

A hand is shown holding a green cannabis leaf with serrated edges. The background is a warm, orange-brown color. A soft shadow of the leaf is cast onto the background behind the hand. The text is overlaid on the image.

Distressed Cannabis: Restructuring Options

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An aerial photograph of a large, intricate maze constructed from tall, green hedges. The maze is composed of many rectangular paths and dead ends. In the center of the maze, a person wearing a dark jacket and light-colored pants is walking along a path. The overall scene is a complex, geometric pattern of greenery.

Where Are We Now?

State of the Industry in the United States

Industry Size

- Actual and Projected Retail Sales, in Billions

Year	Medical	Recreational	Combined
2022	\$10.7	\$19.3	\$30
2023	\$11.1	\$22.5	\$33.6
2024	\$11.6	\$26.9	\$38.4
2025	\$12.3	\$32	\$44.3
2026	\$12.9	\$36.8	\$49.7
2027	\$13.5	\$40	\$53.5
2028	\$14.1	\$42.8	\$56.9

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- At the same time, those are just retail sales and as large as those numbers are, the additional annual economic impact from, among other things, an almost endless series of ancillary businesses and related account for between \$70-100 billion a year over just the next five years alone



State of the Industry in the United States (cont'd)

- Growth market. For example, new states with recent or future recreational use sales include Maryland, Missouri, New York, New Jersey, New Mexico, Rhode Island, Virginia, and Vermont. On the East Coast, you can now drive 800 miles from Fort Kent, ME to Cape May, NJ purchasing legal cannabis along the way.
- Now, more than 75% of the U.S. population lives in states that have legalized cannabis for medical and/or recreational use.

So, Why “Distressed Cannabis”? What Happened?

- Maturing markets with related shakeout
- The pandemic years boom and bust
- Illicit market still operating
- High taxes
- Steep regulatory and compliance costs
- Cost increases due to inflation as it hit labor, materials, and operational costs
- Continued lack of broad access to capital from the typical institutional sources
- Difficulty of smaller entities to compete with multi-state operators (MSOs)
- Market saturation causing price compression
- In short, a bit of a perfect storm even while the cannabis industry continues to grow exponentially

So, Where Does That Leave Us in 2023-2024?

- There have been some significant declines in wholesale prices in the more mature markets and with supply and demand imbalances
- As noted, California and the west coast in general leads that way
- Not surprisingly, customers are very price sensitive, especially during these inflationary times
- The wide range in market maturity is very evident (e.g., CA vs. NJ)
- Capital raises have been down across the board as well as M&A – deals decreased by 70-80% while the size of them also declined by 40-50%
- Post pandemic resetting of markets and demand
- MSOs have moved out of some markets and/or had layoffs; battening down the hatches (e.g., Curaleaf in CA & Oregon)



So Where Does Distressed Cannabis Look for Relief?

Bankruptcy?

- Largely, a no can do.
- In short, generally bankruptcy protections through the federal bankruptcy code and law are not available, particularly for touch-the-leaf businesses.
- Why? Largely because of two longstanding underlying policy considerations.
- First, the federal bankruptcy system cannot be used as an “instrument” for the ongoing commission of a crime and, correspondingly, a plan of reorganization cannot be confirmed if it would allow for continuing illegal activity.
- Second, bankruptcy estate fiduciaries and trustees should not be required to administer assets that would thereby cause them to violate federal criminal law.
- See, e.g., *Why Marijuana Assets May Not Be Administered In Bankruptcy*, Clifford White, John Sheahan, Office of the United States Trustee (2017).





- **Section 856:** prohibits knowingly renting, managing, or using property “for the purpose of manufacturing, distributing, or using any controlled substance – no distinction between the seller or grower and the more downstream participants such as landlords”
- **Section 863:** crime to sell or offer for sale any drug paraphernalia, which includes “equipment or product or material of any kind which is primarily intended or designed for use in manufacturing a controlled substance”
- **Section 855:** provides for a fine against any person “who derives profit or proceeds from an offense of the CSA”

Have There Been Exceptions?

- Generally, that has come down to a distinction in cannabis businesses between what are referred to as plant-touching as opposed to ancillary operations
- Examples:
 - **In re Frank Anthony Arenas**, 535 B.R. 845,854 (B.A.P. 10th Cir. 2015)
 - Court determined that a CO grower was not eligible for Ch 7 or Ch 13 because it would require the trustee to deal with cannabis in violation of federal law
 - **In re Way to Grow**, 597 B.R. 111, 126 (Bankr. D. Colo.2018)
 - Debtor owned and operated a hydroponic supply company. Petition was dismissed because the court found that the debtor knowingly sold products to customers “who will and do violate” the Controlled Substances Act. “Aiding and abetting.”
 - **Burton v. Maney (in re Burton)** 610 B.R. 633 (B.A.P. 9th Cir. 2020)
 - This Arizona-filed Ch 13 case was dismissed since the debtor’s plan was to be funded by the recovery of lawsuit proceeds resulting from breach of contract for the cultivation and sale of cannabis
 - **In Re Players Network**, 2020 Bankr LEXIS 3016 (Bankr D Nev Oct. 23, 2020, No. 20-12890-MKN)
 - The debtor’s Ch 11 case was dismissed as the debtor held an equity interest in a cannabis company so any plan of reorganization, the court determined, could not be proposed in good faith

Have There Been Exceptions? (cont'd)

- However, just last year, there was a bit of a chink in the bankruptcy-and-cannabis-don't-mix armor via the *In re Hacienda Company LLC*, 674 B.R.748 (Bankr. C.D. Cal. 2023) case involving a wholesale manufacturing and packaging company that was caused to stop operations in February 2021, filing for bankruptcy, and moving to sell its intellectual property to a Canadian company that grows and sells cannabis for an almost 10% equity interest in the same Canadian company. The U.S. Trustee moved to dismiss the case. The bankruptcy court refused to do so.
- Why?
 - The “mere presence of marijuana near a bankruptcy case doesn’t automatically prohibit a debtor from bankruptcy relief”
 - Court found that the debtor’s passive stock ownership and intent to liquidate, after paying creditors, would end cannabis connection
 - Congress didn’t adopt a “zero tolerance policy”
 - There is no per se rule requiring dismissal when cannabis is present
 - Congress’ intent was not that any violation of criminal law requires dismissal of the case (e.g., Boy Scouts of America case; Bernie Madoff proceedings)
 - Dismissal deprives debtors’ creditors from an orderly & equitable distribution of the estate’s assets as well as the augmentation of the estate’s assets through its avoidance powers
 - See also *Gavin v. Cook Investments, SPNWY, LLC*, 922 F.3d103 (9th Cir. 2019) (9th Circuit upheld confirmation of plan of debtor that leased land to a cannabis farmer; plan did not rely on funding from the leased land
 - Canadian Companies’ Creditors Arrangement Act (CCAA)
 - Canadian Reverse Vesting Orders (RVOs) (transfer of unwanted assets out of debtor company to an affiliated company to preserve license and some tax attributes)

Are Chapter 15 Cross-Border Bankruptcies Viable?

- The Chapter exists to provide cooperation between U.S. and foreign courts when foreign bankruptcy proceedings also deal with U.S. financial interests.
- It allows a foreign corporate bankruptcy debtor to petition to also have access to the U.S. bankruptcy court system.
- But what if that foreign company is involved with cannabis?
- Well, under Chapter 15 there is not any estate created of the debtor's assets so a trustee would not be "administering" cannabis assets which is one of the two principal policy concerns that has had the U.S. Trustee's Office opposing cannabis-related bankruptcy filings.
- Would a Chapter 15 filing be "manifestly contrary" to U.S. public policy?
- The *Hacienda* case gives ammunition to debtor's counsel to argue to the contrary.
- See also *RSM v. Richter Inc.*, (Bankr. S.D.N.Y).

Could the Rescheduling of Cannabis Affect the Ability to Seek the Protections of the U.S. Bankruptcy Courts?

- Pursuant to a 2022 directive from President Biden, a 2023 recommendation of the U.S. Department of Health and Human Services, and a scientific review released in January supporting the HHS's recommendation, the U.S. Drug Enforcement Administration is now evaluating whether to reclassify cannabis as a Schedule III drug.
- If it does, the effect on the cannabis industry could be seismic because removing the federal prohibition of cannabis should eliminate punishing tax treatment and banking restrictions that are restraining the market's growth.
- That said, as long as cannabis still remains illegal federally, just at a reduced scheduling level, it is unlikely to quell the concerns surrounding the ability to take advantage of the federal bankruptcy laws.

Schedule III...

If Not Bankruptcy, Then What? Receivership

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Typical Alternatives:

- ← State Receiverships
- Out-of-court restructurings →
- ← Assignments for the benefit of creditors (ABCs)
- UCC Article 9 sales →
- ← Wind ups under state statutes

Receiverships



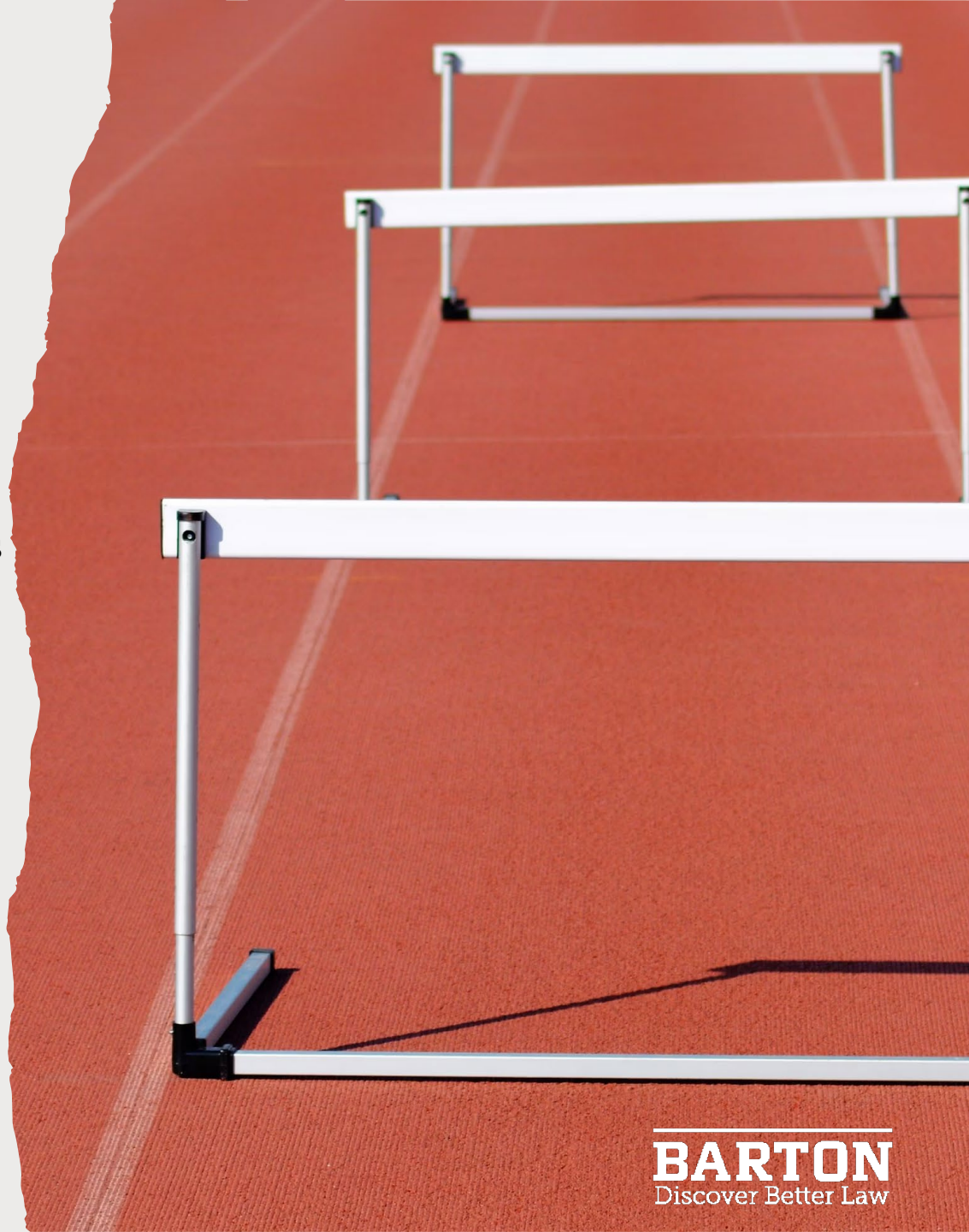
- They tend to be a flexible mode for resolving distressed business and financial issues while allowing operations to continue
- Assistance can be provided by various insolvency professionals overseen by a “receiver” (i.e., a reorganization specialist) as appointed by a state court on a temporary basis to manage the company’s operations while also handling the company’s organization until the business is back on track or its assets are sold and/or liquidated
- Overall goal is to preserve and enhance the operating business’ value to the benefit of its various stakeholders while also continuing to operate the company and maintain its licensing status
- They can be utilized by a distressed cannabis company’s lender(s), its own business operators, or landlord(s) faced with default

What Are the Potential Upsides to Receivership?

- Flexibility: costs (much less expensive than a Chapter 11); less constraints enhancing the timing of the process; less formal procedurally; less court time; greater focus on negotiations
- Information flow: greater access to financial information, reporting and forecasting
- Possibility of pre-packaging contemplated outcomes
- Possibility, through court proceedings, of setting aside certain contracts or leases
- Minimization of public visibility
- Access to a neutral party and insolvency professionals
- Not a legal action per se; a state proceeding usually overseen by business courts
- Possible limited stay of creditor actions
- Party seeking a receiver usually has some control over who the appointed receiver will be and presumably that will be someone with a real understanding of cannabis business and operations
- The buck usually stops at the receiver

Unique Issues for Receivers for Cannabis Business

- Regulatory approval is likely to be required for receivers to manage the business' license(s) and cannabis inventory
- May be dual licensing: state-issued as well as local permits
- There is a wide variance as to change-of-control regulations between the states
- Some states have special regulatory provisions addressing transfers to receivers
- If a particular state has no formal provisions, a receivership may not be possible or only after lengthier regulatory processes
- State regulators can be “touchy” with insolvency situations
- Inability to transfer state licenses
- In California you most interact with the Bureau of Cannabis Control (notice within 14 days, etc.)
- New York currently does not address receiverships within the present cannabis regulations though the Office of Cannabis Management appears receptive to creating a receivership statute
- Local regulations can also be an issue



DE-SCHEDULING OF MARIJUANA

- High-level Overview
- History of Marihuana/Marijuana Scheduling
- Recent Events and Current Situation
- Controlled Substances – Schedule I Drugs
- Controlled Substances – Schedule III Drugs
- What De-scheduling Will NOT Do
- What De-Scheduling Will/May Do
- Is It Enough?

HIGH-LEVEL OVERVIEW

- Lip-services for a half measure, BUT a step in the right direction with the chances of influencing real change.

HISTORY OF MARIHUANA/MARIJUANA SCHEDULING

1600-1890s	Domestic production of hemp encouraged
1900 - 20s	Mexican immigrants introduce recreational use of marijuana leaf
1944	La Guardia Report finds marijuana less dangerous
1940s	"Hemp for Victory"
1970	<p>Repeal of most mandatory minimum sentences YET Marijuana differentiated from other drugs</p> <p>Nixon's War Against Drugs</p> <p>Controlled Substances Act of 1970 classified cannabis as a Schedule 1 Drug</p>
1972	Shafer Commission
1986	Anti-Drug Abuse Act - Mandatory Sentences

RECENT EVENTS AND CURRENT SITUATION

- Biden Administration push for expeditious change
- HHS report
- DEA proposed rule change
- *Proposed Rulemaking Stage*
- 30 days after final rule is passed, Marijuana will be moved to Schedule III

CONTROLLED SUBSTANCES – SCHEDULE I DRUGS

- Schedule I drugs, substances, or chemicals are defined as drugs with **no currently accepted medical use** and **a high potential for abuse**. Some examples of Schedule I drugs are: heroin, lysergic acid diethylamide (LSD), marijuana (cannabis), 3,4 methylenedioxymethamphetamine (ecstasy), methaqualone, and peyote.

CONTROLLED SUBSTANCES – SCHEDULE III DRUGS

- Schedule III drugs, substances, or chemicals are defined as drugs with a **moderate to low potential for physical and psychological dependence**. Schedule III drugs abuse potential is less than Schedule I and Schedule II drugs but more than Schedule IV. Some examples of Schedule III drugs are: products containing less than 90 milligrams of codeine per dosage unit (Tylenol with codeine), ketamine, anabolic steroids, testosterone

WHAT DE-SCHEDULING WILL NOT DO

- Decriminalize
- Legalize
- Affect State Laws

WHAT DE-SCHEDULING WILL/MAY DO

- IRS Tax Provision 280E
- Federal Government Regulation
- Research
- VA & Health Insurance
- IP
- Stock Increases

IS IT ENOUGH?

- Not yet!
- Current Presidential Candidates' Stances