



EMORY  
LAW

## Emory Bankruptcy Developments Journal

---

Volume 30  
Issue 1 *A Tribute to Richard Levin*

---

2013

### Medical Marijuana Dispensaries in Chapter 11 Bankruptcy

Vivian Cheng

Follow this and additional works at: <https://scholarlycommons.law.emory.edu/ebdj>

---

#### Recommended Citation

Vivian Cheng, *Medical Marijuana Dispensaries in Chapter 11 Bankruptcy*, 30 Emory Bankr. Dev. J. 105 (2013).

Available at: <https://scholarlycommons.law.emory.edu/ebdj/vol30/iss1/6>

This Comment is brought to you for free and open access by the Journals at Emory Law Scholarly Commons. It has been accepted for inclusion in Emory Bankruptcy Developments Journal by an authorized editor of Emory Law Scholarly Commons. For more information, please contact [law-scholarly-commons@emory.edu](mailto:law-scholarly-commons@emory.edu).

## **MEDICAL MARIJUANA DISPENSARIES IN CHAPTER 11 BANKRUPTCY**

### **ABSTRACT**

*Since California passed the Compassionate Use Act of 1996, the interaction between state and federal medical marijuana laws have been a subject of frequent legal debate. But few have considered whether state-compliant medical marijuana dispensaries may seek assistance from the bankruptcy system. Two dispensaries recently tested their ability to reorganize under chapter 11 of the Bankruptcy Code, but the cases were quickly dismissed. The U.S. Trustees argued that the debtors' business activities constituted "cause" to dismiss, lack of good faith in filing, and a "means forbidden by law," and left the debtor with little reasonable chance of success.*

*This Comment argues that the requirements in §§ 1112(b), 1129(a)(3), and 1129(a)(11) to propose and confirm a chapter 11 plan do not foreclose bankruptcy protection for a medical marijuana business. Since medical marijuana dispensaries are legitimate businesses under state statute, there should be no lack of good faith or cause to dismiss the case under § 1112(b). Therefore, chapter 11 plans should also be confirmable since § 1129(a)(3) does not bar confirmation of plans based on the legality of the plan's specific terms, but rather on the legality of the manner of the plan's proposal. Such a plan should not be per se infeasible under § 1129(a)(11), although the risk of federal intervention may be a factor weighing against a finding of feasibility.*

*Even if a court decides to assess the substance of a dispensary's plan, they may use their discretion to give greater weight to state rather than federal law. Successful state legalization despite federal prohibition suggests the federal government's tacit acceptance of state-compliant dispensaries. Courts should allow dispensaries to pursue bankruptcy to satisfy more creditors and preserve a regulated medical marijuana market that protects patients and produces positive externalities for society. Debtors should be allowed to fund their repayment plans with state-compliant medical marijuana sales and leave constitutional challenges of state legalization policies to their proper forums. One group of marijuana business attorneys noted that if "bankruptcy courts develop a policy of denial of bankruptcy relief to medical cannabis entities, the legitimacy of the industry itself will continue to be stymied."*

## INTRODUCTION

Medical marijuana dispensaries sell goods, compete for customers, buy or rent property, pay utility bills, hire employees, borrow from creditors, operate under state licenses, and even pay taxes.<sup>1</sup> Thus, they are subject to the same forces that might steer many other businesses into financial trouble. Unlike the deli next door, however, filing for bankruptcy might not be an available solution for struggling dispensaries due to their uncertain legal status. Rather, distressed medical marijuana dispensaries find their efforts to regain solvency thwarted by the federal government's battle with state legislators as both entities jockey for control over the permissibility of medical marijuana.

The Bankruptcy Code ("Code") does not explicitly prohibit dispensaries from filing for bankruptcy. But a U.S. Trustee has argued that medical marijuana businesses, which are prohibited by federal law, provide sufficient "cause" to dismiss under 11 U.S.C. § 1112(b).<sup>2</sup> Similarly, another trustee has argued that dispensaries could not possibly propose a good-faith plan that is not forbidden "by law."<sup>3</sup>

An increasing number of state medical marijuana laws that directly contradict the federal prohibition, coupled with the federal government's lack of enforcement,<sup>4</sup> call into question whether courts should allow state-compliant dispensaries to reorganize in chapter 11 bankruptcy.

Since 1970, the federal government has prohibited selling, growing, and distributing marijuana through the Controlled Substances Act ("CSA").<sup>5</sup> In

---

<sup>1</sup> See, e.g., Maureen O'Hagan & Jonathan Martin, *Pot Dispensaries Clouding Medical Marijuana's Image*, SEATTLE TIMES (Oct. 6, 2012, 8:04 PM), [http://seattletimes.com/html/localnews/2019363501\\_medicalmarijuana07m.html?prmid=4939](http://seattletimes.com/html/localnews/2019363501_medicalmarijuana07m.html?prmid=4939) (stating that, although a minority, about fifty medical marijuana businesses in Washington paid taxes according to the state's Department of Revenue).

<sup>2</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 *Motion to Dismiss*].

<sup>3</sup> United States Trustee's Response to Debtor's Motion to Dismiss Chapter 11 Bankruptcy at 2-3, *In re* Mother Earth's Alternative Healing Coop., Inc., No. 12-10223-11 (Bankr. S.D. Cal. Sept. 4, 2012).

<sup>4</sup> See, e.g., Memorandum from David W. Ogden, Deputy Attorney Gen., to Selected U.S. Attorneys (Oct. 19, 2009), available at <http://blogs.justice.gov/main/archives/192> (announcing that the Department of Justice would not focus on prosecuting marijuana dispensaries that are in clear compliance with state laws).

<sup>5</sup> 21 U.S.C. § 844(a) (2012). Congress classified the drugs encompassed by the CSA into five categories, or schedules, based on their medicinal value, potential for abuse, and effects on the body. *Id.* §§ 811-812. It placed marijuana in schedule I, the most restrictive category. *Id.* Anyone who possesses, cultivates, or distributes marijuana is subject to federal criminal sanctions, though federal prosecutors may choose to approach certain cases of possession as a civil offense. *Id.* The manufacture, distribution, or possession with intent to distribute marijuana is a felony. *Id.*

*Gonzales v. Raich*, the Supreme Court confirmed Congress's power to regulate noncommercial, purely intrastate production and use of marijuana for medical purposes.<sup>6</sup> Although the CSA operates at the outer bounds of Congress's authority under the Commerce Clause, it is clearly constitutional.<sup>7</sup> Prior to *Gonzales*, the Supreme Court rejected the common law medical necessity defense for crimes of manufacturing and distributing marijuana in *United States v. Oakland Cannabis*.<sup>8</sup>

Until recently,<sup>9</sup> every state had prohibited the use and sale of marijuana for nonmedical use since the 1930's.<sup>10</sup> However, after California passed the Compassionate Use Act of 1996 to protect seriously ill patients who rely on marijuana for medical use from "criminal prosecution or sanction,"<sup>11</sup> other states began to similarly contradict the CSA to allow medical marijuana.<sup>12</sup> Today, twenty states and the District of Columbia have similar state or local laws that remove criminal sanctions for qualifying patients, physicians, and caregivers.<sup>13</sup> Some of these laws also allow access to medical marijuana via home cultivation or dispensaries.<sup>14</sup>

This Comment considers how the direct conflict between state and federal law affects a dispensary's ability to reorganize under federal bankruptcy protection. Part I evaluates whether a medical marijuana business can overcome a motion to dismiss for cause or lack of good faith under § 1112(b) and propose a confirmable plan compliant with § 1129(a). Part II argues that a bankruptcy judge may confirm a plan that relies on the sale and cultivation of marijuana by deferring to state medical marijuana laws over the federal ban.

---

<sup>6</sup> *Gonzales v. Raich*, 545 U.S. 1 (2005).

<sup>7</sup> *Id.* at 18.

<sup>8</sup> *United States v. Oakland Cannabis Buyers' Co-Op*, 532 U.S. 483 (2001).

<sup>9</sup> *Infra* notes 208–212 and accompanying text.

<sup>10</sup> Robert A. Mikos, *On the Limits of Supremacy: Medical Marijuana and the States' Overlooked Power to Legalize Federal Crime*, 62 VAND. L. REV. 1421, 1427 (2009); see *infra* notes 208–212 and accompanying text.

<sup>11</sup> CAL. HEALTH & SAFETY CODE § 11362.5 (West 2009).

<sup>12</sup> *The Twenty States and One Federal District with Effective Medical Marijuana Laws*, MARIJUANA POLICY PROJECT (Aug. 26, 2013), <http://www.mpp.org/assets/pdfs/library/MMJLawsSummary.pdf>.

<sup>13</sup> *Id.* The other states and federal districts that have legalized medical marijuana are: Arizona, Alaska, Colorado, Connecticut, Delaware, District of Columbia, Hawaii, Illinois, Maine, Maryland, Massachusetts, Michigan, Montana, Nevada, New Hampshire, New Jersey, New Mexico, Oregon, Rhode Island, Vermont, and Washington. See Chelsea Conaboy, *Massachusetts Voters Approve Ballot Measure to Legalize Medical Marijuana*, BOS. GLOBE (Nov. 6, 2012, 10:34 PM), <http://www.boston.com/metrodesk/2012/11/06/massachusetts-voters-approve-ballot-measure-legalize-medical-marijuana/EpDzjGfBjnOAkoXpJwm1K/story.html>.

<sup>14</sup> *The Twenty States*, *supra* note 12.

Finally, Part III considers how the goals of bankruptcy, other public policy, and potential safeguards suggest that courts should treat medical marijuana businesses no differently than any other businesses permitted to reorganize under chapter 11.

## I. BACKGROUND

### A. “Cause” to Dismiss Under 11 U.S.C. § 1112(b)

Section 1112(b) permits a party in interest to request the dismissal of a case upon demonstration of “cause.”<sup>15</sup> Under the same provision, courts may also dismiss a chapter 11 case sua sponte.<sup>16</sup> The cause standard is intended to further the basic purposes of chapter 11. Its goals include preserving viable businesses while maximizing creditors’ return, facilitating negotiations to accommodate each party’s interests, and producing a reasonable opportunity for plan confirmation.<sup>17</sup>

Section 1112(b)(4) provides a nonexclusive list of sixteen items that constitute grounds for dismissal for cause.<sup>18</sup> Although filing a petition in bad faith is not explicitly included in this list, courts have overwhelmingly held that a debtor’s lack of good faith in filing a petition establishes cause for dismissal.<sup>19</sup>

Section 1112(b) “measures the value of maintaining the [bankruptcy] process, and also polices the diligence of the debtor or other plan proponent to ensure that the process is proceeding with all deliberate speed and in accordance with the requirements of applicable law.”<sup>20</sup> The cause standard recognizes that “when there is no reasonable likelihood that the statutory objective of reorganization can be realized or when the debtor unreasonably

---

<sup>15</sup> 11 U.S.C. § 1112(b) (2012).

<sup>16</sup> *In re Starmark Clinics, L.P.*, 388 B.R. 729, 736 (Bankr. S.D. Tex. 2008); 11 COLLIER ON BANKRUPTCY ¶ 1112.04[2] (Alan N. Resnick & Henry J. Sommer eds., 16th ed. 2010).

<sup>17</sup> 11 COLLIER, *supra* note 16, ¶ 1112.04[5].

<sup>18</sup> 11 U.S.C. § 1112(b)(4). According to the rules of construction, “includes” as used here is not limiting. *Id.* § 102(3).

<sup>19</sup> *See, e.g.*, Official Comm. of Unsecured Creditors v. Nucor Corp. (*In re SGL Carbon Corp.*), 200 F.3d 154, 160 (3d Cir. 1999); *Marsch v. Marsch (In re Marsch)*, 36 F.3d 825, 828 (9th Cir. 1994) (“Although [§] 1112(b) does not explicitly require that cases be filed in ‘good faith,’ courts have overwhelmingly held that a lack of good faith in filing a [c]hapter 11 petition establishes cause for dismissal.”); *In re Winshall Settlor’s Trust*, 758 F.2d 1136, 1137 (6th Cir. 1985) (“[A]n implicit prerequisite to the right to file is ‘good faith’ on the part of the debtor, the absence of which may constitute cause for dismissal under § 1112(b).”).

<sup>20</sup> 11 COLLIER, *supra* note 16, ¶ 1112.07[1].

delays,” provisions meant to help the debtor accomplish reorganization, such as the automatic stay, begin to run counter to the interests of the creditors.<sup>21</sup> The bankruptcy court may therefore “effectuate the provisions of the Bankruptcy Code,” including the implied good faith requirement, to protect the creditors.<sup>22</sup>

This has been reflected in a key test of good faith—whether the plan was “legally and economically feasible.”<sup>23</sup> The term “legally” has been used to ensure that the debtor intends to reorganize to satisfy rather than deter or harass creditors.<sup>24</sup>

Some courts hold that cause to dismiss for lack of good faith arises when “either objective futility or subjective bad faith” is shown.<sup>25</sup> Other courts require *both* a likelihood of ultimate futility and bad faith of the petitioner to create sufficient grounds to dismiss.<sup>26</sup>

Generally, there are three scenarios that may implicate a lack of good faith: “(1) one-asset (usually real estate) debtor cases; (2) cases that resort to bankruptcy court protection in order to make strategic use of a specific bankruptcy law right or power; and (3) cases that use of bankruptcy to secure a tactical litigation advantage.”<sup>27</sup>

*B. Courts Disagree over the Meaning of the 11 U.S.C. § 1129(a)(3) Requirement to Propose a Plan “Not by Any Means Forbidden by Law”*

While a court may not dismiss for cause early in the bankruptcy case, the court may later refuse to confirm the debtor’s plan.<sup>28</sup> Failing to confirm a plan may lead the court to dismiss the debtor’s case. A debtor’s plan must meet a number of requirements in § 1129(a) to be confirmed.<sup>29</sup> Section 1129(a)(3) requires that a plan be “proposed in good faith and not by any means forbidden

<sup>21</sup> United Sav. Ass’n of Tex. v. Timbers of Inwood Forest Assocs. (*In re* Timbers of Inwood Forest Assocs.), 808 F.2d 363, 373 (5th Cir. 1987) (en banc), *aff’d*, 484 U.S. 365 (1988).

<sup>22</sup> *Id.*

<sup>23</sup> *In re Strug-Div., L.L.C.*, 375 B.R. 445, 449 (Bankr. N.D. Ill. 2007).

<sup>24</sup> *Id.*

<sup>25</sup> Lawrence Ponoroff & F. Stephen Knippenberg, *The Implied Good Faith Filing Requirement: Sentinel of an Evolving Bankruptcy Policy*, 85 NW. U. L. REV. 919, 925 (1991).

<sup>26</sup> *Carolin Corp. v. Miller*, 886 F.2d 693, 700 (4th Cir. 1989); Ponoroff & Knippenberg, *supra* note 25.

<sup>27</sup> *Id.* at 927.

<sup>28</sup> 11 COLLIER, *supra* note 16, ¶ 1112.07.

<sup>29</sup> 11 U.S.C. § 1129(a) (2012) (“The court shall confirm a plan only if all of the following requirements are met . . .”).

by law.”<sup>30</sup> Courts generally consider the “good faith” and the “forbidden by law” components of §1129(a)(3) separately.<sup>31</sup>

The “good faith” language in § 1129(a)(3) is distinct from the good faith prerequisite to filing a petition read into § 1112(b).<sup>32</sup> Good faith under § 1129(a)(3) is “more narrowly focused, and tests directly whether the debtor’s conduct in formulating, proposing and confirming a *plan* displays the requisite honesty of intention.”<sup>33</sup> This is in contrast to the good faith prerequisite to filing a *petition* in § 1112(b). Still, courts have the discretion to refuse to dismiss the case if it concludes that the creditors would be better served while the debtor remains in bankruptcy.<sup>34</sup>

The second inquiry in §1129(a)(3), whether a plan is “not by any means forbidden by law,” has been overshadowed by the good faith inquiry.<sup>35</sup> Courts have focused largely on the plan’s ability to reorganize the debtor in a manner consistent with the objectives of the Code when considering this part of §1129(a)(3).<sup>36</sup>

Courts differ on what “law” to consider when assessing a plan’s legality. They have referred to both federal and state nonbankruptcy law.<sup>37</sup> In *In re Koelbl*, the Second Circuit acknowledged that the language “‘means forbidden by law’ refers inter alia to state law.”<sup>38</sup> On the other hand, in *In re Texas Extrusion Corp.*, the Fifth Circuit considered whether the reorganization plan was part of an alleged conspiracy to violate federal antitrust laws.<sup>39</sup>

Source of law aside, courts have disagreed on how to determine whether a plan was proposed by “means forbidden by law.” Some courts have focused on

---

<sup>30</sup> *Id.* § 1129(a)(3). Section 1225(a)(3) also requires that chapter 12 debtors propose a plan “in good faith not by any means forbidden by law.” *Id.* § 1225(a)(3).

<sup>31</sup> *See, e.g., In re Frascella Enters.*, 360 B.R. 435, 445–46 (Bankr. E.D. Pa. 2007); *In re Jartran, Inc.*, 44 B.R. 331, 388–89 (Bankr. N.D. Ill. 1984), *aff’d*, 886 F.2d 859 (7th Cir. 1989).

<sup>32</sup> *See* 11 COLLIER, *supra* note 16, ¶ 1112.07.

<sup>33</sup> *Id.*

<sup>34</sup> *Id.*

<sup>35</sup> *See, e.g., In re Multiut Corp.*, 449 B.R. 323, 341–43 (Bankr. N.D. Ill. 2011); *In re TCI 2 Holdings, L.L.C.*, 428 B.R. 117, 143–44 (Bankr. D.N.J. 2010).

<sup>36</sup> *In re Bravo Enters. USA, L.L.C.*, 331 B.R. 459, 472 (Bankr. M.D. Fla. 2005); 6 WILLIAM L. NORTON, JR. & WILLIAM L. NORTON III, NORTON BANKR. L. & PRAC. § 112:10 (3d ed. 2013).

<sup>37</sup> *See, e.g., In re Tex. Extrusion Corp.*, 844 F.2d 1142, 1160 (5th Cir. 1988) (referring to federal antitrust laws); *In re Flor*, 166 B.R. 512, 515 (Bankr. D. Conn. 1994) (referring to Connecticut state law); *In re Jartran, Inc.*, 44 B.R. 331, 387 (Bankr. N.D. Ill. 1984) (referring to federal law on bankruptcy crimes), *aff’d* 886 F.2d 859 (7th Cir. 1989).

<sup>38</sup> *In re Koelbl*, 751 F.2d 137, 139 (2d Cir. 1984).

<sup>39</sup> *Tex. Extrusion Corp.*, 844 F.2d at 1160.

the plan's substance and asked whether the activities proposed to satisfy claims were contrary to some nonbankruptcy law.<sup>40</sup> Other courts refused to assess the legality of the plan's provisions.<sup>41</sup> Instead, those courts focused on the *proposal* of the plan and assessed "the conduct manifested in obtaining the confirmation votes of a plan of reorganization and not necessarily on the substantive nature of the plan."<sup>42</sup>

### C. *The 11 U.S.C. 1129(a)(11) Feasibility Standard*

A confirmable plan must have a reasonable chance of success, as required by § 1129(a)(11).<sup>43</sup> This is commonly referred to as the feasibility standard.<sup>44</sup> Section 1129(a)(11) conditions plan confirmation on the court's finding that "confirmation of the plan is not likely to be followed by the liquidation, or the need for further financial reorganization."<sup>45</sup> The purpose of § 1129(a)(11) is "to prevent confirmation of visionary schemes which promise creditors . . . more . . . than the debtor can possibly attain."<sup>46</sup> "The feasibility standard is whether the plan offers a reasonable assurance of success. Success need not be guaranteed."<sup>47</sup>

The debtor is only required to prove that its reorganization plan is feasible by a preponderance of the evidence.<sup>48</sup> Courts have described this threshold of

---

<sup>40</sup> See *Settling States v. Carolina Tobacco Co. (In re Carolina Tobacco Co.)*, 360 B.R. 702, 713 (D. Or. 2007), *vacated*, *Alabama v. Carolina Tobacco Co. (In re Carolina Tobacco Co.)*, No. 05-34156, 2012 U.S. Dist. LEXIS 35229 (D. Or. Feb. 22, 2012); *In re Flor*, 166 B.R. at 515.

<sup>41</sup> See, e.g., *In re Frascella Enters.*, 360 B.R. 435, 445 (Bankr. E.D. Pa. 2007); *In re Food City, Inc.*, 110 B.R. 808, 812 (Bankr. W.D. Tex. 1990); see also Richard M. Cieri, Barbara J. Oyer & Dorothy J. Bimbryer, "The Long and Winding Road": *The Standards to Confirm a Plan of Reorganization Under Chapter 11 of the Bankruptcy Code (Part I)*, 3 J. BANKR. L. & PRAC. 3, 39–40 (1993).

<sup>42</sup> *In re Sovereign Grp., 1984-21 Ltd.*, 88 B.R. 325, 328 (Bankr. D. Colo. 1988) (citing 5 COLLIER ON BANKRUPTCY ¶ 1129.02 (Alan N. Resnick & Henry J. Sommer eds., 15th ed. 1984)); see, e.g., *Tex. Extrusion Corp.*, 844 F.2d at 1160 (stating that reorganization plan that is part of an alleged conspiracy to violate federal antitrust laws would be prohibited); *In re Koelbl*, 751 F.2d at 139 (explaining that use of trade secrets or confidential information in violation of New York state law to propose plan would be prohibited).

<sup>43</sup> 11 U.S.C. § 1129(a)(11) (2012).

<sup>44</sup> Stephanie Gleason, *Marijuana Dispensary's Chapter 11 Case Burns Out*, WALL ST. J. BLOGS (Oct. 8, 2012, 3:31 PM), <http://blogs.wsj.com/bankruptcy/2012/10/08/marijuana-dispensarys-chapter-11-case-burns-out/>.

<sup>45</sup> 11 U.S.C. § 1129(a)(11).

<sup>46</sup> *Pizza of Haw., Inc. v. Shakey's, Inc. (In re Pizza of Haw., Inc.)*, 761 F.2d 1374, 1382 (9th Cir. 1985) (quoting 5 COLLIER, *supra* note 42, ¶ 1129.02).

<sup>47</sup> *Kane v. Johns-Manville Corp.*, 843 F.2d 636, 649 (2d Cir. 1988).

<sup>48</sup> *Fin. Sec. Assurance, Ltd. v. T-H New Orleans Ltd. P'ship (In re T-H New Orleans P'shp)*, 116 F.3d 790, 801 (5th Cir. 1997).

proof as “relatively low.”<sup>49</sup> In fact, “the mere potential for failure of the plan is insufficient to disprove feasibility.”<sup>50</sup> Instead, a court reviewing a bankruptcy plan must consider the totality of the circumstances.<sup>51</sup> This may “include the earning power of the business, its capital structure, economic conditions, the continuation of present management, and the efficiency of the management in control of the business after confirmation.”<sup>52</sup> This approach could result in the confirmation of a plan that has less than a 50% chance of success.<sup>53</sup>

## II. PROCEDURAL CAPACITY TO REMAIN IN CHAPTER 11

In the summer of 2012, two medical marijuana dispensaries sought the protection of chapter 11.<sup>54</sup> Given the novelty of these cases and the nature of the debtors’ businesses, it was unclear whether bankruptcy courts would allow the dispensaries to remain in bankruptcy.<sup>55</sup> Although neither case was decided on a “good faith” analysis, in dicta the court in *CGO Enterprise L.L.C.* offered insight into how an examination of complex federalism issues presented in a dispensary filing might be conducted.<sup>56</sup>

Section A discusses the arguments put forth by U.S. Trustees seeking to dismiss these recent medical marijuana bankruptcies. Section B argues that proposing a plan funded by the sale of medical marijuana does not necessarily create cause to dismiss the case under § 1112(b) or implicate a lack of good faith in filing. Section C explains that courts have interpreted § 1129(a)(3) to require that the plan proposal, rather than the specific contents of the plan, be

---

<sup>49</sup> *Computer Task Grp., Inc. v. Brotby (In re Brotby)*, 303 B.R. 177, 191 (B.A.P. 9th Cir. 2003) (citations omitted) (“The Code does not require the debtor to prove that success is inevitable, and a relatively low threshold of proof will satisfy § 1129(a)(11), so long as adequate evidence supports a finding of feasibility.”); see also *Gen. Elec. Credit Equities, Inc. v. Brice Rd. Devs., L.L.C. (In re Brice Rd. Devs., L.L.C.)*, 392 B.R. 274, 283 (B.A.P. 6th Cir. 2008).

<sup>50</sup> *S & P, Inc. v. Pfeifer*, 189 B.R. 173, 182–83 (N.D. Ind. 1995) (quoting *In re Drexel Burnham Lambert Grp.*, 138 Bankr. 723, 762 (Bankr. S.D.N.Y. 1992)).

<sup>51</sup> *In re Mulberry Phosphates, Inc.*, 149 B.R. 702, 709 (M.D. Fla. 1993).

<sup>52</sup> *Id.*

<sup>53</sup> See Rafael I. Pardo, *Reconceptualizing Present-Value Analysis in Consumer Bankruptcy*, 68 WASH. & LEE L. REV. 113, 147–48 (2011) (describing the chapter 11 financial feasibility standard as “two more-likely-than-not assessments”).

<sup>54</sup> See *In re CGO Enter. L.L.C.*, No. 12-19010, 2012 WL 1962267 (Bankr. D. Colo. May 16, 2012); Chapter 11 Voluntary Petition, *In re Mother Earth’s Alternative Healing Coop., Inc.*, No. 12-10223-11 (Bankr. S.D. Cal. June 25, 2012).

<sup>55</sup> Stephanie Gleason, *Blunt Force: Landlord Cleared to Evict Marijuana Dispensary*, WALL ST. J. BANKR. BEAT BLOG (Aug. 22, 2012, 4:15 PM), <http://blogs.wsj.com/bankruptcy/2012/08/22/blunt-force-landlord-cleared-to-evict-marijuana-dispensary/>.

<sup>56</sup> *Motion to Dismiss, supra* note 2; *Marijuana Dispensary’s Chapter 11, supra* note 44.

free from any illegalities. Courts have even confirmed plans that required the debtor to violate nonbankruptcy laws.<sup>57</sup> Section D argues that, although there is some possibility that federal forfeiture may prevent completion of a debtor dispensary's plan, the risk may not arise to a reasonable probability of failure. Thus, a plan relying on the sale of medical marijuana may be feasible under § 1129(a)(11).

A. *U.S. Trustees' Arguments to Dismiss in Recent Medical Marijuana Cases*

1. *Trustee in CGO Enterprise Argued that Proposing a Plan to Sell Medical Marijuana Indicates Lack of Good Faith*

A U.S. Trustee objected to the chapter 11 filing of a Denver-based medical marijuana cultivator CGO Enterprise, L.L.C., arguing that the dispensary's filing was not made in good faith.<sup>58</sup> The trustee also argued that CGO's failure to respond to the court's notice of deficiency was a second basis for dismissal.<sup>59</sup> According to its petition, CGO owed a total of \$896,000 in unsecured claims.<sup>60</sup> Of its \$142,970 in listed assets, \$130,000 consisted of uncultivated medical marijuana crops.<sup>61</sup>

Citing *In re Strug-Div., L.L.C.*, the trustee raised § 1112(b), to explain that § 1112(b) provides for dismissal when the debtor cannot "propose a legally and economically feasible plan of reorganization."<sup>62</sup> But, the court in *Strug-Div.*, used the term "legally" to ensure that the debtor intended to reorganize to satisfy, rather than deter or harass, creditors.<sup>63</sup> Moreover, the trustee seemingly conflated the good faith prerequisite read into § 1112(b) with the good faith provision in § 1129(a)(3).<sup>64</sup> Requesting the court to dismiss CGO's case under § 1112(b), the trustee argued that CGO's proposed plan "will have to be

---

<sup>57</sup> *Settling States v. Carolina Tobacco Co. (In re Carolina Tobacco Co.)*, 360 B.R. 702, 711 (D. Or. 2007) *vacated*, *Alabama v. Carolina Tobacco Co. (In re Carolina Tobacco Co.)*, No. 05-34156, 2012 U.S. Dist. LEXIS 35229 (D. Or. Feb. 22, 2012).

<sup>58</sup> *Motion to Dismiss*, *supra* note 2; see also Hilary Bricken, *MMJ Bankruptcy? Not So Fast*, CANNA LAW BLOG (Aug. 10, 2012), <http://www.cannalawblog.com/mmj-bankruptcy-not-so-fast/>.

<sup>59</sup> *Motion to Dismiss*, *supra* note 2, at 3.

<sup>60</sup> Chapter 11 Voluntary Petition, at 3, 10, *In re CGO Enter. L.L.C.*, No. 12-19010 (Bankr. D. Colo. May 1, 2012), 2012 WL 1962267.

<sup>61</sup> *Id.* at 6.

<sup>62</sup> *Motion to Dismiss*, *supra* note 2, at 2 (citing *In re Strug-Div., L.L.C.*, 375 B.R. 445, 449 (Bankr. N.D. Ill. 2007)).

<sup>63</sup> *In re Strug-Div., L.L.C.*, 375 B.R. at 449.

<sup>64</sup> See *Motion to Dismiss*, *supra* note 2.

proposed ‘by means forbidden by law’” under § 1129(a)(3),<sup>65</sup> which requires good faith in the proposal of a plan, rather than the filing of a petition.<sup>66</sup> According to the trustee, CGO failed one or both good faith tests because CGO would inevitably have to rely on the sale of its marijuana crops to fund its bankruptcy plan.<sup>67</sup> The trustee noted that the sale and cultivation of marijuana is a federal crime under the CSA, but did not mention Colorado state law.<sup>68</sup>

The debtor subsequently communicated to the trustee that the debtor would not oppose the motion to dismiss.<sup>69</sup> In its response, the debtor acknowledged that it failed to file required financial reports and supplements to its voluntary petition and that the debtor’s business was “no longer solvent or capable of being operated as a viable and ongoing concern.”<sup>70</sup> Although the debtor requested that the court grant the trustee’s motion to dismiss, the debtor disagreed with the allegations of criminal activity.<sup>71</sup>

The court ultimately dismissed the case for CGO’s failure to produce missing documents in accordance with the court’s “Notice of Deficiency for Omission of Information.”<sup>72</sup> This might suggest that bankruptcy courts are resistant to take on this issue despite the trustee’s arguments.

## 2. *Trustee in In re Mother Earth’s Alternative Healing Cooperative Argued that a Plan to Sell Medical Marijuana is Forbidden by Law*

Soon after CGO’s bankruptcy was dismissed, a medical marijuana dispensary named Mother Earth’s Alternative Healing Cooperative filed for chapter 11 in California.<sup>73</sup> The dispensary complied with California’s medical

---

<sup>65</sup> *Id.*

<sup>66</sup> 11 COLLIER, *supra* note 16, ¶ 1112.07.

<sup>67</sup> *Motion to Dismiss*, *supra* note 2.

<sup>68</sup> *Id.* at 3.

<sup>69</sup> Debtor’s Joint Response to Trustee’s Motion to Dismiss and Order to File Status Report, *In re* CGO Enter. L.L.C., No. 12-19010 (Bankr. D. Colo. May 25, 2012), 2012 WL 1932712.

<sup>70</sup> *Id.* The debtor also acknowledged the “complications regarding the ‘ownership’ of individual medical marijuana plants under applicable Colorado law.” *Id.*

<sup>71</sup> *Id.*

<sup>72</sup> *In re* CGO Enter. L.L.C., No. 12-19010 (D. Colo. dismissed July 13, 2012); *see also* Katy Stech, *Judge Puts Out Marijuana Grower’s Chapter 11 Case*, WALL ST. J. BANKR. BEAT BLOG (June 13, 2012, 2:56 PM), <http://blogs.wsj.com/bankruptcy/2012/06/13/judge-puts-out-marijuana-grower%E2%80%99s-chapter-11-case/>.

<sup>73</sup> Chapter 11 Voluntary Petition, *In re* Mother Earth’s Alt. Healing Coop., Inc., No. 12-10223-11 (Bankr. S.D. Ca. dismissed Oct. 23, 2012).

marijuana laws<sup>74</sup> and was the only licensed dispensary in southern California.<sup>75</sup> Like CGO, the main asset of Mother Earth's was marijuana it intended to sell to patients.<sup>76</sup> Unlike CGO's substantial insolvency, however, Mother Earth sought bankruptcy mainly for the protection of the automatic stay to prevent its landlord from evicting Mother Earth in response to pressure from the federal government.<sup>77</sup>

The trustee in *Mother Earth's* objected and moved to dismiss on grounds similar to the trustee in *CGO*.<sup>78</sup> The trustee claimed that this case was a bad faith filing under § 1112(b) because Mother Earth's could not have proposed a plan of reorganization that met the requisite good faith in proposing a plan in § 1129(a)(3).<sup>79</sup> The trustee reasoned that the debtor's only means of funding a chapter 11 plan would be by cultivating and distributing a federally prohibited substance, which ran afoul of the "not by any means forbidden by law" condition to confirmation residing in § 1129(a)(3).<sup>80</sup>

Unlike in *CGO*, the trustee in this case acknowledged that California state law may allow the sale of medical marijuana.<sup>81</sup> But the trustee did not mention how this might affect the debtor's ability to reorganize under chapter 11.<sup>82</sup> While this conflict between state and federal law raises preemption issues, the trustee sidestepped them by ignoring the state laws, under which the debtor would not violate § 1129(a)(3), and focused entirely on the Supreme Court upholding federal regulation of marijuana in *Gonzales v. Raich*.<sup>83</sup>

The court dismissed the case, stating, "Cause for dismissal exists where the only bankruptcy purpose is to attempt to preserve a lease and to otherwise support a business that is engaged in activity that is prohibited, indeed criminal, under federal law."<sup>84</sup> Since Mother Earth's admitted that its goal was

---

<sup>74</sup> See Letter from Bob Filner, U.S. Representative, to Laura E. Duffy, U.S. Attorney (July 13, 2012), available at [http://media.sreader.com/news/documents/2012/07/23/AAA\\_2012-07-17-My\\_Mother\\_Earth\\_Co-op\\_Letter\\_to\\_Laura\\_Duffy.pdf](http://media.sreader.com/news/documents/2012/07/23/AAA_2012-07-17-My_Mother_Earth_Co-op_Letter_to_Laura_Duffy.pdf).

<sup>75</sup> *Blunt Force*, *supra* note 55.

<sup>76</sup> Stephanie Gleason, *Chapter 420?*, WALL ST. J. BANKR. BEAT BLOG (July 27, 2012, 10:47 AM), <http://blogs.wsj.com/bankruptcy/2012/07/27/chapter-420/>.

<sup>77</sup> *Id.*

<sup>78</sup> See United States Trustee's Response to Debtor's Motion to Dismiss Chapter 11 Bankruptcy, No. 12-10223-11 (Bankr. S.D. Ca. Sept. 4, 2012).

<sup>79</sup> *Id.* at 3.

<sup>80</sup> *Id.* (citing 11 U.S.C. § 1129(a)(3) (2012)).

<sup>81</sup> *Id.*

<sup>82</sup> See *id.*

<sup>83</sup> *Id.*

<sup>84</sup> *Marijuana Dispensary's Chapter 11*, *supra* note 44.

to avoid eviction through the automatic stay rather than to produce a plan to repay its creditors, the court could have dismissed the case irrespective of the nature of its business or manner of funding its reorganization. Still, the court found that confirmation and consummation of the plan was impossible under § 1129(a)(11) because the proceeds from the sale of marijuana would have been subject to forfeiture, an argument that the trustee did not make in its motion to dismiss.<sup>85</sup> The court emphasized, however, that it would not oversee Mother Earth's sale of marijuana since such conduct is in violation of the CSA.<sup>86</sup>

*B. No Cause to Dismiss Under § 1112(b) or for Lack of Good Faith*

Filing for bankruptcy when a debtor's assets and income are linked to the medical marijuana industry does not fall within the three general scenarios that may implicate a lack of good faith, regardless of the dismissals of the cases above.<sup>87</sup>

Even if the court in *CGO* had dismissed the case for lack of good faith under § 1112(b) or § 1129(a)(3), it would be merely one decision to consider as part of the evolution of what type of conduct and cases bankruptcy courts find permissible.<sup>88</sup> The good faith doctrine has been described as “the instrument of a controlled evolution” that “systematically [tests bankruptcy courts’] performance in guarding the portal into bankruptcy.”<sup>89</sup> Courts’ conclusions on what is appropriate in bankruptcy, and thus the good faith doctrine, change to accommodate “evolving reality of social, political, and economic challenges.”<sup>90</sup>

No circuit court has addressed these issues in a medical marijuana business case. Moreover, even if a bankruptcy court ultimately denies plan confirmation, the debtor and its creditors might not consider the bankruptcy a

---

<sup>85</sup> Order After Hearing Dismissing Chapter 11 Case at 2–3, *In re Mother Earth's Alt. Healing Coop., Inc.*, No. 12-10223-11 (Bankr. S.D. Cal. Oct. 23, 2012).

<sup>86</sup> *Marijuana Dispensary's Chapter 11*, *supra* note 44.

<sup>87</sup> See Ponoroff & Knippenberg, *supra* note 25, at 927.

<sup>88</sup> Ponoroff & Knippenberg, *supra* note 25, at 973–74 (“[P]ast decisions serve merely to highlight the flow and development of bankruptcy policy; they do not forever establish its boundaries. Therefore, it is important to go beyond mechanical division of the cases in favor of a more demanding and policy-sensitive analysis.”).

<sup>89</sup> *Id.* at 972.

<sup>90</sup> *Id.* at 972–73.

failure.<sup>91</sup> Elizabeth Warren and Jay Lawrence Westbrook stated, “While it is true that not every confirmed plan would meet a refined definition of success, the reverse is equally true: not every company whose [c]hapter 11 case is dismissed represents a complete failure.”<sup>92</sup> Often, debtors use the breathing room afforded through the automatic stay as an opportunity to negotiate a satisfactory plan with its creditors. “Anecdotal evidence from experienced bankruptcy lawyers and judges suggests that a fair number of cases are dismissed because debtors and creditors have worked out a settlement that they were not able to achieve prior to the [c]hapter 11 filing.”<sup>93</sup> A settlement satisfactory to both parties provides the debtor with a fresh start and repays creditors, two fundamental goals of bankruptcy,<sup>94</sup> and therefore may be considered a success facilitated by the bankruptcy system even though discharge is never achieved.

*C. Section 1129(a)(3) Does Not Open Inquiry into the Substantive Nature of the Plan*

The federal bankruptcy system does not nullify state laws.<sup>95</sup> “Unless preempted by the Code, state laws remain in place and a debtor must be able to comply with those state laws for a plan to be confirmed.”<sup>96</sup> The Code is silent on whether the business activities of a state-compliant medical marijuana dispensary are impermissible as part of a reorganization plan. Thus, state medical marijuana laws are not in conflict with the Code, and should remain in place throughout the plan confirmation stage.

Moreover, there is sufficient jurisprudence to suggest the trustees insistence on compliance with federal law in *Mother Earth’s* and *CGO* was a misguided attempt to apply § 1129(a)(3) to the debtors’ plans. As explained by the Bankruptcy Court for the Southern District in New York in *In re Buttonwood Partners*, “[T]here is no requirement imposed by § 1129(a) that the contents of

---

<sup>91</sup> See Elizabeth Warren & Jay Lawrence Westbrook, *The Success of Chapter 11: A Challenge to the Critics*, 107 MICH. L. REV. 603, 611 (2009).

<sup>92</sup> *Id.*

<sup>93</sup> *Id.*

<sup>94</sup> *In re Epstein*, 39 B.R. 938, 941 (Bankr. D.N.M. 1984).

<sup>95</sup> See *Settling States v. Carolina Tobacco Co. (In re Carolina Tobacco Co.)*, 360 B.R. 702, 711 (D. Or. 2007), *vacated* *Alabama v. Carolina Tobacco Co. (In re Carolina Tobacco Co.)*, 2012 U.S. Dist. LEXIS 35229 (D. Or. Feb. 22, 2012).

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

a plan comply in all respects with the provisions of all nonbankruptcy laws and regulations.”<sup>97</sup>

The court explored the legislative history that compels this reading of § 1129(a)(3):

Section 1129(a)(3) is derived from § 221(3) of the Bankruptcy Act which stated that the court could confirm a plan if satisfied that “the proposal of the plan and its acceptance are in good faith and have not been made or procured by means or promises forbidden by this Act.” Consequently, given the relationship between § 221(3) of the Act and § 1129(a)(3), it must be construed that the term “means forbidden by law” subsumes some conduct in connection with obtaining confirmation of such proposal. The enlargement from “forbidden by this Act” to “forbidden by law” merely “requires that the proposal of the plan comply with all applicable law, not merely the bankruptcy law.”<sup>98</sup>

A bankruptcy court should not be the forum to determine substantive state and federal law. Doing so would impose requirements on bankruptcy judges that are “inimical to the basic function of bankruptcy judges in bankruptcy proceedings.”<sup>99</sup> According to the court, this construction “would convert the bankruptcy judge into an ombudsman without portfolio, gratuitously seeking out possible ‘illegalities’ in every plan.”<sup>100</sup>

Permitting a bankruptcy judge unbridled jurisdiction over matters of state law also jeopardizes the holding of *Stern v. Marshall*. In *Stern*, the Supreme Court held that bankruptcy courts lack the constitutional authority to enter a final judgment on state law counterclaims.<sup>101</sup> Since a bankruptcy court might rely on state law to reason that a plan contains some illegality, requiring this ombudsman role is akin to asking bankruptcy courts to adjudicate state law counterclaims.

Further, even though a court may deny confirmation because the substantive nature of the plan violates the CSA, § 1129(a)(3) may be interpreted such that courts would not require an open inquiry into this

---

<sup>97</sup> *In re Buttonwood Partners*, 111 B.R. 57, 59 (Bankr. S.D.N.Y. 1990).

<sup>98</sup> *Id.* at 59–60 (quoting *In re Koelbl*, 751 F.2d 137, 139 (2d Cir.1984)).

<sup>99</sup> *In re Food City, Inc.*, 110 B.R. 808, 812 (Bankr. W.D. Tex. 1990) (citing H.R. REP. NO. 95-595, at 397 (1978), *reprinted in* 1978 U.S.C.C.A.N. 5963, 5963).

<sup>100</sup> *Id.*

<sup>101</sup> *Stern v. Marshall*, 131 S. Ct. 2594, 2620 (2011).

substantive nature. Then a court would not even need to reach or address this conflict between state and federal law.<sup>102</sup>

Moreover, other sections of the Code demonstrate that Congress sought to preserve the adjudication of matters external to the plan to the judgment of other tribunals. Assessing the substance of a plan for illegalities is unnecessary since the discharge granted after plan confirmation does not shield debtors from post-confirmation actions, even if they arise from the plan itself.<sup>103</sup> Section 1141(d) also limits the debtor's discharge in several ways.<sup>104</sup> More importantly, Congress specifically excluded criminal proceedings from the automatic stay in § 362(b)(1).<sup>105</sup>

Blocking plan confirmation when the plan contains terms that might violate laws would also introduce logistical hurdles to the confirmation process—not to mention delay relief to creditors and waste judicial resources.<sup>106</sup> As one court explained:

All regulatory agencies (and there are thousands) would have to participate in all chapter 11 cases, introducing extraordinary delay into the system and imposing an *impossible burden* on the agencies. Moreover, a rule which requires a debtor to affirmatively represent in its plan and disclosure statement that the plan does not violate *any* law imposes an unrealistic due diligence burden upon both the debtor and debtor's counsel. The extraordinary legal costs of sustaining such a burden would inevitably be borne by the estate's unsecured creditors.<sup>107</sup>

Courts have recognized, “Because only the proposal of the plan must not be by a means forbidden by law, plans proposing terms that arguably violate some statute or common law doctrine have passed muster under [§] 1129(a)(3).”<sup>108</sup> For example, in *In re Carolina Tobacco Co.*, the court concluded that the “debtor's proposal to pay the prepetition escrow deposits over time is not forbidden by law, even though it means that debtor will be out of compliance

---

<sup>102</sup> See, e.g., *In re Frascella Enters., Inc.*, 360 B.R. 435, 445 (Bankr. E.D. Pa. 2007) (refusing to analyze the potential illegalities in the debtor's chapter 11 plan).

<sup>103</sup> *Food City*, 110 B.R. at 813.

<sup>104</sup> See 11 U.S.C. § 1141(d) (2012).

<sup>105</sup> *Id.* § 362(b)(1).

<sup>106</sup> See *Food City*, 110 B.R. at 813.

<sup>107</sup> *Id.* (footnote omitted) (emphasis added).

<sup>108</sup> Cieri, Oyer & Bimbryer, *supra* note 41.

with state law until the prepetition escrow deposits are made.”<sup>109</sup> Here, the court even acknowledged that the state law was not preempted by the Code and was a consideration in the plan confirmation.<sup>110</sup>

*In re Frascella Enterprises* provides another example of a chapter 11 plan satisfying § 1129(a)(3) even though the plan’s terms may have violated state or federal law. In this case, the debtor sought to salvage its payday lending business through chapter 11 bankruptcy.<sup>111</sup> However, the debtor was involved in a consumer class action at the time of its bankruptcy.<sup>112</sup> Consumers sought damages against the debtor for payday loans they received from the debtor that allegedly violated usury laws.<sup>113</sup> The consumers objected to confirmation of the debtor’s plan because it was to be funded by these same payday loan practices.<sup>114</sup>

Similar to how the trustees in *CGO* and *Mother Earth* argued that the dispensaries’ businesses violated the CSA, the consumers in *In re Frascella* argued that the debtor’s “contemplated business activity of payday lending over the telephone and internet to consumers in Pennsylvania violates state and federal consumer law.”<sup>115</sup> However, the court abstained from fully evaluating the legality of the debtor’s payday lending, reasoning that it was beyond its role in the bankruptcy system.<sup>116</sup> This suggests that courts are unwilling to analyze the contents of a plan for potential illegalities when it is unclear how relevant state and federal laws would play out for the questioned activity.

Other courts have confirmed that it is not the bankruptcy court’s role to decide a preemption question when there is a conflict between state and federal laws.<sup>117</sup> In *In re Food City*, the court similarly stated that “convert[ing] the bankruptcy judge into an ombudsmen without portfolio” is contrary to the “basic function of bankruptcy judges in bankruptcy proceedings . . . .”<sup>118</sup> If determining whether a plan contains illegalities is beyond the realm of

---

<sup>109</sup> *Settling States v. Carolina Tobacco Co. (In re Carolina Tobacco Co.)*, 360 B.R. 702, 713 (D. Or. 2007), *vacated* *Alabama v. Carolina Tobacco Co. (In re Carolina Tobacco Co.)*, 2012 U.S. Dist. LEXIS 35229 (D. Or. Feb. 22, 2012).

<sup>110</sup> *Id.* at 711.

<sup>111</sup> *In re Frascella Enters., Inc.*, 360 B.R. 435, 437 (Bankr. E.D. Pa. 2007).

<sup>112</sup> *Id.* at 439.

<sup>113</sup> *Id.*

<sup>114</sup> *Id.* at 440.

<sup>115</sup> *Id.* at 445.

<sup>116</sup> *Id.* (citing *In re Food City, Inc.*, 110 B.R. 808, 812 (Bankr. W.D. Tex. 1990)).

<sup>117</sup> *Food City*, 110 B.R. at 812.

<sup>118</sup> *Id.*

bankruptcy courts, then deciding whether state or federal law is the authority on a potential illegality must also go beyond the bankruptcy courts' responsibilities.

In the medical marijuana industry, such a due diligence burden would require the Drug Enforcement Administration and state drug enforcement agencies to thoroughly evaluate and examine each of the debtor's bankruptcy plans. These agencies are likely to view this as an "impossible burden" as mentioned above, especially since they have made state-compliant medical marijuana businesses a low priority due to limited resources.<sup>119</sup> The federal government has repeatedly acknowledged its lack of resources to investigate and prosecute drug offenses.<sup>120</sup>

#### *D. Section 1129(a)(11) Feasibility Requirement Would Not Prevent Confirmation*

The feasibility requirement of § 1129(a)(11) only requires the debtor to prove that its reorganization plan is feasible by a preponderance of the evidence.<sup>121</sup> Moreover, a court reviewing a bankruptcy plan must consider the totality of the circumstances.<sup>122</sup>

Although dispensary reorganizations are not infeasible per se, trustees may argue that the plans are not feasible because any proceeds generated by the dispensary are subject to government seizure.<sup>123</sup> Courts should consider the likelihood of a government seizure when assessing a plan's feasibility rather than viewing dispensary plans as per se infeasible. For example, if the debtor dispensary has been under investigation and enforcement agencies have expressed a plan to raid the dispensary, a court may be less likely to find that its plan meets the § 1129(a)(11) feasibility requirement. On the other hand, if the debtor is located in an area where U.S. Attorneys have not targeted state-

---

<sup>119</sup> See Memorandum from David W. Ogden, *supra* note 4 ("As a general matter, pursuit of [significant traffickers of illegal drugs] 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.").

<sup>120</sup> See, e.g., Matthew Volkov, *Holder Defends Department's Medical Marijuana Track Record*, MAIN JUSTICE (June 8, 2012, 12:24 PM), <http://www.mainjustice.com/2012/06/08/holder-defends-departments-medical-marijuana-track-record/> (referring to the Justice Department's "limited resources"); Memorandum from David W. Ogden, *supra* note 4 (referring to the Justice Department's "limited investigative and prosecutorial resources").

<sup>121</sup> *Financial Sec. Assurance, Ltd. v. T-H New Orleans Ltd. P'ship (In re T-H New Orleans P'ship)*, 116 F.3d 790, 801 (5th Cir. 1997).

<sup>122</sup> *In re Mulberry Phosphates, Inc.*, 149 B.R. 702, 709 (M.D. Fl. 1993).

<sup>123</sup> See *Marijuana Dispensary's Chapter 11*, *supra* note 44.

compliant dispensaries or has made a special effort to demonstrate its compliance with medical marijuana laws, such as by offering tours to law enforcement officers, a court may be more likely to find its plan is feasible.

As it is unclear whether the CSA preempts state medical marijuana laws, the federal government might seize dispensary proceeds meant to fund a plan. But this alone does not meet the standard of proof. A mere possibility of seizure does not indicate a reasonable probability it would occur and so frustrate the plan that liquidation or further financial reorganization becomes necessary.<sup>124</sup> As with any plan, the facts vary greatly from debtor to debtor.<sup>125</sup>

The possibility of a government seizure of dispensary proceeds is tied to courts' concern over legally uncertain businesses. Courts have recognized that the "risk of uncertain legal foundation of [a] business" may impede plan confirmation if that risk is "borne disproportionately by unsecured creditors."<sup>126</sup> In *In re Frascella Enterprises*, the party opposing the debtor's plan confirmation argued that the debtor's business plan was "fatally flawed" because "an enforcement action which would enjoin [the debtor's business activities], in their view, [was] inevitable, thus rendering [the] revenue projections unrealistic."<sup>127</sup> The court recognized that the legality of the debtor's business was not as clear as the consumers claimed.<sup>128</sup> The conflict between state and federal marijuana laws would add an additional layer of uncertainty for a court assessing a dispensary's plan for the risk of an enforcement action.

The legal and legislative landscape for the medical marijuana industry has and will continue to change, but dispensaries may hedge against the risk of seizure by complying with all state and local laws. In contrast, the court in *Frascella* denied plan confirmation because the debtor chose not to hedge against the legal uncertainty of its payday loan business.<sup>129</sup> The debtor could have purchased licenses in every state in which it did business to minimize the potential for regulatory impairment of its business, but instead planned to "take a 'wait and see approach' in 'reaction to state attorney general complaints.'"<sup>130</sup> The fact that the state attorney general had already received complaints about

---

<sup>124</sup> See 11 COLLIER, *supra* note 16, ¶ 1129.02 ("[T]he possibility of failure is not fatal.").

<sup>125</sup> *Id.* ("[F]easibility is typically regarded as an intensely factual inquiry.").

<sup>126</sup> See *In re Frascella Enters., Inc.*, 360 B.R. 435, 456 (Bankr. E.D. Pa. 2007).

<sup>127</sup> *Id.* at 445.

<sup>128</sup> *Id.* at 456.

<sup>129</sup> See *id.*

<sup>130</sup> *Id.*

the debtor's business further distinguishes this debtor's reorganization plan in *Frascella* from those of the state-compliant medical marijuana business.<sup>131</sup>

Unlike the nefarious payday lenders, medical marijuana dispensaries that are inspected for compliance with state laws are less likely to be subject to seizure that would interfere with bankruptcy plan payments. This should weigh in favor of a finding of feasibility.

A court discussed the feasibility requirement for a plan that relied in part on the proceeds from the debtor's sale and cultivation of marijuana in *In re McGinnis*.<sup>132</sup> This case is distinguishable from *Frascella* because the debtor did not comply with state law. The court in *McGinnis* concluded that the debtor's proceeds from its marijuana business were insufficient to fund the plan since the sale of marijuana was in violation of *both* the CSA and Oregon's Medical Marijuana Act.<sup>133</sup> The court based their decision to deny the debtors plan on § 1325 (a)(6), the chapter 13 analog to § 1129(a)(11) that similarly places a condition of feasibility on plan confirmation.<sup>134</sup> However, the chapter 13 feasibility standard is much more stringent than the chapter 11 feasibility standard.<sup>135</sup> "Whereas the financial-feasibility requirement for confirmation of a [c]hapter 13 plan requires a court to find that 'the debtor will be able to make all payments under the plan,'" § 1129(a)(11) requires a court to only "find that it is more likely than not that the [c]hapter 11 plan is not likely to fail."<sup>136</sup>

Even if the court believes that the dispensary's potential for seizure renders the plan too unreliable, a creditor is still free to reject the debtor's plan,<sup>137</sup> though the cramdown provisions may override this safeguard.<sup>138</sup>

### III. UNCERTAINTY OF MEDICAL MARIJUANA LAWS LEAVES OPEN POSSIBILITY OF PLAN CONFIRMATION NOTWITHSTANDING § 1129(A)(3)

Even if § 1129(a)(3), one of the good-faith provisions, refers to both state and federal nonbankruptcy law *and* considers the substance of a chapter 11

---

<sup>131</sup> *See id.*

<sup>132</sup> *See In re McGinnis*, 453 B.R. 770, 773 (Bankr. D. Or. 2011).

<sup>133</sup> *See id.* ("I cannot find that the predicted income stream from the marijuana operations is reasonably certain to produce sufficient income to fund the Plan.").

<sup>134</sup> 11 U.S.C. § 1325(a)(6) (2012).

<sup>135</sup> *See Pardo, supra* note 53, at 147–48 (comparing the chapter 11 and chapter 13 feasibility standards).

<sup>136</sup> *Id.* (quoting 11 U.S.C. § 1325(a)(6) (2006)).

<sup>137</sup> *See* 11 U.S.C. § 1129(a)(8) (2012).

<sup>138</sup> *See id.* § 1129(b).

plan, the lack of binding authority on whether state-legal medical marijuana businesses may reorganize in the bankruptcy system may lead courts to disagree on whether a dispensary plan is confirmable. The § 1129(a)(3) inquiry requires that courts consider “the totality of the circumstances” in a “fact-intensive, case-by-case inquiry.”<sup>139</sup> Moreover, the bankruptcy court has discretion to interpret evidence regarding the alleged lack of good faith or illegality.<sup>140</sup> Courts have recognized that “[t]he bankruptcy judge is in the best position to assess the good faith of the proposal of a plan.”<sup>141</sup>

In particular, uncertainty over the legality and future of state medical marijuana laws may convince some bankruptcy courts that the sale of medical marijuana does not render the plan unconfirmable.<sup>142</sup> In this Part, Section A demonstrates that, given the preemption issue, some courts may look to state laws rather than the federal CSA to determine whether a plan involving the sale of medical marijuana satisfies § 1129(a)(3). Rather, the passive nature of the CSA invites the possibility that the CSA does *not* preempt state legalization.<sup>143</sup> One academic contends that states have merely stopped punishing the medical use of marijuana and that the anti-commandeering rule prohibits Congress from requiring states to enforce the CSA.<sup>144</sup> Should a bankruptcy court agree with that interpretation, the court may prioritize state laws and conclude that a dispensary’s plan was “proposed . . . not by any means forbidden by law.”<sup>145</sup>

Section B argues that some courts might prioritize state medical marijuana laws in the § 1129(a)(3) analysis because the state law “constitute[s] the de facto governing law of the land.”<sup>146</sup> Criminal law is usually the state’s domain. Accordingly, states generally exhibit greater power over controlled substance management.<sup>147</sup> Increasing public acceptance of medical marijuana<sup>148</sup> has also

---

<sup>139</sup> *In re TCI 2 Holdings, L.L.C.*, 428 B.R. 117, 142 (Bankr. D.N.J. 2010) (quoting *In re PPI Enters., Inc.*, 324 F.3d 197, 211).

<sup>140</sup> *See In re Tex. Extrusion Corp.*, 844 F.2d 1142, 1160 (5th Cir. 1988); *In re Koelbl*, 751 F.2d 137, 139 (2d Cir. 1984).

<sup>141</sup> *Tex. Extrusion Corp.*, 844 F.2d at 1160.

<sup>142</sup> This Comment assumes that the debtor does not engage in any activities that would make it proper for the court to appoint a trustee to operate the debtor’s business.

<sup>143</sup> *See, e.g., City of Garden Grove v. Superior Court*, 68 Cal. Rptr. 3d 656, 676 (Ct. App. 2007); Mikos, *supra* note 10, at 1453–55.

<sup>144</sup> *See Mikos, supra* note 10, at 1455–56.

<sup>145</sup> 11 U.S.C. § 1129(a)(3) (2012).

<sup>146</sup> Mikos, *supra* note 10, at 1422.

<sup>147</sup> *Id.* at 1463–65; *see also* John Ingold, *Medical Marijuana in Colorado Gets Scant Attention from Federal Prosecutors*, DENVER POST (May 18, 2011, 5:44 AM), <http://www.denverpost.com/news/marijuana/>

shown that the federal government's efforts to influence private behavior have been unsuccessful despite its proscription of all marijuana.<sup>149</sup>

Section C contends that the growing number of state legalizations indicate an increase in percolation through the federal ban. There are merits to allowing such state experimentation.<sup>150</sup> If medical marijuana businesses and their customers (medical users) may exist mostly without trouble from the federal government, then they should also be permitted to file for bankruptcy like any other business. Otherwise, the states would not receive an accurate depiction of how their medical marijuana policies work in practice. This is especially important for states that pushed for legalization on economic grounds.

Section D discusses the Code's silence on this issue and other arbitrary and unfair results that may occur should the sale of medical marijuana poison a debtor's reorganization plan. A bankruptcy court might consider these arguments to allow confirmation of a dispensary's plan.

*A. Preemption Analysis May Lead Bankruptcy Judges to Refer to State Medical Marijuana Laws for the § 1129(a)(3) Requirement*

Despite the clear conflict between the CSA and mounting state legalization of medical marijuana, the Supreme Court has never directly addressed the preemption issue.<sup>151</sup> Shortly after the *Raich* decision, California Attorney General Bill Lockyer stated that the ruling did not affect California's legalization of medical marijuana.<sup>152</sup> "Lockyer also underscored the role of local law enforcement in upholding state, not federal, law," according to

---

ci\_18084197 (reporting low levels of federal prosecution of marijuana cases in states that have legalized medical marijuana).

<sup>148</sup> See Fred Backus, *CBS News Poll: Marijuana and Medical Marijuana*, CBS NEWS (Nov. 18, 2011, 6:00 AM), [http://www.cbsnews.com/htdocs/pdf/poll\\_marijuana\\_111811.pdf](http://www.cbsnews.com/htdocs/pdf/poll_marijuana_111811.pdf).

<sup>149</sup> Mikos, *supra* note 10, at 1470.

<sup>150</sup> See *United States v. Oakland Cannabis Buyers' Co-op.*, 532 U.S. 483, 502 (2001) (Stevens, J., concurring) (quoting *New State Ice Co. v. Liebmann*, 285 U.S. 262 (1932) (Brandeis, J., dissenting)); Margaret H. Lemos, *State Enforcement of Federal Law*, 86 N.Y.U. L. REV. 698, 751–52 (2011).

<sup>151</sup> See *City of Garden Grove v. Superior Court*, 68 Cal. Rptr. 3d 656, 674 (Cal. Ct. App. 2007); Mikos, *supra* note 10, at 1442; Orde F. Kittrie, *Federalism, Deportation, and Crime Victims Afraid to Call the Police*, 91 IOWA L. REV. 1449, 1490 (2006) ("[The *Raich* Court] neither declared California's law invalid on preemption or any other grounds nor gave any indication that California officials must assist in enforcement of the CSA."); Ernest A. Young, *Just Blowing Smoke? Politics, Doctrine, and the Federalist Revival After Gonzales v. Raich*, 2005 SUP. CT. REV. 1, 34.

<sup>152</sup> *Federal Marijuana Law*, AMERICANS FOR SAFE ACCESS, <http://safeaccessnow.org/article.php?id=2638> (last visited, Oct. 3, 2013).

Americans for Safe Access.<sup>153</sup> The Offices of the Attorney Generals of Alaska, Colorado, Hawaii, Maine, Montana, Nevada, and Oregon as well as the Governor of Vermont and the Washington State Department of Health have issued similar statements upholding their state medical marijuana laws post-*Raich*.<sup>154</sup>

Part of the states' power is rooted in the anti-commandeering rule, which limits Congress's preemption power.<sup>155</sup> To distinguish between state actions that are subject to preemption and those that are not, Robert Mikos proposes the "state-of-nature framework" as the boundary between commandeering and preemption: "Congress may drive states into—or prevent states from departing from—this state of nature (preemption), but Congress may not drive them out of—or prevent them from returning to—the state of nature (commandeering)."<sup>156</sup> Mikos argues, "This new state-of-nature framework is better suited for the largely ignored paradigm[,] . . . situations in which states allow behavior Congress has banned[,] than is the commonly employed action/inaction framework."<sup>157</sup>

After California voters passed the Compassionate Use Act in 1996, over a dozen other states and many local governments followed with their own legalization efforts. The legalization of medical marijuana is effectively state inaction against the CSA.<sup>158</sup> Federal drug laws are not enforceable in the face of the states' inaction because allowing Congress to preempt the states' inaction would amount to Congress commanding the states to enforce the federal ban on medical marijuana.<sup>159</sup> Mikos explained that "forc[ing] states to criminalize drugs Congress has banned, adopt mandatory prosecution policies, raise sanctions, revise sentencing laws, and shift resources toward marijuana cases . . . tread[s] on whatever values the anti-commandeering rule seeks to promote."<sup>160</sup>

A California state appellate court has stated, "[T]here is no conflict based on the fact that Congress has chosen to prohibit the possession of medical

---

<sup>153</sup> *Id.*

<sup>154</sup> *Implications of U.S. Supreme Court Medical Marijuana Ruling*, MARIJUANA POLICY PROJECT, <http://www.mpp.org/reports/gonzales-v-raich-the-impact.html> (last visited, Oct. 3, 2013).

<sup>155</sup> Mikos, *supra* note 10, at 1446.

<sup>156</sup> *Id.* at 1448.

<sup>157</sup> *Id.* at 1445.

<sup>158</sup> *See id.* at 1424.

<sup>159</sup> *Id.*

<sup>160</sup> *Id.* at 1454.

marijuana, while California has chosen not to.”<sup>161</sup> In *City of Garden Grove v. Superior Court of Orange County*, the court considered whether a police department was required to return small amounts of marijuana that had been seized from a medical marijuana patient qualified under the Compassionate Use Act.<sup>162</sup> It held that the federal CSA did not prohibit the return of marijuana to an individual “whose possession of the drug is legally sanctioned under state law.”<sup>163</sup> The court reasoned that the state’s return of a small quantity of marijuana did not pose a “real or meaningful threat to the federal drug enforcement effort.”<sup>164</sup> It further explained that California’s Compassionate Use Act “does not expressly exempt medical marijuana from prosecution” under the CSA, but merely “limits state prosecution for medical marijuana possession.”<sup>165</sup>

*B. Courts May Defer to State Medical Marijuana Laws over the Federal CSA Due to the Greater Impact of States’ Laws*

Taking aside the preemption issue, on a practical level, the federal government lacks the necessary resources to enforce its own ban against medical marijuana diligently.<sup>166</sup> Some have observed that even after *Gonzales v. Raich*, “[t]he states continue to wield both de jure and de facto power to legalize medical marijuana in the CSA’s shadow.”<sup>167</sup> Despite the federal government’s threat of strong penalties for violating the CSA, its impact on private behavior is restricted.<sup>168</sup> This is due in large part to the lack of “wholehearted cooperation of state law enforcement authorities.”<sup>169</sup> States wield greater influence over private forces that shape our actions, because state legalization has led to more relaxed personal attitudes towards the use and sale of medical marijuana.<sup>170</sup>

In Colorado, federal prosecutors pursued only 19 forfeiture cases related to marijuana and only four criminal marijuana cases in 2010.<sup>171</sup> This suggests a

---

<sup>161</sup> *Garden Grove v. Superior Court of Orange Cnty.*, 157 Cal. App. 4th 355, 385 (2008); *see also* *Cnty. of Butte v. Superior Court*, 175 Cal. App. 4th 729, 735 (3d Dist. 2009).

<sup>162</sup> *Garden Grove*, 157 Cal. App. 4th at 363, 373.

<sup>163</sup> *Id.* at 386.

<sup>164</sup> *Id.* at 384.

<sup>165</sup> *Id.* at 384–85.

<sup>166</sup> Mikos, *supra* note 10, at 1424.

<sup>167</sup> *Id.* at 1444.

<sup>168</sup> *See id.* at 1424.

<sup>169</sup> *Id.*

<sup>170</sup> *Id.*

<sup>171</sup> *See* Ingold, *supra* note 147.

low level of federal enforcement in a state that has more medical marijuana dispensaries than McDonalds and Starbucks combined.<sup>172</sup>

In fact, “[a]s a practical matter, virtually all arrests and prosecutions for marijuana possession occur at the state level.”<sup>173</sup> However, state law enforcement has been more lenient with these marijuana violations than the federal government, even when the arrest is for recreation rather than medical use.<sup>174</sup> State law enforcement agencies “drop cases that the federal government would likely prosecute if they had the resources. They expunge drug convictions that trigger federal supplemental sanctions. And they punish offenders less severely than would federal sentencing authorities. None of these decisions by the states have been declared preempted . . . .”<sup>175</sup>

Opinion polls suggest citizens generally support state medical marijuana legalization. A May 2012 poll by Mason-Dixon Polling & Research showed that of 1,000 likely 2012 general election voters, 74% believed that the president should respect state medical marijuana laws.<sup>176</sup> Only 15% of the respondents believed that the federal government should prosecute under the federal law regardless of whether the individuals were acting in compliance with state law.<sup>177</sup>

Individuals have also been able to assert their lenient view on medical marijuana in the judicial system.<sup>178</sup> In New Hampshire, a man who had been growing medical marijuana was charged by the state with felony drug manufacturing.<sup>179</sup> He “argued that a conviction would be unjust in light of the fact that [he] was growing cannabis for his own religious and medical use.”<sup>180</sup> The court used its discretion to provide a jury instruction on the nullification

---

<sup>172</sup> *60 Minutes: Medical Marijuana: Will Colorado's "green rush" last?*, (CBS television broadcast Oct. 19, 2012), available at <http://www.cbsnews.com/video/watch/?id=50133577n>.

<sup>173</sup> Judd Legum, *After Passage of Legalization Initiative, 220 Marijuana Cases Dismissed in Washington State*, THINK PROGRESS (Nov. 10, 2012, 1:11 PM), <http://thinkprogress.org/justice/2012/11/10/1176151/after-passage-of-legalization-initiative-220-marijuana-cases-dismissed-in-washington-state/>.

<sup>174</sup> Mikos, *supra* note 10, at 1453.

<sup>175</sup> *Id.* at 1453–54.

<sup>176</sup> See Mason-Dixon Polling & Research, Inc., *Marijuana Policy Project National Survey Question*, MARIJUANA POLICY PROJECT 1, 1 (2012), <http://www.mpp.org/assets/pdfs/download-materials/MPP-M-D-Poll-5-12.pdf>.

<sup>177</sup> See *id.*

<sup>178</sup> See Ian Millhiser, *New Hampshire Jury Acquits Marijuana Grower in Apparent Case of Jury Nullification*, THINK PROGRESS (Sept. 17, 2012, 3:00 PM), <http://thinkprogress.org/justice/2012/09/17/856381/new-hampshire-jury-acquits-marijuana-grower-in-apparent-case-of-jury-nullification/>.

<sup>179</sup> *Id.*

<sup>180</sup> *Id.*

issue even though the prosecutor had argued against this.<sup>181</sup> The judge instructed the jury that “even if you find that the State has proven each and every element of the offense charged beyond a reasonable doubt, you may still find the defendant not guilty if you have a conscientious feeling that a not guilty verdict would be a fair result in this case.”<sup>182</sup> The jury unanimously acquitted the defendant.<sup>183</sup>

The jury’s lenience in New Hampshire suggests that even the most stringent American communities are warming to legalization. New Hampshire remains the only New England state to resist state medical marijuana legislation.<sup>184</sup> Polls and successful jury nullifications suggest that increasing state legalization may affect the public perception of medical marijuana use even in states that have resisted the shift in policy.

A similar attitude has developed in Colorado. Boulder District Attorney Stan Garnett told CBS’s *60 Minutes* that it is difficult to find a jury that will convict a marijuana defendant because of the state’s overwhelming support for legalization.<sup>185</sup> Garnett stated, “This community has made it very clear that criminal enforcement of marijuana is not something they want me to spend any time on.”<sup>186</sup> These situations demonstrate the influence that state constituents’ attitudes toward medical marijuana can have on local law enforcement and state courts.

Even federal judges may afford state medical marijuana laws more weight than the federal ban. In *United States v. Daubert*, the federal government charged Daubert with conspiracy to maintain a drug-involved premises.<sup>187</sup> Daubert was previously a partner in a medical marijuana business in Montana, a state that has legalized medical marijuana.<sup>188</sup> The suit arose after the DEA

---

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

<sup>182</sup> *Id.*

<sup>183</sup> *Id.*

<sup>184</sup> See Matt Simon, *NH Poised to Be Next to Legalize Medical Marijuana*, THE TELEGRAPH (Nov. 11, 2012), <http://www.nashuatelegraph.com/opinion/commentary/983281-465/simon-nh-poised-to-be-next-to.html#>.

<sup>185</sup> *60 Minutes*, *supra* note 172.

<sup>186</sup> *Id.*

<sup>187</sup> Information: Conspiracy to Maintain Drug-Involved Premises, at \*1, *United States v. Daubert*, No. CR 12-21-M (D. Mont. Apr. 10, 2012), 2012 WL 7810147.

<sup>188</sup> Gwen Florio, *Medical Marijuana Activist Daubert Gets Probation in Federal Drug Case*, MISSOULIAN (Sept. 7, 2012, 6:15 AM), [http://missoulian.com/news/local/medical-marijuana-activist-daubert-gets-probation-in-federal-drug-case/article\\_e279b332-f850-11e1-abe0-0019bb2963f4.html](http://missoulian.com/news/local/medical-marijuana-activist-daubert-gets-probation-in-federal-drug-case/article_e279b332-f850-11e1-abe0-0019bb2963f4.html).

raided the business in 2011.<sup>189</sup> Daubert pled guilty to the charge and potentially faced a maximum sentence of twenty years in prison.<sup>190</sup> The federal government sought to impose a six-and-a-half to eight-year sentence.<sup>191</sup> Judge Christensen, sitting for the United States District Court of Montana, entered a sentence for only five years of probation.<sup>192</sup> Judge Christensen explained that in determining Daubert's sentence she considered his education, intelligence, faith, poor health, and the fact that "he ha[d] been an advocate for the use of medical marijuana in conformance with what he believed to be the spirit and the intent of Montana law."<sup>193</sup> The lawmakers and law enforcement officers partly operated on the state level by considering Daubert's efforts to comply with Montana law.<sup>194</sup>

### *C. The Federal Government's Concession to State Experimentation*

Over a third of the states in the U. S. have legalized medical marijuana as of the November 2012 elections.<sup>195</sup> Thus far, the federal government has not challenged the state legalization and lack of enforcement against medical marijuana businesses in compliance with state laws, which suggests that Congress is allowing states to experiment on their own.<sup>196</sup>

Several members of Congress have been working towards federal acceptance of state legalization. Colorado Representatives Dianna DeGette, Ed Perlmutter, and Jared Polis are drafting legislation that would exempt states that have legalized marijuana from the federal CSA.<sup>197</sup> Texas Representative Ron Paul and former Massachusetts Representative Barney Frank also sent a

---

<sup>189</sup> *Id.*

<sup>190</sup> Plea Agreement at \*2, *United States v. Daubert*, No. CR 12-21-M, (D. Mont. Apr. 11, 2012), 2012 WL 7810073.

<sup>191</sup> Florio, *supra* note 188.

<sup>192</sup> Transcript of Sentencing at 57, *United States v. Daubert*, No. CR 12-21-M (D. Mont. Nov. 1, 2012).

<sup>193</sup> *Id.* at 58–59.

<sup>194</sup> Nicole Flatow, *Meet the Montana Man Convicted of a Federal Crime for Working to Make Medical Marijuana Safer*, THINK PROGRESS (Oct. 4, 2012, 3:45 PM), <http://thinkprogress.org/justice/2012/10/04/906271/meet-the-montana-lobbyist-convicted-of-a-federal-crime-for-working-to-make-medical-marijuana-safer/?mobile=nc>.

<sup>195</sup> *State Medical Marijuana Laws*, NAT'L CONFERENCE OF STATE LEGISLATURES (Sept. 2013), <http://www.ncsl.org/research/health/state-medical-marijuana-laws.aspx>.

<sup>196</sup> See Young, *supra* note 151, at 34.

<sup>197</sup> Scot Kersgaard, *Colorado Reps Seek State Exemption from Federal Pot Prohibition Laws*, COLORADO INDEPENDENT (Nov. 10, 2012, 12:49 PM), <http://coloradoindependent.com/126304/colorado-reps-seek-exemption-from-federal-pot-prohibition-laws>.

letter to President Obama, asking that he urge his administration to stop prosecuting marijuana activity that is legal under state law.<sup>198</sup>

A particularly telling federal concession to state medical marijuana laws occurred in early 2012, when Congress approved a District of Columbia Council bill that allows D.C. to license up to eight medical marijuana dispensaries.<sup>199</sup> Congress must approve all D.C. bills before they become law pursuant to the U.S. Constitution.<sup>200</sup> In this dual role of national and local governance, members of Congress are required to uphold federal laws in that local governance as representatives of the federal government. This may be considered evidence that the federal government is changing its position and acquiescing to legalization on some level.<sup>201</sup>

This recent change is especially revealing in light of the fact that Congress had previously derailed D.C.'s efforts to legalize medical marijuana.<sup>202</sup> D.C. voters had actually approved a referendum to authorize the sale of medical marijuana back in 1998.<sup>203</sup> The referendum passed by nearly 70% of the vote, the greatest majority of any medical marijuana initiative passed at the time.<sup>204</sup> However, the success of the initiative was thwarted by Congressman Bob Barr (R-GA), who authorized a last minute amendment that withdrew funds necessary to implement the passed referendum.<sup>205</sup> The Barr Amendment effectively blocked any new medical marijuana legalization efforts for over a decade until Congress lifted it in December 2009.<sup>206</sup> Without the Barr Amendment, the D.C. Council was free to seek congressional approval of plans to implement its legalization initiative.<sup>207</sup>

---

<sup>198</sup> Flatow, *supra* note 194.

<sup>199</sup> See Deborah Morgan, *Congress Conflicts with Federal Law by Approving D.C. Medical Marijuana*, EXAMINER (Aug. 18, 2012), <http://www.examiner.com/article/congress-conflicts-with-federal-law-by-approving-dc-medical-marijuana>.

<sup>200</sup> U.S. CONST. art. I, § 8, cl. 17.

<sup>201</sup> See Morgan, *supra* note 199.

<sup>202</sup> Sam Jewler, *Medical Marijuana Finally Heads for D.C.*, TIME (January 27, 2010), <http://www.time.com/time/nation/article/0,8599,1956673,00.html>.

<sup>203</sup> *Id.*

<sup>204</sup> *Id.* Eight other state initiatives to legalize medical marijuana had passed by 1998. *Id.*

<sup>205</sup> *Id.*

<sup>206</sup> *Id.* Ironically, Barr left the Republican Party in 2006 and joined the Medical Marijuana Project to lobby against the Barr Amendment. *Marijuana Project Parties with Barr*, WASHINGTON TIMES (May 23, 2008), <http://www.washingtontimes.com/news/2008/may/23/marijuana-project-parties-with-barr/?page=all#pagebreak>.

<sup>207</sup> See Jewler, *supra* note 202.

The November 2012 elections and referendums also shed light on the federal government treatment of state legalization, as Washington and Colorado became the first states to legalize recreational marijuana.<sup>208</sup> This significant change in state law highlighted the clear disagreement on marijuana between state and federal law, which has existed since California first legalized the controlled substance for medical use in 1996.<sup>209</sup> The federal government's close evaluation of these laws is likely to crossover into state medical marijuana laws. However, federal reaction has remained widely uncertain.<sup>210</sup>

The U.S. Attorney's Office initially declined to comment on whether it would sue to block the states from executing the ballot measures<sup>211</sup>—something it did not do when state medical marijuana laws passed. Jeff Dorschner, a spokesman for the U.S. Attorney's Office in the District of Colorado issued the following statement the day after the election: “The Department of Justice’s enforcement of the Controlled Substances Act remains unchanged. In enacting the Controlled Substances Act, Congress determined that marijuana is a Schedule I controlled substance. We are reviewing the ballot initiative and have no additional comment at this time.”<sup>212</sup>

---

<sup>208</sup> Jack Healy, *Voters Ease Marijuana Laws in 2 States, but Legal Questions Remain*, N.Y. TIMES, Nov. 8, 2012, at P15, available at [http://www.nytimes.com/2012/11/08/us/politics/marijuana-laws-eased-in-colorado-and-washington.html?\\_r=0](http://www.nytimes.com/2012/11/08/us/politics/marijuana-laws-eased-in-colorado-and-washington.html?_r=0).

<sup>209</sup> Kristen Wyatt, *Pot Votes in 2 States Challenge U.S. Drug War*, CBS MONEY WATCH (Nov. 8, 2012, 8:15am), [http://www.cbsnews.com/8301-505245\\_162-57546861/pot-votes-in-2-states-challenge-us-drug-war/](http://www.cbsnews.com/8301-505245_162-57546861/pot-votes-in-2-states-challenge-us-drug-war/). John Davis, a medical marijuana provider in Washington, noted that “[Washington’s new] law does not prevent conflicts,” but instead “will highlight the necessity to find some kind of resolution between state and federal laws.” *Id.*

<sup>210</sup> See Press Release, United States Attorney's Office, Statement by U.S. Attorney's Office Regarding Passage of Amendment 64, (Nov. 6, 2012), [http://www.justice.gov/usao/co/press\\_releases/2012/November2012/11\\_7\\_12.html](http://www.justice.gov/usao/co/press_releases/2012/November2012/11_7_12.html) (indicating no comment from the Department of Justice).

<sup>211</sup> Healy, *supra* note 208.

<sup>212</sup> Statement by U.S. Attorney's Office, *supra* note 210. In August 2013, the Department of Justice announced an update to its marijuana enforcement policy, taking into account of the Colorado and Washington ballot initiatives that legalized medical marijuana under state law. Press Release, Department of Justice, Justice Department Announces Update to Marijuana Enforcement Policy (Aug. 29, 2013), <http://www.justice.gov/opa/pr/2013/August/13-opa-974.html>. The Deputy Attorney General provided guidance regarding marijuana enforcement in a memorandum to all United States Attorneys. Memorandum from James M. Cole, Deputy Attorney Gen., to All U.S. Attorneys (Aug. 29, 2013), available at <http://www.justice.gov/iso/opa/resources/3052013829132756857467.pdf>. The memorandum listed the federal government's eight enforcement priorities, which included preventing distribution to minors, preventing diversion of marijuana from states where it is legal under state law to other states, and preventing state-authorized marijuana activity from being used as a pretext for other illegal activity. *Id.* The memorandum did not indicate that the U.S. Attorney's Office would sue to block Colorado and Washington's ballot initiatives, but rather stated that prosecutors should “review 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” when exercising prosecutorial discretion. *Id.*

U.S. Attorney General Eric Holder's silence on the issue on the eve of the election also contributes to the uncertainty over the future of state marijuana laws. This uncertainty may place greater weight on the bankruptcy court's interpretation of § 1129(a)(3) when a dispensary's bankruptcy reaches the confirmation stage. Marijuana supporters believe that Holder's silence indicates that the federal government is unlikely to intervene with state marijuana laws.<sup>213</sup> Advocates point to 2010, when Holder strongly opposed a California ballot measure that would have similarly legalized recreational marijuana.<sup>214</sup> Nine former DEA officials sent a letter urging Holder to denounce the California ballot measure.<sup>215</sup> In response, Holder vowed that the federal government would "vigorously enforce the [CSA] against those individuals and organizations that possess, manufacture or distribute marijuana for recreational use, even if such activities are permitted under state law."<sup>216</sup>

However, Holder's statement specifically addressed *recreational* use and not medical use.<sup>217</sup> When DEA officials asked Holder to publicly reiterate the Administration's opposition to medical marijuana during the 2012 election, Holder declined to comment.<sup>218</sup> In response, the former DEA officials took Holder's silence to "convey[] to the American public and the global community a tacit acceptance of these dangerous initiatives."<sup>219</sup>

The same "tacit acceptance" can be said to apply to state medical marijuana laws. And it is this "tacit acceptance" by the federal government that has led states to experiment further in progressively weakening the federal ban.

The resulting state experimentation allows medical marijuana policies to be tailored to "local conditions and local tastes, while a national government must take a uniform—and hence less desirable—approach."<sup>220</sup> The state laws

---

<sup>213</sup> See Bill Briggs, *Weed Wars: If States Legalize Marijuana, Will Feds Still Crack Down or Steer Clear?*, NBCNEWS.COM (Nov. 5, 2012), [http://usnews.nbcnews.com/\\_news/2012/11/04/14886823-weed-wars-if-states-legalize-marijuana-will-feds-still-crack-down-or-steer-clear?lite](http://usnews.nbcnews.com/_news/2012/11/04/14886823-weed-wars-if-states-legalize-marijuana-will-feds-still-crack-down-or-steer-clear?lite).

<sup>214</sup> See *id.*

<sup>215</sup> Alex Dobuzinskis, *Eric Holder Urged to Oppose Marijuana Ballot By Ex-DEA Heads*, HUFFINGTON POST (Sept. 7, 2012, 9:02 pm), [http://www.huffingtonpost.com/2012/09/07/eric-holder-marijuana\\_n\\_1866384.html](http://www.huffingtonpost.com/2012/09/07/eric-holder-marijuana_n_1866384.html).

<sup>216</sup> Steve Gorman, *Attorney General Holder Opposes California Marijuana Bill*, REUTERS (Oct. 16, 2010, 12:45 AM), <http://www.reuters.com/article/2010/10/16/us-usa-marijuana-california-idUSTRE69F03V20101016>.

<sup>217</sup> *Id.*

<sup>218</sup> See Dobuzinskis, *supra* note 215.

<sup>219</sup> *Id.*

<sup>220</sup> Michael W. McConnell, *Federalism: Evaluating the Founders' Design*, 54 U. CHI. L. REV. 1484, 1493 (1987).

deviate not only from the federal law, but also vary greatly from one another.<sup>221</sup> For example, while all states require that prospective medical marijuana users prove they are suffering from a qualifying condition, the types of conditions may be highly restricted, as in New Mexico,<sup>222</sup> or may encompass all “illnesses for which marijuana provides relief,” as in California.<sup>223</sup> The amount patients are allowed to possess and the mechanisms for dispensing medical marijuana also depend on the state or local government.<sup>224</sup> Such variety among and within the many states presents an opportunity to test different theories in political “laboratories.”<sup>225</sup>

In *Oakland Cannabis*, Justice Stevens articulated a similar benefit in his concurrence, joined by Justice Souter and Justice Ginsberg:

That respect [for the sovereign States] imposes a duty on federal courts, whenever possible, to avoid or minimize conflict between federal and state law, particularly in situations in which the citizens of a [s]tate have chosen to “serve as a laboratory” in the trial of “novel social and economic experiments without risk to the rest of the country.” . . . By passing Proposition 215, California voters have decided that seriously ill patients and their primary caregivers should be exempt from prosecution under state laws for cultivating and possessing marijuana if the patient’s physician recommends using the drug for treatment.<sup>226</sup>

In the *Raich* case, Justice O’Connor wrote a dissenting opinion criticizing the Court’s inflexible interpretation of the federal ban and acknowledged the merits of the state legalization “experiment.”<sup>227</sup> O’Connor stated, “California . . . has come to its own conclusion about the difficult and sensitive question of whether marijuana should be available to relieve severe pain and suffering. Today the Court sanctions an application of the [CSA] that extinguishes that experiment . . . .”<sup>228</sup>

---

<sup>221</sup> Y. Lu, *Medical Marijuana Policy in the United States*, HUNTINGTON’S OUTREACH PROJECT FOR EDUC. AT STANFORD (May 15, 2012), <http://www.stanford.edu/group/hopes/cgi-bin/wordpress/2012/05/medical-marijuana-policy-in-the-united-states/>.

<sup>222</sup> See *The Twenty States*, *supra* note 12.

<sup>223</sup> CAL. HEALTH & SAFETY CODE § 11362.5 (West 2009).

<sup>224</sup> See Lu, *supra* note 221.

<sup>225</sup> See *New State Ice Co. v. Liebmann*, 285 U.S. 262, 311 (1932) (Brandeis, J., dissenting) (“It is one of the happy incidents of the federal system that a single courageous state may, if its citizens choose, serve as a laboratory; and try novel social and economic experiments without risk to the rest of the country.”).

<sup>226</sup> *United States v. Oakland Cannabis Buyers’ Co-op.*, 532 U.S. 483, 502 (2001) (Stevens, J., concurring) (quoting *Liebmann*, 285 U.S. at 311 (1932) (Brandeis, J., dissenting)).

<sup>227</sup> See *Gonzales v. Raich*, 545 U.S. 1, 43 (2005) (O’Connor, J., dissenting).

<sup>228</sup> *Id.*

In *Raich*, the Court reasoned that even marijuana grown for home consumption would make its way into interstate commerce, therefore permitting federal regulation.<sup>229</sup> Permitting states freedom to experiment with marijuana legalization “without risk to the rest of the country” is not necessarily inconsistent with *Raich*, because the “laboratory” theory underlying tacit federal approval of state experimentation “assumes that successful state experiments will often be adopted at the national level.”<sup>230</sup>

Demonstrably, the debate surrounding the legalization of marijuana has been compared to the national debate during the Prohibition Era. Similar to marijuana legalization, the repeal of prohibition progressed largely on the state level.<sup>231</sup> Before the federal government repealed national prohibition in 1933, eleven states repealed their state prohibition laws.<sup>232</sup> Anti-prohibition voters overwhelmingly decided<sup>233</sup> that, “if the federal government believes so strongly in prohibition, then let them—and them alone—be responsible for enforcing it.”<sup>234</sup> The first state repeal occurred in 1923 when New York Governor Al Smith signed legislation repealing the state’s prohibition law.<sup>235</sup> In a memorandum, Governor Smith noted that the legislation did not exempt New York from federal prohibition, but simply left alcohol prosecutions for the federal government.<sup>236</sup> He reasoned, “The burden imposed on the [s]tate to prosecute traffickers in liquor as violators of the [s]tate statute is a wasteful and futile one because of the refusal of grand juries to indict and of petit juries to convict.”<sup>237</sup>

Similar reasoning can be applied to state legalization of medical marijuana. The Department of Justice has repeatedly indicated that its limited resources are best spent on those who “go[] beyond that which the states have

---

<sup>229</sup> See Margaret H. Lemos, *State Enforcement of Federal Law*, 86 N.Y.U. L. REV. 698, 751–52 (2011) (“[N]ot all interstate effects are incompatible with the concept of states as laboratories.”).

<sup>230</sup> *Id.*

<sup>231</sup> See, e.g., Briggs, *supra* note 213.

<sup>232</sup> DAVID E. KYVIG, *REPEALING NATIONAL PROHIBITION* 168 (2d ed. 2000).

<sup>233</sup> See *id.* (“In every [state election], wets won by a considerable margin, including two-to-one in Michigan and California, and over four-to-one in New Jersey.”).

<sup>234</sup> Paul Armentano & Richard Evans, *Californians Repealed Alcohol Prohibition, They Should Vote To Repeal Marijuana Prohibition Too*, LEWROCKWELL.COM (Oct. 29, 2010), <http://www.lewrockwell.com/armentano-p/armentano-p48.1.html>.

<sup>235</sup> HENRY MOSKOWITZ, ALFRED E. SMITH: AN AMERICAN CAREER 251 (1924), available at [http://www.archive.org/stream/alfredesmithanam009261mbp/alfredesmithanam009261mbp\\_djvu.txt](http://www.archive.org/stream/alfredesmithanam009261mbp/alfredesmithanam009261mbp_djvu.txt).

<sup>236</sup> *Id.*

<sup>237</sup> *Id.* at 253.

authorized,” and not “people who are acting in conformity with state law.”<sup>238</sup> Furthermore, as previously discussed, there has been at least one instance in which a jury unanimously acquitted a marijuana grower charged with marijuana cultivation through jury nullification.<sup>239</sup>

#### *D. Statutory Interpretation and Unfair and Arbitrary Results*

The Code does not explicitly prohibit medical marijuana businesses from participating in bankruptcy even though provisions in the U.S. Tax Code and the Code suggest that Congress had the ability to specifically exclude such businesses.<sup>240</sup>

The language of § 362(b)(23) suggests that Congress deliberately chose not to impose limitations on the ability of medical marijuana businesses to file for bankruptcy or utilize the protections provided under the bankruptcy umbrella.<sup>241</sup> Congress amended § 362(b) to except from the automatic stay actions to evict the debtor from a residential leasehold when the action is based on “illegal use of controlled substances on [that] property.”<sup>242</sup> Although Congress has clearly contemplated how illegal drug use may impact a debtor’s bankruptcy,<sup>243</sup> similar consequences for businesses in either chapter 7 or chapter 11 are not present in the Code. That Congress deliberately declined to impose any limitations on a marijuana dispensary’s ability to file for bankruptcy suggests that dispensaries should be able to file for bankruptcy like any other business.<sup>244</sup>

By contrast, Congress specifically carved out an exception to the deduction of business expenses as it applies to businesses in violation of the CSA in the Tax Code.<sup>245</sup> Section 280E of the Tax Code prohibits the deduction of expenses related to trafficking controlled substances.<sup>246</sup> The inclusion of this

---

<sup>238</sup> Volkov, *supra* note 120 (quoting U.S. Attorney General Eric Holder at a House Judiciary Committee meeting); *see also* Memorandum from David W. Ogdan, *supra* note 4.

<sup>239</sup> *Supra* notes 178–183 and accompanying text.

<sup>240</sup> *See* 26 U.S.C. § 280E (2012) (addressing deduction of drug trafficking expenses); 11 U.S.C. § 362(b)(23) (2012) (limiting bankruptcy protection for individual debtors who used controlled substances in a residential leasehold).

<sup>241</sup> *See* 11 U.S.C. § 362(b)(23).

<sup>242</sup> *Id.*

<sup>243</sup> *Id.*

<sup>244</sup> 21 U.S.C. § 844(a) (2012).

<sup>245</sup> 26 U.S.C. § 280E.

<sup>246</sup> *Id.*

provision suggests that Congress was aware that certain states have legalized medical marijuana to the extent that dispensary businesses existed.

The restriction Congress placed on marijuana dispensaries' ability to deduct business expenses was not a categorical condemnation of the business. In *Californians Helping to Alleviate Medical Problems, Inc. v. Commissioner*, the U.S. Tax Court held that § 280E applied only to expenditures "in connection with the *illegal sale* of drugs."<sup>247</sup> Thus, while the dispensary in *CHAMP* was prohibited from deducting its business expenses incurred in dispensing medical marijuana, it was able to deduct expenses from the operation of its caregiving business.<sup>248</sup> Since the caregiving expenses were sufficiently separate from the dispensary's marijuana distribution expenses, the § 280E prohibition on deduction did not apply.<sup>249</sup> The court noted that § 280E and its legislative history "do not express an intent to deny the deduction of all of a taxpayer's business expenses simply because the taxpayer was involved in trafficking in a controlled substance."<sup>250</sup>

A bankruptcy court considering the chapter 13 filing of an individual engaged in medical marijuana business applied a similar analysis. In *McGinnis* the court held that the debtor could remain in bankruptcy if he could support his plan with income produced from activities other than the sale and cultivation of marijuana.<sup>251</sup> The debtor's chapter 13 plan indicated that it would be funded by three sources: a business that rented space to medical marijuana growers, sales from his own medical marijuana operation, and rental income from a commercial property.<sup>252</sup> The court held that it could not confirm the debtor's plan because it relied in part on the proceeds from the debtor's sale and cultivation of marijuana.<sup>253</sup>

However, the court gave the debtor a chance to submit an amended plan for confirmation.<sup>254</sup> This suggests that the court had no issue with the debtor's sale and cultivation of marijuana, but rather with the debtor funding its bankruptcy

---

<sup>247</sup> *Californians Helping to Alleviate Med. Problems, Inc. v. Comm'r*, 128 T.C. 173, 177 (2007) (emphasis added) (quoting 26 U.S.C. § 280E (2006)). The court also held that § 280E applies to such activities regardless of their compliance with state laws. *Id.*

<sup>248</sup> *Id.* at 185.

<sup>249</sup> *Id.* at 182.

<sup>250</sup> *Id.*

<sup>251</sup> *In re McGinnis*, 453 B.R. 770, 773 (Bankr. D. Or. 2011); *see also supra* notes 132–133 and accompanying text.

<sup>252</sup> *McGinnis*, 453 B.R. at 771.

<sup>253</sup> *Id.* at 773.

<sup>254</sup> *Id.*

with proceeds generated from marijuana sales. If the debtor were able to fund its bankruptcy with income from sources unrelated to marijuana, it would seem an absurd result that the debtor could still receive income from marijuana distribution but not use this income to pay its creditors.

Debtor's disposable income in chapter 13 is defined as "current monthly income" which includes income "from all sources."<sup>255</sup> If bankruptcy courts adopt the interpretation of Tax Code § 280E stated in *CHAMP* and restrict plan funding to only non-marijuana income, distressed creditors would lose out on a source of income to satisfy the debtor's outstanding obligations. Moreover, legislative history suggests Congress intended the term "individual with regular income" to include individuals who receive income from less traditional sources.<sup>256</sup> The Senate Report illustrates the Congress intended a broad interpretation of "income":

The effect of this definition, and of its use in [§] 109(e), is to expand substantially the kinds of individuals that are eligible for relief under chapter 13 . . . . The definition encompasses all individuals with incomes that are sufficiently stable and regular to enable them to make payments under a chapter 13 plan. Thus, individuals on welfare, social security, fixed pension incomes, or who live on investment incomes, will be able to work out repayment plans . . . .<sup>257</sup>

In light of the exception for businesses in violation of the CSA in the Tax Code, Congress's silence on the consequences of the use or sale of controlled substances on the ability to reorganize under chapter 11 suggests that banning dispensaries from the protection of chapter 11 would be an unfair and arbitrary result.

---

<sup>255</sup> 11 U.S.C. § 101(10A) (2012).

<sup>256</sup> See S. REP. NO. 95-989, at 24 (1978), *reprinted in* 1978 U.S.C.C.A.N. 5787, 5810; H.R. REP. NO. 95-595, at 311-12 (1977), *reprinted in* 1978 U.S.C.C.A.N. 5963, 6268-69 (explaining the effect of the definition for "individual with regular income" in 11 U.S.C. § 101(30)).

<sup>257</sup> *Supra* note 256.

#### IV. POLICY ARGUMENTS IN FAVOR OF ALLOWING BANKRUPTCIES OF MARIJUANA DISPENSARIES

##### A. *Bankruptcy Policy Supports Allowing Medical Marijuana Dispensaries to File for Bankruptcy*

Prohibiting marijuana dispensaries from reorganizing under chapter 11 would contradict the policy goals of bankruptcy. Marijuana dispensaries face the same financial difficulties that compel traditional businesses into bankruptcy.<sup>258</sup> Similarly, a dispensary's creditors are subject to the same universal problem suffered by all creditors in bankruptcy: too many creditors and not enough assets.

If a court refuses to consider a dispensary's income as a source of repayment, creditors will be the ones harmed. They might only receive the business's liquidation value rather than its going-concern value. When a debtor dispensary does not have enough assets to pay most of its unsecured creditors, courts should allow the dispensary to pursue bankruptcy to satisfy more of its creditors and minimize the common pool problem. Bankruptcy has been described as "a debt collection device targeted to the common pool problem."<sup>259</sup> Denying bankruptcy protection to medical marijuana dispensaries also denies their creditors the ability to maximize the amount they can recover in bankruptcy.

Furthermore, bankruptcy is not an appropriate forum to challenge the constitutionality of state laws. The preemption issue is sure to arise should more courts deny medical marijuana dispensaries plan confirmation. As explained in the Introduction, courts have referred to both federal and state laws when evaluating the § 1129(a)(3) condition to confirmation.<sup>260</sup>

One group of medical marijuana business attorneys noted that the inability to reorganize around the sale of medical marijuana would imply "serious issues for the legitimacy of the medical cannabis industry as bankruptcy is a fundamental escape hatch for most entities and their creditors."<sup>261</sup> Should bankruptcy courts develop a policy of denial of bankruptcy relief to medical

---

<sup>258</sup> See *supra* Introduction.

<sup>259</sup> Ponoroff & Knippenberg, *supra* note 25, at 950.

<sup>260</sup> See *supra* Introduction.

<sup>261</sup> Bricken, *supra* note 58.

cannabis entities, the legitimacy of the industry itself will continue to be stymied.”<sup>262</sup>

### B. Patients' Loss of Access to Safe Medical Marijuana

If bankruptcy protection is not available to medical marijuana dispensaries operating legally under state law, insolvent dispensaries may turn to black market sources to sell their remaining assets when their debts preclude them from their normal, regulated operations. Similarly, if state licensed dispensaries continue to disappear, unregulated distributors may take over their demand. This moves medical marijuana patients out of the regulated regime and poses a significant risk to their health.<sup>263</sup>

Consider *Mother Earth's* as an example. At a press conference held during its bankruptcy, the attorney representing Mother Earth's explained that closing the facility would force its patients to resort to the black market.<sup>264</sup> “They have exhausted all other means of access,” he said.<sup>265</sup> Before the bankruptcy judge granted the debtor's landlord relief from the automatic stay, forcing Mother Earth's to shut down, Mother Earth's was the only licensed medical marijuana dispensary in the area.<sup>266</sup> It served patients in Riverside, San Diego, Imperial, and Orange County.<sup>267</sup> According to its bankruptcy filings, Mother Earth's “receive[d] referrals from physicians and well-established institutions throughout the county. These medical institutions include[d] Kaiser Permanente, Sharp HealthCare, Scripps, and USCD Oncology Department.”<sup>268</sup>

Unlike black market sources in the area, Mother Earth's held a license from the San Diego Sheriff's Department.<sup>269</sup> In a letter in support of Mother Earth's, U.S. Representative Bob Filner noted that the dispensary “operate[d] under a

---

<sup>262</sup> *Id.*

<sup>263</sup> See AMERICANS FOR SAFE ACCESS, MEDICAL CANNABIS DISPENSING COLLECTIVES AND LOCAL REGULATION 1, 9 (2011), available at <http://medicalmarijuana.procon.org/sourcefiles/dispensaries.pdf>.

<sup>264</sup> Nadin Abbott, *Mother Earth Dispensary Files Emergency Stay; Patients Tell Their Stories*, EAST COUNTY MAGAZINE (July 25, 2012), <http://www.eastcountymagazine.org/node/10522>. According to the owner of Mother Earth's, Bob Reidel, “more than 70,000 legitimate medical marijuana patients” will suffer from the closure while “the black market will flourish.” Dorian Hargrove, *San Diego County's Last Legal Marijuana Dispensary Forced Out of Business*, SAN DIEGO READER (Aug. 31, 2012), <http://www.sandiegoreader.com/weblogs/news-ticker/2012/aug/31/san-diego-countys-last-legal-marijuana-dispensary-/>.

<sup>265</sup> Abbott, *supra* note 264.

<sup>266</sup> Letter from Bob Filner, *supra* note 74.

<sup>267</sup> Abbott, *supra* note 264; see also Letter from Bob Filner, *supra* note 74.

<sup>268</sup> Abbott, *supra* note 264.

<sup>269</sup> *Id.*

strict county ordinance that mandates that the facility is inspected monthly by the San Diego Sheriff's Department and according to these inspection reports, all parties have followed the letter of law."<sup>270</sup> Congressman Filner also urged the U.S. Attorney to consider the thirteen employees who would lose their jobs if the dispensary shut down.<sup>271</sup>

California passed the Medical Marijuana Program Act ("MMP") of 2003 to combat the perils of marijuana distribution on the black market and to clarify an existing basis to "implement a plan to provide for the safe and affordable distribution of marijuana to all patients in medial need of marijuana."<sup>272</sup> The MMP allows qualified patients and their caregivers to "collectively or cooperatively" cultivate medical marijuana.<sup>273</sup> It exempts collectives and cooperatives, such as Mother Earth's, from criminal sanctions associated with the sale of marijuana.<sup>274</sup> Dispensaries also provide access to patients who do not have the means to cultivate their own medical marijuana.<sup>275</sup>

Dispensaries have produced other positive externalities for society as well.<sup>276</sup> Dispensaries offer a safer environment for patients who might otherwise resort to the black market to acquire the materials they need for medical treatment.<sup>277</sup> They provide patients with counseling, psychosocial support, and social services such as food and housing.<sup>278</sup> This type of service integration is particularly beneficial for those diagnosed with chronic or terminal illnesses.<sup>279</sup> Experts who have studied medical marijuana patients have noted that the patient based care model employed by most dispensaries may help "address issues besides the illness itself that might contribute to long-term physical and emotional health outcomes, such as the prevalence of depression among the chronically ill."<sup>280</sup>

---

<sup>270</sup> Letter from Bob Filner, *supra* note 74.

<sup>271</sup> *Id.*

<sup>272</sup> AMERICANS FOR SAFE ACCESS, *supra* note 263, at 4.

<sup>273</sup> CAL. HEALTH & SAFETY CODE § 11362.775 (West 2009); AMERICANS FOR SAFE ACCESS, *supra* note 263, at 22.

<sup>274</sup> CAL. HEALTH & SAFETY CODE § 11362.775 (West 2009).

<sup>275</sup> AMERICANS FOR SAFE ACCESS, *supra* note 263, at 3, 4.

<sup>276</sup> *See id.* at 6–8.

<sup>277</sup> *Id.* at 1.

<sup>278</sup> Amanda E. Reiman, *Self-Efficacy, Social Support and Service Integration at Medical Cannabis Facilities in the San Francisco Bay Area of California*, 16 HEALTH & SOCIAL CARE 31, 32–33 (2008).

<sup>279</sup> *Id.* at 33.

<sup>280</sup> AMERICANS FOR SAFE ACCESS, *supra* note 263, at 11–12.

There is also evidence that the high security measures employed by dispensaries reduce crime in the surrounding community.<sup>281</sup> The California Center for Population Research evaluated survey data from all dispensaries operating in Sacramento, California and concluded that “some security measures, such as security cameras, having a door man outside, and having signs requiring an ID prescription card, taken by medical marijuana dispensary owners might be effective at reducing crime within the immediate vicinity of the dispensaries.”<sup>282</sup> Patients and dispensary operators report criminal activity—such as the resale of medical marijuana or the sale to improper persons.<sup>283</sup> While discussing an ordinance that provides regulatory oversight to dispensaries, Oakland city administrator Barbara Killey stated, “The areas around the dispensaries may be some of the safest areas of Oakland now because of the level of security [and] surveillance . . . .”<sup>284</sup> Residents in cities with dispensary regulations have noted in city hearings that the dispensaries actually help revitalize neighborhoods and bring new customers to adjacent businesses.<sup>285</sup> Thus, there are a myriad of benefits to allowing dispensaries “in possession” to remain in chapter 11 while they work out a plan to repay creditors.

Although there are technically two exceptions to the federal ban, they are highly unlikely to offset the loss of access patients may experience should dispensaries continue to close their doors after being denied the protections of bankruptcy.<sup>286</sup> First is the Compassionate Investigational New Drug program, created in 1976 to allow patients to use marijuana legally for therapeutic purposes.<sup>287</sup> Qualifying patients suffered from debilitating illnesses including glaucoma, AIDS or HIV, multiple sclerosis, and exotosis, a rare bone

---

<sup>281</sup> *Id.* at 6.

<sup>282</sup> Nancy J. Williams et al., *Evaluating Medical Marijuana Dispensary Policies* 20 (Oct. 2011) (unpublished manuscript) (on file with the Cal. Center for Population Res. On-Line Working Paper Series), available at <http://papers.cpr.ucla.edu/papers/PWP-CCPR-2011-011/PWP-CCPR-2011-011.pdf>; see also Nancy J. Keeple & Bridget Freisthler, *Exploring the Ecological Association Between Crime and Medical Marijuana Dispensaries*, 73 *STUD. ALCOHOL & DRUGS* 523, 523–30 (2012) (suggesting “that the density of medical marijuana dispensaries may not be associated with crime rates or that other factors, such as measures dispensaries take to reduce crime (i.e., doormen, video cameras), may increase guardianship such that it deters possible motivated offenders”).

<sup>283</sup> AMERICANS FOR SAFE ACCESS, *supra* note 263, at 12.

<sup>284</sup> *Id.* at 8.

<sup>285</sup> *Id.*

<sup>286</sup> Mikos, *supra* note 10, at 1433–34.

<sup>287</sup> *Despite Marijuana Furor, 8 Users Get Drug from the Government*, N.Y. TIMES, Dec. 1, 1996, at L33.

disorder.<sup>288</sup> It stopped accepting new applications in 1992, but the remaining Compassionate IND patients were grandfathered in.<sup>289</sup> Today, only four patients currently receive medical marijuana through the program.<sup>290</sup>

The second exception is triggered by participating in a FDA-approved research study involving marijuana use.<sup>291</sup> However, since the federal government rarely approves such studies, they would only accommodate a miniscule portion of the patients who currently qualify for state exemptions.<sup>292</sup>

### C. Potential Safeguards

The federal government's vacillating approach to licensed state dispensaries only exacerbates existing ambiguity in the law. Although the DOJ announced in 2009 that it would not focus on prosecuting marijuana dispensaries that are in clear compliance with state laws,<sup>293</sup> it began to contradict this approach around 2011.<sup>294</sup> The exception of criminal proceedings from the automatic stay may serve as a safeguard to a complete shift in policy against state-compliant dispensaries. If federal prosecutors later decide to target these dispensaries, § 362(b)(1) ensures that "the commencement or continuation of a criminal action or proceeding against the debtor" remains available.<sup>295</sup> The U.S. Trustee is also likely to request the appointment of a trustee when a chapter 11 bankruptcy involves a medical marijuana business.<sup>296</sup> This would provide the federal government notice of the

---

<sup>288</sup> *Who Are the Patients Receiving Medical Marijuana Through the Federal Government's Compassionate IND Program?*, PROCON.ORG (July 19, 2012), <http://medicalmarijuana.procon.org/view.answers.php?questionID=000257>.

<sup>289</sup> *See Despite Marijuana Furor*, *supra* note 287, at L33; Clinton A. Werner, *Medical Marijuana and the AIDS Crisis*, J. CANNABIS THERAPEUTICS 17, 25 (2001), available at <http://www.cannabis-med.org/membersonly/mo.php?aid=2001-03-04&fid=2001-03-04-2&mode=p&sid=>.

<sup>290</sup> *Who Are the Patients*, *supra* note 288. Two patients in the program have been held anonymous by request. Although their status in the program cannot be confirmed, these two patients are thought to have passed away.

<sup>291</sup> Mikos, *supra* note 10, at 1433.

<sup>292</sup> *Id.* at 1433–34.

<sup>293</sup> Memorandum from David W. Ogden, *supra* note 4.

<sup>294</sup> Memorandum from James M. Cole, Deputy Att'y Gen., to U.S. Att'ys (June 29, 2011), available at [http://americansforsafeaccess.org/downloads/James\\_Cole\\_memo\\_06\\_29\\_2011.pdf](http://americansforsafeaccess.org/downloads/James_Cole_memo_06_29_2011.pdf); see also Rob Kampa, *Medical Marijuana Meets Hostility from Obama Administration*, WASH. POST, May 4, 2012, available at [http://www.washingtonpost.com/opinions/medical-marijuana-meets-hostility-from-obama-administration/2012/05/04/gIQA80GK2T\\_story.html](http://www.washingtonpost.com/opinions/medical-marijuana-meets-hostility-from-obama-administration/2012/05/04/gIQA80GK2T_story.html).

<sup>295</sup> 11 U.S.C. §362(b)(1) (2012).

<sup>296</sup> In chapter 11, "a party in interest or the United States [T]rustee" may request the appointment of a trustee "[a]t any time after the commencement of the case but before confirmation of a plan." *Id.* § 1104(a).

dispensary's business and allow it to determine whether criminal proceedings are worth pursuing.

The CSA also provides a process for rescheduling controlled substances.<sup>297</sup> “[A]ny interested party” may petition the Attorney General to evaluate a particular drug based on scientific evidence.<sup>298</sup>

Moreover, allowing only state-compliant dispensaries and growers to file for bankruptcy would reinforce the legitimate marijuana dispensation industry and avoid consumers' retreat to the black market. In *Raich*, the federal government argued that allowing any legal category of marijuana would lead to problems with prosecuting users who illegally obtain marijuana for non-medical use.<sup>299</sup> However, state legalization has not occurred without accompanying regulatory systems.<sup>300</sup> For example, most states legalizing medical marijuana use require that prospective users suffer from a qualifying condition.<sup>301</sup> Qualifying patients must also consider other treatment options with a physician and ultimately obtain a physician's recommendation for medical marijuana.<sup>302</sup> Anyone caught violating the prohibition against the resale of medical marijuana is typically banned from visiting its dispensary.<sup>303</sup> Prosecutors may check dispensaries for required licenses,<sup>304</sup> closely monitor activities within the dispensaries,<sup>305</sup> check for patient ID cards,<sup>306</sup> and engage in any other preventative monitoring requested by statute.

---

<sup>297</sup> 21 U.S.C. § 811(b)–(c) (2012); *United States v. Fogarty*, 692 F.2d 542, 548 (8th Cir. 1982).

<sup>298</sup> 21 U.S.C. § 811(b)–(c); *see also Fogarty*, 692 F.2d at 548.

<sup>299</sup> *Gonzales v. Raich*, 545 U.S. 1, 12–13 (2005).

<sup>300</sup> *See The Twenty States*, *supra* note 12.

<sup>301</sup> *Id.* Typical conditions include “cancer, glaucoma, AIDS (or HIV), and other chronic diseases that produce symptoms like severe pain, nausea, seizures, or persistent muscle spasms.” Mikos, *supra* note 10, at 1428.

<sup>302</sup> Mikos, *supra* note 10, at 1428.

<sup>303</sup> AMERICANS FOR SAFE ACCESS, *supra* note 263, at 20.

<sup>304</sup> *Id.*

<sup>305</sup> *Id.* Many dispensaries have security cameras installed both inside and outside the premises. *See 60 Minutes*, *supra* note 172. In Colorado, the surveillance video is used to ensure that dispensaries adhere to state laws. *See id.* Dispensaries have also allowed state and local law enforcement officials as well as state legislators to regularly tour their facilities. *See, e.g.,* Rebecca Richman Cohen, *The Fight Over Medical Marijuana*, N.Y. TIMES (Nov. 7, 2012), [http://www.nytimes.com/2012/11/08/opinion/the-fight-over-medical-marijuana.html?\\_r=0](http://www.nytimes.com/2012/11/08/opinion/the-fight-over-medical-marijuana.html?_r=0) (showing state officials on a tour of a Montana dispensary); Nicole Flatow, *supra* note 194 (quoting a former dispensary worker in Montana).

<sup>306</sup> Most states require users or caregivers and suppliers to register with the state to qualify for protection from criminal sanctions. Mikos, *supra* note 10, at 1428.

Just as these extensive state regulations allow law enforcement officers to distinguish between permissible and prohibited activities,<sup>307</sup> they would allow bankruptcy courts to determine which marijuana businesses are recognized by the state as legitimate businesses and thus worthy of a chance to reorganize.

### CONCLUSION

Nothing in the Code explicitly prohibits medical marijuana businesses from seeking chapter 11. Furthermore, no court has held that a dispensary is unable to achieve a confirmable chapter 11 plan solely because of the nature of its business. Bankruptcy courts that have considered U.S. Trustees' arguments on this issue have not given much weight to the idea that a dispensary's business constitutes cause to dismiss or would prevent plan confirmation.

Since medical marijuana businesses may file for chapter 11 for the same legitimate reasons as a more traditional business, there should be no cause or lack of good faith to dismiss the case under § 1112(b). Reorganization plans based on the sale and cultivation of medical marijuana should also be confirmable since § 1129(a)(3) does not bar confirmation of plans based on the legality of the plan's terms, but rather on the legality of the manner of the plan's proposal. Section 1129(a)(11) may not be an obstacle to dispensaries that are unlikely to be pursued by law enforcement officials.

Furthermore, the federal government has allowed the states to pervade its prohibition of marijuana through its tacit acceptance of state medical marijuana laws and limited enforcement. Thus, it is effectively allowing the states to experiment with medical marijuana dispensaries. If states are allowed to test the merits of their particular form of legalization, then dispensaries should be afforded the opportunity to file for bankruptcy like any other business. This solution is sensible, as the nation increasingly supports the state legalization efforts and state governments gain financial and other benefits from medical marijuana businesses despite a depressed economy.

VIVIAN CHENG\*

---

<sup>307</sup> Young, *supra* note 151, at 37.

\* Managing Editor, *Emory Bankruptcy Developments Journal*; J.D. Candidate, Emory University School of Law (2014); B.S., Cornell University (2011). I would like to thank Professor Rafael Pardo for his guidance in developing and writing this Comment. I would also like to thank the Staff of the *Emory Bankruptcy Developments Journal* for their work in polishing this Comment. Finally, special thanks to my parents for their encouragement and support throughout my law school career.