RELATED BUSINESSES 4 n.7 (2014) [hereinafter FinCEN 2014 Banking Guidance].

<sup>64</sup> *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).

<sup>65</sup> *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.

<sup>66</sup> *See* Befort, *supra* note 34, at 33–34.

a transaction is typically considered a gift, not a loan,<sup>67</sup> and is insufficient to attract the capital resources necessary for industry growth.<sup>68</sup>

Furthermore, a violation of anti-money laundering laws is also considered a violation of Federal Deposit Insurance Corporation (“FDIC”) laws.<sup>69</sup> In the most extreme cases, such a violation “could ultimately lead to termination of FDIC insurance” for the violating

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<sup>67</sup> 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).

<sup>68</sup> Cf. DEMIRGÜÇ-KUNT ET AL., *supra* note 28 (describing how economic growth relies on availability of credit and financing). A gift could still trigger liability directly under the CSA as aiding and abetting or conspiring with an illegal business. See Brad Scheick, *Do You Feel Lucky, Bankers? The Shaky Prospects for Financial Transactions with Marijuana-Related Businesses*, 28 MILLER & STARR REAL EST. NEWSALERT 459, 460 (2018).

<sup>69</sup> 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,<sup>70</sup> a fate akin to financial suicide for banks.<sup>71</sup> 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.<sup>72</sup>

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.<sup>73</sup> While medical marijuana programs have existed in states since the late 1990s,<sup>74</sup> state legalization of recreational marijuana did not begin until 2012, with Colorado and Washington being the first.<sup>75</sup> With the momentum of recreational legalization drastically increasing the number of individuals who could violate the CSA as business owners and consumers,<sup>76</sup> the ability to criminalize this growing population rests squarely on the shoulders of federal prosecutors.<sup>77</sup> 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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<sup>70</sup> *Bank Secrecy Act Examination Program Overview*, FED. DEPOSIT INS. CORP. (last updated Feb. 20, 2009), <https://www.fdic.gov/regulations/examinations/bsa/>; see also 12 U.S.C. § 1818(a)(2)(A)(iii) (2012) (the FDIC may terminate insurance for a financial institution that has “violated any applicable law, regulation, order . . .”).

<sup>71</sup> See Scheick, *supra* note 68, at 462.

<sup>72</sup> See Murphy, *supra* note 25; *infra* Part II.

<sup>73</sup> See *infra* Part I.C.

<sup>74</sup> See *State Medical Marijuana Laws*, *supra* note 3.

<sup>75</sup> See *Marijuana Overview*, *supra* note 3.

<sup>76</sup> See *supra* note 3 and accompanying text.

<sup>77</sup> 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.<sup>78</sup> In 2009, the Department of Justice announced new enforcement guidelines for states that had authorized medical marijuana.<sup>79</sup> 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."<sup>80</sup> This enforcement policy echoed Obama's campaign trail promises to respect state laws on marijuana.<sup>81</sup>

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").<sup>82</sup> The Cole Memo attempted to provide clarity in an environment riddled with confusion by allocating enforcement responsibility between state and federal authorities.<sup>83</sup> 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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<sup>78</sup> *Id.* at 524–25.

<sup>79</sup> DAVID W. OGDEN, DEPUTY ATT'Y GEN., DEP'T OF JUSTICE, MEMORANDUM FOR SELECTED UNITED STATES ATTORNEYS ON INVESTIGATIONS AND PROSECUTIONS IN STATES AUTHORIZING THE MEDICAL USE OF MARIJUANA (OCT. 19, 2009), <https://www.justice.gov/sites/default/files/opa/legacy/2009/10/19/medical-marijuana.pdf>.

<sup>80</sup> *Id.*

<sup>81</sup> *See* Scheuer, *supra* note 26, at 524 n.21.

<sup>82</sup> *See generally* JAMES M. COLE, DEPUTY ATT'Y GEN., DEP'T OF JUSTICE, MEMORANDUM FOR ALL UNITED STATES ATTORNEYS ON GUIDANCE REGARDING MARIJUANA ENFORCEMENT (AUG. 29, 2013), <https://www.justice.gov/iso/opa-resources/3052013829132756857467.pdf> [hereinafter COLE MEMO 2013].

<sup>83</sup> *See id.*

local law enforcement and regulatory bodies should remain the primary means of addressing marijuana-related activity.”<sup>84</sup> 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.<sup>85</sup>

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.<sup>86</sup>

Following the Department of Justice guidance, the Financial Crimes Enforcement Network (“FinCEN”)<sup>87</sup> released its own guidance, outlining proper procedures for financial institutions to follow

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<sup>84</sup> *Id.* at 3.

<sup>85</sup> *Id.* at 1–2 (original bulleted formatting omitted).

<sup>86</sup> *See id.*; see also Steven T. Taylor, *High Expectations: Business Keeps Heating Up in Cannabis Law Area*, OF COUNSEL, Oct. 2018 at 17–18, <https://www.hopkinscarley.com/uploads/pdf/of-counsel-cannabis-article-10-2018.pdf> (“‘More and more law firms, including larger ones, are willing to get into this area,’ Heyl says. ‘They have clients with lots of money that are investing – and more people are recognizing that the federal government isn’t prosecuting so as this happens there’s less and less fear.’”).

<sup>87</sup> FinCEN is an organization under the treasury department responsible for combatting money laundering and illegal use of U.S. financial systems. *See What*

when lending or providing banking services to the marijuana industry.<sup>88</sup> 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”).”<sup>89</sup> Since a bank that knowingly conducts transactions with illegally derived funds is engaged in illegal money laundering under the Bank Secrecy Act,<sup>90</sup> banks are required to file an SAR any time they believe such a transaction has occurred.<sup>91</sup> In doing so, the bank assists law enforcement in investigating the criminal activity and mitigates its own liability for money laundering.<sup>92</sup> 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.<sup>93</sup>

To differentiate SARs arising from state-legitimized marijuana businesses from SARs for traditional criminal enterprises, FinCEN created a three-category system.<sup>94</sup> 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.<sup>95</sup> 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.<sup>96</sup> 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

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*We Do*, FIN. CRIMES ENF’T NETWORK, <https://www.fincen.gov/what-we-do> (last visited July 14, 2019).

<sup>88</sup> FinCEN 2014 Banking Guidance, *supra* note 63 at 2.

<sup>89</sup> *Id.* at 3.

<sup>90</sup> Bank Secrecy Act, 31 U.S.C. § 5311 *et. seq.* (2012).

<sup>91</sup> *Id.*; *see also* FinCEN 2014 Banking Guidance, *supra* note 63, at 4 n.7.

<sup>92</sup> Gerald L. Blanchard, *Reports of Suspicious Activity in Bank Secrecy Act*, in 2 LENDER LIABILITY: LAW, PRACTICE, AND PREVENTION § 21:6. (2018).

<sup>93</sup> *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>.

<sup>94</sup> FinCEN 2014 Banking Guidance, *supra* note 63 at 3–5.

<sup>95</sup> *Id.* at 3.

<sup>96</sup> *Id.* at 4.

the marijuana client because it would be supporting illegal activity of a company that is not compliant with state laws.<sup>97</sup>

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.<sup>98</sup> 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.<sup>99</sup> 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.<sup>100</sup> 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.<sup>101</sup> 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.<sup>102</sup>

## 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.<sup>103</sup> On the campaign trail, then-candidate Donald Trump took the position that "enforcement

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<sup>97</sup> *Id.* at 4–5.

<sup>98</sup> See Scheick, *supra* note 68, at 465–66.

<sup>99</sup> 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*].

<sup>100</sup> See Bricken, *Navigating the Hazy Status of Marijuana Banking*, *supra* note 99, at 2.

<sup>101</sup> See Bricken, *Funding and Financing*, *supra* note 25, at 7.

<sup>102</sup> *Id.*

<sup>103</sup> 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.”<sup>104</sup> However, following the 2016 presidential elections,<sup>105</sup> federal agencies under the Trump administration seemed keen to abandon the Obama-era’s *laissez-faire* enforcement policies,<sup>106</sup> resulting in a heightened awareness of the risks of entering an industry that is criminalized by the federal government.<sup>107</sup> In 2017, the director of the U.S. Trustee Program, who is responsible for overseeing federal bankruptcy courts,<sup>108</sup> stated, “debtors with assets or income derived from marijuana may not proceed through the bankruptcy system.”<sup>109</sup> This is consistent with federal bankruptcy judges’ treatment of bankruptcy petitions in the marijuana industry so far, which have almost exclusively been dismissed.<sup>110</sup> 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.”<sup>111</sup> In his memo, Sessions reminded prosecutors that violations of the CSA may also

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<sup>104</sup> Eileen Sullivan, *Trump Says He’s Likely to Back Marijuana Bill*, in *Apparent Break with Session*, NY TIMES (June 8, 2018), <https://www.nytimes.com/2018/06/08/us/politics/trump-marijuana-bill-states.html>.

<sup>105</sup> Harrison Smith, *Donald Trump is Elected President of the United States*, WASH. POST (Nov. 9, 2016), [https://www.washingtonpost.com/lifestyle/kidspost/donald-trump-is-elected-president-of-the-united-states/2016/11/09/58046db4-a684-11e6-ba59-a7d93165c6d4\\_story.html?utm\\_term=.4bc6a9c93c5f](https://www.washingtonpost.com/lifestyle/kidspost/donald-trump-is-elected-president-of-the-united-states/2016/11/09/58046db4-a684-11e6-ba59-a7d93165c6d4_story.html?utm_term=.4bc6a9c93c5f).

<sup>106</sup> See Sullivan, *supra* note 104.

<sup>107</sup> Ben Curren, *With Jeff Sessions Out, The New AG Should Advance Marijuana Policy by Restoring The Cole Memorandum*, FORBES (Nov. 7, 2018, 3:15 PM), <https://www.forbes.com/sites/bencurren/2018/11/07/with-jeff-sessions-out-the-new-ag-should-restore-the-cole-memorandum/#709ec4a8705d>.

<sup>108</sup> *U.S. Trustee Program: About the Program*, DEP’T OF JUSTICE, <https://www.justice.gov/ust/about-program> (last visited July 22, 2019).

<sup>109</sup> A Time to Reform: Oversight of the Activities of the Justice Department’s Civil, Tax, and Environment and Natural Resources Divisions and the U.S. Trustee Program, Hearing Before the Subcomm. on Regulatory Reform, Commercial, and Antitrust Law, U.S. House of Rep. Comm. on the Judiciary, 115th Cong. 5 (2017) (statement by Clifford J. White, III, Dir. of Exec. Office for U.S. Tr.), <https://www.justice.gov/ust/file/testimony06082017.pdf/download>.

<sup>110</sup> See *infra* Part II.

<sup>111</sup> 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,<sup>112</sup> confirming a main concern among financial institutions.<sup>113</sup>

Despite Sessions' notorious opposition to the legalization of marijuana,<sup>114</sup> the actual effects of the rescission may not be so dramatic.<sup>115</sup> 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."<sup>116</sup> 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.<sup>117</sup> 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.<sup>118</sup> Furthermore,

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<https://www.justice.gov/opa/press-release/file/1022196/download> [hereinafter SESSIONS MEMO].

<sup>112</sup> *Id.* at 1.

<sup>113</sup> See Bricken, *Funding and Financing*, *supra* note 25, at 7.

<sup>114</sup> Sessions' fervent disapproval of marijuana legalization is no secret, as he has stated "we need grown-ups in charge in Washington to say marijuana is not the kind of thing that ought to be legalized . . . it's in fact a very real danger." Curren, *supra* note 107. When asked about his view on the KKK in 1986, he joked they were "O.K. until I found out they smoked pot." Morgan Roger, *Jeff Sessions' 5 Craziest Quotes on Marijuana*, CIVILIZED (Aug. 27, 2017), <https://www.civilized.life/articles/jeff-sessions-5-craziest-quotes-on-marijuana/>. He later apologized for the comment and denied his sympathy for the organization but maintained his stance on marijuana legalization. Compare *id.*, with Katharine Q. Seelye, *Barack Obama, Asked About Drug History, Admits He Inhaled - Americas - International Herald Tribune*, N.Y. TIMES (Oct. 24, 2006), <https://www.ny-times.com/2006/10/24/world/americas/24iht-dems.3272493.html> (discussing how President Obama has admitted to marijuana use in his youth, famously quipping that he inhaled because "[t]hat was the point.>").

<sup>115</sup> Curren, *supra* note 107.

<sup>116</sup> Press Release No. 18-8, *supra* note 111.

<sup>117</sup> COLE MEMO 2013, *supra* note 82 at 2-3; see also Curren, *supra* note 107.

<sup>118</sup> Consolidated and Further Continuing Appropriations Act, 2015, Pub. L. No. 113-235, § 538, 128 Stat. 2130, 2217 (2014) (codified in scattered sections of the U.S.C.). The bill, now known as the Rohrabacher-Farr Amendment, provides that the Department of Justice may not use federal funds to interfere with states'

FinCEN's marijuana banking guidance remains valid and continues to report a steady increase in the number of banks serving the marijuana industry,<sup>119</sup> but, like the Cole Memo, it is merely guidance, not law, and cannot eliminate liability.<sup>120</sup>

Shortly after rescinding the Cole Memo, Sessions was replaced by William Barr as Attorney General.<sup>121</sup> 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.<sup>122</sup> 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.<sup>123</sup> 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.<sup>124</sup> This

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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.*

<sup>119</sup> FIN. CRIMES ENF'T NETWORK, MARIJUANA BANKING UPDATE 1 (2018), [https://www.fincen.gov/sites/default/files/shared/Marijuana\\_Banking\\_Update\\_September\\_2018.pdf](https://www.fincen.gov/sites/default/files/shared/Marijuana_Banking_Update_September_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.

<sup>120</sup> Scheick, *supra* note 68, at 465–66.

<sup>121</sup> Sarah Lynch, Andy Sullivan, *Senate Confirms William Barr as U.S. Attorney General*, REUTERS (Feb. 14, 2019, 6:07 AM) <https://www.reuters.com/article/us-usa-trump-barr/senate-confirms-william-barr-as-attorney-general-idUSKCN1Q31I6>.

<sup>122</sup> Nina Godlewski, *Attorney General Barr Says He Would Favor Making Marijuana Illegal Across the United States*, NEWSWEEK (Apr. 10, 2019, 5:32 PM) <https://www.newsweek.com/attorney-general-barr-marijuana-law-1392561>.

<sup>123</sup> *Id.*

<sup>124</sup> See STATES Act, H.R. 2093, 116th Cong. §2 (2019).



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.”<sup>125</sup>

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.<sup>126</sup> 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.<sup>127</sup>

## 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,<sup>128</sup> the marijuana industry’s access to financial resources has been stifled.<sup>129</sup> 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,<sup>130</sup> and to bankruptcy, where businesses in distress typically turn for help.<sup>131</sup> As a result, foreign marijuana businesses are gaining an advantage over similarly-situated domestic marijuana businesses,<sup>132</sup> and lenders and marijuana businesses operate beyond the reach of legal enforcement mechanisms for financial obligations,<sup>133</sup> in the capital markets and bankruptcy realms, respectively.

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<sup>125</sup> Sullivan, *supra* note 104.

<sup>126</sup> Scheick, *supra* note 68, at 465–66

<sup>127</sup> *Id.*

<sup>128</sup> *See supra* Part I.

<sup>129</sup> *See* Scheuer, *supra* note 26, at 529 n.100.

<sup>130</sup> *See infra* Part II.A

<sup>131</sup> *See infra* Part II.B

<sup>132</sup> *See infra* Part II.A

<sup>133</sup> *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,<sup>134</sup> the Altria Group announced a \$1.8 billion investment in the Cronos Group, a Canadian cannabis company.<sup>135</sup> This deal was financed by JPMorgan Chase Bank.<sup>136</sup> 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.<sup>137</sup>

These deals illustrate the abundance of available capital and a desire by U.S. investors to put capital to use in the marijuana industry.<sup>138</sup> With such high growth rates anticipated from increased state legalization and large U.S. companies willing to provide bullish endorsements for the product,<sup>139</sup> the natural assumption would be that

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<sup>134</sup> *Constellation Brands' \$5 Billion CAD (\$4 Billion USD) Investment in Canopy Growth Closes Following Shareholder and Canadian Government Approval*, CONSTELLATION BRANDS (Nov. 1, 2018), <https://www.cbrands.com/news/articles/constellation-brands-5-billion-cad-4-billion-usd-investment-in-canopy-growth-closes-following-shareholder-and-canadian-government-approval>.

<sup>135</sup> *See Altria to Make Growth Investment in Cronos Group*, BUSINESS WIRE (Dec. 7, 2018, 7:15 AM), <https://www.businesswire.com/news/home/20181207005164/en/Altria-Growth-Investment-Cronos-Group>. Altria is the U.S.-based parent company of tobacco giant, Phillip Morris. *Id.*

<sup>136</sup> *Id.*

<sup>137</sup> *See Paul R. La Monica, Marlboro Owner Altria Invests \$1.8 Billion in Cannabis Company Cronos*, CNN BUSINESS (Dec. 7, 2018, 9:22 AM), <https://www.cnn.com/2018/12/07/investing/altria-cronos-investment-marijuana/index.html>; Lewis, *supra* note 4.

<sup>138</sup> *See Scheuer, supra* note 26, at 530.

<sup>139</sup> *See Lewis, supra* note 4.

the industry is ripe for investment and prosperity.<sup>140</sup> But willing investors have not been able to capitalize on that opportunity<sup>141</sup> because both the FinCEN Guidance and Department of Justice enforcement memoranda merely diminish the *likelihood* banks will suffer consequences for violating federal law.<sup>142</sup> They do not alter the substantive law to eliminate the criminality altogether.<sup>143</sup> 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.<sup>144</sup> Currently, that means investing in foreign operations.<sup>145</sup>

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<sup>140</sup> See, e.g., Drew Hendricks, *5 Things Goldman Sachs Looks for in a Company Before Investing*, INC. (Sept. 29, 2014), <https://www.inc.com/drew-hendricks/5-things-goldman-sachs-look-for-in-a-company-before-investing.html>. Growth potential is such a key factor that investment in companies in their early and expansion stages accounted for nearly fifty percent of venture capital investments in U.S. companies over the last five years. See PWC/CB INSIGHTS, MONEYTREE REPORT: Q4 2018, at 7 (2019).

<sup>141</sup> See Scheuer, *supra* note 26, at 529–30.

<sup>142</sup> *Fourth Corner Credit Union v. Fed. Reserve Bank of Kansas City*, 861 F.3d 1052, 1055–56 (10th Cir. 2017) (per curiam) (Moritz, J., concurring).

<sup>143</sup> *Id.*

<sup>144</sup> See, e.g., Leslie Picker, *Meet the Banks That Are Leading the Flourishing Deal Market for Pot Stocks*, CNBC (Sept. 25, 2018, 4:06 PM), <https://www.cnbc.com/2018/09/25/meet-the-banks-that-are-leading-the-deal-market-for-pot-stocks.html>.

<sup>145</sup> 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.<sup>146</sup> 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.<sup>147</sup> State law governs business incorporation<sup>148</sup> and states that have legalized marijuana that have licensing and registration requirements can, in fact, provide a statement of good standing.<sup>149</sup> 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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<sup>146</sup> 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 . . .”).

<sup>147</sup> Cleary Gottlieb Steen & Hamilton LLP, *The IPO Process: Prospectus in NYSE IPO GUIDE* 35, 38–39 (Nicolas Grabar et al., 2d ed. 2013), [https://www.nyse.com/publicdocs/nyse/listing/nyse\\_ipo\\_guide.pdf](https://www.nyse.com/publicdocs/nyse/listing/nyse_ipo_guide.pdf).

<sup>148</sup> *State Guide: Corporation Law*, FINDLAW, <https://smallbusiness.findlaw.com/incorporation-and-legal-structures/state-guide-corporation-laws.html> (last visited July 17, 2019).

<sup>149</sup> See, e.g., MARIJUANA ENF’T DIVISION, COLO. DEP’T OF REVENUE, RETAIL MARIJUANA BUSINESS LICENSE APPLICATION 1 (2016), <https://www.colorado.gov/pacific/sites/default/files/DR%208548e%20Retail%20Application%201-2017.pdf>.

company that they know is violating federal laws.<sup>150</sup> 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.<sup>151</sup>

As of October 17, 2018, recreational sales of marijuana are legal in Canada,<sup>152</sup> so Canadian marijuana growers and retailers can, and, in fact have, successfully listed on U.S. stock exchanges.<sup>153</sup> 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.<sup>154</sup> In a political climate colored by protectionist policies intended to bolster the domestic economy, the laws governing the marijuana industry result in an

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<sup>150</sup> See MAYER BROWN, INITIAL PUBLIC OFFERINGS: AN ISSUER’S GUIDE 22 (2017), [https://www.mayerbrown.com/files/Publication/d8ba3792-3c20-4cfe-859f-124f1c43bfaf/Presentation/PublicationAttachment/70e2f333-4c89-4b81-bc16-4d16faf864bf/Initial-Public-Offerings-An-Issuers-Guide-US-Edition\\_1117.pdf](https://www.mayerbrown.com/files/Publication/d8ba3792-3c20-4cfe-859f-124f1c43bfaf/Presentation/PublicationAttachment/70e2f333-4c89-4b81-bc16-4d16faf864bf/Initial-Public-Offerings-An-Issuers-Guide-US-Edition_1117.pdf) (“the lawyers for both the underwriters and the issuer will deliver certain legal opinions . . . with regard to . . . no violation of the company’s organization documents or of any laws or agreements by which the issuer is bound, [and] accuracy of the disclosures”).

<sup>151</sup> See *id.* at 27–30.

<sup>152</sup> See CANADA DEP’T OF JUSTICE, *supra* note 7.

<sup>153</sup> 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-n.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.*

<sup>154</sup> 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.<sup>155</sup> 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.<sup>156</sup> In either case, U.S. assets are drained from the domestic economy.

B. *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.<sup>157</sup> The bankruptcy code does not explicitly prohibit state-legalized marijuana businesses from filing a petition for bankruptcy,<sup>158</sup> 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.<sup>159</sup> 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

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<sup>155</sup> See Aiello & Ell, *supra* note 154.

<sup>156</sup> See Bill Hutchinson, *One of California's Biggest Cannabis Companies Looks to Grow Some Green on the Canadian Stock Exchange*, ABC NEWS (Jun. 10, 2019, 10:52 AM), <https://abcnews.go.com/International/californias-biggest-cannabis-companies-grow-green-canadian-stock/story?id=63529520>.

<sup>157</sup> See, e.g., Order After Hearing Dismissing Chapter 11 Case at 3, *In re Mother Earth's Alt. Healing Coop., Inc.*, No. 12-10223-11 (Bankr. S.D. Cal. Oct. 23, 2012) [hereinafter *Mother Earth Order*].

<sup>158</sup> Vivian Cheng, Comment, *Medical Marijuana Dispensaries in Chapter 11 Bankruptcy*, 30 EMORY BANKR. DEV. J. 105, 106 (2013).

<sup>159</sup> See *id.* at 113–19.

a business becomes insolvent.<sup>160</sup> 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.<sup>161</sup> Under normal circumstances, these remedies are governed by federal bankruptcy law.<sup>162</sup> 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.<sup>163</sup> However, the bankruptcy system is a creation of federal law,<sup>164</sup> and as such, marijuana businesses have not been able to proceed with claims for relief.<sup>165</sup> Chapter 11 and Chapter 7 are the two forms most commonly used for businesses<sup>166</sup> and a brief overview of each process is warranted to explain why neither avenue has been open to state-sanctioned marijuana businesses.

#### 1. 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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<sup>160</sup> See Todd Plummer, Research Memo, *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](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 . . . ?").

<sup>161</sup> See *id.*

<sup>162</sup> See ADMIN. OFFICE OF THE U.S. COURTS, BANKRUPTCY BASICS 5–7 (3d ed. 2011), <https://www.uscourts.gov/sites/default/files/bankbasics-post10172005.pdf> [hereinafter BANKRUPTCY BASICS].

<sup>163</sup> See *id.*; see also *Bankruptcy: Overview*, Practical Law Practice Note 1-380-9908, WESTLAW (last visited July 22, 2019) [hereinafter *Bankruptcy Practice Note*].

<sup>164</sup> 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.*

<sup>165</sup> See Plummer, *supra* note 160; see also *infra* Part II.B.

<sup>166</sup> See *Bankruptcy Practice Note*, *supra* note 162.

pursue a new strategy to continue operating, and pay back loans over a longer period of time.<sup>167</sup> 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.<sup>168</sup> Often, the debtor itself, or the debtor with the help of a plan sponsor, will manage the process as the "Debtor in Possession."<sup>169</sup> This allows the business to both remain in possession of its assets and remain functional while it forms a plan of reorganization.<sup>170</sup> 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.<sup>171</sup> 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.<sup>172</sup> After creditor approval, the reorganization plan is presented to the bankruptcy court judge for approval.<sup>173</sup> 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.<sup>174</sup> However, if the court does not approve the plan, the case may be dismissed or converted into a Chapter 7 liquidation.<sup>175</sup>

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.<sup>176</sup> The key distinction between Chapter 11 and Chapter 7 processes, for the purposes of this Note, is that all of

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<sup>167</sup> *See id.*

<sup>168</sup> 11 U.S.C. §§ 301, 303 (2012); *see also* BANKRUPTCY BASICS, *supra* note 162, at 29.

<sup>169</sup> 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.

<sup>170</sup> Kaup & Dorsey, *supra* note 169, at 49.

<sup>171</sup> 11 U.S.C. § 1125; *see also* Kaup & Dorsey, *supra* note 169, at 50.

<sup>172</sup> 11 U.S.C. § 1121; *see also* Kaup & Dorsey, *supra* note 169, at 50–51.

<sup>173</sup> 11 U.S.C. § 1128.

<sup>174</sup> BANKRUPTCY BASICS, *supra* note 162, at 39–40.

<sup>175</sup> *See id.* at 38.

<sup>176</sup> *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.<sup>177</sup> The assets of the business are sold at auction and the money is used to provide as much value to the creditors as possible.<sup>178</sup> 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.<sup>179</sup> The Trustee simply liquidates all of the business's assets and pays creditors to the extent possible.<sup>180</sup> 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.<sup>181</sup>

## 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).<sup>182</sup> 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.<sup>183</sup> 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.<sup>184</sup> 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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<sup>177</sup> *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 . . .").

<sup>178</sup> *Id.* at 15, 18.

<sup>179</sup> 11 U.S.C. § 727(a)(1) (2012); *see also* BANKRUPTCY BASICS, *supra* note 162, at 15.

<sup>180</sup> Bethany K. Laurence, *Chapter 7 Bankruptcy for Corporations and LLCs*, BANKRUPTCY SITE, <https://www.thebankruptcysite.org/resources/bankruptcy/chapter-7-bankruptcy-corporations-and-llcs.htm> (last visited Nov. 3, 2019).

<sup>181</sup> *See id.*

<sup>182</sup> *See* Cheng, *supra* note 158, at 108–09, 113–16.

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

<sup>184</sup> 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.<sup>185</sup> 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.”<sup>186</sup> 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.<sup>187</sup> The second argument was that CGO failed to file timely documents, which was grounds for dismissal.<sup>188</sup> CGO withdrew its petition, conceding to the failure to file timely documents, but rejected the notion that any plan would have been illegal.<sup>189</sup> 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.<sup>190</sup> 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.”<sup>191</sup>

### 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,<sup>192</sup> 11 U.S.C. § 1129 requires a reorganization plan to be financially viable.<sup>193</sup> In California, Mother Earth’s Alternative Healing Cooperative’s Chapter 11 bankruptcy petition<sup>194</sup> illustrates

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<sup>185</sup> *See id.* at 3.

<sup>186</sup> 11 U.S.C. § 1129(a)(3).

<sup>187</sup> CGO Motion to Dismiss, *supra* note 184, at 3.

<sup>188</sup> *Id.*

<sup>189</sup> Debtor’s Joint Response to Trustee’s Motion to Dismiss and Order to File Status Report at 1–2, *In re* CGO Enter. L.L.C., No. 12-19010 (Bankr. D. Colo. May 25, 2012), 2012 WL 1932712 [hereinafter Debtor’s Response to Motion to Dismiss].

<sup>190</sup> *See id.* at 1.

<sup>191</sup> *Id.*

<sup>192</sup> 11 U.S.C. § 1112(b) (2012).

<sup>193</sup> 11 U.S.C. § 1129.

<sup>194</sup> Chapter 11 Voluntary Petition, *In re* Mother Earth’s Alternative Healing Coop., Inc., No. 12-10223-11 (Bankr. S.D. Cal. Jul 25, 2012), <http://bankrupt.com/misc/casb12-10223.pdf>.

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.<sup>195</sup> Mother Earth openly admitted its goal in seeking bankruptcy protection was to avoid eviction.<sup>196</sup> 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.<sup>197</sup> The judge noted that the “[d]ebtor fil[ing] this bankruptcy solely to preserve a lease” was grounds for dismissal.<sup>198</sup> Furthermore, to win court approval, a plan must “not [be] by any means forbidden by law”<sup>199</sup> and must be feasible.<sup>200</sup> 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.”<sup>201</sup>

#### 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.<sup>202</sup> 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.”<sup>203</sup> The court’s dismissal in *Mother Earth* similarly refused to convert the Chapter 11 petition to

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<sup>195</sup> Order After Hearing Dismissing Chapter 11 Case at 3, *In re Mother Earth’s Alt. Healing Coop., Inc.*, No. 12-10223-11 (Bankr. S.D. Cal. Oct. 23, 2012) [hereinafter *Mother Earth Order*].

<sup>196</sup> See Stephanie Gleason, *Chapter 420?*, WALL ST. J.: BLOG (Jul. 27, 2012, 10:47 AM), <https://blogs.wsj.com/bankruptcy/2012/07/27/chapter-420/>.

<sup>197</sup> *Id.*

<sup>198</sup> *Mother Earth Order*, *supra* note 195, at 2.

<sup>199</sup> 11 U.S.C. § 1129(a)(3) (2012).

<sup>200</sup> *See id.* § 1129(a)(11).

<sup>201</sup> *Mother Earth Order*, *supra* note 195, at 2.

<sup>202</sup> *See, e.g., id.* at 3.

<sup>203</sup> 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.”<sup>204</sup>

##### 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.’”<sup>205</sup> 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.<sup>206</sup> 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.<sup>207</sup> 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.<sup>208</sup> 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.<sup>209</sup>

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<sup>204</sup> Mother Earth Order, *supra* note 195, at 3.

<sup>205</sup> 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)).

<sup>206</sup> 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.”).

<sup>207</sup> 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.”).

<sup>208</sup> *Id.* at 186–87.

<sup>209</sup> *Id.*; see also Chemerinsky et al., *supra* note 35, at 96–97 (describing a case almost parallel to *Medpoint*: Judgment of Dismissal, *Hammer v. Today’s Health Care II*, CV2011-051310 (Ariz. Super. Ct. April 17, 2012)).

### 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,<sup>210</sup> the business and legal arenas must work together to create stability. While insolvency is a fate debtors and creditors alike hope to avoid,<sup>211</sup> the bankruptcy system has a stabilizing effect on markets by identifying the best outcome in a bad situation.<sup>212</sup> “The Bankruptcy Code [] does not explicitly prohibit [marijuana businesses] from filing for bankruptcy”<sup>213</sup> 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.<sup>214</sup> The key distinction between those laws and bankruptcy law,

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The court recognized the absurdity of this result—excusing the defendants from repaying the loan because they were, in the eyes of the law, drug dealers—but was unwilling to give the plaintiffs the benefit of their bargain when the conduct envisioned by the agreement remained illegal under federal law.

*Id.*

<sup>210</sup> See McCarthy, *supra* note 36.

<sup>211</sup> See Bill Fay, *What is Insolvency?*, DEBT.ORG, <https://www.debt.org/faqs/insolvency/> (last visited Nov. 3, 2019).

<sup>212</sup> See Gamble, *supra* note 31 (“Bankruptcy is the most important part of any economic crisis. It is the plumbing of economics. It allows the market to flush away the inefficient businesses and reallocate capital to efficient businesses.”).

<sup>213</sup> Cheng, *supra* note 158, at 106.

<sup>214</sup> 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.<sup>215</sup> 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.<sup>216</sup> 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.<sup>217</sup> Both Congress and bankruptcy judges have noted that the bankruptcy courts are courts of limited jurisdiction to address financial affairs.<sup>218</sup> 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).

<sup>215</sup> “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.’” *In re Perrotta*, 406 B.R. 1, 7 (Bankr. D.N.H. 2009) (quoting *Local Loan Co. v. Hunt*, 292 U.S. 234, 244 (1934)) (internal quotation marks omitted) (alterations in original).

<sup>216</sup> *See Cheng, supra* note 158, at 118–20.

<sup>217</sup> *See id.* at 119–21.

<sup>218</sup> *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. *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. *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. *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.” *Id.* at 495.

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 proceedings.’”<sup>219</sup> 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 conflicting governing body—the federal government—has demonstrated 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.<sup>220</sup>

Furthermore, the tests applied in each bankruptcy process to determine 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 determining the criminality of state-approved actions.<sup>221</sup> 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 unconfirmable.<sup>222</sup> 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.<sup>223</sup> Under a

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<sup>219</sup> Cheng, *supra* note 158, at 120–21 (2013) (quoting *In Re Food City Hall* at 812).

<sup>220</sup> See Gamble, *supra* note 31 (“To accurately determine the risk of these investments, 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.”).

<sup>221</sup> See Cheng, *supra* note 158, at 110.

<sup>222</sup> See *CGO Motion to Dismiss*, *supra* note 184, at 2–3; *Mother Earth Order*, *supra* note 195, at 2–3.

<sup>223</sup> *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 provide 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 Dismiss*, *supra* note 189, at 1.

Chapter 11 reorganization, the court has a fiduciary duty to apply the best interest of the creditors test.<sup>224</sup> 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.<sup>225</sup> 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.<sup>226</sup> 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.<sup>227</sup> 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."<sup>228</sup> A contract that is illegal is unenforceable,<sup>229</sup> 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.<sup>230</sup> 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

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<sup>224</sup> 11 U.S.C. §1129(a)(7) (2012); *see also* Jonathan Hicks, Note, *Foxes Guarding the Henhouse: The Modern Best Interests of Creditors Test in Chapter 11 Reorganizations*, 5 NEV. L.J. 820, 831 (2005).

<sup>225</sup> 11 U.S.C. § 1129(a)(7).

<sup>226</sup> *See* Debtor's Response to Motion to Dismiss, *supra* note 189, at 1.

<sup>227</sup> *Travelers Cas. & Sur. Co. of Am. v. Pac. Gas & Elec. Co.*, 549 U.S. 443, 450 (2007).

<sup>228</sup> *Id.* at 451 (quoting *Butner v. United States*, 440 U.S. 48, 55 (1979)) (alterations in original).

<sup>229</sup> 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.").

<sup>230</sup> *Compare* Controlled Substances Act, 21 U.S.C. §§ 812 Schedule 1(c)(10), 841 (2012), *with* CAL. BUS. & PROF. §26000(b) (2016).



because an interested party is involved in a bankruptcy proceeding.”<sup>231</sup> 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.<sup>232</sup> 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. *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.<sup>233</sup> A major goal of the states’ legalization programs is to eliminate the harms caused by the illegal marijuana trade.<sup>234</sup> 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.<sup>235</sup> Otherwise, states’ efforts may be thwarted by consumers turning to the black market for cheaper or more accessible products.<sup>236</sup> 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

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<sup>231</sup> *Travelers Cas.*, 549 U.S. at 451 (quoting *Butner*, 440 U.S. at 55).

<sup>232</sup> See generally Proclamation No. 9816, 83 Fed. Reg. 55,457 (Nov. 6, 2018).

<sup>233</sup> See Gamble, *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.”).

<sup>234</sup> See, e.g., Cheng, *supra* note 158, at 140.

<sup>235</sup> ADAM ORENS ET AL., MARIJUANA POLICY GROUP & UNIV. COLO. BOULDER, COLORADO DEPARTMENT OF REVENUE, 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%20%20Study%20%20082018.pdf>.

<sup>236</sup> *Id.*; see also Jeff Desjardins, *California’s Recreational Cannabis Industry Is Booming—But Regulations Are Posing a Unique Threat*, 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>.

availability of funding for the industry grows, so too will the industry's competition and its ability to fully address demand.<sup>237</sup> 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.<sup>238</sup>

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.<sup>239</sup> 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.<sup>240</sup> 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.<sup>241</sup> The continuing recovery of the U.S. economy in the wake of the 2008 financial crisis is a

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<sup>237</sup> See Desjardins, *supra* note 236; see also ORENS ET AL., *supra* note 235, at 14–15.

<sup>238</sup> Cf. ORENS ET AL., *supra* note 235, at 14–15.

<sup>239</sup> 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.

[E]ven 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.

*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>).

<sup>240</sup> See *In re Perrotta*, 406 B.R. 1, 7 (Bankr. D.N.H. 2009) (quoting *Local Loan Co. v. Hunt*, 292 U.S. 234, 244 (1934)).

<sup>241</sup> Hicks, *supra* note 224, at 831; see also Gamble, *supra* note 31.

salient illustration of the economic function of the bankruptcy system.<sup>242</sup> 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.’”<sup>243</sup> Over \$130 billion in claim settlements have been paid and the process is still ongoing.<sup>244</sup> It is unclear what, if any, recovery creditors would have had without bankruptcy.<sup>245</sup>

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.<sup>246</sup> 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”<sup>247</sup> and reasoned “that Congress regards such extensive failure to comply with the mandate as tolerable suggests that Congress did

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<sup>242</sup> See, e.g., Matt Egan, *The US Economy Just Hit a Milestone*, CNN (May 1, 2018, 10:57 AM), <https://money.cnn.com/2018/05/01/news/economy/us-economy-great-recession-recovery/index.html>.

<sup>243</sup> *Lehman Brothers \$11bn Case Against Barclays Fails*, BBC NEWS (Feb. 23, 2011), <https://www.bbc.com/news/business-12549242>.

<sup>244</sup> Renea Merle, *A Guide to the Financial Crisis—10 Years Later*, WASH. POST (Sept. 10, 2018), [https://www.washingtonpost.com/business/economy/a-guide-to-the-financial-crisis--10-years-later/2018/09/10/114b76ba-af10-11e8-a20b-5f4f84429666\\_story.html?utm\\_term=.5c5dbcd59242](https://www.washingtonpost.com/business/economy/a-guide-to-the-financial-crisis--10-years-later/2018/09/10/114b76ba-af10-11e8-a20b-5f4f84429666_story.html?utm_term=.5c5dbcd59242).

<sup>245</sup> See *id.*

<sup>246</sup> 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.

<sup>247</sup> Nat’l Fed’n of Indep. Bus. v. Sebelius, 567 U.S. 519, 568 (2012).

not think it was creating four million outlaws.”<sup>248</sup> Similarly, there are currently over 1.2 million registered medical marijuana users in California and thirty-nine million consumers.<sup>249</sup> Recreational marijuana is now legalized in California, and therefore available to more than thirty-nine million people.<sup>250</sup> With nine other recreational states and thirty-two other medical states’ populations,<sup>251</sup> 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*.<sup>252</sup> 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.<sup>253</sup> 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.<sup>254</sup> 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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<sup>248</sup> *Id.*

<sup>249</sup> See *Medical Marijuana Patient Numbers*, MARIJUANA POLICY PROJECT, <https://www.mpp.org/issues/medical-marijuana/state-by-state-medical-marijuana-laws/medical-marijuana-patient-numbers/> (last updated July 10, 2019).

<sup>250</sup> See Desjardins, *supra* note 236.

<sup>251</sup> See *supra* note 3 and accompanying text.

<sup>252</sup> See *Sebelius*, 567 U.S. 519, 568 (2012).

<sup>253</sup> See, e.g., *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).

<sup>254</sup> Consolidated and Further Continuing Appropriations Act, 2015, Pub. L. No. 113-235, § 538, 128 Stat. 2130, 2217 (2014) (codified in scattered sections of the U.S.C.); see also Bricken, *Funding and Financing*, *supra* note 25, at 6–7.

prosecution efforts, finding that the prosecution under the CSA violated the appropriations bill.<sup>255</sup>

#### 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.<sup>256</sup> By granting state-legitimized marijuana businesses access

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<sup>255</sup> *United States v. McIntosh*, 833 F.3d 1163, 1177 (9th Cir. 2016).

<sup>256</sup> “The 1978 Bankruptcy Code profoundly changed the bankruptcy system and its importance in society and the economy. . . . By making bankruptcy more attractive for corporations as well, [the 1978 Bankruptcy Code] routinized corporate bankruptcy, turning it into a business and strategic decision rather than a last resort.” Todd J. Zywicki, *The Past, Present, and Future of Bankruptcy Law in America*, 101 MICH. L. REV. 2016, 2021 (2003). In 2005, Bankruptcy Code reforms to ensure bankruptcy remains a legitimate tool, and not a tool abused by bad-faith actors to escape their responsibilities passed with bipartisan support. See *BAPCPA: Know Your Bankruptcy Rights*, DEBT.COM (May 10, 2019), <https://www.debt.com/bankruptcy/abuse-prevention-and-consumer-protection-act/>. The importance of access to bankruptcy, especially for small businesses, continues to receive attention and support from democrats and republicans alike. On the legislative branch, see, e.g., Press Release, Collins, Bipartisan Colleagues Introduce Legislation to Help Small Businesses Restructure Debt, (Nov. 30, 2018), <https://dougcollins.house.gov/media-center/press-releases/collins-bipartisan-colleagues-introduce-legislation-help-small> (quoting Republican Senator Grassley explaining that “[a] well-functioning bankruptcy system, specifically for small businesses, allows businesses to reorganize, preserve jobs, maximize the value of assets and ensure the proper allocation of resources” and Democratic Senator Whitehouse opining that “[s]mall businesses form the backbone of the American economy. When these businesses are struggling, the bankruptcy process should give them a chance to reorganize to preserve jobs and boost local communities.”). For perspective on the executive branch, see, e.g., Clare O’Connor, *Fourth Time’s A Charm: How Donald Trump Made Bankruptcy Work for Him*, FORBES (Apr. 29, 2011, 7:31 PM), <https://www.forbes.com/sites/clareoconnor/2011/04/29/>

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.

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[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).