

## STIRRING THE BANKRUPTCY POT

BRITTANY BYRNES

*Law Clerk at Clayson, Schneider & Miller, PC*

With the November election quickly approaching, the legalization of recreational marijuana has been a trending topic for Michigan residents for months. According to the American Bankruptcy Institute, the marijuana business is “big business”<sup>1</sup> and is comprised of a “multi-billion-dollar industry consisting of producers, developers and distributors, and the landlords, vendors and others who do business with these new entrepreneurs.”<sup>2</sup> While many may be eager to break into the industry at the promise of impressive financial gains, the risks of operating a business in which the use, cultivation, and distribution are still a violation of federal law cannot be ignored.<sup>3</sup> One such major risk in the marijuana industry is inability of marijuana professionals to file for the protections of bankruptcy. An individual or business entity in the marijuana industry is unlikely going to receive relief from the bankruptcy court, regardless of which chapter they file under.<sup>4</sup> With federal lenders becoming increasingly weary of extending credit to those in the marijuana business,<sup>5</sup> bankruptcy could be a very real outcome for some.

In Michigan, individual debtors in the state legal medical marijuana industry are likely to face extreme challenges in discharging their debt. Moreover, a denial of debt discharge for similarly situated individuals may become precedent in Michigan.” In *in re Johnson*, a sixty-six-year-old western Michigan resident filed

---

<sup>1</sup> Candace C. Carlyon & Matthew R. Carlyon, *Bankruptcy Courts Deny Relief to Marijuana Businesses*, 33-12 ABIJ 42, 42 (2014).

<sup>2</sup> B. Summer Chandler, *It's All Going to Pot: Is Relief Available for Debtors in the Marijuana Business?*, 34-12 ABIJ 46, 46 (2015).

<sup>3</sup> Comprehensive Drug Abuse Prevention and Control Act of 1970, Pub. L. No. 91-513, 84 Stat. 1236 (1970) (codified as amended at 21 U.S.C. §§ 801–971).

<sup>4</sup> Carlyon, *supra* note 1, at 42; see *General Comparison of Chapter 7 and Chapter 13 Bankruptcy*, AM. B. ASS'N (Oct. 9, 2018), [https://www.americanbar.org/content/dam/aba/migrated/publiced/practical/books/family\\_legal\\_guide/bankruptcy\\_7\\_13.authcheckdam.pdf](https://www.americanbar.org/content/dam/aba/migrated/publiced/practical/books/family_legal_guide/bankruptcy_7_13.authcheckdam.pdf).

<sup>5</sup> U.S. Dep't of Treasury, Fin. Crimes Enf't Network, FIN-2014-G001, Guidance: BSA Expectations Regarding Marijuana-Related Businesses (Oct. 9, 2018), [fincen.gov/statutes\\_regs/guidance/pdf/FIN-2014-G001.pdf](https://www.fincen.gov/statutes_regs/guidance/pdf/FIN-2014-G001.pdf).

for chapter 13 bankruptcy protection in an attempt to save his home and car from seizure.<sup>6</sup> Mr. Johnson worked part-time as a state licensed caregiver to supplement his Social Security Income (“SSI”), however he was still unable to repay his debts.<sup>7</sup> Mr. Johnson claimed that because his SSI alone was enough to cover his chapter 13 monthly payment plan, he should not be denied a discharge because the payments could be maintained through federal legal means.<sup>8</sup> The Bankruptcy Court for the Western District of Michigan disagreed and denied Mr. Johnson chapter 13 bankruptcy protection unless he agreed to cease all marijuana-related business activity and dispose of all marijuana contraband.<sup>9</sup> The Court stated that the debtor’s work was “patently incompatible” to the protections of bankruptcy because it would require federal officers to violate their oaths and require a trustee to hold onto instrumentalities or funds from a federal criminal activity.<sup>10</sup> The Court also explained that the continued automatic stay imposed by the bankruptcy filing was thereby allowing the debtor to retain and use assets which furthered his illegal operations, such as his vehicle and home which he used to cultivate marijuana products. In essence, Mr. Johnson’s plea for debt discharge in combination with an automatic stay equated to prolonged illegal activity.<sup>11</sup> Therefore, Mr. Johnson was faced with the difficult choice of either dismantling his business or losing his car and home.

This result is not happening only in Michigan, but all over the country. In *in re Arenas*, the Bankruptcy Court for Colorado granted the U.S. trustee’s motion to dismiss a chapter 7 case filed by a marijuana grower and his wife, finding that since a trustee could not administer the business without violating federal law, the case should be dismissed for cause.<sup>12</sup> Not only did the Court dismiss the case and deny the Arenas’ a discharge of their debts, it also denied the debtor’s motion for alternative relief by converting the case to a chapter 13.<sup>13</sup> Similarly, in *in re McGinnis*, the Bankruptcy Court in

---

<sup>6</sup> *In re Johnson*, 532 B.R. 53, 54 (Bankr. W.D. Mich. 2015).

<sup>7</sup> *Id.* at 54–56.

<sup>8</sup> *Id.* at 55–57.

<sup>9</sup> *Id.* at 57–59.

<sup>10</sup> *Id.* at 55–58.

<sup>11</sup> *Id.* at 58.

<sup>12</sup> *In re Arenas*, 514 B.R. 887 (Bankr. D. Colo. 2014).

<sup>13</sup> *Id.* at 892.

Oregon denied a debtor's chapter 13 plan, holding that "the sale and cultivation of marijuana as envisioned in [the] Debtor's Plan is illegal under federal law." As such, the Court could not "find that the predicted income stream from the marijuana operations is reasonably certain to produce sufficient income to fund the Plan."<sup>14</sup> Because confirmation of a chapter 13 bankruptcy plan requires that the bankruptcy court find that the plan "has been proposed in good faith and not by any means forbidden by law," confirmation in this case was deemed impossible.<sup>15</sup>

Since marijuana businesses are currently critically scrutinized by the federal legal system, even unrelated businesses which rely on marijuana operations for income have also been denied bankruptcy relief. For example, in *in re Beyries*, a California attorney filed for personal bankruptcy protection and was denied a discharge on the basis of accepting funds from his client who operated a medical marijuana facility.<sup>16</sup> Michael Beyries received regular deliveries of cash from his client in case anyone associated with the business was prosecuted.<sup>17</sup> The Court denied the debtor's complaint for debt discharge because he was "engaged in unlawful activity."<sup>18</sup> The Court emphasized that "[t]his is not the sort of case [that] is supposed to darken the doors of a federal court."<sup>19</sup>

The trending practice by the bankruptcy courts has resulted in negative effects for not only the debtors, but also the creditors of marijuana related businesses. In *in re Medpoint Management*, four creditors petitioned for an involuntary chapter 7 proceeding against a marijuana dispensary management company. The Court dismissed the involuntarily petition altogether, allowing the debtor to use its federal illegal conduct as a shield from the collection efforts of

---

<sup>14</sup> *In re McGinnis*, 453 B.R. 770, 773 (Bankr. D. Or. 2011).

<sup>15</sup> *Id.* at 772–73.

<sup>16</sup> *In re Beyries*, No. 10-13482, 2011 WL 5975445 (Bankr. N.D. Cal. Nov. 29, 2011), *aff'd sub nom.* Northbay Wellness Group, Inc. v. Beyries, No. C 11-06255 JSW, 2012 WL 4120409 (N.D. Cal. Sept. 18, 2012), *re'd and remanded*, 789 F.3d 956 (9th Cir. 2015), *aff'd in part, rev'd in part*, 607 Fed. Appx. 693 (9th Cir. 2015) (mem.).

<sup>17</sup> *Beyries*, No. 10-13482 at \*1.

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

<sup>19</sup> *Id.* at \*2.

undisputed creditors.<sup>20</sup> This was the case even though the debtor did not cultivate, distribute, or manufacture the marijuana itself, but simply provided high-level business services to medical marijuana faculties.<sup>21</sup> This trend will likely cause the lenders to become more apprehensive in future transactions with marijuana faculties. Because the lenders' claims will likely be uncollectable against an insolvent marijuana business, the lenders' incentives to provide service to businesses in the industry should decrease.

With the steps that many states have taken to legalize the business of marijuana, both medical and otherwise, it can become easy to overlook the many ways in which these operations are still not accepted under federal law. From difficulties in securing funding from lenders, to seeking the protection of a bankruptcy, many marijuana businesses and their unrelated business partners are faced with a multitude of challenges. As shown above, even creditors and legal professionals who work with these entities are not immune. Therefore, no matter what the results are of the vote to legalize recreational marijuana in Michigan this November, it is important for these businesses and their legal counsel to be aware of these difficulties and have a plan to address them going forward.

---

<sup>20</sup> In re Medpoint Mgmt. LLC, 528 B.R. 178 (Bankr. D. Ariz. 2015), *vacated in part*, In re Medpoint Mgmt., LLC, No. AZ-15-1130-KuJaJu, 2016 Bankr. LEXIS 2197 (B.A.P. 9th Cir. June 3, 2016).

<sup>21</sup> Steven J. Boyajian, *Code to Code, Just Say No to Drugs? Creditors Not Getting a Fair Shake When Marijuana-Related Cases Are Dismissed*, 39-9 ABIJ 24, 75 (2017).