Marijuana bankruptcy

By Hilary Hudson Clifton

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Hilary Hudson Clifton is a litigation attorney who represents individuals and both privately-held and public companies in a wide range of civil litigation matters.

Although the legal medicinal and recreational marijuana industries continue to expand throughout the country, it is well-known that the possession and distribution of marijuana remain criminal offenses under the federal Controlled Substances Act. As a consequence, businesses that cultivate or sell marijuana generally are unable to take advantage of bankruptcy protections, which are governed by federal statutes and overseen by federal courts. Moreover, even attempting to initiate a bankruptcy proceeding could subject a marijuana

operation and its principals to scrutiny by federal authorities, including referral to federal prosecutors.

Less well understood than this general prohibition, however, is its potential scope. In recent years, the denial of bankruptcy relief has been extended to individuals and businesses more tangentially tied to the marijuana industry. Cases decided in recent years indicate that access to bankruptcy courts may be denied merely by virtue of an individual's interest in assets related to or derived from marijuana businesses. In 2017, the United States Trustee directed bankruptcy trustees not to administer marijuana assets in bankruptcy, even where the assets are not illegal under state law. Since that time, several bankruptcy courts have denied debtors relief based on the debtors' ownership of assets tied to marijuana businesses.

One of the more well-known of these cases is *In re: Way to Grow, Inc.,* in which a Colorado business that sold hydroponic cultivation equipment was denied bankruptcy relief. Though the business was not directly involved in "manufacturing, distributing, dispensing, or possessing" a controlled substance, the court concluded the business had "reasonable cause to believe" its equipment would be used to manufacture marijuana. That was sufficient to find the business was violating federal law.

In another case arising in Arizona, two individual debtors sought the bankruptcy court's assistance in developing a plan to repay their debts. Their petition was dismissed by the Arizona bankruptcy court, and the individuals appealed. The appellate court, however, agreed that the couple could not seek bankruptcy relief due to their ownership interest in a defunct, non-operational marijuana business. At the time, the defunct entity was pursuing two state court lawsuits for breach of contract. Because any recovery in those lawsuits would be derived from illegal conduct, the court concluded that allowing the Chapter 13 case to continue would require

the trustee to become involved in such illegal conduct.

As Judge Michael Romero concluded in another case from Colorado, *In re Malul,* "[i]f the uncertainty of outcomes in marijuana-related bankruptcy cases were an opera, Congress, not the judiciary, would be the fat lady." Unless and until Congress sings via an amendment to the Controlled Substances Act, individuals and their legal and financial advisers should take these limitations under careful consideration. Any individuals or entities with assets tied to a marijuana-related business should be aware that the doors to the bankruptcy courthouse may be locked indefinitely.

Hilary H. Clifton is a litigation attorney at the law firm of Phillips Murrah.

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