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## Why Marijuana Assets May Not Be Administered in Bankruptcy

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

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

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

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<sup>1</sup> Controlled Substances Act, 21 U.S.C. §§ 801 *et seq.* (the “CSA”); *Gonzales v. Raich*, 545 U.S. 1, 12 (2005).

in order to reorganize its balance sheet and thereby facilitate its violations of the law going forward.

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

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

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

Given these concessions, the author’s disagreement with the USTP’s position would appear to be limited to a fairly narrow range of cases – those where administration of the estate would not require the trustee to sell marijuana (but would require the trustee to administer other marijuana-derived property), or where the debtor is a “downstream” participant in a marijuana business, such as a lessor of a building used for a marijuana dispensary.<sup>5</sup>

Yet under the CSA, there is no distinction between the seller or the grower of marijuana and the supposedly more “downstream” participants whom the article proposes to protect: all are in violation of federal criminal law. In particular,

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<sup>2</sup> Steven J. Boyajian, “Just Say No to Drugs? Creditors Not Getting a Fair Shake When Marijuana-Related Cases Are Dismissed,” *ABI Journal*, September 2017, at 24.

<sup>3</sup> *Id.* at 25.

<sup>4</sup> *Id.*

<sup>5</sup> *Id.* at 74.

section 856 of the CSA specifically prohibits knowingly renting, managing, or using property “for the purpose of manufacturing, distributing, or using any controlled substance;” section 863 of the CSA makes it a crime to sell or offer for sale any drug paraphernalia – which is defined to include, among other things, “equipment, product, or material of any kind which is primarily intended or designed for use” in manufacturing a controlled substance; and section 855 provides for a fine against a person “who derives profits or proceeds from an offense [of the CSA].”<sup>6</sup> Thus, not only would a trustee who offers marijuana for sale violate the law but so, too, would a trustee who liquidated the fertilizer or equipment used to grow marijuana, who collected rent from a marijuana business tenant, or who sought to collect the profits of a marijuana investment.

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

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

Finally, the article suggests that the “ongoing conflict over marijuana policy” is one that should take place outside the bankruptcy system. The USTP

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<sup>6</sup> Controlled Substances Act, 21 U.S.C. §§ 801 *et seq.*

<sup>7</sup> *Id.* at 25.

<sup>8</sup> See *Dep’t of Revenue v. Kurth Ranch*, 511 U.S. 767 (1994); *In re Chapman*, 264 B.R. 565 (B.A.P. 2001).

agrees. But that does not mean that the USTP or the courts should turn a blind eye to bankruptcy filings by marijuana businesses. Rather than make its own marijuana policy, the USTP will continue to enforce the legislative judgment of Congress by preventing the bankruptcy system from being used for purposes that Congress has determined are illegal.

In re Burton, 610 B.R. 633 (2020)

68 Bankr.Ct.Dec. 52, 21 Cal. Daily Op. Serv. 6041, 2020 Daily Journal D.A.R. 240

610 B.R. 633  
United States Bankruptcy Appellate Panel of the  
Ninth Circuit.

IN RE: Brigham A. BURTON, a/k/a [Kent Burton](#)  
and Carly Rae Burton, Debtors.  
Brigham A. Burton, a/k/a [Kent Burton](#); Carly Rae  
Burton, Appellants,  
v.  
Edward John Maney, Chapter 13 Trustee; [Stratton  
Restoration, LLC](#), Appellees.

BAP No. AZ-19-1126-LTaF

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Bk. No. 2:18-bk-04571-BMW

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Submitted Without Argument on November 21,  
2019

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Filed – January 14, 2020

**Synopsis**

**Background:** Debtors appealed from order of the United States Bankruptcy Court for the District of Arizona, [Brenda Moody Whinery](#), Chief Judge, dismissing their Chapter 13 case.

**[Holding:]** The Bankruptcy Appellate Panel, Laffery, J., held that Bankruptcy Court did not abuse its discretion in dismissing debtors’ Chapter 13 case based on debtors’ ownership of interest in entity that was involved in litigation seeking to recover damages for breach of contracts related to growing and selling marijuana.

Affirmed.

**Procedural Posture(s):** On Appeal.

West Headnotes (4)

**[1] Bankruptcy** Discretion

Bankruptcy Appellate Panel (BAP) reviews a bankruptcy court’s dismissal of a Chapter 13 case for abuse of discretion.

4 Cases that cite this headnote

**[2] Bankruptcy** Discretion

A bankruptcy court abuses its discretion if it applies the wrong legal standard, misapplies the correct legal standard, or makes factual findings that are illogical, implausible, or without support in inferences that may be drawn from the facts in the record.

**[3] Bankruptcy** Who May Be a Debtor

The mere presence of marijuana near a bankruptcy case does not automatically prohibit a debtor from bankruptcy relief; instead, a bankruptcy court must be explicit in articulating its legal and factual bases for dismissal in cases involving marijuana.

4 Cases that cite this headnote

**[4] Bankruptcy** Grounds or cause in general; bad faith

Bankruptcy Court did not abuse its discretion in dismissing debtors’ Chapter 13 case based on debtors’ ownership of interest in entity that was involved in litigation seeking to recover damages for breach of contracts related to growing and selling marijuana, such that any recovery from those lawsuits would require the Bankruptcy Court or trustee to administer assets derived from conduct that was illegal under the Controlled Substances Act (CSA). 11 U.S.C.A. §§ 105(a), 1307(c); Comprehensive Drug Abuse Prevention and Control Act of 1970 § 101, 21 U.S.C.A. § 801 et seq.

[1 Case that cites this headnote](#)

Appeal from the United States Bankruptcy Court for the District of Arizona, Honorable Brenda Moody Whinery, Chief Bankruptcy Judge, Presiding

**Attorneys and Law Firms**

Appellants Brigham A. Burton, a/k/a Kent Burton, and Carly Rae Burton, pro se on brief;

Ross M. Mumme, Esq. on brief for Appellee Edward J. Maney, Chapter 13 Trustee.

Before: LAFFERTY, TAYLOR, and FARIS, Bankruptcy Judges.

**OPINION**

LAFFERY, Bankruptcy Judge:

**\*634 INTRODUCTION**

Brigham and Carly Rae Burton appeal the bankruptcy court’s dismissal of their chapter 13<sup>1</sup> case. The Burtons own the majority interest in Agricann, LLC (“Agricann”), an entity that was engaged in cultivating and selling marijuana, which, while legal under Arizona law, violated federal law. In response to the bankruptcy court’s order to show cause why the case should not be dismissed based on the Burtons’ interest in Agricann, the Burtons asserted that Agricann was no longer operating and was not being relied upon to fund the Burtons’ chapter 13 plan. Agricann, however, was a plaintiff in at least two state court lawsuits in which it sought recovery of damages for breach of contracts related to growing and selling marijuana. The Burtons asserted that recovery from those lawsuits was unlikely, but the bankruptcy court rejected this assertion as not credible and concluded that any recovery from those lawsuits would be derived from conduct that is illegal under federal law. Accordingly,

allowing the case to continue would likely require the court and the trustee to become involved in such illegal conduct.

Because the Burtons did not provide sufficient evidence that the potential litigation proceeds would not materialize, requiring the court and the trustee to become involved in their administration, the bankruptcy court did not abuse its discretion in dismissing the Burtons’ case.

We AFFIRM.

**FACTUAL BACKGROUND**

The Burtons filed a chapter 13 petition in April 2018. On their original Schedule A/B, they disclosed interests in four limited liability companies, all with unknown values, including a 65 % membership interest in Agricann, of which Mr. Burton was a manager and its president. They also listed a pending claim belonging to Agricann against Natural Remedy Patient Center LLC, described as a breach of contract action, also with an unknown value. They later amended Schedule A/B to disclose additional ownership interests in other LLCs.<sup>2</sup>

According to original and amended Schedule I, Mr. Burton was unemployed during the pendency of the bankruptcy case. All Schedule I income was attributed to Ms. Burton’s wages from her employment. Schedule J showed a monthly net income of \$458.80, with which the Burtons proposed to fund their chapter 13 plan.<sup>3</sup>

Postpetition, Agricann sued Total Accountability Systems I, Inc. and Cannabis Research Group in state court. Both lawsuits \*635 sought damages for breach of contracts under which Agricann was to cultivate, grow, and sell medical marijuana.

Although the Burtons proposed three different chapter 13 plans during the approximately one year their case was pending, they were unsuccessful in getting a plan confirmed.<sup>4</sup>

On May 29, 2018, creditor Stratton Restoration filed a motion to convert, in which it argued that there was cause to convert the bankruptcy case to chapter 7. It contended that the Burtons were ineligible for chapter 13 relief because their debts exceeded the limitations under § 109(e), based on Stratton’s \$2.4 million unsecured claim arising from state court breach of contract litigation, which the Burtons had not included on their schedules. It also argued that the Burtons filed their case in bad faith

because, among other things, Mr. Burton derived income from a marijuana business that was illegal under federal law.

At the preliminary hearing on the motion to convert held on March 5, 2019, the bankruptcy court raised its concerns regarding the Burtons' alleged connections to the marijuana industry. After that hearing, the court issued an order to show cause ("OSC") requiring the Burtons to appear and show cause why their case should not be dismissed due to their ownership interest in, and deriving income from, an entity involved in the marijuana industry.

The Burtons filed a response to the OSC, verified by Mr. Burton's declaration, in which they disputed having an interest in an entity involved in the marijuana industry. They stated that Agricann went out of business in 2016 and had generated no income since then. As such, they claimed they did not currently derive income from any entity involved in the marijuana industry. Although they acknowledged that Agricann was a party to litigation, they stated they did not expect to receive any proceeds from such litigation due to a contingency fee agreement with the attorney handling the litigation and a litigation financing lien on any recovery. The Burtons also stated their intention to abandon from the estate their interest in Agricann, after which they would divest themselves of their interest in that entity. Finally, they asserted that the sole source of funding for the chapter 13 plan would be Mrs. Burton's employment income. The following day, they filed a motion to compel abandonment of their interest in Agricann.<sup>5</sup>

\*636 Trustee and Stratton Restoration each filed responsive briefs in which they argued that the case should be dismissed given the Burtons' involvement in the medical marijuana industry.

The bankruptcy court held a preliminary hearing on the OSC on April 3, 2019. The court stated that it did not expect to resolve the matter without an evidentiary hearing.<sup>6</sup> The court noted that there were other entities owned by the Burtons and that there was no evidence regarding whether those businesses were also involved in the marijuana business.<sup>7</sup> The bankruptcy court heard argument from the Burtons' counsel as well as counsel for Trustee, Stratton Restoration, creditor Kevin Erdmann, creditor Kerry Lechner, and the United States Trustee. The Burtons' counsel represented that the Debtors were not currently involved in the cannabis industry and were "willing to get out of the Agricann business entirely." Counsel for Trustee noted that the Burtons had provided no evidence of the value of the Agricann lawsuit other than a "one-page self-serving spreadsheet" and no

evidence regarding the litigation financing agreement. Trustee's counsel also pointed out that there were questions regarding whether the Burtons had disclosed all their interests in business entities and sources of income, which raised concerns about the Burtons' good faith.

At the May 6, 2019 final hearing on the OSC, the bankruptcy court delivered its oral ruling. The court stated that it had determined it did not need to hold an evidentiary hearing because the record before it was sufficient for it to rule. It found that dismissal was appropriate under the circumstances because, despite the assertion that Agricann was no longer in the medical marijuana business, it was seeking recovery in the state court litigation

of funds attributable to contracts under which it was to serve as a cultivator, grower, holder, deliverer, and/or seller of marijuana. Any recovery from the litigation would be derived from conduct that is illegal under federal law. Any distributions from Agricann to its members, specifically the Debtors, would also be derived from illegal conduct. The Debtors assert that the Agricann litigation has no value.

However, this assertion is not credible given that the litigation continues to be pursued. These cases are still active and pending.

Given the nature[ ] of Agricann's business, which was clearly involvement in the marijuana industry, neither a case \*637 trustee, nor these Debtors, can sell or liquidate the 65 percent ownership interest in Agricann, which is property of this estate through the bankruptcy case. This would necessitate the Court and the Trustee's involvement in condoning the illegal activity.

Hr'g Tr. (May 6, 2019) at 13:21-14:13.

The bankruptcy court entered an order dismissing the case, and the Burtons timely appealed.

## JURISDICTION

The bankruptcy court had jurisdiction under 28 U.S.C. §§ 1334 and 157(b)(1) and (b)(2)(A). We have jurisdiction under 28 U.S.C. § 158.

## ISSUE

In re Burton, 610 B.R. 633 (2020)

68 Bankr.Ct.Dec. 52, 21 Cal. Daily Op. Serv. 6041, 2020 Daily Journal D.A.R. 240

Whether the bankruptcy court abused its discretion in dismissing the Burtons' chapter 13 case.

### STANDARD OF REVIEW

<sup>11</sup> <sup>12</sup>We review a bankruptcy court's dismissal of a chapter 13 case for abuse of discretion. *Ellsworth v. Lifescape Med. Assoc., P.C. (In re Ellsworth)*, 455 B.R. 904, 914 (9th Cir. BAP 2011). A bankruptcy court abuses its discretion if it applies the wrong legal standard, misapplies the correct legal standard, or makes factual findings that are illogical, implausible, or without support in inferences that may be drawn from the facts in the record. See *TrafficSchool.com, Inc. v. Edriver Inc.*, 653 F.3d 820, 832 (9th Cir. 2011) (citing *United States v. Hinkson*, 585 F.3d 1247, 1262 (9th Cir. 2009) (en banc)).

### DISCUSSION

<sup>13</sup>In recent years, numerous states have legalized the medical and recreational use of marijuana. Marijuana, however, remains a Schedule I controlled substance under the federal Controlled Substances Act, 21 U.S.C. §§ 801-904 ("CSA"). The CSA prohibits, among other things, the manufacture, distribution, dispensing of, or possession with intent to manufacture, distribute, or dispense, a controlled substance. 21 U.S.C. § 841(a). As a result, a bankruptcy filing by an individual or entity with ties to a marijuana business raises difficult issues regarding how involved the debtor may be in that business and still be permitted to seek relief under the Code. The case law continues to evolve, and few bright line rules have emerged from decisions published to date. One principle seems implicit in the case law, however: the mere presence of marijuana near a bankruptcy case does not automatically prohibit a debtor from bankruptcy relief. *Olson v. Van Meter (In re Olson)*, BAP No. NV-17-1168-LTIF, 2018 WL 989263, at \*7 (9th Cir. BAP Feb. 5, 2018) (Tighe, J., concurring) (citing *Northbay Wellness Grp., Inc. v. Beyries*, 789 F.3d 956, 960-61 (9th Cir. 2015)); cf. *Garvin v. Cook Inv. NW, SPNWX, LLC*, 922 F.3d 1031 (9th Cir. 2019) (affirming bankruptcy court's confirmation of a chapter 11 plan where the plan derived indirect support from rental income from a lessor engaged in a marijuana growing business).<sup>8</sup> Instead, a \*638 bankruptcy court must be explicit in articulating its legal and factual bases for dismissal in cases involving marijuana. See *In re Olson*,

2018 WL 989263 at \*6 (remanding for the bankruptcy court to "articulate the findings that led it to determine that Debtor was violating the CSA and what legal standard it relied upon in dismissing the case.").

Several courts have held that a bankruptcy case must be dismissed if the continuation of the case would require the court, trustee, or debtor in possession to administer assets that are illegal under the CSA or that constitute proceeds of activity criminalized by the CSA. *Arenas v. U.S. Tr. (In re Arenas)*, 535 B.R. 845, 853 (10th Cir. BAP 2015); *In re Way to Grow, Inc.*, 597 B.R. 111, 120 (Bankr. D. Colo. 2018), *aff'd*, No. 18-cv-3245-WJM, 610 B.R. 338, 2019 WL 6332541 (D. Colo. Sept. 18, 2019); *In re Medpoint Mgmt., LLC*, 528 B.R. 178, 184-85 (Bankr. D. Ariz. 2015), *vacated in part, Medpoint Mgmt., LLC v. Jensen (In re Medpoint Mgmt., LLC)*, 2016 WL 3251581 (9th Cir. BAP June 3, 2016); *In re Johnson*, 532 B.R. 53, 56-57 (Bankr. W.D. Mich. 2015). Cf. *In re Rent-Rite Super Kegs W. Ltd.*, 484 B.R. 799, 810 (Bankr. D. Colo. 2012) (noting that, where a chapter 11 debtor rented warehouse space to tenants who were growing marijuana, conversion of the case would require the trustee to be responsible for a site where continuing criminal conduct is taking place, raising a question of feasibility of chapter 7 estate administration).

Additionally, some courts have held that a bankruptcy filing or a plan of reorganization proposed by a debtor who is involved in an illegal enterprise is not in good faith, even where the debtor does not have a subjective bad motive, is in legitimate need of bankruptcy relief, and there are no other indicia of an attempt to abuse the bankruptcy process. *In re Arenas*, 535 B.R. at 852-53; see also *In re Rent-Rite Super Kegs W. Ltd.*, 484 B.R. at 809.<sup>9</sup> Related to the good faith analysis, some courts have concluded that a debtor engaged in an illegal business who seeks bankruptcy relief comes into court with unclean hands and is not eligible for relief. *In re Rent-Rite Super Kegs W. Ltd.*, 484 B.R. at 807; cf. *In re Medpoint Mgmt., LLC*, 528 B.R. at 186-87 (petitioning creditors who knew the putative debtor was engaged in a federally prohibited medical marijuana business had unclean hands and could not seek relief from the bankruptcy court).

The reported decisions also illustrate that the nature and extent of debtors' involvement in the marijuana business can vary widely. Compare *In re Arenas*, 535 B.R. at 847 (where the debtor grew and sold marijuana and leased premises to a marijuana dispensary), with *In re Rent-Rite Super Kegs W. Ltd.*, 484 B.R. at 803 (where the

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debtor derived about 25% of its income from leasing space to a marijuana grower). The connection between the debtors' illegal business and the bankruptcy case can also vary: some debtors attempt to reorganize and continue their marijuana-related business, see *In re Way to Grow, Inc.*, 597 B.R. at 115, while other debtors wish to use the bankruptcy process to sever their connection to the business, see *In re Olson*, 2018 WL 989263 at \*3 (where the debtor declared, "I wish \*639 only to terminate any dealings with [a marijuana dispensary tenant] and to sell my property and pay my creditors in full.>").

We believe that the stated reluctance in this Circuit to adopt per se bright-line rules requiring the immediate disposition of bankruptcy cases in which marijuana activity is present, and the flexible cause standard under § 1307(c), coupled with the abuse of discretion standard of review on appeal, give bankruptcy courts appropriate latitude to deal with these variations.

<sup>14</sup>Against this backdrop, the bankruptcy court dismissed the Burtons' chapter 13 case pursuant to §§ 105(a) and 1307(c), finding that their ownership interest in Agricann constituted "cause" for dismissal<sup>10</sup> because the continuation of the case would likely require the trustee or the court to become involved in administering the proceeds of the Agricann litigation, which the court implicitly found would be tainted as proceeds of an illegal business. The bankruptcy court did not err in this finding, nor did it abuse its discretion in dismissing the case on those grounds.

Moreover, the court sufficiently articulated the legal and factual bases for its ruling. It is undisputed that the Burtons own an interest in Agricann, an entity that was engaged in a business that is illegal under federal law, and that interest became property of the estate when they filed their chapter 13 petition. Whether Agricann is currently actively engaged in growing or selling marijuana is irrelevant, given that Agricann is a plaintiff in litigation seeking to recover damages consisting at least in part of profits lost as a result of breaches of contracts related to the growing and selling of marijuana. As such, any proceeds received from the litigation would represent profits from a business that is illegal under federal law.

The Burtons contend that the bankruptcy court should have held an evidentiary hearing to determine the true nature of Agricann's operations and the value of the Burtons' interest in that entity, arguing that there was no evidence that it was involved in any of the activities prohibited by the CSA. But the bankruptcy court did not err in ruling on the evidence it had before it. It based its ruling on the undisputed fact that Agricann, in which the

Burtons held a membership interest, was a plaintiff in litigation seeking recovery for breaches of contract relating to growing and selling marijuana. The Burtons point to no disputed material factual issue, nor do they describe any evidence they would have presented to resolve any such issue.

In response to the court's OSC, the Burtons needed to produce evidence to satisfy the court that its ownership interest in Agricann was not cause for dismissal. The Burtons did not do so.<sup>11</sup> With respect to the value of the litigation, they provided only a foundationless, conclusory, and equivocal statement that they did not expect to receive any proceeds from the Agricann litigation after payment of a contingency fee and repayment of a litigation loan. This statement was far from a categorical \*640 denial that the claims had value, and the Burtons provided no details or documentary evidence to support it. While we cannot agree with the bankruptcy court's blanket assertion that Agricann's pursuit of these claims was indicative, per se, that they had value, in light of Agricann's undoubted legal obligation under the litigation funding agreement fully to pursue the claims, we discern no evidentiary support in the record for the Burtons' assertions that the litigation would not result in their receipt of any litigation proceeds.

The Burtons' next arguments misconstrue the court's ruling. They argue that the bankruptcy court erred in concluding that they were involved in any business activities that violated the CSA, such as manufacturing, distributing, or dispensing marijuana. They also contend that dismissal was not warranted because they did not propose to fund their plan with proceeds generated by the illegal marijuana business. But the court's ruling was not based on those factors; its concern was that any litigation recovery entering the bankruptcy estate would constitute proceeds from a federally prohibited business, regardless of whether or not the business was still engaged in activities prohibited by the CSA.

The Burtons also argue that the bankruptcy court was not required to dismiss their case, citing *In re Johnson* and *In re McGinnis*, 453 B.R. 770 (Bankr. D. Or. 2011). In *Johnson*, the bankruptcy court permitted a debtor to remain in chapter 13 on condition that he discontinue growing, selling, and transferring marijuana and cease using property of the estate to further the marijuana business. *Johnson*, 532 B.R. at 58. And in *McGinnis*, the court stated that if the debtor could propose a plan meeting the requirements of the bankruptcy code, it was prepared to allow its confirmation. *McGinnis*, 453 B.R. at 773.

But the Burtons read too much into these cases. Although it is true that a bankruptcy court has broad discretion in deciding whether to dismiss a case, a particular court's signal that it might permit a case to continue under certain circumstances does not create a rule that all bankruptcy courts must, in every instance, permit a debtor with ties to the marijuana business to stay in bankruptcy. To the extent a court has discretion to decline to dismiss such a case, that result would seem appropriate only if the case were otherwise in compliance with the Code and rules. Here, there were numerous unresolved issues that would have supported dismissal but that did not arise out of the Burtons' connections with the marijuana business. For example, the Burtons' eligibility for chapter 13 was called into question when Stratton Restoration filed a proof of claim for \$2.4 million, and, although the case was pending over a year, the Burtons had failed to propose a confirmable plan.

Finally, the Burtons argue that Congress deliberately chose not to impose limitations on the ability of medical marijuana businesses to file for bankruptcy. In support, they point to § 362(b)(23), which excepts from the automatic stay an eviction action seeking possession of a residential property where the tenant is engaging in the illegal use of controlled substances. This argument was

not raised before the bankruptcy court, and in any event reflects a complete misreading of the cited statute. We need not address it further. [🚩 Roberts v. Erhard \(In re Roberts\)](#), 331 B.R. 876, 881 (9th Cir. BAP 2005).

## CONCLUSION

The Burtons failed to demonstrate that their ties to Agricann would not result in proceeds of an illegal business becoming part of the bankruptcy estate, requiring [\\*641](#) the trustee and the court to administer assets that constitute proceeds of activity criminalized by the CSA. Under the facts presented, the bankruptcy court did not abuse its discretion in dismissing the case for that reason. Accordingly, we AFFIRM.

## All Citations

610 B.R. 633, 68 Bankr.Ct.Dec. 52, 21 Cal. Daily Op. Serv. 6041, 2020 Daily Journal D.A.R. 240

## Footnotes

- <sup>1</sup> Unless specified otherwise, all chapter and section references are to the Bankruptcy Code, [🚩 11 U.S.C. §§ 101-1532](#).
- <sup>2</sup> The other LLC membership interests included on original and amended Schedule A/B were as follows: (1) a 70% interest in 363, LLC; (2) a 100% interest in 363 Business Alliance, LLC; (3) a 50% interest in Natural Agriculture, LLC; and (4) a 100% interest in Carly Rae Burton, PLLC. The Burtons also listed entities that they had owned but which they contended were "inactive, insolvent and [had] no assets." Those entities were: Zyrex, LLC, Burton Partners, LLC, Eleava, LLC, B & B Businesses, LLC, Nestaba, LLC. Finally, they disclosed a "de minimus" (less than 20%) interest in Twenty Sixth Ave Ventures, LLC.
- <sup>3</sup> We have exercised our discretion to review the bankruptcy court's electronic docket and pleadings. See [🚩 O'Rourke v. Seaboard Sur. Co. \(In re E.R. Fegert, Inc.\)](#), 887 F.2d 955, 957-58 (9th Cir. 1989); [🚩 Atwood v. Chase Manhattan Mortg. Co. \(In re Atwood\)](#), 293 B.R. 227, 233 n.9 (9th Cir. BAP 2003).
- <sup>4</sup> The Burtons' Second Amended Plan filed January 6, 2019, drew an objection from creditor Kevin Erdmann on grounds of: (1) lack of good faith; and (2) failure to pledge all disposable income (based on an allegation that Debtors had not disclosed income from their business entities). The chapter 13 trustee, John Maney ("Trustee"), filed an Evaluation and Recommendation indicating that the plan was not ready for

confirmation for numerous reasons, including the unresolved Erdmann objection and the fact that the Debtors' general unsecured debts of \$2.5 million reflected on the claims register were well over the chapter 13 debt limits. Trustee also required Debtors to provide documentation of a value for all of the Debtors' businesses listed on amended Schedule B.

- 5 Attached to the motion to compel abandonment (but not included with the response to the OSC) was a spreadsheet entitled "Agricann, LLC Financial Information" that purported to show the expected recovery from the litigation. Although difficult to decipher, the spreadsheet does not seem to support the Burtons' assertion that the litigation is worthless. The spreadsheet shows, as of March 2019, a potential gross recovery of \$31,285,273.45, reduced to a net of \$18,771,164.07 after deducting a 40 % contingency fee, with a litigation loan balance of \$15,731,993.03. This leaves a final net figure of over \$3 million. The spreadsheet then projects that the litigation loan balance would be nearly \$21 million by June 2019, but there is no explanation or backup documentation regarding the source of these figures. In any event, the bankruptcy court never ruled on the motion to compel abandonment.
  
- 6 On the eve of the hearing, Stratton Restoration had filed a 35-page (including exhibits) document entitled "Creditor Stratton Restoration, LLC's Supplemental Evidence Regarding Debtors' Bad Faith Filings," to which it attached documents that it argued showed that (1) Mr. Burton has an interest in an entity called Green Tree Alliance, LLC (which had paid the Burtons' chapter 13 counsel's fees), which had been set up using other LLCs so as to hide the Burtons' interest in that entity; and (2) the Burtons had set up a GoFundMe page during the bankruptcy case that explicitly told donors that due to their bankruptcy, the Burtons could not receive funds directly and so funds would go to a member of their church who had agreed to be the "Shepard [sic] of the funds."
  
- 7 In fact, there **was** evidence that the Burtons held an interest in another entity that was involved in the marijuana business. Stratton Restoration attached to its response to the OSC a copy of a deposition transcript from a January 30, 2017, judgment debtor exam in state court litigation between Mr. Erdmann and the Burtons, in which Mr. Burton testified that Natural Agriculture, LLC, in which Debtors held a 50% membership interest, was engaged in the medical marijuana business.
  
- 8 The sole issue before the Ninth Circuit in [Garvin](#) was whether the plan at issue violated § 1129(a)(3)'s requirement that a chapter 11 plan be proposed "not by any means forbidden by law." The Circuit held that § 1129(a)(3) directs courts to look only to the proposal of a plan, not its terms. [Garvin](#), 922 F.3d at 1035 (citing [Irving Tanning Co. v. Me. Superintendent of Ins. \(In re Irving Tanning Co.\)](#), 496 B.R. 644, 660 (1st Cir. BAP 2013)). The Circuit specifically rejected the notion that § 1129(a)(3) forecloses confirmation of a plan that relies on income from criminal activity, as held by some bankruptcy courts considering whether to dismiss a case based on a debtor's involvement in the marijuana business. [Id.](#) The court acknowledged that there may be consequences arising from a debtor's connections with criminal activity, but denial of confirmation under § 1129(a)(3) is not one of them. See [id.](#) at 1036.
  
- 9 The Ninth Circuit appears to have rejected this line of reasoning, at least as it pertains to plan confirmation. See [Garvin](#), 922 F.3d at 1036 n.3 (noting that the good faith confirmation requirement pertains to a plan's **proposal**, not its contents).

## 2023 BANKRUPTCY BATTLEGROUND WEST

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- <sup>10</sup> Trustee assumes on appeal that the bankruptcy court dismissed the case for bad faith. To the contrary, the bankruptcy court made no bad faith finding, instead determining that the Burtons' connection with the marijuana business in the circumstances presented here was itself "cause" for dismissal.
- <sup>11</sup> We note that the bankruptcy court found not credible the Burtons' assertion that Agricann's litigation claims were worthless. Ordinarily, credibility determinations are not proper absent an evidentiary hearing. However, we interpret the bankruptcy court's credibility determination (to which the Burtons do not assign error) as a finding that the Burtons did not meet their burden of proof.

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644 B.R. 220  
United States Bankruptcy Court, D. Colorado.

IN RE: Michael J. ROBERTS, Sr. SSN/EIN:  
XXX-XX-XXXX, Debtor.

Case No. 22-10521-JGR  
|  
Signed September 23, 2022

**Synopsis**

**Background:** Creditors filed motion to convert Chapter 11 case to Chapter 7, and debtor objected.

**Holdings:** The Bankruptcy Court, Joseph G. Rosania, J., held that:

[1] debtor filed case in bad faith, and thus there was cause for dismissal or conversion;

[2] debtor’s alleged ownership interests in cannabis-related companies did not compel dismissal of case; and

[3] conversion, and appointment of trustee, was in best interests of creditors.

Motion granted.

**Procedural Posture(s):** Motion to Convert or Dismiss Case.

West Headnotes (9)

[1] **Bankruptcy** — In General; Grounds in General

Dismissal or conversion of a Chapter 11 case is a two-step process: a bankruptcy court must determine if cause exists for dismissal or conversion, and if so, the court then must determine whether dismissal or conversion of the case is in the best interest of creditors and the estate. 11 U.S.C.A. § 1112(b)(1).

[2] **Bankruptcy** — “Bad faith.”

Chapter 11 cases vary widely and do not lend themselves to a cookie cutter approach to analyzing the bad faith of a bankruptcy filing.

[3] **Bankruptcy** — “Bad faith.”

Bad faith, in the context of a Chapter 11 filing as in most other bankruptcy contexts, is always determined on a case by case basis.

[4] **Bankruptcy** — Proceedings

The movant for dismissal or conversion of a Chapter 11 case bears the burden of establishing cause by a preponderance of the evidence. 11 U.S.C.A. § 1112(b)(1).

[5] **Bankruptcy** — Proceedings

Once cause is demonstrated for dismissal or conversion of a Chapter 11 case, the burden shifts to the opposing party to prove unusual circumstances establishing that converting or dismissing the case is not in the best interest of creditors and the estate. 11 U.S.C.A. § 1112(b)(2).

[6] **Bankruptcy** — Discretion

A bankruptcy court has broad discretion to either grant or deny a request for dismissal or conversion of a Chapter 11 case. 🚩 11 U.S.C.A. § 1112(b).

[7] **Bankruptcy** 🚩 Abuse of judicial process

Chapter 11 debtor filed case in bad faith, and thus there was cause for dismissal or conversion; case was filed on eve of state court damages hearing in order to stay hearing and obtain debtor's release from jail without purging state court's civil contempt orders, and case was filed to re-litigate and invalidate state court's judgments, manipulate judicial system, and regain control of debtor's property. 🚩 11 U.S.C.A. § 1112(b).

[8] **Bankruptcy** 🚩 In General; Grounds in General

Chapter 11 debtor's alleged ownership interests in cannabis-related companies did not compel dismissal of case, rather than conversion to Chapter 7, upon bankruptcy court's finding that case was filed in bad faith; though debtor's conduct may have violated Controlled Substances Act (CSA) and it would be illegal for appointed trustee to administer debtor's purported cannabis-related assets, there was not enough information for court to discern extent of debtor's connections to cannabis, as he owned interests in businesses that had amorphous investments in cannabis industry, and, importantly, United States Trustee did not object to conversion, since Trustee could later seek dismissal of case once converted to Chapter 7 depending on cannabis entanglements. 🚩 11 U.S.C.A. § 1112(b).

[9] **Bankruptcy** 🚩 Abuse of judicial process

Conversion of Chapter 11 case to Chapter 7 liquidation, and appointment of trustee, was in best interests of creditors, upon finding that debtor had filed case in bad-faith; debtor engaged in prepetition litigation misconduct, failed to present excuse for noncompliance with court orders, and exhibited utter disregard for valid orders of state court, and attempted to alter outcome of his financial affairs via bankruptcy filing. 🚩 11 U.S.C.A. § 1112(b).

**Attorneys and Law Firms**

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Michael T. Gilbert, Brenton L. Gragg, Allen Vellone Wolf Helfrich & Factor PC, Denver, CO, Jennifer Schlatter, Denver, CO, for Trustee.

Paul Moss, Byron G. Rogers Federal Building, Denver, CO, for U.S. Trustee.

**ORDER CONVERTING CHAPTER 11 CASE TO CHAPTER 7**

Joseph G. Rosania, Jr., United States Bankruptcy Judge

This matter is before the Court on the Motion to Convert Chapter 11 Case to Chapter 7 (Doc. 149; "Motion") filed by PdC, LLC; Timothy Flaherty; Timothy Kneen; and Riviera Country Club, S. de R.L. de C.V. (collectively, "PdC Creditors") on May 6, 2022, and Debtor's Objection and Response in Opposition thereto (Doc. 175; "Response") filed by Debtor Michael Roberts, Sr. on May 20, 2022. On June 29-30, 2022, the Court held an evidentiary hearing on this matter. Following the hearing,

the parties submitted proposed findings of fact and conclusions of law. Having considered the parties' submissions, the evidence presented to the Court, and being otherwise fully advised in the premises, the Court makes the following findings and conclusions.

## INTRODUCTION

Roberts is an individual investor who has been engaged in litigation with the PdC Creditors for at least four years. He filed this case while in jail for civil contempt of the Denver District Court. As a result of other orders entered by the Denver District Court, the PdC Creditors hold a writ of attachment on substantially all of Roberts' assets and an injunction prohibiting Roberts from conveying, transferring, encumbering, selling, disposing, or otherwise affecting the location or ownership of any of the assets. Roberts filed his Chapter 11 case on the eve of a damages hearing in the Denver District Court, shortly after he filed a motion to continue the damages hearing for the third time but before the Denver District Court ruled on the motion.

## BACKGROUND

### I. Assets and Liabilities

Roberts testified and filed Schedules A and B asserting he owns, directly or indirectly \*222 through wholly owned entities, assets of approximately \$53 million. Such assets include a home in Boulder valued at \$5.278 million; artwork; a vintage car collection; cabins in Ferncliffe, Colorado; undeveloped lots in Hawaii, Costa Rica, and Mackinac Island; a coffee business in Hawaii; and an office building in Boulder. Of particular note here, Roberts has a 33% ownership interest in PdC, LLC and a 100% ownership interest in Ciro Properties, LLC. As of this writing, entities controlled by Roberts have recently sold, or are in the process of selling, substantial items of Roberts' claimed assets, including Hawaiian property and the office building in Boulder. Additionally, certain creditors recently received a comfort order to foreclose on other Hawaiian property titled in the name of an entity wholly owned by Roberts without the hindrance of the automatic stay. However, the proceeds from these sales are subject to a writ of attachment in favor of the PdC Creditors. Roberts' only consensual secured debt is represented by two mortgages totaling approximately

\$700,000 encumbering his home in Boulder, which have remained current. His unsecured debts consist of two categories: credit card debt of \$88,000 and attorney's fees and expenses for his various counsel totaling \$1.58 million. His debts arising out of the litigation with the PdC Creditors have been set by the state court at \$21 million, with further hearings to be conducted to increase the damages. Roberts is an investor who is not employed and does not receive W-2 income.

He filed his first proposed Chapter 11 plan of reorganization on May 19, 2022. Due to the pending Motion, the Court has not set dates for voting on, objecting to, or holding a hearing on plan confirmation.

### II. State Court Litigation

Roberts, creditor Timothy Flaherty, and creditor Timothy Kneen were the three members and managers of a Colorado entity, PdC, LLC, which was formed to purchase and develop beachfront land in Mexico near Playa del Carmen, Quintana Roo. Because Mexican law does not allow foreign nationals to directly own land on Mexico's coast, the venture was to be carried out via a Mexican subsidiary of PdC, Riviera Country Club, S. de R.L. de C.V. ("RCC"), beginning in 2007. Like PdC, RCC's three managers were Flaherty, Kneen, and Roberts. PdC acquired its first parcel of Mexican land, known as "Serenio I" for \$8 million in 2006. Another entity, TMTBC, LLC—also owned by Flaherty, Kneen, and Roberts—obtained a neighboring property, referred to as the "Beach House," in 2008. Finally, in 2012, RCC acquired two parcels next to Serenio I, known as "Serenio II" and "Serenio III," (sometimes referred to as the "Mustapha Properties") for \$11.5 million. In this transaction, \$6 million was paid outright, with the remaining \$5.5 million subject to a lien held by a Spanish entity, Hoteles Turisticos Unidos, S.A. ("Hotusa"). At the time of RCC's purchase of Serenio II and Serenio III, the properties were subject to foreclosure litigation initiated by Hotusa. After purchasing Serenio II and Serenio III, RCC signed a settlement agreement with Hotusa by which Hotusa agreed to release its lien in exchange for \$6.5 million.

RCC made an initial payment of \$1 million to Hotusa, funded by two \$500,000 loans, one each from Flaherty and Kneen. While RCC tried to come up with the remaining funds, it made several extension payments delaying payment of the final \$5.5 million through December 31, 2016. During this time, Roberts contemplated in a note to himself whether he "could skirt

RCC and sign away their rights and position by using [his] power of attorney?” Ex. 44 ¶¶ 16, 31. After sources of external \*223 funding did not materialize, Flaherty agreed to loan the \$5.5 million (using funds he readily had available) to PdC to satisfy RCC’s final payment to Hotusa. Roberts objected, instead offering to source RCC’s \$5.5 million himself, subject to certain conditions that included the right to pursue development of the property for six months rather than immediately offering it for sale (as planned by Flaherty and Kneen). After Flaherty and Kneen agreed to Roberts’ plan, instead of making the \$5.5 million payment on behalf of PdC or RCC, he fraudulently granted a power of attorney on RCC’s behalf—without Flaherty or Kneen’s knowledge or permission—to his personal attorney in Mexico, who then ratified a settlement agreement in the Mexican courts effectuating Roberts’ personal acquisition of the Sereno II and Sereno III lien from Hotusa. Roberts then attempted to foreclose on Sereno II and Sereno III and hired armed guards to take physical possession of all the Mexican properties: the Beach House and Serenos I, II, and III. These guards denied access to Flaherty, Kneen, and PdC’s agents. By attempting to foreclose on Sereno II and Sereno III for himself at the expense of RCC and PdC, Roberts’ actions violated his “fiduciary duties to PdC and its stakeholders by violating his duty of loyalty and engaging in intentional misconduct.” Ex. 44 ¶ 66.

As a result of the aforementioned events, in 2018 the PdC Creditors filed cross claims and a third-party complaint against Roberts and two of his entities in an existing Denver District Court lawsuit that had been filed against the PdC Creditors by creditor Richard Lang. This litigation occurred concurrently with other litigation in Mexico, wherein Roberts claims to have prevailed and cemented his sole legal rights to the Hotusa lien. In the Denver District Court, the PdC Creditors alleged that Roberts engaged in a fraudulent scheme to misappropriate the rights of his partners in the Mexican land venture. Roberts has claimed that the Denver District Court lacks subject matter jurisdiction over these disputes because RCC’s Articles of Incorporation contain a clause that any disputes about the Mexican projects are subject to the exclusive jurisdiction of the Mexican courts. The Denver District Court has rejected this argument on multiple occasions. *See, e.g.*, Ex. 44 ¶ 58.

On January 24, 2019, the PdC Creditors obtained a preliminary injunction against Roberts after a full day evidentiary hearing in front of Denver District Judge Plotz, enjoining Roberts from taking any further action to misappropriate PdC property in Mexico. Ex. 4. Roberts defied the preliminary injunction by, among other actions, transferring his interest in the Hotusa lien (on Sereno II

and Sereno III) to a Mexican entity he controlled, Logistics Desarrollos Publicitarios e Inmobiliarios (“Logistics”) in July 2019. Roberts then transferred his interest in Logistics to two Mexican nationals for no consideration, effectively transferring “legal control over the properties to persons beyond the jurisdiction of [the Denver District Court].” Ex. 44 ¶ 53. After Roberts ignored the preliminary injunction, the PdC Creditors filed a motion for contempt.

On January 6, 2020, after another full day evidentiary hearing, Denver District Judge Johnson entered a contempt order requiring Roberts to be jailed and pay a fine of \$1,000 per day until his contempt was purged. Ex. 7. Following the entry of the contempt order, on January 24, 2020, Judge Johnson conducted a trial on the merits and on June 19, 2020, entered a judgment against Roberts finding he had breached his fiduciary duty to the PdC Creditors in executing the secret and fraudulent scheme to take Hotusa’s position for himself. Ex. 8.

\*224 Then, on August 28, 2020, based upon Roberts’ failure to comply with the preliminary injunction or contempt order, Judge Johnson granted the PdC Creditors an *ex parte* attachment to freeze Roberts’ assets and ordered Roberts to be taken into custody for contempt. Ex. 14.

Next, on October 20, 2020, Judge Johnson entered a discovery sanctions order striking all of Roberts’ defenses, dismissing his answer to cross claims and his counter cross claims, precluding him from introducing evidence he had failed to produce, and entering default in favor of the PdC Creditors and against Roberts on all claims. Ex. 15. The Denver District Court set a damages hearing for December 21, 2020, which was continued not once, but twice.

After another full day evidentiary hearing on August 6, 2021, Denver District Judge Moses remanded Roberts to be incarcerated until he complied with the outstanding orders of the Court and remedied his misappropriation of the Mexican property. Ex. 23. Roberts was released two weeks after his incarceration, but Judge Moses had Roberts jailed again when he failed to purge his contempt. On October 6, 2021, in upholding the previously issued writ of attachment, Judge Moses found that Roberts concealed himself and his assets, thereby avoiding service of process, defying court orders, and acting with an intent to hinder or delay his creditors. Ex. 24. Judge Moses set the damages hearing for February 22, 2022, the third time this hearing was scheduled, but Roberts filed bankruptcy on February 18, 2022, resulting in yet another postponement of the damages hearing. The bankruptcy

filing also effectuated his release from jail even though he had not purged his remedial contempt and was still in violation of Denver District Court orders.

### III. Bankruptcy Litigation

#### A. Relief from Stay

The PdC Creditors have twice obtained relief from stay during the pendency of Roberts' bankruptcy case.

First, the PdC Creditors obtained relief from stay on March 25, 2022, over Roberts' objection, to conduct the damages trial in the Denver District Court case. On June 23, 2022, Judge Moses entered a detailed 32-page damages award in favor of the PdC Creditors and against Roberts for a total of \$10,456,162 in actual damages, \$5,500,000 in exemplary damages, and \$5,168,824 in prejudgment interest on actual damages. Ex. 44. She also awarded attorney's fees and expenses, in an amount to be determined. Judge Moses' damages order—like many earlier orders of the Denver District Court—detailed numerous instances of Roberts' bad conduct, including disobeying court orders, defrauding investors, and lying under oath. Judge Moses found that Roberts' actions prevented Kneen and Flaherty from selling all four properties as a bundle. When Flaherty and Kneen finally decided to sell Sereno I by itself in 2021, it was at a lower price than if they had sold it, as they had hoped, in 2017. As to Sereno II and Sereno III, Judge Moses concluded that Roberts caused a total loss to the PdC creditors.

At the hearing on the Motion in the Bankruptcy Court, Roberts' counsel argued that because of Roberts' ownership interests and investments in PdC, Roberts is entitled to more than half of the Denver District Court's \$21 million judgment against him and in favor of the PdC Creditors. Roberts also argues that he is entitled to a large sum (in excess of 68% of \$40 million) on behalf of his entity, *Ciro Properties*, which has filed an adversary proceeding in this Court (discussed below). The PdC Creditors argue that Roberts is \*225 not entitled to any of their favorable Denver District Court judgment because Judge Moses already set-off Roberts' \$5.5 million paid for the Hotusa lien. The PdC Creditors also argue that they might be entitled to future profits from the Mexican properties under Colorado law on breach of fiduciary duty. The PdC Creditors argue that these set off issues should and will be decided by the Denver District Court.

Second, on May 12, 2022, the PdC Creditors obtained relief from stay to proceed in state court to enforce the previous orders of the Denver District Court related to the preliminary injunction, writ of attachment, and civil contempt order.

#### B. Adversary Proceedings

Roberts has filed three adversary proceedings since the filing of the bankruptcy case:

(1) *Roberts v. Riviera Country Club S. de R.L. de C.V.*, Case No. 22-1052-JGR, which, in the view of this Court, seeks to relitigate issues already decided by the Denver District Court, namely by seeking recognition of the result of the Mexico litigation. The PdC Creditors have moved to dismiss this action on the bases of lack of subject matter jurisdiction; res judicata and collateral estoppel; and the Rooker-Feldman doctrine. The Court entered a stay of this Adversary Proceeding on June 1, 2022, pending the outcome of the Motion to Convert.

(2) *Ciro Properties, LLC v. PdC, LLC*, Case No. 22-1137-JGR, which is an attempted removal by Roberts of a state district court civil action to which he is not a party. The state court action was filed in Arapahoe County and subsequently ordered consolidated with the pending Denver District Court litigation. The PdC Creditors have moved the Court to remand this Adversary Proceeding back to the Denver District Court. The Court entered a stay of this Adversary Proceeding on June 1, 2022, pending the outcome of the Motion to Convert.

(3) *Roberts v. Almazan*, Case No. 22-1133-JGR, which is an avoidance action against two Mexican Nationals to recover Roberts' interest in Logistics that he consensually transferred for no consideration as part of his fraudulent scheme. As of the date of this writing, this Adversary Proceeding has been pending for over five months, yet Roberts has not served the defendants with process. The Court has not stayed this Adversary Proceeding pending the outcome of the Motion to Convert.

#### C. Motion to Convert or Dismiss

Movants, the PdC Creditors, claim that Roberts filed the

Chapter 11 case in bad faith and it should be converted to a liquidation case under Chapter 7 to be administered by a Chapter 7 trustee. They claim he filed the bankruptcy case under Subchapter V of the Bankruptcy Code on the eve of the damages hearing to delay the hearing, get out of jail, and avoid having the judgments of the PdC creditors liquidated. The PdC Creditors argue this bad faith results in his ineligibility to be a debtor under Subchapter V. They also claim the filing of the three adversary proceedings was in bad faith because they seek to relitigate issues either previously decided or over which the bankruptcy court lacks jurisdiction. They also claim his bad faith is evidenced by filing a plan of reorganization which contains terms contrary to the judgments of the Denver District \*226 Court, that he intends to initiate claims objections against the PdC Creditors even though the Denver District Court has ruled on those issues, and that he has significant assets that should be liquidated to pay creditors rather than engaging in prolonged litigation. At bottom, they claim this is, in essence, a two-party dispute which is more appropriately resolved by the Denver District Court and that Roberts is seeking a second “bite at the apple” by filing the bankruptcy case and adversary proceedings. Finally, they assert Roberts’ pre-petition litigation misconduct and disregard of lawful orders of the Denver District Court prohibits him from being a Chapter 11 debtor-in-possession and in control of his assets.

Roberts argues that it is proper, and common, to file a bankruptcy petition when faced with an impending judgment. He claims that the Court should ignore the previous protracted litigation in state court—including four evidentiary hearings and his unsuccessful appeals therefrom—and focus on his alleged good faith post-petition conduct as a debtor-in-possession in control of his assets. Roberts intends to continue litigating with the PdC Creditors and use the damages he recovers from the PdC Creditors, and sale and reinvestment of the proceeds of his non-exempt assets, to fund his 100% repayment Chapter 11 plan. While Roberts argues that it is premature to analyze the legitimacy of his proposed plan, he also argues that his plan has a reasonable likelihood of being confirmed, and that he satisfies 11 U.S.C. § 1112(b)’s test for preventing conversion or dismissal. As a last-ditch argument, Roberts argues that if cause for conversion or dismissal exists, his case must be dismissed because his assets include investments in cannabis companies that would become property of the estate in a Chapter 7 case.

Roberts was the only witness at the hearing. He was regularly evasive and nonresponsive on cross-examination. The Court agrees with the assessment

of Roberts’ lack of credibility made previously by three Denver District Court judges.

### LEGAL STANDARDS

This Court has jurisdiction over this Chapter 11 case pursuant to 28 U.S.C. §§ 157(a) and (b) and 1334(a) and (b). This matter constitutes a core proceeding under 28 U.S.C. § 157(b)(2)(A) and (O), as it is a proceeding to convert the Roberts Bankruptcy Case to Chapter 7. Venue is proper in this Court pursuant to 28 U.S.C. §§ 1408 and 1409.

Section 1112(b)(1) of the Bankruptcy Code provides:

Except as provided in paragraph (2) and subsection (c), on request of a party in interest, and after notice and a hearing, the court shall convert a case under this chapter to a case under chapter 7, or dismiss a case under this chapter, whichever is in the best interest of creditors and the estate, for cause unless the court determines that the appointment under section 1104(a) of a trustee or an examiner is in the best interests of creditors and the estate.

<sup>11</sup>Dismissal or conversion under this section is a two-step process. The Court must determine if cause exists for dismissal or conversion. If so, the Court then must determine whether dismissal or conversion of the case is in the best interest of creditors and the estate. *In re Peak Serum, Inc.*, 623 B.R. 609, 619 (Bankr. D. Colo. 2020) (citing *In re OptInRealBig.com, LLC*, 345 B.R. 277, 282 (Bankr. D. Colo. 2006)).

Section 1112(b)(4) sets forth a non-exclusive list of 16 factors that may constitute cause under 11 U.S.C. § 1112(b)(1). “While \*227 bad faith is not an enumerated factor under § 1112(b), [i]t is well established under the Bankruptcy Code, as it was under the Bankruptcy Act, that a Chapter 11 Petition must be filed in good faith ....” *In re Springs Hosp., Inc.*, 2006 WL 2458679, at \*3,

2006 Bankr. LEXIS 1804, at \*8-9 (Bankr. D. Colo. Aug. 22, 2006) (citing [Pacific Rim Invs., LLP v. Oriam, LLC](#) (In re *Pacific Rim Invs., LLP*), 243 B.R. 768, 771 (D. Colo. 2000)).

<sup>[2]</sup> <sup>[3]</sup> <sup>[4]</sup> <sup>[5]</sup>“Chapter 11 cases vary widely and do not lend themselves to a cookie cutter approach to analyzing the bad faith of a bankruptcy filing. As a consequence, bad faith, in the context of a chapter 11 filing as in most other bankruptcy contexts, is always determined on a case by case basis.” *Id.* at \*3, 2006 Bankr. LEXIS 1804, at \*9. The movant bears the burden of establishing cause by a preponderance of the evidence. Once cause is demonstrated, the burden shifts to the opposing party to prove “unusual circumstances” establishing that converting or dismissing the case is not in the best interest of creditors and the estate. [11 U.S.C. § 1112\(b\)\(2\)](#); *In re Whetten*, 473 B.R. 380, 382 (Bankr. D. Colo. 2012).

<sup>[6]</sup>“When presented with a request for dismissal or conversion under [Section 1112\(b\)](#), case law and congressional intent make it clear that a bankruptcy court has broad discretion to either grant or deny such relief. The Tenth Circuit has stated in unequivocal terms that a bankruptcy court is to be afforded broad discretion under [Section 1112\(b\)](#).” [In re Western Pac. Airlines](#), 218 B.R. 590, 593-94 (Bankr. D. Colo. 1998) (citing [Small Business Admin. v. Preferred Door Co., Inc.](#), (In re *Preferred Door Co., Inc.*) 990 F.2d 547, 549 (10th Cir. 1993)).

## ANALYSIS

### I. Bad Faith Factors

<sup>[7]</sup>In [Udall v. FDIC](#) (In re *Nursery Land Dev.*), 91 F.3d 1414 (10th Cir. 1996), the Tenth Circuit affirmed the bankruptcy court’s imposition of sanctions for filing a Chapter 11 case in bad faith. The Tenth Circuit affirmed the bankruptcy court’s finding that the debtor lacked a realistic possibility of reorganization. Further, the bankruptcy court’s conclusion that the specific purpose of the filing was to frustrate legitimate efforts to enforce creditor rights to foreclose was amply supported by numerous indicia that constitute classic badges of bad faith. The Tenth Circuit enumerated those factors as:

Nursery Land (1) has only one asset; (2) has only one creditor; (3) acquired property which was posted for foreclosure and the prior owners had been unsuccessful in defending against the foreclosure; (4) was revitalized on the eve of foreclosure to acquire the insolvent property; (5) has no ongoing business or employees; and (6) lacks a reasonable possibility of reorganization, and (7) the Chapter 11 filing stopped the foreclosure.

[Id.](#) at 1416 (citations omitted).

These factors applied to the facts in [Nursery Land](#) but, despite Roberts’ arguments to the contrary, they do not establish a definitive test for a finding of bad faith. In fact, when enumerating these factors, [Nursery Land](#) cited three other cases concerning bad faith Chapter 11 filings, including [In re Laguna Associates Ltd. Partn.](#), 30 F.3d 734, 738 (6th Cir. 1994), which set forth the following factors as helpful in analyzing a Chapter 11 debtor’s good faith:

- (1) the debtor has one asset;
- (2) the pre-petition conduct of the debtor has been improper;
- \*228 (3) there are only a few unsecured creditors;
- (4) the debtor’s property has been posted for foreclosure, and the debtor has been unsuccessful in defending against the foreclosure in state court;
- (5) the debtor and one creditor have proceeded to a standstill in state court litigation, and the debtor has lost or has been required to post a bond which it cannot afford;
- (6) the filing of the petition effectively allows the debtor to evade court orders;
- (7) the debtor has no ongoing business or employees; and
- (8) the lack of possibility of reorganization.

Except for the first factor, the remaining seven [Laguna](#) factors are instructive here:

(2) Pre-petition, Roberts committed fraud and breached his fiduciary duties; lied under oath multiple times; and disobeyed direct orders of the Denver District Court.

(3) Although the more than \$21 million in judgments owed to the PdC Creditors is secured by a pre-judgment writ of attachment, the writ of attachment only issued because of Roberts' improper conduct. *See* Denver District Court Order Re: July 23, 2021 Hearing on Traverse of August 20, 2020 Writ of Attachment (October 6, 2021). But for Roberts' improper prepetition conduct, the PdC creditors would be Roberts' only significant unsecured creditor. While Roberts owes approximately \$1.5 million in unsecured debt to other creditors, nearly all of these unsecured debts are for legal fees for litigation with the PdC Creditors and living expenses while his assets were frozen by the Denver District Court.

(4) Although not posted for foreclosure, Roberts' property has been attached to satisfy his creditors—the same function as a foreclosure—and Roberts has been unsuccessful in defending against the attachment in state court.

(5) Roberts filed this Chapter 11 case on the eve of the damages hearing that had been continued three times. He had already lost on the merits and was facing multiple millions of dollars in judgments against him. These judgments were eventually liquidated in excess of \$21 million and will grow even larger.

(6) Roberts filed for bankruptcy while in jail for civil contempt for disobeying Denver District Court orders and after filing two federal habeas corpus petitions. One was denied and another was pending when he filed his bankruptcy petition. Doc. 104 at 9 n.4. His bankruptcy petition secured his prompt release from jail without purging his contempt. Approximately three months after the case was filed, on May 12, 2022, the Court found that the automatic stay does not apply to the Denver District Court's contempt and enforcement proceedings against Roberts. The Court lacks complete knowledge of the extent to which the Denver District Court contempt and enforcement orders (of which there are several) are currently being enforced but notes that Roberts appeared in-person at the hearing on June 29-30, 2022, and the Court has not been informed that he has been remanded to custody.

\*229 (7) Roberts is an individual investor who has

no ongoing business or employees.

(8) As touched on above, Roberts' Chapter 11 plan involves reinvesting his assets into income-producing ventures. He proposes to pay unsecured creditors (among which he included the PdC Creditors) approximately \$2 million over five years, and then to pay the balance via a balloon payment of approximately \$22 million, which will be funded by a liquidation of property. The Court questions whether Roberts' plan is feasible and proposed by means not forbidden by law (in contravention of orders of the Denver District Court), and therefore whether the plan is confirmable under 11 U.S.C. § 1191 and the applicable subsections of 11 U.S.C. § 1129.

After reviewing these factors, the Court concludes Roberts filed this Chapter 11 case in bad faith. In fact, this case presents a textbook example of a bad faith bankruptcy filing. It was filed on the eve of a state court damages hearing in order to stay the hearing and obtain release from jail without purging the Denver District Court's civil contempt orders. It is a two-party case. The credit card debt was substantially incurred due to the asset freeze. The attorney's fees were incurred to litigate with the PdC Creditors in a Mexican court, the Denver District Court, the Arapahoe County District Court, the Colorado Court of Appeals, and the Colorado Supreme Court. It was filed to re-litigate and invalidate the judgments of the Denver District Court, manipulate the judicial system, and seek to regain control of Roberts' property.

The plan relies on relitigating the losses in state court and liquidating non-exempt assets not to pay creditors but to re-invest in other income producing assets and pay the creditors through the income stream from such assets with a \$22 million balloon payment in five years.

## II. Cannabis

<sup>18]</sup>No better example of Roberts' lack of good faith can be found than with respect to his opposition to conversion.

Roberts claims interests in two cannabis-related companies. The first, Serovita Holding Corp., may not relate to cannabis at all. Roberts testified at the hearing that Serovita previously consulted in the marijuana industry in the past, but that he does not know if it does anymore. Not only is the nature of Serovita's business unknown, but so too is the amount of Roberts' interest in

the company. The second cannabis-related company is Denver Packaging Company, LLC (“D-Pack”). According to Roberts’ hearing testimony, D-Pack is “a marijuana business.” However, the Court lacks any information about D-Pack’s daily business operations. While the Court is aware that Roberts’ 99%-owned entity, Sandstone Ventures, LLC, owns approximately 15-20% of D-Pack, the value of Roberts’ cannabis assets is unknown. In the liquidation analysis attached to Roberts’ first proposed plan, he values marijuana-related assets as worth \$2.2 million, but only \$265,000 if they are liquidated. In his proposed findings of fact submitted to the Court, Roberts appears to misquote his own liquidation analysis, representing instead that he has \$4 million worth of investments in companies whose operations involve marijuana.

Roberts voluntarily sought relief under Chapter 11 of the Bankruptcy Code, and has remained in Chapter 11 for seven-and-a-half months, with the knowledge of his interests in these companies. Nevertheless, Roberts argues that a Chapter 7 trustee \*230 cannot administer his cannabis-related assets (presumably because it would be illegal to do so) and therefore his case may not be converted to Chapter 7.

In making his argument, Roberts relies on [Marrama v. Citizens Bank of Massachusetts](#), 549 U.S. 365, 371-76, 127 S.Ct. 1105, 166 L.Ed.2d 956 (2007) and [In re Arenas](#), 535 B.R. 845, 845 (10th Cir. BAP (Colo.) 2015). However, neither of those cases compel dismissal here.

In analyzing the interplay between [11 U.S.C. §§ 706](#) and [1307\(c\)](#) when a debtor seeks conversion of a Chapter 7 case to Chapter 13, the [Marrama](#) Court wrote:


In practical effect, a ruling that an individual’s Chapter 13 case should be dismissed or converted to Chapter 7 because of prepetition bad-faith conduct, including fraudulent acts committed in an earlier Chapter 7 proceeding, is tantamount to a ruling that the individual does not qualify as a debtor under Chapter 13. That individual, in other words, is not a member of the class of “ ‘honest but unfortunate debtor[s]’ ” that the bankruptcy laws were enacted to

protect.... The text of [§ 706\(d\)](#) therefore provides adequate authority for the denial of [the debtor’s] motion to convert.

[549 U.S. at 373-74](#), 127 S.Ct. 1105. [Marrama](#) involved a bad faith debtor seeking to convert his Chapter 7 case to Chapter 13 in order to wrest control of the bankruptcy estate away from the trustee and back to himself. In its opinion affirming the lower courts’ denial of conversion, the Supreme Court did not go so far as to require that the debtor’s Chapter 7 case be dismissed. To the contrary, the Supreme Court implicitly endorsed the principal that while bad faith may preclude a debtor from proceeding under Chapter 13, it does not necessarily require dismissal of his Chapter 7 case. Such reasoning also bears on a finding of bad faith Roberts’ case: he may either proceed in Chapter 7 or have his Chapter 11 case dismissed.

Both the Bankruptcy Code and the other case law interpreting it reinforce the proposition that a bad faith Chapter 11 case may either be dismissed or converted to Chapter 7. The list of constraints on conversion in [11 U.S.C. § 1112\(a\)](#) do not include bad faith. Additionally, numerous courts have found that “bad faith” is an unenumerated factor constituting cause under [11 U.S.C. § 1112\(b\)](#), which permits—but does not require—dismissal. See [In re Springs Hosp., Inc.](#), 2006 WL 2458679, at \*3, 2006 Bankr. LEXIS 1804, at \*8-9 (Bankr. D. Colo. Aug. 22, 2006). After all, the definition of “cause” under [11 U.S.C. § 1112\(b\)\(4\)](#) does not dictate what a court may do upon a finding of “cause.” That charge is found in [11 U.S.C. § 1112\(b\)\(1\)](#), which requires a court to “convert a case under this chapter to a case under chapter 7 or dismiss a case under this chapter, whichever is in the best interest of creditors and the estate ....” Accordingly, only one inquiry bears on whether this case should be dismissed or converted. It is not Roberts’ “bad faith,” but only what is in the best interest of creditors and the estate.

Roberts’ other case, [In re Arenas](#), specifically analyzes a cannabis issue. There, the Tenth Circuit Bankruptcy Appellate Panel (“BAP”) affirmed the denial of conversion, and the subsequent dismissal at the request of the United States Trustee, of a jointly filed Chapter 7 case in which the debtors grew marijuana in one unit of their building and leased the other unit to a marijuana dispensary. The BAP’s opinion relies heavily on the

bankruptcy court's finding that the debtors violated the federal Controlled Substances Act ("CSA"). Here, although Roberts' conduct may have violated the CSA, the Court lacks adequate information to analyze that question; \*231 there are simply not enough facts in the record. However, the Court notes that even based on the record, Roberts' connections to cannabis appear far more attenuated than those of the  *Arenas* debtors. He only owns interests in businesses that have amorphous investments in the cannabis industry. Importantly, the United States Trustee did not object to conversion in this case, but stated that it might later seek dismissal if the case is converted to Chapter 7, depending on the cannabis entanglements. If Roberts' connections to cannabis require dismissal, that issue will have to wait until a later date and more developed record.

As a final point on the cannabis issue, the Court is guided by the Ninth Circuit Bankruptcy Appellate Panel who, in reviewing cannabis cases, wrote that "the mere presence of marijuana near a bankruptcy case does not automatically prohibit a debtor from bankruptcy relief ... Instead, a bankruptcy court must be explicit in articulating its legal and factual bases for dismissal in cases involving marijuana" *In re Burton*, 610 B.R. 633, 637-38 (Bankr. App. 9th Cir. 2020). Because the Court cannot explicitly articulate its factual bases for a marijuana-based dismissal beyond an unacceptable level of speculation, the Court will not dismiss Roberts' case due to cannabis at this time but rather grant the PdC Creditors' Motion to Convert.

### CONCLUSION

<sup>191</sup>Roberts has engaged in a level of pre-petition litigation misconduct not previously seen by this Court. He never presented an excuse for noncompliance with court orders—or any efforts to show compliance—and exhibited utter disregard for valid orders of the Denver District Court. His bankruptcy filing attempts to alter not only the outcome of his financial affairs, but a bankruptcy outcome under which he never intends to purge his contempt of the Denver District Court. He seeks to wave a "magic wand" to sanitize his transgressions and remain in control of his assets as a fiduciary to his creditors for five more years. This case demands the swift appointment of a neutral third party in the form of a Chapter 7 trustee.

Therefore, the Court hereby

#### ORDERS:

1. PdC Creditors' Motion to Convert Chapter 11

Case to Chapter 7 is GRANTED. This Chapter 11 case is converted to a case under Chapter 7.

2. The United States Trustee is authorized appoint a Chapter 7 Trustee to administer the estate. Within 60 days after appointment, the Chapter 7 Trustee shall file status reports in each of the three adversary proceedings referenced on page 5 of this Order.


3. The Debtor in possession shall:

a. forthwith turn over to the Chapter 7 Trustee all records and property of the estate in its possession or control as required by *Fed. R. Bankr. P. 1019(4)*;

b. within 14 days of the date of entry of this order, file a schedule of all unpaid debts incurred after the commencement of the Chapter 11 case, including the name and address of each creditor, as required by *Fed. R. Bankr. P. 1019(5)*;

c. within 30 days following the entry of the order of conversion, file and transmit to the United States Trustee a final report and account.

d. within 15 days of the date of entry of this order, file the statements and schedules required by *Fed. R. Bankr. P. 1019(1)(A)* and *1007(b)*, if such documents have not already been filed.

e. within 30 days of the date of entry of this order, or before the first \*232 date set for the meeting of creditors, whichever is earlier, if required, file a statement of intention with respect to retention or surrender of property securing consumer debts, as required by  11 U.S.C. § 521(a)(2)(A) and *Fed. R. Bankr. P. 1019(1)(B)*; and

f. if this Order enters after confirmation a plan of reorganization, file, within 30 days of the date of entry of this order, the schedules required by *Fed. R. Bankr. P. 1019(5)(C)(i)-(iii)*. The Court

FURTHER ORDERS that the Debtor, and his agents, servants, employees, and attorneys are herein enjoined from taking any action with respect to any assets or records of the Debtor, save and except to preserve the same and to forthwith turn over the same to the Chapter 7 trustee appointed herein pursuant to *Fed. R. Bankr. P. 1019(4)*.

#### All Citations

In re Roberts, 644 B.R. 220 (2022)

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644 B.R. 220

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647 B.R. 748  
United States Bankruptcy Court, C.D. California.

IN RE: The HACIENDA COMPANY, LLC, Debtor.

Case No.: 2:22-bk-15163-NB

Signed January 20, 2023

operations and transferring its value to Canadian company, because no appellate court had yet granted the UST’s motion for leave to appeal, and Bankruptcy Court’s opinion did not alter or expand any prior rulings, but rather, merely provided further explanation, as anticipated on the record at hearing on dismissal motion.

**Synopsis**

**Background:** United States Trustee (UST) filed motion to dismiss Chapter 11 case of debtor that, prepetition, manufactured and packaged cannabis products before ceasing operations and transferring its value to Canadian company and selling vacant land that debtor had intended for use as cannabis cultivation center.

[2] **Bankruptcy** → Proceedings

Burden of establishing “cause” for dismissal of Chapter 11 case rests with party seeking dismissal. 🚩 11 U.S.C.A. § 1112(b)(1).

**Holdings:** The Bankruptcy Court, Neil W. Bason, J., held that:

[1] fact that UST filed notice of appeal did not divest Bankruptcy Court of jurisdiction to issue opinion following denial of UST’s motion to dismiss;

[3] **Bankruptcy** → Proceedings

Movant must show “cause” for dismissal of Chapter 11 case by preponderance of evidence. 🚩 11 U.S.C.A. § 1112(b)(1).

[2] UST failed to establish “cause” to dismiss case based on any violations of Controlled Substances Act (CSA); and

[3] unusual circumstances precluded dismissal under Bankruptcy Code’s “for cause” provision.

[4] **Bankruptcy** → Proceedings

If party moving to dismiss or convert a Chapter 11 case under Bankruptcy Code’s “for cause” provision demonstrates the requisite “cause,” burden shifts to debtor to make the statutorily required four-part showing for an “unusual circumstances” defense. 🚩 11 U.S.C.A. § 1112(b)(2).

Motion denied.

**Procedural Posture(s):** Motion to Convert or Dismiss Case.

West Headnotes (15)

[1] **Bankruptcy** → Effect of Transfer

Fact that United States Trustee (UST) filed notice of appeal did not divest Bankruptcy Court of jurisdiction to issue opinion following denial of UST’s motion to dismiss Chapter 11 case of debtor that, prepetition, manufactured and packaged cannabis products before ceasing

[5] **Bankruptcy** → In General; Grounds in General

If debtor cannot satisfy “unusual circumstances”

defense to dismissal or conversion of Chapter 11 case under Bankruptcy Code’s “for cause” provision, then the bankruptcy court must choose between conversion or dismissal based on the best interests of the creditors and the estate. 🚩 11 U.S.C.A. § 1112(b).

[6] **Bankruptcy** ➡ Dismissal or suspension

Violations of nonbankruptcy law can be “cause” for dismissal of Chapter 11 case; that said, there are many remedies for debtor’s violations of law, rule, or procedure, and dismissal is one of the more extreme remedies. 🚩 11 U.S.C.A. § 1112(b)(1).

[7] **Bankruptcy** ➡ Dismissal or suspension

Violations of nonbankruptcy law might establish “cause” for dismissal for Chapter 11 case because such violations might establish a lack of good faith. 🚩 11 U.S.C.A. § 1112(b)(1).

[8] **Bankruptcy** ➡ Dismissal or suspension

Violations of nonbankruptcy law might constitute “gross mismanagement” of Chapter 11 estate, within meaning of “for cause” dismissal provision of Bankruptcy Code, because violations of nonbankruptcy law might expose the estate to financial losses and criminal sanctions, and violating the law might constitute “mismanagement” per se. 🚩 11 U.S.C.A. § 1112(b)(4)(B).

[9] **Bankruptcy** ➡ Dismissal or suspension

Violations of nonbankruptcy law might warrant dismissal under general principles applicable to a bankruptcy court as a court of equity, pursuant to bankruptcy judges’ oath of office to uphold the law, or on other theories.

[10] **Bankruptcy** ➡ Dismissal or suspension

Ongoing postpetition violations of nonbankruptcy law are far more problematic than prepetition violations, in deciding whether to dismiss Chapter 11 case.

[11] **Bankruptcy** ➡ Dismissal or suspension

United States Trustee (UST) failed to establish “cause” to dismiss Chapter 11 case of debtor that, prepetition, manufactured and packaged cannabis products before ceasing operations and transferring its value to Canadian company and selling vacant land that debtor had intended for use as cannabis cultivation center, based on any violations of Controlled Substances Act (CSA); UST did not demonstrate any ongoing violation of the CSA by debtor, as distinguished from any prepetition violations, either by any connection to distributing cannabis or by stock ownership in a cannabis-related enterprise, nor did the UST demonstrate that if the case were converted to Chapter 7 liquidation, any trustee would have to engage in violation of CSA. 🚩 11 U.S.C.A. § 1112(b)(1); Comprehensive Drug Abuse Prevention and Control Act of 1970 § 101, 🚩 21 U.S.C.A. § 801 et seq.

[12] **Bankruptcy** ➡ Sale or Assignment of Property

Orderly liquidation in bankruptcy typically

maximizes the value of debtor’s assets; bankruptcy can preserve going concern value, or can authorize a sale of assets free and clear of liens and other interests, thereby obtaining higher bids than outside of bankruptcy. 11 U.S.C.A. §§ 363(f), 1129(b)(2)(A)(ii).

In general, bankruptcy court should defer to prosecutors to use their discretion about whether and how to address any violations of nonbankruptcy law.

[13] **Bankruptcy** Discretion

Bankruptcy Code’s mandate that court “shall” dismiss or convert bankruptcy case for “cause” does not mean that any violation of criminal law requires dismissal, but rather, court has discretion to determine whether dismissal is warranted based on all the facts and circumstances. 11 U.S.C.A. § 1112(b)(1).

**Attorneys and Law Firms**

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[David L. Neale](#), [Juliet Y. Oh](#), [Lindsey L. Smith](#), [Levene, Neale, Bender, Yoo & Golubchik L.L.P.](#), Los Angeles, CA, for Debtor.

[14] **Bankruptcy** Dismissal or suspension

Unusual circumstances precluded dismissal under Bankruptcy Code’s “for cause” provision in Chapter 11 case of debtor that, prepetition, manufactured and packaged cannabis products before ceasing operations and transferring its value to Canadian company and selling vacant land that debtor had intended for use as cannabis cultivation center; debtor had divested itself, prepetition, of any direct involvement in the cannabis business, and any dismissal would undermine a very realistic possibility of a substantial payment to creditors, as the only thing for debtor to do was to sell its stock in the Canadian company, which appeared to be legal and feasible under Canadian law, and then to use the proceeds to pay creditors, or alternatively to distribute the stock to creditors. 11 U.S.C.A. § 1112(b)(2).

**OPINION ON MOTION TO DISMISS  
CANNABIS-RELATED CASE**

[Neil W. Bason](#), United States Bankruptcy Judge

This Bankruptcy Court has already issued an order (docket no. 71) denying the motion of the United States Trustee’s (“UST”) to dismiss this case (docket no. 53, the “MTD”). This Opinion memorializes and further explains this Court’s reasoning.<sup>1</sup>

**1. BACKGROUND**

The above-captioned Debtor was in the business of wholesale manufacturing and packaging cannabis products under the “Lowell Herb Co.” brand, a/k/a “Lowell Farms,” and it ceased operations on February 25, 2021. At one time, Debtor owned land that was intended for use as a cannabis cultivation center, but Debtor did not achieve this goal and the vacant land was sold in 2020 to pay creditors.

[15] **Bankruptcy** Frivolity or bad faith; sanctions

After Debtor ceased operations, it transferred its value to

a publicly traded Canadian company – allegedly by structuring the sale as one of intellectual property, not the sale of an operating cannabis business. The acquirer’s sole business is cannabis growth and sales, which apparently are legal under Canadian law. In return, Debtor received a roughly 9.4% share of the equity shares of the acquiring entity. The acquiring entity changed its name to Lowell Farms, Inc.

On September 21, 2022, Debtor filed this bankruptcy case. In Debtor’s initial status report, Debtor stated that it intended “to propose a plan of reorganization that provides for Debtor to sell off the shares of [Lowell Farms, Inc. that] it owns in an orderly fashion and use the proceeds from the stock to pay creditors [or] ... Debtor may elect to distribute the shares it owns to its creditors directly.” At oral argument, Debtor’s counsel elaborated that the stock of Lowell Farms, Inc. is thinly traded and therefore, to avoid flooding the market and depressing the return to creditors, “we’re talking about selling it off in chunks [over time] ....” Tr. 12/20/23 (docket no. 76), p. 16:19.

**2. JURISDICTION, AUTHORITY AND VENUE**

<sup>[1]</sup>This Bankruptcy Court has jurisdiction to decide the MTD, and venue is proper, under <sup>28</sup> U.S.C. §§ 1334 and <sup>14</sup> 1408. This is a “core” proceeding in which this Bankruptcy Court has the authority to enter a final judgment or order under <sup>28</sup> U.S.C. § 157(b)(2)(A) and (O). See also <sup>Stern v. Marshall</sup>, 564 U.S. 462, 131 S. Ct. 2594, 180 L.Ed.2d 475 (2011).<sup>2</sup>

**\*751 3. DISCUSSION**

**a. Legal standards**

<sup>[2]</sup> <sup>[3]</sup>As the parties acknowledge, the burden of establishing “cause” for dismissal under § 1112(b) rests with the party seeking dismissal. See *In re Rosenblum*, 608 B.R. 529, 536 (Bankr. D. Nev. 2019). The movant must show such cause by “a preponderance of the evidence.” <sup>In re Woodbrook Assocs.</sup>, 19 F.3d 312, 317 (7th Cir. 1994).

<sup>[4]</sup>If the movant establishes that “cause” exists under §

1112(b)(1), then the opponent can still prevent conversion or dismissal under § 1112(b)(2) if (1) the court “finds and specifically identifies unusual circumstances establishing” that conversion or dismissal is “not in the best interests of creditors”; (2) the opponent shows that “there is a reasonable likelihood” of confirming a plan in a reasonable amount of time; (3) the opponent establishes that the grounds for conversion or dismissal include an act or omission of the debtor for which there is a “reasonable justification”; and (4) the opponent establishes that the act or omission can be “cured within a reasonable time.” See *Rosenblum*, 608 B.R. at 536-37 (summarizing § 1112(b)(2)).

<sup>[5]</sup>If the debtor cannot satisfy the “unusual circumstances” elements under § 1112(b)(2), then the bankruptcy court must choose “between conversion or dismissal based on the best interests of the creditors and the estate.” <sup>In re Nelson</sup>, 343 B.R. 671, 675 (9th Cir. BAP 2006) (citation and internal quotation marks omitted).

**b. Violations of nonbankruptcy law, generally**

<sup>[6]</sup>A violation of nonbankruptcy law is not expressly listed as “cause” for dismissal under § 1112(b)(1) & (4), but compliance with applicable nonbankruptcy law generally is required both by statute (e.g., 28 U.S.C. § 959) and under the authorities cited by both parties, so it appears to be undisputed that violations of nonbankruptcy law can be cause for dismissal. That said, there are many remedies for any debtor’s violations of any law, rule, or procedure, and dismissal is one of the more extreme remedies.

<sup>[7]</sup>There are several alternative reasons why violations of nonbankruptcy law might establish cause for dismissal. First, such violations might establish a lack of “good faith” sufficient to warrant dismissal. See, e.g., <sup>In re Arenas</sup>, 535 B.R. 845 (10th Cir. BAP 2015) (debtors’ marijuana business, while legal under state law, was illegal under federal law, and thus the debtors could not propose a confirmable plan in good faith). See generally <sup>In re Leavitt</sup>, 171 F.3d 1219, 1224 (9th Cir. 1999) (“cause” for dismissal not defined by the Code, but can include “bad faith”/lack of “good faith”); *Rosenblum*, 608 B.R. at 537 (listing common considerations in assessing good faith).

<sup>[8]</sup>Second, violations of nonbankruptcy law might constitute “gross mismanagement” \*752 of the estate, within the meaning of § 1112(b)(4)(B), because violations of nonbankruptcy law might expose the estate to financial

losses and criminal sanctions, and violating the law might constitute “mismanagement” *per se*. See, e.g., [In re Rent-Rite Super Kegs West Ltd.](#), 484 B.R. 799, 809 (Bankr. D. Colo. 2012) (Debtor’s decision to continue leasing warehouse space to tenants engaged in the business of growing marijuana exposed Debtor to criminal liability and the risk of forfeiture which amounted to gross mismanagement).

<sup>19</sup>In addition, violations of nonbankruptcy law might warrant dismissal under general principles applicable to a bankruptcy court as a court of equity, pursuant to bankruptcy judges’ oath of office to uphold the law, or on other theories. See, e.g., [In re Johnson](#), 532 B.R. 53, 56-58 (Bankr. W.D. Mich. 2015) (suggesting that authorizing debtor to continue generating income from marijuana operations appears inconsistent with judicial oath to uphold the law, but concluding that Debtor could remain in bankruptcy and avoid dismissal of his case if he ceased marijuana operations). See also MTD (docket no. 53) pp. 8:18-17:11; Opp. (docket no. 59) pp. 3:6-19:26; and Reply (docket no. 63) pp. 7:22-11:14 (discussing authorities).

<sup>10</sup>But the authorities cited by the parties also appear to reflect some degree of discretion. Ongoing postpetition violations are far more problematic than prepetition violations; and although indirect connections with illegal activity might violate nonbankruptcy law, the degree of connection appears to be important to deciding whether to dismiss the case. See e.g., [In re Burton](#), 610 B.R. 633, 637-638 (9th Cir. BAP 2020) (affirming dismissal as within bankruptcy court’s discretion, but holding that “the mere presence of marijuana near a bankruptcy case does not automatically prohibit a debtor from bankruptcy relief,” so a “bankruptcy court must be explicit in articulating its legal and factual bases for dismissal in cases involving marijuana”) (citations omitted); and see also [Garvin v. Cook Investments NW, SPNWX, LLC](#), 922 F.3d 1031, 1036 (9th Cir. 2019) (bankruptcy judge is not an “ombudsman without portfolio, gratuitously seeking out ‘illegalities’ ..., a result that would be “inimical to the basic function of bankruptcy judges ...”) (footnote, citations, and internal quotation marks omitted).

### c. The Controlled Substances Act, [21 U.S.C. § 801 et seq.](#) (the “CSA”)

<sup>11</sup>The UST has not established any ongoing violation of the CSA by Debtor, as distinguished from any prepetition

violations, either (i) by any connection to distributing cannabis or (ii) by stock ownership in a cannabis-related enterprise. Nor has the UST established that, if a chapter 11 trustee were appointed or if this case were to be converted to a chapter 7 liquidation, any trustee would have to engage in a violation of the CSA.

#### i. No ongoing distribution of cannabis

True, the CSA covers conspiracies with intent to distribute cannabis, and one way to characterize the facts might be that Debtor is effectively conspiring to continue carrying on its California-based cannabis business indirectly, through its ownership interest in a Canadian company operating under Debtor’s former name. See [21 U.S.C. §§ 846](#) (conspiracy) and 856(a) (illegal to “control any place” or “profit from” a place used to manufacture, store, distribute, or use cannabis), and MTD p. 8:1-8. Alternatively, even if (as this Bankruptcy Court finds and concludes) Debtor is *not* effectively carrying on its prepetition cannabis business indirectly, Debtor did structure its own liquidation in a manner designed [\\*753](#) to maximize the value derived from its connection with cannabis, which might be characterized as an indirect way to “profit from” the cannabis business.

On the other hand, this interpretation of section 856(a) of the CSA goes too far. Debtor’s passive ownership of stock, with intent to liquidate that stock to pay creditors, will *terminate* any connection with cannabis. This appears to be the opposite of an intent to profit from an ongoing scheme to distribute cannabis, at least if Debtor does not maintain its investment in Lowell Farms, Inc. for too long a period of time (which is an issue that can be addressed in connection with confirmation of any chapter 11 plan). Therefore, the UST has not established a violation of section 856(a) of the CSA.

#### ii. No future investment of profits from cannabis

Similarly, although the UST has shown that Debtor’s prepetition receipt of stock in its acquiring entity probably violated section 854 of the CSA, the UST has not established a likelihood of any postpetition violation from use or investment of cannabis proceeds. Section 854 of the CSA makes it illegal for a “person who has received any income derived, directly or indirectly, from [a relevant violation of the CSA]” to “use or invest, directly or indirectly, any part of such income, or the proceeds of

such income, in acquisition of any interest in, or the establishment or operation of, any enterprise [engaged in or affecting interstate commerce].” See MTD p. 11:21-28 at n. 5 (quoting statute). Debtor does not propose, postpetition, to use any of its remaining assets to “invest” in any enterprise (cannabis-related or otherwise). Instead, Debtor proposes to sell the stock and distribute the resulting cash to creditors, or else transfer the stock directly to creditors.

**iii. No showing that a future trustee would have to violate the CSA**

The UST raises the specter that any future bankruptcy trustee would have to engage in illegal activity. But the UST does not explain how a trustee would have to violate the CSA or any other law.

For example, even if Debtor still had possession of any cannabis or marijuana products (which it does not), a trustee could “ask[ ] the responsible federal authorities to dispose of the estate’s marijuana” and then fulfill the trustee’s statutory duty to “liquidat[e] other estate property for distribution to creditors in accordance with the priorities of [§] 726.” Steven J. Boyajian, [Just Say No to Drugs? Creditors Not Getting a Fair Shake When Marijuana-Related Cases are Dismissed](#), 36 Am. Bankr. Inst. J. 24, 75 & n. 21 (Sept. 2017).

Moreover, it is not a foregone conclusion that the rights of any federal governmental unit to seize assets would supersede creditors’ rights. See *id.* at 75 (text accompanying nn. 28-32). Therefore, not only has the UST failed to show that a future trustee would have to violate the CSA but, to the contrary, it appears that any future trustee probably might have a duty to administer assets rather than simply turn them over to federal authorities.

In addition, if any future trustee were concerned about any of these issues, the trustee could seek declaratory relief or other protections to assure compliance with the law and protection from liability. Alternatively, the trustee could always seek dismissal of this case at that point.

For all of the foregoing reasons, the UST has not established any ongoing violation of the CSA, nor has the UST established that any future trustee would have to violate the CSA. The lack of any demonstrated illegality, now or in the foreseeable \*754 future, is one ground for denial of the MTD.<sup>3</sup>

**d. Alternatively, Congress did not adopt a “zero tolerance” policy under § 1112(b) for any illegality**

Supposing for the sake of discussion that the UST could establish a violation of the CSA (which it has not done), that it not enough. Congress did not adopt a “zero tolerance” policy that requires dismissal of any bankruptcy case involving violation of the CSA (or other activity that might be proven to be illegal). See *Burton*, 610 B.R. at 637 (no per se rule requiring dismissal when marijuana is present).

True, Congress has enacted the CSA and this Bankruptcy Court’s duty is to follow Congressional directives. On the other hand, Congress has not specified what should be the *bankruptcy-specific* remedy for any violation of the CSA.

Congress could have included within the examples of “cause” in § 1112(b)(4) a violation of the CSA, or any other nonbankruptcy laws, but it chose not to do so. This implies that violations of nonbankruptcy laws do not *necessarily* constitute cause for dismissal or conversion.

In addition, such a broad reading of “cause” for dismissal could be extremely disruptive in other cases before this Bankruptcy Court, perhaps even the vast majority of all bankruptcy cases. See, e.g., *In re CWNevada LLC*, 602 B.R. 717, 728 n. 25 (Bankr. D. Nev. 2019) (“bankruptcy courts have a long history of considering cases whose activities and operations have included past, present and possibly ongoing violations of applicable non-bankruptcy, civil and criminal laws”) (citing examples); Hon. Keith M. Lundin (Ret.), [Up in Smoke](#), Bankruptcy Workshop, Season 2, Episode 3, available at <https://lundin.onchapter13.com/Content/WorkshopVideos> (last visited on January 18, 2023) (noting bankruptcy courts’ and trustees’ statutory mandate to administer assets, and extensive history of doing so notwithstanding some connection to illegal activity).

Dismissing every case that had a connection with illegal activity would be contrary to Congress’ directives under the Bankruptcy Code. Consider what would happen if the doors of the bankruptcy courts were closed to any debtor who had crossed the line into illegal activity prepetition, and were attempting to wind up that activity postpetition.

Some of the largest business bankruptcy cases, like those of Pacific Gas & Electric Co. of “Erin Brockovich” fame, Enron Corporation, and Bernie Madoff, involve alleged or actual criminal activity. Should those cases have been

dismissed? How about cases involving sexual abuse? See *CW Nevada*, 602 B.R. at 728 n. 25 (citing, *inter alia*, NCR Staff, Catholic Diocese and Orders that Filed for Bankruptcy and Other Major Settlements, National Catholic Reporter (2018), <https://www.ncronline.org/news/catholic-dioceses-and-orders-filed-bankruptcy-and-other-major-settlements> (last visited on January 18, 2023) (listing numerous bankruptcy proceedings \*755 to address sexual abuse claims, from July 6, 2004 through approximately February 28, 2018)).

On a smaller scale, this Bankruptcy Court takes judicial notice that many small business bankruptcies involve restaurants or small apartment buildings, and most of those businesses have at least some ongoing level of violations of health and safety regulations. When dealing with food and shelter, although it is important to strive for perfection, realistically that goal can be extremely difficult to achieve.

Likewise, many individual debtors have crossed the line into illegality in ways both large and small, from engaging in criminal gang activity to failing to pay taxes or parking fines. This Bankruptcy Court takes judicial notice that individuals who are struggling financially may have difficulty paying parking fines, for example, and there are societal debates about the criminalization of nonpayment of such fines, so barring such a debtor from bankruptcy would not be a step to take lightly.

If all of the foregoing examples were sufficient “cause” for mandatory dismissal, this Bankruptcy Court might have to dismiss most bankruptcy cases. That would harm the constituencies that Congress attempted to protect using all of the tools of the Bankruptcy Code, including creditors, debtors, employees of debtors, and local governments and communities that depend on debtors’ ability to reorganize their finances and resume making contributions to commerce and society.

For example, the automatic stay of § 362(a) protects creditors from a “race to collect”: absent that stay the assets go to anyone who is able to seize them before other creditors. Insiders or other favored creditors might have an advantage in doing so, contrary to Congress attempts to prevent such favoritism. See, e.g., § 547(b)(4) (longer “look back” period for preference recipients who are insiders).

<sup>112</sup>In addition, an orderly liquidation in bankruptcy typically maximizes the value of a debtor’s assets. Bankruptcy can preserve going concern value, or can authorize a sale of assets free and clear of liens and other interests, thereby obtaining higher bids than outside of

bankruptcy. See, e.g., §§ 363(f) and 1129(b)(2)(A)(ii), and see also *In re Olson*, 2018 WL 989263 at \*7 (9th Cir. BAP Feb. 5, 2018) (Tighe, J., concurring) (noting the usefulness of sales free and clear, even in cases connected to marijuana).

In addition, dismissal of bankruptcy cases would shield recipients of avoidable transfers (e.g., §§ 547, 548) and persons whose misdeeds might only come to light in the bankruptcy forum, with all of its mandated disclosures and investigative tools. See, e.g., Rules 1007 & 2004; see also Boyajian, *Just Say No to Drugs?*, *supra*, 36 Am. Bankr. Inst. J. 24 at 75 (text accompanying nn. 22-27) (arguing that dismissal of involuntary chapter 7 petition allowed “the alleged debtor to use its own federally proscribed conduct [running a marijuana business] as a shield to protect it from the collection efforts of creditors holding seemingly undisputed claims”). This Bankruptcy Court doubts that Congress intended to shield recipients of avoidable transfers, and wrongdoers, by mandating dismissal of any bankruptcy case that might be connected to violations of criminal law.

In fact, in many situations the victims of illegal activity are the persons who might be most severely harmed by dismissal of any bankruptcy case. This is true whether that illegal activity involves releasing carcinogens into the water supply, financial fraud, being a “slumlord,” causing food poisoning, abusing employees, child sexual abuse, or other criminal activity. The victims \*756 may be the biggest creditors, or those with the most to lose.

One other type of creditor who might well be harmed by any mandated dismissal of any case connected to illegal activity is any government agency charged with enforcing the law, such as the Department of Justice, which encompasses the Office of the UST itself. Such agencies’ funding, and their ability to continue policing against criminal activity, might depend in part on the preservation and recovery of assets, including through bankruptcy.

<sup>113</sup>For all of these reasons, this Bankruptcy Court does not interpret Congress’ mandate that this Bankruptcy Court “shall” dismiss or convert a bankruptcy case for “cause” under § 1112(b) to mean that any violation of criminal law requires dismissal. Rather, this Court interprets the statute as giving discretion to determine whether dismissal is warranted based on all the facts and circumstances. See generally *Burton*, 610 B.R. 633, 640 and *passim* (review of various authorities, and referring to bankruptcy courts’ “broad discretion in deciding whether to dismiss a case”).

Nor does this Bankruptcy Court interpret the UST’s MTD

to advocate for such an extreme position. Cf. Clifford J. White III and John Sheahan, [Why Marijuana Assets May Not Be Administered In Bankruptcy](#), 36 Am. Bankr. Inst. J. 34, 34-35 (Dec. 2017) (contrasting bankruptcy cases “in which the criminal activity has already been terminated and the principal concern of the bankruptcy court is to resolve competing claims by victims for compensation” from a case involving “a company that is not only continuing in its business, but even seeking the affirmative assistance of the bankruptcy court in order to ... facilitate its violations of the law going forward”) (the authors are listed, respectively, as the director of the Executive Office for U.S. Trustees and as a trial attorney in the Office of the General Counsel).

In sum, this Bankruptcy Court interprets both § 1112(b) and the UST’s MTD as adopting a middle ground, under which this Bankruptcy Court must exercise its discretion to determine whether, given all of the facts and circumstances, a debtor’s connection to cannabis profits and any past or future investment in cannabis enterprises warrants dismissal of this bankruptcy case. Under this standard, the UST has not met its burden to establish sufficient cause for dismissal, for the reasons stated above, including (i) Debtor’s indirect connection with any violation of the CSA (assuming, contrary to this Court’s analysis in the prior section of this Opinion, that such a violation exists), (ii) Debtor’s intent to liquidate its assets and pay creditors, and (iii) the benefits of a bankruptcy case for all parties in interest, including creditors.

**e. Alternatively, the “unusual circumstances” exception applies**

<sup>14</sup>Congress has provided that even when there is “cause” to dismiss or convert a case, this Bankruptcy Court must not do so under the “unusual circumstances” test described above. See § 1112(b)(2). The elements of this test have been satisfied, at least in the absence of evidence that prosecutors intend to single out Debtor for particularly harsh treatment that would undermine any ability to pay creditors and otherwise make appropriate use of the bankruptcy system.

Specifically, the unusual circumstances in this case are as follows. First, Debtor has divested itself, prepetition, of any direct involvement in the cannabis business. Second, unlike most dismissals by this Court, which generally involve situations such as a pending foreclosure of fully-encumbered \*757 property and no realistic possibility of a distribution to unsecured creditors, in this case any dismissal would undermine a very realistic

possibility of a substantial payment to creditors. That successful outcome appears to be very likely because the only thing for Debtor to do is to sell its stock in the Canadian company, which appears to be legal and feasible under Canadian law, and then to use the proceeds to pay creditors; or alternatively to distribute the stock to creditors.

These facts also establish the other elements of the “unusual circumstances” test: conversion or dismissal is not in the best interests of creditors; there is a reasonable likelihood of confirming a plan in a reasonable amount of time; even if Debtor’s acts and omissions in seeking to divest itself of its assets and pay creditors somehow violated the CSA or other law, and would otherwise mandate dismissal, Debtor’s attempt to maximize value and pay creditors establishes a “reasonable justification” for such acts and omissions; and, so long as Debtor’s process of selling or distributing its stock in the Canadian company does not take too long, any violation of law can be “cured within a reasonable time.” [Rosenblum](#), 608 B.R. at 536-37 (reviewing elements of § 1112(b)(2)).

In addition, this Bankruptcy Court is mindful of the fact that there are many other tools to address any wrongful or illegal conduct by any debtor in possession of the bankruptcy estate. For example, in appropriate circumstances a trustee or examiner can be appointed (§ 1104), or sanctions can be imposed. See, e.g., Rule 9011. The availability of such alternatives reinforces a more flexible interpretation of § 1112 as just one of many possible tools, not a tool that this Bankruptcy Court has to use regardless of the consequences.

In addition, this Bankruptcy Court notes that there are many non-bankruptcy tools that can be used to address any illegal activity. Remedies can be sought, in appropriate situations, by prosecutors, private attorneys general, class action representatives, individual plaintiffs, and others, such as local, state, and national governments, to address any violations of nonbankruptcy law in a more nuanced and targeted manner than the blunt tool of dismissing bankruptcy cases. Again, the availability of such alternatives reinforces this Bankruptcy Court’s interpretation of § 1112(b) as providing some discretion: dismissal is not the only remedy.

**f. No intent to condone illegal activity**

To be clear, nothing in this Opinion should be interpreted as condoning illegal activity. Illegal activity can be cause for dismissal in appropriate circumstances, both as a

matter of interpreting Congress' directives in § 1112(b) and, more generally, to preserve the integrity of the bankruptcy system and the bankruptcy courts that Congress has established. See, e.g., *In re Mattiace Industries, Inc.*, 76 B.R. 44, 47-48 (Bankr. E.D.N.Y. 1987) (dismissing chapter 11 bankruptcy case because debtor's continued violations of state environmental regulations endangered public health and conversion was inappropriate due to difficulties a trustee would face in managing debtor's hazardous waste site with limited estate resources)

<sup>15</sup>But this Bankruptcy Court would be overstepping its role, and acting contrary to Congress' directives within the Bankruptcy Code, if it were to deny creditors, debtors, employees, equity investors, and other constituencies the benefits and protections of bankruptcy based on the facts and circumstances presented. In general this Bankruptcy Court should defer to prosecutors, and all of the other types of persons mentioned above, to use their discretion \*758 about whether and how to address any violations of

nonbankruptcy law. See *Cook Investments*, 922 F.3d 1031, 1036 (rejecting "ombudsman" role of bankruptcy court). Such parties can pursue remedies in a more nuanced and targeted manner, rather than using the blunt tool of dismissal, which on the record presented is contrary to the best interests of creditors and the estate.

#### 4. CONCLUSION

For all of the foregoing reasons, the MTD has been denied by separate order.

#### All Citations

647 B.R. 748, 72 Bankr.Ct.Dec. 59

#### Footnotes

- 1 Unless the context suggests otherwise, a "chapter" or "section" ("§") refers to the United States Bankruptcy Code, *11 U.S.C. § 101 et seq.* (the "Code"), a "Rule" means the Federal Rules of Bankruptcy Procedure or other federal or local rule, and other terms have the meanings provided in the Code, Rules, and the parties' filed papers.
- 2 Although the UST has filed a notice of appeal, that does not divest this Bankruptcy Court of jurisdiction to issue this Opinion for two alternative reasons. First, so far as this Bankruptcy Court is aware, no appellate court has granted the UST's motion for leave to appeal (docket no. 90). See *In re Rains*, 428 F.3d 893, 903-904 (9th Cir. 2005) ("if the order at issue is interlocutory, any appeal ... would not transfer jurisdiction to an appellate court") (citations omitted); *In re Bertain*, 215 B.R. 438 (9th Cir. BAP 1997) ("The denial of a motion to dismiss is an interlocutory order") (cleaned up; citations omitted). Second, this Opinion does not alter or expand any prior rulings, and instead merely provides further explanation, as anticipated on the record at the above-captioned hearing. See *Rains*, 428 F.3d at 904 (other exceptions to rule that notice of appeal divests lower court of jurisdiction).
- 3 To be clear, Debtor's apparent ownership of over 9% of the stock of a cannabis business puts it in uncomfortably close proximity to the cannabis industry. Perhaps, if all the facts and circumstances were known to this Bankruptcy Court, and if this Bankruptcy Court were to engage in independent research beyond the authorities cited by the parties, Debtor's proposed liquidation actually would be a violation of the CSA or some other criminal statute. But this Bankruptcy Court has not been asked to render any summary judgment as to purported violations of criminal law, and this Bankruptcy Court's rulings above should not be interpreted as any such summary judgment. Rather, on the present record and solely for purposes of the UST's MTD, no violation of the CSA has been established.

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In re Hacienda Company, LLC, 647 B.R. 748 (2023)

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# Faculty

**Jessica Bagdanov** is a partner with BG Law in Woodland Hills, Calif., and focuses her practice on insolvency and restructuring. She consistently represents chapter 7 trustees and receivers, as well as both debtors and creditors in chapter 11 matters. She also has significant business litigation experience, and is routinely responsible for a wide range of motion practice in contested matters, adversary proceedings and related appeals. Prior to joining the firm, Ms. Bagdanov clerked for Hon. Ellen Carroll (ret.) and Hon. Robert N. Kwan of the Los Angeles Division of the U.S. Bankruptcy Court for the Central District of California. Additionally, she worked as a staff attorney for the Ninth Circuit Bankruptcy Appellate Panel. Ms. Bagdanov serves as a board member for the Los Angeles Bankruptcy Forum and an associate editor of the Business Law News section of the California Lawyers Association, and she is an Education co-chair for the 2020 California Bankruptcy Forum. Previously, she served as one of the Young Insolvency Professionals (YIP) co-chairs for the 2019 California Bankruptcy Forum, and as secretary of the International Women's Insolvency and Restructuring Confederation (2015-17). Ms. Bagdanov has been recognized as a Southern California Rising Star in *Super Lawyers* from 2015-21, and she has been listed in *The Best Lawyers in America* since 2018. Ms. Bagdanov received her undergraduate degree in philosophy from Westmont College and her J.D. from Chapman University Fowler School of Law.

**Hon. Martin R. Barash** is a U.S. Bankruptcy Judge for the Central District of California in Woodland Hills and Santa Barbara, sworn in on March 26, 2015. He brings more than 20 years of legal experience to the bench. Prior to his appointment, Judge Barash had been a partner at Klee, Tuchin, Bogdanoff & Stern LLP in Los Angeles since 2001, where he represented debtors and other parties in chapter 11 cases and bankruptcy litigation. He first joined the firm as an associate in 1999. Earlier in his career, Judge Barash worked as an associate of Stutman, Treister & Glatt P.C. in Los Angeles. He also has served as an adjunct professor of law at California State University, Northridge. Following law school, Judge Barash clerked for Hon. Procter R. Hug, Jr. of the U.S. Court of Appeals for the Ninth Circuit from 1992-93. He is a former ABI Board member, for which he served on its Education Committee and currently serves on its Committee for Diversity, Equity, and Inclusion, and he is a former member of the Board of Governors of the Financial Lawyers Conference. In addition, he is a judicial director of the Los Angeles Bankruptcy Forum and a frequent panelist and lecturer on bankruptcy law. He also is a co-author of the national edition of the *Rutter Group Practice Guide: Bankruptcy*. Judge Barash received his A.B. *magna cum laude* in 1989 from Princeton University and his J.D. in 1992 from the UCLA School of Law, where he served as member, editor, business manager and symposium editor of the *UCLA Law Review*.

**Hon. Neil W. Bason** is a U.S. Bankruptcy Judge for the Central District of California in Los Angeles, appointed in 2011. While in private practice at Howard Rice Nemerovski Canady Falk & Rabkin, P.C. and Duane Morris LLP, he represented a wide variety of interests in commercial bankruptcy and insolvency matters, including secured and unsecured creditors, trustees, receivers, debtors/borrowers, guarantors, prospective asset-purchasers, and other parties in interest. Before that, he clerked for Hon. Dennis Montali, U.S. Bankruptcy Judge for the Northern District of California and Chief Judge of the Bankruptcy Appellate Panel of the Ninth Circuit. Judge Bason received his J.D. *magna cum laude* from Boston University School of Law in 1988, where he was a note editor on its law review.

**Hon. Scott C. Clarkson** is a U.S. Bankruptcy Judge for the Central District of California in Santa Ana and Riverside, appointed on Jan. 20, 2011, and has also sat on the Ninth Circuit Bankruptcy Appellate Panel. Prior to his appointment, Judge Clarkson practiced bankruptcy law and bankruptcy litigation for more than 20 years in Los Angeles, and he served as chair of the Los Angeles County Bar Association's Commercial Law and Bankruptcy Section from 2008-09, and on the board of directors of the Los Angeles Bankruptcy Forum and the Los Angeles Financial Lawyers Conference. He also previously served as judicial chair of the California Bankruptcy Forum, on the advisory board of ABI's Bankruptcy Battleground West, and for the Association of Insolvency and Restructuring Advisors' National Conference. Judge Clarkson has served as co-chair of the Legislative Committee of the National Conference of Bankruptcy Judges, and he is currently a member of the ABI Task Force on Veterans and Servicemembers Affairs. He has also served on the board of directors of the Orange County Federal Bar Association and the Orange County Bankruptcy Forum. Judge Clarkson was admitted to the bars of Virginia, the District of Columbia and California. He was admitted to the bar of the U.S. Supreme Court in 1988. Beginning in January 1977, Judge Clarkson was a legislative assistant to a U.S. Congressman serving on the Judiciary Committee of the U.S. House of Representatives, where he was a direct observer and participant in the drafting of the Bankruptcy Code of 1978. He also served on the first board of advisors for the *Norton Annual Survey of Bankruptcy Law* (1979). Judge Clarkson has served as a judicial mediator in various cases over the last 12 years, including Exide Technologies, Inc. (Delaware), Ruby's Diners (Los Angeles), Eagen Avenatti, LLC (Orange County) and the City of San Bernardino, California (San Bernardino). He has presided over dozens of other judicial mediations over his career. Judge Clarkson received his undergraduate degree from Indiana University in Bloomington in 1979 and his J.D. from George Mason University School of Law in 1982, where he was a member and an editor of its law review.

**Hon. Mark D. Houle** is a U.S. Bankruptcy Judge for the Central District of California in Riverside, appointed on Feb. 17, 2012. Previously, he had practiced law for 13 years at Pillsbury Winthrop Shaw Pittman, LLP in Los Angeles and at Winthrop Couchot, PC, where he specialized in chapter 11 cases. Judge Houle served four years in the U.S. Air Force and four years in the Massachusetts Air National Guard prior to becoming an attorney. He began his legal career as a clerk for the Santa Ana bankruptcy judges from 1996-98, then was an associate with Winthrop Couchot, PC, where he worked with chapter 11 debtors, creditors' committees and chapter 7 trustees. From 2000 until his appointment, he worked with Pillsbury Winthrop Shaw Pittman, LLP. Judge Houle received his B.A. *summa cum laude* from Salem State College in 1993 and his J.D. from the Boston College Law School in 1996.

**Hon. Sandra R. Klein** is a U.S. Bankruptcy Judge for the Central District of California in Los Angeles, appointed April 22, 2011. Prior to her appointment to the bench, she worked for more than 13 years for the U.S. Department of Justice, most recently as the acting assistant director of the Office of Criminal Enforcement of the U.S. Trustee Program, where she focused nationally on increasing detection and prosecution of criminal conduct in the bankruptcy system. From 2003-09, Judge Klein was a bankruptcy fraud criminal coordinator with the U.S. Trustee Program, responsible for assisting federal law enforcement agents and assistant U.S. attorneys with bankruptcy-related investigations and prosecutions. From 1997-2003, she was a special assistant U.S. attorney in the Central District of California (on permanent detail from the U.S. Trustee Program), where she focused on complex white collar crime cases and bankruptcy fraud cases in particular. Before joining the DOJ, Judge Klein served as a litigation associate with O'Melveny & Myers LLP and began her legal career clerk-

ing for Hon. Arthur L. Alarcón of the Ninth Circuit Court of Appeals and Hon. Lourdes G. Baird of the Central District of California. Judge Klein is a member of ABI, the American, Federal and Los Angeles County Bar Associations, the National Conference of Bankruptcy Judges and the Women Lawyers Association of Los Angeles. She has received numerous awards, including the 2018 National Conference of Bankruptcy Judges Public Outreach Award, the 2018 WLALA Distinguished Service Award, and the 2019 Girl Scouts of Greater Los Angeles Woman of Distinction Award. Judge Klein received her Bachelor's degree *magna cum laude* in music education from the University of Lowell in Massachusetts, her J.D. *magna cum laude* from Loyola Law School in Los Angeles, where she was admitted to the Order of the Coif and served as a senior note and comment editor for the *Loyola International and Comparative Law Journal*, and her M.B.A. with honors from UCLA's Anderson School of Management in Los Angeles.

**Malhar S. Pagay** is a business lawyer with Pachulski Stang Ziehl & Jones LLP in Los Angeles, where he focuses his practice on the development and implementation of strategic alternatives for and against distressed businesses. A member of the firm's Healthcare Restructuring Group, he has substantial experience representing chapter 11 debtors, trustees, unsecured creditors, creditors' committees and other parties in the contexts of bankruptcy cases, adversary proceedings, commercial litigation, mediations, domestic and international business transactions, business reorganizations, and out-of-court corporate restructurings of debt. Mr. Pagay has broad industry experience, including in health care and life sciences, real estate, technology, retail, manufacturing, transportation, sports and entertainment. His recent representations include reorganizing the Ruby Tuesday casual-dining chain with more than 200 restaurants through a debt-for-equity transaction with its secured lenders, implemented through a chapter 11 plan confirmed after only four months in bankruptcy; counseling technology entrepreneur Yueting "YT" Jia, the founder of mobility ecosystem company Faraday Future, in the successful restructuring of more than \$3 billion in debt held almost entirely by creditors located in the People's Republic of China (this representation was recognized at Global M&A Network's 13th Annual Turnaround Atlas Awards as "Cross-Border Turnaround of the Year"); advising a creditors' committee in connection with a successful hospital reorganization; and completing a § 363 sale of a \$100 million Class A commercial office property over the objections of co-owners. He also has served as principal counsel to China Export & Credit Insurance Corp. and its Chinese policyholders and clients in complex U.S. insolvency matters. Mr. Pagay has lectured both in the U.S. and internationally regarding a variety of legal issues, including cross-border transactions and insolvencies. He has been named a "Super Lawyer" in the field of Bankruptcy & Creditor/Debtor Rights every year since 2009 in a peer survey conducted by *Law & Politics* and the publishers of *Los Angeles* magazine, and he is rated AV-Preeminent by Martindale-Hubbell. In addition, he has been listed among *The Best Lawyers in America* in the practice areas of Bankruptcy and Creditor/Debtor Rights/Insolvency and Reorganization Law and Litigation – Bankruptcy. Mr. Pagay received his B.A. in 1989 from Yale University and his J.D. in 1994 from the University of Southern California.

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nondischargeability, discharge, asset sales and claims disputes. He also specializes in handling appeals and myriad other bankruptcy issues. Mr. Raanan has held leadership positions with various bar groups, including serving as a member of the California Lawyers Association's Board of Representatives, chair of the Business Law Section and co-chair of the Insolvency Law Committee of the State Bar of California, president of the Beverly Hills Bar Foundation, and member of the Board of Governors of the Beverly Hills Bar Association. He was recently elected to serve on the Board of Directors of the Los Angeles Bankruptcy Forum (LABF). In 2019, Mr. Raanan was honored as Bankruptcy Lawyer of the Year by the Century City Bar Association. He received his B.A. in 1988 from San Diego State University and his J.D. in 1992 from the University of the Pacific Mc George School of Law.

**William J. Rochelle, III** is ABI's editor-at-large, based in New York. He joined ABI in 2015 and writes every day on developments in consumer and reorganization law. For the prior nine years, Mr. Rochelle was the bankruptcy columnist for Bloomberg News. Before turning to journalism, he practiced bankruptcy law for 35 years, including 17 years as a partner in the New York office of Fulbright & Jaworski LLP. In addition to writing, Mr. Rochelle travels the country for ABI, speaking to bar groups and professional organizations on hot topics in the turnaround community and trends in consumer bankruptcies. He earned his undergraduate and law degrees from Columbia University, where he was a Harlan Fiske Stone Scholar.

**Hon. Deborah J. Saltzman** is a U.S. Bankruptcy Judge for the Central District of California in Los Angeles and San Fernando Valley, appointed on March 18, 2010; she also hears cases in the Northern Division in Santa Barbara. As a member of the Ninth Circuit Bankruptcy Education Committee, she welcomes the opportunity to participate in bankruptcy education programs. She also currently serves on the Ninth Circuit Wellness Committee. Prior to her appointment to the bench, Judge Saltzman practiced bankruptcy law in Los Angeles, representing debtors, secured and unsecured creditors, asset-purchasers, creditors' committees and landlords in chapter 11 and out-of-court restructurings, as well as related financing transactions and litigation. She received her B.A. in 1991 from Amherst College Phi Beta Kappa and her J.D. in 1996 from the University of Virginia School of Law.

**Lovee Sarenas** is a partner with Dinsmore & Shohl LLP in Los Angeles, where she concentrates her practice on trustee representations in chapter 7 bankruptcy cases and on representing creditors' committees and distressed small businesses in chapter 11 cases. She has assisted and worked with institutional banks, insurance companies, airlines, storage facilities, commercial property owners, small businesses and turnaround professionals. Ms. Sarenas's experience includes counseling international companies in major retail bankruptcy cases; handling bankruptcy-related real estate issues; defending institutional clients in a variety of bankruptcy litigation, avoidance actions and fraudulent transfer claims; and serving as debtor-in-possession counsel to a B2B e-commerce company in an intellectual property sale. She also has experience with PACA claims and bankruptcy-related issues in farm business reorganizations. Ms. Sarenas is the first Filipino-American to serve as a judicial clerk for two bankruptcy judges: the late Hon. Richard M. Neiter and Hon. Ellen A. Carroll (ret.) of the U.S. Bankruptcy Court for the Central District of California. Before she clerked with Judge Neiter, she practiced as a restructuring attorney for a prominent chapter 11 boutique bankruptcy firm in Northern California. Ms. Sarenas is also active in the community, having had several leadership roles in bar and community organizations in Los Angeles, including the Los Angeles Bankruptcy Forum,

the Central District U.S. Bankruptcy Court Small Business Reorganizational Task Force, the UPAAGLA Board of Directors and the California Bankruptcy Forum. She is currently the vice president of the Los Angeles Bankruptcy Forum after a successful year chairing its Diversity Equity & Inclusion Committee, during which time she co-founded the Hon. Richard M. Neiter Externship Fellowship, which awards stipends to law students from underrepresented backgrounds who are full-time externs with the federal bankruptcy judiciary in the Central District. Ms. Sarenas is a member of the USC Gould School of Law adjunct faculty and serves as an adjunct professor of bankruptcy law at Southwestern Law School in Los Angeles. She received her B.A. from the University of the Philippines and her J.D. from Southwestern University School of Law.