

Insights

Cannabis Companies Can't File for Bankruptcy – So Now What?

Article

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The government's response to the COVID-19 pandemic has resulted in federal assistance to numerous industries and individual taxpayers, but notably has left the state legalized marijuana industry out in the cold.

Business and individuals involved in the marijuana industry are likely ineligible for bankruptcy protection because marijuana remains illegal under federal law and the federal bankruptcy courts cannot be used to facilitate the possession or sale of illegal assets.

Even now-legal hemp businesses have faced pushback on bankruptcy protections, as recently evidenced in the case of United Cannabis Corp., which drew a still-pending attempt to dismiss from the United States Trustee disputing that the company deals solely in hemp based on its own prior SEC filings.

However, other options may be available for financially distressed marijuana businesses.

Assignments for Benefit of Creditors

A close alternative to a Chapter 7 bankruptcy, an assignment for benefit of creditors (often referred to as an "ABC"), allows a business to assign all of its assets to a third party (the assignee) who then can wind down the company's affairs in an orderly fashion. As ABCs are created under state law, an ABC may be a viable alternative for a business who is operating in a manner consistent with state law, even though still in violation of federal law and therefore ineligible for bankruptcy protection.

Receiverships

Another alternative may be the consensual appointment of a receiver over the company. When faced with litigation from a creditor, one remedy available to the creditor may be requesting the court to appoint a third party (the receiver) to run the company.

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While this process is often adversarial as the appointment of a receiver will divest control of the company from current management, if no better alternatives exist, the company may be able to negotiate for favorable provisions in the receivership order. Such favorable provisions could include permitting the receiver to sell the company's assets or the whole company as a going concern, potentially realizing proceeds over and above the debt owed.

Workouts

Finally, the best alternative may be to engage in workout negotiations with the company's creditors in advance of any litigation or ABC. Workouts are done outside the court system entirely and are dependent upon all parties reaching a mutually acceptable solution.

This process could involve simple negotiations between the parties or potentially the mediation of multi-party disputes. While bankruptcy may not be an option, the way a creditor's claims would be treated in bankruptcy or in an ABC may be a useful starting point for these negotiations.

We would be glad to discuss these options with you. Please contact a member of our Cannabis & Controlled Substances or Banking & Finance practices if we can be of assistance.