



Insights

Marijuana Tenants and the Effects on Landlord's Rights in Bankruptcy

Lowndes Leasing Lawyers Blog
02.11.2020

Though states continue to legalize the use and sale of marijuana for medicinal and recreational uses, under federal law, marijuana remains an illegal "Schedule 1" drug pursuant to the Controlled Substances Act. As legalization of marijuana expands, the conflict between state law and federal law continues to cause confusion regarding the rights of parties who enter into contracts with businesses in the marijuana industry. This disconnect is especially problematic in bankruptcy matters, which are adjudicated under Title 11 of the United States Code.

Debtors associated with the marijuana industry have suffered significant challenges when attempting to avail themselves of bankruptcy protections, and a series of court decisions evidence a strong disfavor for allowing such businesses to seek protection. In the case *In re Rent-Rite Super Kegs W. Ltd.*, 484 B.R. 799 (Bankr. D. Colo. 2012), the bankruptcy court dismissed the bankruptcy petition of a debtor that derived 25% of its revenues by leasing warehouse space to tenants engaged in the business of growing marijuana, stating "because a significant portion of the Debtor's income is derived from any illegal activity . . . § 1129(a)(3) forecloses any possibility of [a] Debtor obtaining confirmation of a plan that relies in any part on income derived from a criminal activity." *In re Rent-Rite Super Kegs W. Ltd.*, 484 B.R. 799, 809 (Bankr. D. Colo. 2012). In 2015, the Bankruptcy Appellate Panel for the Tenth Circuit affirmed a dismissal of a Chapter 7 case filed by a marijuana grower based on the same reasoning. See, *Arenas v. United States Trustee (In re Arenas)*, 535 B.R. 845 (10th Cir. BAP 2015). Finally, in the case of *In re Way to Grow, Inc.*, 597 B.R. 111 (Bankr. D. Colo. 2018), the bankruptcy court dismissed a Chapter 11 case filed by a debtor who was in the business of selling equipment for indoor hydroponic systems and garden-related supplies to marijuana growers.

Most recently, in *Garvin v. Cook Investments NW, SPNWX, LLC*, 922 F. 3d 1031 (2019), the United States Ninth Circuit Court of Appeals considered whether a landlord's bankruptcy plan could be approved in light of the fact that the plan included rental income from a tenant engaged in a marijuana growing operation. In *Garvin*, the Court first noted that to be confirmed, the landlord's Chapter 11 bankruptcy plan must satisfy the sixteen

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requirements set forth in 11 U.S.C. § 1129(a), including the requirement that “the plan has been proposed in good faith and not by any means forbidden by law.” 11 U.S.C. § 1129(a)(3).

The *Garvin* Court acknowledged that other bankruptcy courts had accepted the position that “a federal court cannot be asked to enforce the protections of the Bankruptcy Code in aid of a Debtor whose activities constitute a continuing federal crime.” *In re Rent-Rite Super Kegs W. Ltd.*, 484 B.R. at 805. Nevertheless, the Court went on to rule that the phrase “not by any means forbidden by law” refers solely to the phrase “the plan has been proposed” and therefore that a bankruptcy court need not consider whether the bankruptcy plan complies with all applicable laws, but rather must only consider whether the plan complies with the Bankruptcy Code.

While this decision does provide some hope for landlords, it has already been met with opposition. Within a month of the *Garvin* decision, the United States Bankruptcy Court for the Eastern District of Michigan dismissed the bankruptcy action of a debtor landlord who leased space to a medical marijuana dispensary. *See In re Basrah Custom Design, Inc.*, 600 B.R. 368 (2019). While not bound by the *Garvin* decision, the *Basrah* Court did voice its disagreement with the Ninth Circuit’s interpretation of 11 U.S.C. § 1129(a)(3). The dismissal in *Basrah*, however, was based on the Court’s determination that the debtor had “unclean hands” and thus there was “cause” to dismiss the case under 11 U.S.C. § 1112(b).

There is still significant uncertainty as to the legal rights of parties associated with the marijuana industry, including the bankruptcy rights of landlords who lease to marijuana-related businesses. This issue, along with other marijuana-related issues, will undoubtedly remain the subject of court cases for so long as marijuana remains illegal under federal law.