2018 Hon. Steven W. Rhodes Consumer Bankruptcy Conference

Marijuana and Bankruptcy

Chief Judge Scott W. Dales
U.S. Bankruptcy Court (W.D. Mich.); Grand Rapids

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Bankruptcy Workshop; Pittsburgh

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CONCURRENT SESSION

2018

Marijuana and Bankruptcy
2:10-3:20 p.m.

With the legalization of marijuana in many states, there are now large numbers of individuals and businesses that derive their income from growing and selling marijuana and from other business activities related to marijuana. This session addresses the issues that emerge when individuals and businesses in this industry encounter financial problems. What are the sources of governing law (state/federal)? Is bankruptcy an option? How are marijuana-related income and assets treated? What are a bankruptcy trustee's rights and responsibilities in dealing with a marijuana-related business? What ethical issues arise for attorneys representing individuals and entities in this industry? How does the U.S. Trustee's Office address these issues in light of the conflict between federal law and some states' laws? What is the direction of the developing body of bankruptcy case law regarding this industry?

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Marijuana Related Assets in Bankruptcy Cases[1]

I. Introduction

It's illegal. Possessing, growing, distributing, and prescribing marijuana is illegal under federal law. Pursuant to the supremacy clause of the U.S. Constitution, federal law supersedes all state laws to the contrary. The fact that a violator is never charged, tried, or convicted of a crime does not change the fact that the crime has been committed.

The marijuana industry is expanding in providing goods and services to the economy. However, Congress has not changed federal laws regarding marijuana, but says the DOJ cannot spend money to pursue and prosecute conduct as long as it complies with state law.

For bankruptcy lawyers many challenges are posed by this clash between federal and state law. Debtor and creditor lawyers must think carefully (maybe with the assistance of criminal defense counsel) about businesses that directly produce, distribute, or sell marijuana legally at the state level and those third parties who may indirectly help those businesses operate including medical providers, bankers, investors, vendors, landlords, architects, and general contractors. The list goes on. Your typical debtor bankruptcy intake form may be expanding to inquire whether your client derives any income from sources related to marijuana or owes money to those in the marijuana industry. The same inquiries should be made by creditor attorneys.

Pursuant to the Michigan Rules of Professional Conduct a lawyer cannot ethically assist a client in conduct that the lawyer knows or reasonably should know is criminal. Rule 1.2(c) provides:

> "A lawyer shall not counsel a client to engage, or assist a client, in conduct that the lawyer knows is illegal or fraudulent, but a lawyer may discuss the legal consequences of any proposed course of conduct with a client and may counsel or assist a client to make good-faith effort to determine the validity, scope, meaning, or application of the law."

Other ethics rules to consider include:

- MRPC 1.2 Scope of Representation (lawful objectives)
- MRPC 1.6 Communications
- MRPC 1.16 Declining or Terminating Representation
- MRPC 3.3 Candor Toward the Tribunal

[1] This Panel thanks Attorney Tom Phinney and his colleagues for the substantive contributions made to these materials.

The federal government has not immunized marijuana businesses that comply with state laws. Many people incorrectly believe that DOJ has agreed not to prosecute marijuana businesses that comply with state laws. Previous guidance includes: David W. Ogden, Deputy Att'y Gen., Memorandum for Selected United States Attorneys: Investigations and Prosecutions in States Authorizing the Medical Use of Marijuana (Oct. 19, 2009); James M. Cole, Deputy Att'y Gen., Memorandum for United States Attorneys: Guidance Regarding the Ogden Memo in Jurisdictions Seeking to Authorize Marijuana for Medical Use (June 29, 2011;.James M. Cole, Deputy Att'y Gen., Memorandum for All United States Attorneys: Guidance Regarding Marijuana Enforcement (Aug. 29, 2013); James M. Cole. Deputy Att'y Gen., Memorandum for All United States Attorneys: Guidance Regarding Marijuana Related Financial Crimes (Feb. 14, 2014); and Monty Wilkinson, Director of the Executive Office for U.S. Att'ys, Policy Statement Regarding Marijuana Issues in Indian Country (Oct. 28, 2014). See attached memos/articles.

Being the owner, operator, financier, banker, landlord, or vendor for a marijuana business is illegal. In addition to the potential life felony for dealing in marijuana, it is a separate federal crime, punishable by up to 20 years in prison, to manage or control any place, permanently or temporarily, for the purpose of manufacturing, distributing, storing, or using marijuana. (21 U.S.C. § 856.) This statute is commonly used to prosecute owners and operators of illegal marijuana grow houses, crack houses, and methamphetamine labs. Nevertheless, a landlord, lender, investor, or service provider to a legal marijuana business potentially could be prosecuted under this statute, either as a principal, a co-conspirator, or an aider and abettor. The point is not to allow the wave of state law legalization to confuse you or your client when dealing with federal bankruptcy court.

Be careful about accepting retainer fees. Federal money laundering laws also apply to certain common financial transactions with legal marijuana businesses. For example, receiving a payment of more than $10,000 from a known marijuana business may be a federal crime punishable by up to 10 years in prison. (18 U.S.C. 1956.) A vendor who supplies material or equipment to a legal marijuana business, knowing that those goods will be used to help the business operate may be committing a 20-year felony by accepting payment for those goods. Similarly, a lawyer who receives payment from a legal marijuana business could be violating the federal money laundering laws, depending on the scope of representation.

A lawyer is unlikely to create personal liability if the services rendered are limited to pure legal advice. A lawyer can safely fulfill the traditional counselor's role of advising the client on the legal consequences of proposed action. The client. having received this advice, then chooses how to act.

For a bankruptcy lawyer, once the legal services go beyond giving advice and begin assisting with pleading preparation, filing of documents, filing proofs of claim that

help the business or individual file the risks of violating federal law need to be recognized and evaluated.

II. Federal Law vs. State Law Dichotomy

A. The majority of the states in the Sixth Circuit have legalized some form of marijuana use. Michigan voters will have the opportunity on November 6 to vote on a proposal to legalize marijuana in Michigan for recreational purposes. The majority of Americans, over 200 million, live in states that have legalized the use of marijuana for medical or recreational use (states that allow recreational use constitute 21% of the population).

B. However, marijuana remains a "controlled substance" under the Federal Controlled Substances Act ("CSA"). *See* 21 U.S.C. §§ 802 & 812. Under the CSA, it is unlawful to:

1) "manufacture, distribute, or dispense, or possess with intent to manufacture, distribute, or dispense, a controlled substance[.]" 21 U.S.C. § 841.

2) "**knowingly** open, lease, rent, **use**, or maintain any place, whether permanently or temporarily, for the purpose of manufacturing, distributing, or **using** any controlled substance[.]"21 U.S.C. § 856(a)(1).

3) "manage or control any place, whether permanently or temporarily, either as an owner, lessee, agent, employee, occupant, or mortgagee, and **knowingly and intentionally** rent, lease, profit from, or **make available for use, with or without compensation**, the place for the purpose of unlawfully manufacturing, storing, distributing, or **using** a controlled substance[.]" 21 U.S.C. § 856(a)(2).

C. The Controlled Substances Act ("CSA"), 21 U.S.C. §§ 801-904, has been described by the United States Supreme Court as a lengthy and detailed statute creating a comprehensive framework for regulating the production, distribution, and possession of five classes of controlled substances. Under the CSA, marijuana is classified as a Schedule I controlled substance. 21 U.S.C. § 812 Schedule I(c)(10). When a substance is placed on Schedule I, that represents a legislative judgment that the drug or other substance has a high potential for abuse, the drug or other substance has no currently accepted medical use in treatment in the United States, and there is a lack of accepted safety for use of the drug or other substance under medical supervision. 21 U.S.C. § 812(b)(1). Under the CSA, any person who seeks to manufacture, distribute, or possess a Schedule I controlled substance must apply for and obtain a certificate of registration from the Drug Enforcement Agency. 21 U.S.C. §§ 822-823.

D. The Supremacy Clause of the United States Constitution, provides that federal law shall be the supreme law of the land, anything in the constitution or laws or any state to the contrary notwithstanding. The United States Supreme Court has had many opportunities to construe the Supremacy Clause, and it has said that Congress may expressly preempt state law. Even without an express provision for preemption, the Court has found that state law must yield to a congressional act in at least two circumstances. First, state law is naturally preempted to the extent of any conflict with a federal statute. Second, the Supreme Court has deemed state law preempted when the scope of a federal statute indicates that Congress intended federal law to occupy a field exclusively.

III. The Position of the United States Trustee: Marijuana = Dismissal

A. "It is the policy of the United States Trustee Program that the United States Trustees shall move to dismiss or object in all cases involving marijuana assets on grounds that such assets may not be administered under the Bankruptcy Code . . . ." Letter from C. White, Director of Executive Office for the United States Trustee, to Chapter 7 and Chapter 13 trustees.

B. "[T]he basic argument for dismissal is that the bankruptcy system cannot be used to facilitate illegal activity and the Bankruptcy Code does not provide a mechanism to administer assets that cannot be legally possessed or sold under federal law." The position of the United States Trustee Program is that "debtors with assets or income derived from marijuana may not proceed through the bankruptcy system." Statement of C. White.

IV. Dismissal of Case Involving Marijuana Related Assets or Business

A. Many bankruptcy courts have dismissed cases involving marijuana assets or marijuana related business even though the business was legal under state law.

1) *In re Arenas*, 535 B.R. 845, 852 (B.A.P. 10th Cir. 2015) (denying a motion to convert to chapter 13 and dismissing for cause the chapter 7 case of a debtor who grew and sold marijuana and leased commercial property to a legal dispensary because the debtor could not propose a feasible plan without violating federal law and the chapter 7 trustee's administration of the estate by selling the debtors' assets would constitute federal offenses).

2) *In re Medpoint Management, LLC*, 528 B.R. 178 (Bankr. Az. 2015) (dismissing involuntary case of a debtor that owned intellectual property leased to a third party that sold marijuana products due to the "dual risks" of the potential forfeiture of the debtor's assets and a trustee's violation of the CSA in administering the debtor's assets).

B. Other courts have provided the debtor with an opportunity to cease the marijuana related activity.

1) *In re Johnson*, 532 B.R. 53, 58-59 (Bankr. W.D. Mich. 2015) (recognizing that the debtor's business, growing and selling marijuana as a licensed caregiver, violated federal law, but holding that dismissal is not required, and instead ordering (i) the debtor to cease using any property of the estate in connection with any marijuana related business activities, (ii) the abandonment of any marijuana plants, and (iii) the debtor to destroy any marijuana plants and any by-products).

2) *In re Olson*, BAP No. NV-17-1158-LTiF (B.A.P. 9th Cir. 2018) (reversing and remanding a bankruptcy court's *sua sponte* dismissal of the bankruptcy case of a 92-year old and legally blind debtor living in an assisted living facility and who owned commercial property leased to a marijuana dispensary authorized under California law because the court did not articulate the legal basis for dismissal or make factual findings to support its legal basis).

V. Confirmation of Plan Involving a Marijuana Related Business

A. Plans that depend on the cultivation or sale of marijuana or other conduct in violation of the CSA cannot be confirmed.

In re McGinnis, 453 B.R. 770, 771 (Bankr. Or. 2011) (holding that a chapter 13 plan funded from leasing property to medical marijuana growers and the profits of selling medical marijuana could not be confirmed because it depends on conduct that violates federal law and, therefore, is not feasible and does not satisfy § 1325(a)(3)).

B. Plan can (maybe) be confirmed if not dependent on any marijuana-related assets.

1) *Cook Investments NW, SPNWY, LLC*, Case No. 3:17-cv-05516-BHS (W.D. WA 2017) (rejecting broad interpretation of § 1129(a)(3) by the U.S. Trustee and upholding confirmation of a plan where the debtor rejected a lease with a state-licensed grower of marijuana and payments were to be made solely from non-marijuana related income).

- Does it matter whether creditors are being paid in full from other (non marijuana-related) sources (which they were in Cook)?

- Must the debtor show that the tenant actually vacated or stopped performing under the lease? Under § 365(h), the tenant may remain in possession and continue to pay rent (subject to the

tenant's right to reduce rent payment to offset for damage caused by the debtor's nonperformance). If the lease is rejected but the tenant remains, is the debtor still knowingly and intentionally leasing the property in violation of the CSA?

- Can the debtor accept the net rent, provided the debtor is not using the rent to make plan payments?

- Can the creditor file a proof of claim seeking damages for a breached lease if the debtor/tenant was affiliated with the legal distribution of marijuana in accordance with state law?

2) *In re ARM Ventures, LLC*, 564 B.R. 77, 86 (Bankr. S.D. Fla. 2017) (holding that a plan premised on leasing commercial property to a marijuana business could not be confirmed under § 1129(a)(3), but giving the debtor an opportunity to file a new plan that was not dependent on the marijuana business as a source of income).

VI. DOJ has no funding to prosecute marijuana violations that comply with state law

A. The $1.3 trillion budget Congress passed on March 23, 2018 included a rider that continues to bar the DOJ from enforcing the federal marijuana ban in some circumstances. It is identical in substance to the Rohrabacher-Farr (or Rohrabacher-Blumenauer) amendments Congress has passed each budget cycle since 2014 (see book pages 353-358). The latest rider will expire at the end of the federal government's current fiscal year, September 30, 2018.

Here is the text of the rider:

SEC. 538. None of the funds made available under 4 this Act to the Department of Justice may be used, with respect to any of the States of Alabama, Alaska, Arizona, Arkansas, California, Colorado, Connecticut, Delaware, Florida, Georgia, Hawaii, Illinois, Indiana, Iowa, Kentucky, Louisiana, Maine, Maryland, Massachusetts, Michigan, Minnesota, Mississippi, Missouri, Montana, Nevada, New Hampshire, New Jersey, New Mexico, New York, North Carolina, North Dakota, Ohio, Oklahoma, Oregon, Pennsylvania, Rhode Island, South Carolina, Tennessee, Texas, Utah, Vermont, Virginia, Washington, West Virginia, Wisconsin, and Wyoming, or with respect to the District of Columbia, Guam, or Puerto Rico, to prevent any of them from implementing their own laws that authorize the use, distribution, possession, or cultivation of medical marijuana.

B. Congressional appropriations rider ("Rider") since December 2014 prohibits the use of any Department of Justice ("DOJ") funds to prevent certain specific

states, including Michigan, Ohio, Kentucky, and Tennessee "from implementing their own laws that authorize the use, distribution, possession, or cultivation of medical marijuana." This rider is currently in effect until September 30, 2018.

C. The Ninth Circuit, in United States v. McIntosh, 833 F.3d 1163 (9th Cir. 2016), ruled that the rider's practical effect was to prevent the DOJ from using funds appropriated to it by Congress to prosecute defendants, if the defendants fully complied with state law while engaged in authorized medical marijuana activities. *See also U.S. v. Kleinman*, 880 F.3d 1020, 1027 (9th Cir. 2017) (similar); *but see In re Medpoint Management, LLC*, 528 B.R. 178, 185-86 (Bankr. Az. 2015) (holding that limitations on the use of DOJ funds did not foreclose the possibility of enforcement, explaining that the DOJ could spend money from the Asset Forfeiture Funds, and because Congress may not limit the use of general funds in the future).

D. Bankruptcy courts have held that lack of prosecutorial discretion does not justify a result different from dismissal of the case because a marijuana related business is still illegal under Federal law and there remains a risk of federal criminal prosecution. *See In re Arenas*, 535 B.R. 845, 853 n.39 (B.A.P. 10th Cir. 2015); *see also re McGinnis*, 453 B.R. 770, 772 (Bankr. Or. 2011).

E. *In re Cook Investments*, NW, SPNWY, LLC, 2018 U.S. Dist. Lexis 49640.

Four of the five Debtors-Appellees in this case own commercial real estate leased to third parties. As of the commencement of the underlying bankruptcy cases, one tenant of one of the debtors was a state-licensed cannabis producer - heavily regulated and legally operating under Washington state law. The United States Trustee filed a motion to dismiss that debtor's bankruptcy case on the basis the existence of the lease constituted "gross mismanagement" of the bankruptcy estate. The UST argued in the Cook Investments case that involvement with marijuana assets is "gross mismanagement" that is grounds for dismissal under 1112, since such involvement can subject the debtor' assets to forfeiture. The "Rider" is evidence that the risk of such hypothetical forfeiture is remote, and there is no gross mismanagement.

The debtor/lessor thereafter filed a motion to reject the lease with the cannabis producer. The bankruptcy court granted that motion without any opposition. At that point, the lease ceased to be an asset of the debtor/lessor's bankruptcy estate by operation of law.

The debtors thereafter proposed and sought confirmation of a joint plan of reorganization that did not even mention – much less rely on – the rejected lease or any of its income. All creditors would be paid in full from income from the remaining tenants – three lumber yards and a trucking company.

Nevertheless, the UST objected to confirmation of the plan alleging that the plan violated a requirement that it be "proposed in good faith and not by any means forbidden by law." The UST failed to point to any provision in the plan as violating that statutory requirement, but instead based its objection solely on its surmise that the producer might be continuing to operate on the property, and that alone was a basis to deny confirmation. The Bankruptcy Court disagreed, entered detailed written findings of fact and conclusion of law, and confirmed the debtors' proposed plan.

USTP MARIJUANA ENFORCEMENT ACTIONS
BY DISTRICT AND CHAPTER

	A	B	C	D	E	F	G	H	I	J	K
1	**DISTRICT & CHAPTER**	**2010**	**2011**	**2012**	**2013**	**2014**	**2015**	**2016**	**2017**	**2018 Qs. 1 and 2**	**TOTALS**
2	Ariz. 11					1					1
3	Cal. Central 11		1	1	1		1	1		1	6
4	Cal. Central 13									1	1
5	Cal. Eastern 7						1		2		3
6	Cal. Northern 11	1				1			2	1	5
7	Cal. Northern 13								1		1
8	Cal. Northern 7									1	1
9	Cal. Southern 11			1							1
10	Colo. 11			3				1			4
11	Colo. 12									1	1
12	Colo. 13				1		2	1	5	2	11
13	Colo. 7					1		1		1	3
14	Fla. Southern 7						1				1
15	Ill. Central 11								1		1
16	Me. 13								2		2
17	Me. 7						1				1
18	Mich. Eastern 13								1		1
19	Mich. Eastern 7								1	2	3
20	Mich. Western 13						1				1
21	Mich. Western 7						1				1
22	Miss. Northern 13								1		1
23	N.J. 11					1					1
24	N.J. 7								1		1
25	Ore. 11							2	1		3
26	Ore. 13							1	4		5
27	P.R. 13								1		1
28	Pa. Eastern 11									1	1
29	Pa. Eastern 13									1	1
30	USVI 7								1		1
31	Wash. Eastern 11					1					1
32	Wash. Eastern 13					1	1				2
33	Wash. Western 11							2			2
34	Wash. Western 13								5	2	7
35	Wash. Western 7						1	1			2
36											
37	Action Case Totals	1	1	5	2	6	10	10	29	14	78
38											
39											
40	Action Cases By Chapter										
41	7					1	5	2	5	4	17
42	11	1	1	5	1	4	1	6	4	3	26
43	13				1	1	4	2	20	6	34
44	12									1	1

Office of the Attorney General
Washington, D. C. 20530

January 4, 2018

MEMORANDUM FOR ALL UNITED STATES ATTORNEYS

FROM: Jefferson B. Sessions, III
Attorney General

SUBJECT: Marijuana Enforcement

In the Controlled Substances Act, Congress has generally prohibited the cultivation, distribution, and possession of marijuana. 21 U.S.C. § 801 *et seq*. It has established significant penalties for these crimes. 21 U.S.C. § 841 *et seq*. These activities also may serve as the basis for the prosecution of other crimes, such as those prohibited by the money laundering statutes, the unlicensed money transmitter statute, and the Bank Secrecy Act. 18 U.S.C. §§ 1956-57, 1960; 31 U.S.C. § 5318. These statutes reflect Congress's determination that marijuana is a dangerous drug and that marijuana activity is a serious crime.

In deciding which marijuana activities to prosecute under these laws with the Department's finite resources, prosecutors should follow the well-established principles that govern all federal prosecutions. Attorney General Benjamin Civiletti originally set forth these principles in 1980, and they have been refined over time, as reflected in chapter 9-27.000 of the U.S. Attorneys' Manual. These principles require federal prosecutors deciding which cases to prosecute to weigh all relevant considerations, including federal law enforcement priorities set by the Attorney General, the seriousness of the crime, the deterrent effect of criminal prosecution, and the cumulative impact of particular crimes on the community.

Given the Department's well-established general principles, previous nationwide guidance specific to marijuana enforcement is unnecessary and is rescinded, effective immediately.[1] This memorandum is intended solely as a guide to the exercise of investigative and prosecutorial discretion in accordance with all applicable laws, regulations, and appropriations. It is not intended to, does not, and may not be relied upon to create any rights, substantive or procedural, enforceable at law by any party in any matter civil or criminal.

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[1] Previous guidance includes: David W. Ogden, Deputy Att'y Gen., Memorandum for Selected United States Attorneys: Investigations and Prosecutions in States Authorizing the Medical Use of Marijuana (Oct. 19, 2009); James M. Cole, Deputy Att'y Gen., Memorandum for United States Attorneys: Guidance Regarding the Ogden Memo in Jurisdictions Seeking to Authorize Marijuana for Medical Use (June 29, 2011); James M. Cole, Deputy Att'y Gen., Memorandum for All United States Attorneys: Guidance Regarding Marijuana Enforcement (Aug. 29, 2013); James M. Cole, Deputy Att'y Gen., Memorandum for All United States Attorneys: Guidance Regarding Marijuana Related Financial Crimes (Feb. 14, 2014); and Monty Wilkinson, Director of the Executive Office for U.S. Att'ys, Policy Statement Regarding Marijuana Issues in Indian Country (Oct. 28, 2014).

On Our Watch

By Clifford J. White III and John Sheahan

Why Marijuana Assets May Not Be Administered in Bankruptcy

Clifford J. White III
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Clifford White is the director of the Executive Office for U.S. Trustees. He served as an ex officio *member of the ABI Commission to Study the Reform of Chapter 11 and currently serves in the same capacity on the ABI Commission on Consumer Bankruptcy. John Sheahan is a trial attorney in the Office of the General Counsel. Both are based in Washington, D.C.*

Marijuana continues to be regulated by Congress as a dangerous drug, and as the U.S. Supreme Court has recognized, the federal prohibition of marijuana takes precedence over state laws to the contrary.[1] The primacy of federal law over state law is hardly a novel proposition and has been the rule since the ratification of the Constitution. Thus, whenever a marijuana business files for bankruptcy relief, a threshold question is whether the debtor can be granted relief consistent with the Bankruptcy Code and other federal law. If the answer to that question is "no," the U.S. Trustee Program (USTP), in its role as the watchdog of the bankruptcy system, will move to dismiss.

Illegal enterprises simply do not come through the doors of the bankruptcy courthouse seeking help to further their criminal activities. To obtain bankruptcy relief, some may try to hide the nature of their business or income, but bankruptcy courts require full financial disclosure and are not a hospitable forum for continuing a fraudulent or criminal scheme.

Marijuana businesses are a unique and unprecedented exception to this rule because they often involve companies that openly propose to continue their illegal activity during and after the bankruptcy case. Those cases present a challenge to the bankruptcy system because they generally involve assets that are illegal even to possess. In contrast to other types of cases involving illegal businesses, in which the criminal activity has already been terminated and the principal concern of the bankruptcy court is to resolve competing claims by victims for compensation, a marijuana bankruptcy case might involve a company that is not only continuing in its business, but even seeking the affirmative assistance of the bankruptcy court in order to reorganize its balance sheet and thereby facilitate its violations of the law going forward.

The USTP's response to marijuana-related bankruptcy filings is guided by two straightforward and uncontroversial principles. First, the bankruptcy system may not be used as an instrument in the ongoing commission of a crime, and reorganization plans that permit or require continued illegal activity may not be confirmed. Second, bankruptcy trustees and other estate fiduciaries should not be required to administer assets if doing so would cause them to violate federal criminal law.

The USTP's policy of seeking dismissal of marijuana bankruptcy cases that cannot lawfully be administered is not a new one; rather, it is a policy that has been applied consistently over two presidential administrations and under three attorneys general. Nor are these concerns unique to marijuana. These same principles would also guide the USTP's response in a case involving any other type of ongoing criminal conduct or administration of illegal property.

> **[T]he USTP will continue to enforce the legislative judgment of Congress by preventing the bankruptcy system from being used for purposes that Congress has determined are illegal.**

Although a recent *ABI Journal* article[2] takes the USTP to task for its marijuana-enforcement efforts, it is noteworthy that the author fully agrees with the USTP's position as to the first of the two aforementioned principles and appears to agree to a significant extent with the second principle. As the author concedes, "it hardly needs explanation that a bankruptcy court should not supervise an ongoing criminal enterprise regardless of its status under state law."[3] As to the second principle, "[i]t would obviously violate federal law for the trustee to sell marijuana."[4]

Given these concessions, the author's disagreement with the USTP's position would appear to be limited to a fairly narrow range of cases: those where the administration of the estate would not require the trustee to sell marijuana (but would require the trustee to administer other marijuana-derived property), and those where the debtor is a "downstream" participant in a marijuana business, such as a lessor of a building used for a marijuana dispensary.[5]

Yet under the CSA, there is no distinction between the seller or the grower of marijuana and the

1 Controlled Substances Act, 21 U.S.C. § 801, *et seq.* (the "CSA"); *Gonzales v. Raich*, 545 U.S. 1, 12 (2005).

2 Steven J. Boyajian, "Just Say No to Drugs? Creditors Not Getting a Fair Shake When Marijuana-Related Cases Are Dismissed," XXXVI *ABI Journal* 9, 24-25, 74-75, September 2017, *available at* abi.org/abi-journal.

3 *Id.* at 25.

4 *Id.*

5 *Id.* at 74.

supposedly more "downstream" participants whom the article proposes to protect: All are in violation of federal criminal law. In particular, § 856 of the CSA specifically prohibits knowingly renting, managing or using property "for the purpose of manufacturing, distributing, or using any controlled substance;" § 863 of the CSA makes it a crime to sell or offer for sale any drug paraphernalia, which is defined to include, among other things, "equipment, product, or material of any kind which is primarily intended or designed for use" in manufacturing a controlled substance; and § 855 provides for a fine against a person "who derives profits or proceeds from an offense [of the CSA]."[6] Thus, not only would a trustee who offers marijuana for sale violate the law, so too would a trustee who liquidated the fertilizer or equipment used to grow marijuana, who collected rent from a marijuana business tenant or who sought to collect the profits of a marijuana investment.

Although cases involving illicit proceeds of Ponzi schemes and other criminal activities — seen in such notorious cases as *Enron*, *Dreier LLP* and *Madoff* — are administered in bankruptcy, they deal with the aftermath of fraud, usually after individual wrongdoers have been removed from the business. Such cases are wholly inapposite analogies to a marijuana case, where the illegal activity is still continuing through the bankruptcy administration process and where bankruptcy relief might allow the company to expand its violations of law in the future. Nor do any of those cases involve proposed chapter 11 and 13 plans where the feasibility of the plan itself is directly premised on the continued receipt of profits from an illegal enterprise. And none of them requires the courts or trustees to deal with property of the kind described in the CSA, for which mere possession is a federal crime.

Similarly, although the author cites two decades-old decisions in support of his claim that "courts have not always shied away from handling marijuana-related bankruptcies,"[7] it is noteworthy that neither of those decisions involved active marijuana operations or would have required a bankruptcy trustee to administer any illegal marijuana assets.[8] Both *Chapman* and *Kurth Ranch* involved bankruptcy cases that were filed *after* law enforcement had arrested and seized the assets of marijuana growers. The legal issues raised by the current wave of marijuana filings were simply not present in those cases: Neither case involved an ongoing violation of law, and in neither case were there any marijuana assets to be administered, because all illegal assets had been seized and disposed of pre-petition.

Finally, the article suggests that the "ongoing conflict over marijuana policy" is one that should take place outside the bankruptcy system. The USTP agrees. However, that does not mean that the USTP or the courts should turn a blind eye to bankruptcy filings by marijuana businesses. Rather than make its own marijuana policy, the USTP will continue to enforce the legislative judgment of Congress by preventing the bankruptcy system from being used for purposes that Congress has determined are illegal. abi

6 Controlled Substances Act, 21 U.S.C. § 801, *et seq.*

7 *Id.* at 25.

8 *See Dep't of Revenue v. Kurth Ranch*, 511 U.S. 767 (1994); *In re Chapman*, 264 B.R. 565 (B.A.P. 9th Cir. 2001).

U.S. Department of Justice

Office of the Deputy Attorney General

The Deputy Attorney General

Washington, D.C. 20530

October 19, 2009

MEMORANDUM FOR SELECTED UNITED STATES ATTORNEYS

FROM: David W. Ogden
Deputy Attorney General

SUBJECT: Investigations and Prosecutions in States Authorizing the Medical Use of Marijuana

This memorandum provides clarification and guidance to federal prosecutors in States that have enacted laws authorizing the medical use of marijuana. These laws vary in their substantive provisions and in the extent of state regulatory oversight, both among the enacting States and among local jurisdictions within those States. Rather than developing different guidelines for every possible variant of state and local law, this memorandum provides uniform guidance to focus federal investigations and prosecutions in these States on core federal enforcement priorities.

The Department of Justice is committed to the enforcement of the Controlled Substances Act in all States. Congress has determined that marijuana is a dangerous drug, and the illegal distribution and sale of marijuana is a serious crime and provides a significant source of revenue to large-scale criminal enterprises, gangs, and cartels. One timely example underscores the importance of our efforts to prosecute significant marijuana traffickers: marijuana distribution in the United States remains the single largest source of revenue for the Mexican cartels.

The Department is also committed to making efficient and rational use of its limited investigative and prosecutorial resources. In general, United States Attorneys are vested with "plenary authority with regard to federal criminal matters" within their districts. USAM 9-2.001. In exercising this authority, United States Attorneys are "invested by statute and delegation from the Attorney General with the broadest discretion in the exercise of such authority." *Id.* This authority should, of course, be exercised consistent with Department priorities and guidance.

The prosecution of significant traffickers of illegal drugs, including marijuana, and the disruption of illegal drug manufacturing and trafficking networks continues to be a core priority in the Department's efforts against narcotics and dangerous drugs, and the Department's investigative and prosecutorial resources should be directed towards these objectives. As a general matter, pursuit of these priorities should not focus federal resources in your States on

individuals whose actions are in clear and unambiguous compliance with existing state laws providing for the medical use of marijuana. For example, prosecution of individuals with cancer or other serious illnesses who use marijuana as part of a recommended treatment regimen consistent with applicable state law, or those caregivers in clear and unambiguous compliance with existing state law who provide such individuals with marijuana, is unlikely to be an efficient use of limited federal resources. On the other hand, prosecution of commercial enterprises that unlawfully market and sell marijuana for profit continues to be an enforcement priority of the Department. To be sure, claims of compliance with state or local law may mask operations inconsistent with the terms, conditions, or purposes of those laws, and federal law enforcement should not be deterred by such assertions when otherwise pursuing the Department's core enforcement priorities.

Typically, when any of the following characteristics is present, the conduct will not be in clear and unambiguous compliance with applicable state law and may indicate illegal drug trafficking activity of potential federal interest:

- unlawful possession or unlawful use of firearms;
- violence;
- sales to minors;
- financial and marketing activities inconsistent with the terms, conditions, or purposes of state law, including evidence of money laundering activity and/or financial gains or excessive amounts of cash inconsistent with purported compliance with state or local law;
- amounts of marijuana inconsistent with purported compliance with state or local law;
- illegal possession or sale of other controlled substances; or
- ties to other criminal enterprises.

Of course, no State can authorize violations of federal law, and the list of factors above is not intended to describe exhaustively when a federal prosecution may be warranted. Accordingly, in prosecutions under the Controlled Substances Act, federal prosecutors are not expected to charge, prove, or otherwise establish any state law violations. Indeed, this memorandum does not alter in any way the Department's authority to enforce federal law, including laws prohibiting the manufacture, production, distribution, possession, or use of marijuana on federal property. This guidance regarding resource allocation does not "legalize" marijuana or provide a legal defense to a violation of federal law, nor is it intended to create any privileges, benefits, or rights, substantive or procedural, enforceable by any individual, party or witness in any administrative, civil, or criminal matter. Nor does clear and unambiguous compliance with state law or the absence of one or all of the above factors create a legal defense to a violation of the Controlled Substances Act. Rather, this memorandum is intended solely as a guide to the exercise of investigative and prosecutorial discretion.

Finally, nothing herein precludes investigation or prosecution where there is a reasonable basis to believe that compliance with state law is being invoked as a pretext for the production or distribution of marijuana for purposes not authorized by state law. Nor does this guidance preclude investigation or prosecution, even when there is clear and unambiguous compliance with existing state law, in particular circumstances where investigation or prosecution otherwise serves important federal interests.

Your offices should continue to review marijuana cases for prosecution on a case-by-case basis, consistent with the guidance on resource allocation and federal priorities set forth herein, the consideration of requests for federal assistance from state and local law enforcement authorities, and the Principles of Federal Prosecution.

cc: All United States Attorneys

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Office of the Deputy Attorney General

The Deputy Attorney General

Washington, D.C. 20530

August 29, 2013

MEMORANDUM FOR ALL UNITED STATES ATTORNEYS

FROM: James M. Cole
Deputy Attorney General

SUBJECT: Guidance Regarding Marijuana Enforcement

In October 2009 and June 2011, the Department issued guidance to federal prosecutors concerning marijuana enforcement under the Controlled Substances Act (CSA). This memorandum updates that guidance in light of state ballot initiatives that legalize under state law the possession of small amounts of marijuana and provide for the regulation of marijuana production, processing, and sale. The guidance set forth herein applies to all federal enforcement activity, including civil enforcement and criminal investigations and prosecutions, concerning marijuana in all states.

As the Department noted in its previous guidance, Congress has determined that marijuana is a dangerous drug and that the illegal distribution and sale of marijuana is a serious crime that provides a significant source of revenue to large-scale criminal enterprises, gangs, and cartels. The Department of Justice is committed to enforcement of the CSA consistent with those determinations. The Department is also committed to using its limited investigative and prosecutorial resources to address the most significant threats in the most effective, consistent, and rational way. In furtherance of those objectives, as several states enacted laws relating to the use of marijuana for medical purposes, the Department in recent years has focused its efforts on certain enforcement priorities that are particularly important to the federal government:

- 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.

These priorities will continue to guide the Department's enforcement of the CSA against marijuana-related conduct. Thus, this memorandum serves as guidance to Department attorneys and law enforcement to focus their enforcement resources and efforts, including prosecution, on persons or organizations whose conduct interferes with any one or more of these priorities, regardless of state law.[1]

Outside of these enforcement priorities, the federal government has traditionally relied on states and local law enforcement agencies to address marijuana activity through enforcement of their own narcotics laws. For example, the Department of Justice has not historically devoted resources to prosecuting individuals whose conduct is limited to possession of small amounts of marijuana for personal use on private property. Instead, the Department has left such lower-level or localized activity to state and local authorities and has stepped in to enforce the CSA only when the use, possession, cultivation, or distribution of marijuana has threatened to cause one of the harms identified above.

The enactment of state laws that endeavor to authorize marijuana production, distribution, and possession by establishing a regulatory scheme for these purposes affects this traditional joint federal-state approach to narcotics enforcement. The Department's guidance in this memorandum rests on its expectation that states and local governments that have enacted laws authorizing marijuana-related conduct will implement strong and effective regulatory and enforcement systems that will address the threat those state laws could pose to public safety, public health, and other law enforcement interests. A system adequate to that task must not only contain robust controls and procedures on paper; it must also be effective in practice. Jurisdictions that have implemented systems that provide for regulation of marijuana activity

[1] These enforcement priorities are listed in general terms; each encompasses a variety of conduct that may merit civil or criminal enforcement of the CSA. By way of example only, the Department's interest in preventing the distribution of marijuana to minors would call for enforcement not just when an individual or entity sells or transfers marijuana to a minor, but also when marijuana trafficking takes place near an area associated with minors; when marijuana or marijuana-infused products are marketed in a manner to appeal to minors; or when marijuana is being diverted, directly or indirectly, and purposefully or otherwise, to minors.

must provide the necessary resources and demonstrate the willingness to enforce their laws and regulations in a manner that ensures they do not undermine federal enforcement priorities.

In jurisdictions that have enacted laws legalizing marijuana in some form and that have also implemented strong and effective regulatory and enforcement systems to control the cultivation, distribution, sale, and possession of marijuana, conduct in compliance with those laws and regulations is less likely to threaten the federal priorities set forth above. Indeed, a robust system may affirmatively address those priorities by, for example, implementing effective measures to prevent diversion of marijuana outside of the regulated system and to other states, prohibiting access to marijuana by minors, and replacing an illicit marijuana trade that funds criminal enterprises with a tightly regulated market in which revenues are tracked and accounted for. In those circumstances, consistent with the traditional allocation of federal-state efforts in this area, enforcement of state law by state and local law enforcement and regulatory bodies should remain the primary means of addressing marijuana-related activity. If state enforcement efforts are not sufficiently robust to protect against the harms set forth above, the federal government may seek to challenge the regulatory structure itself in addition to continuing to bring individual enforcement actions, including criminal prosecutions, focused on those harms.

The Department's previous memoranda specifically addressed the exercise of prosecutorial discretion in states with laws authorizing marijuana cultivation and distribution for medical use. In those contexts, the Department advised that it likely was not an efficient use of federal resources to focus enforcement efforts on seriously ill individuals, or on their individual caregivers. In doing so, the previous guidance drew a distinction between the seriously ill and their caregivers, on the one hand, and large-scale, for-profit commercial enterprises, on the other, and advised that the latter continued to be appropriate targets for federal enforcement and prosecution. In drawing this distinction, the Department relied on the common-sense judgment that the size of a marijuana operation was a reasonable proxy for assessing whether marijuana trafficking implicates the federal enforcement priorities set forth above.

As explained above, however, both the existence of a strong and effective state regulatory system, and an operation's compliance with such a system, may allay the threat that an operation's size poses to federal enforcement interests. Accordingly, in exercising prosecutorial discretion, prosecutors should not consider the size or commercial nature of a marijuana operation alone as a proxy for assessing whether marijuana trafficking implicates the Department's enforcement priorities listed above. Rather, prosecutors should continue to review marijuana cases on a case-by-case basis and weigh all available information and evidence, including, but not limited to, whether the operation is demonstrably in compliance with a strong and effective state regulatory system. A marijuana operation's large scale or for-profit nature may be a relevant consideration for assessing the extent to which it undermines a particular federal enforcement priority. The primary question in all cases – and in all jurisdictions – should be whether the conduct at issue implicates one or more of the enforcement priorities listed above.

As with the Department's previous statements on this subject, this memorandum is intended solely as a guide to the exercise of investigative and prosecutorial discretion. This memorandum does not alter in any way the Department's authority to enforce federal law, including federal laws relating to marijuana, regardless of state law. Neither the guidance herein nor any state or local law provides a legal defense to a violation of federal law, including any civil or criminal violation of the CSA. Even in jurisdictions with strong and effective regulatory systems, evidence that particular conduct threatens federal priorities will subject that person or entity to federal enforcement action, based on the circumstances. This memorandum is not intended to, does not, and may not be relied upon to create any rights, substantive or procedural, enforceable at law by any party in any matter civil or criminal. It applies prospectively to the exercise of prosecutorial discretion in future cases and does not provide defendants or subjects of enforcement action with a basis for reconsideration of any pending civil action or criminal prosecution. Finally, nothing herein precludes investigation or prosecution, even in the absence of any one of the factors listed above, in particular circumstances where investigation and prosecution otherwise serves an important federal interest.

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