

# Cannabis Business Restructurings Under Conflicting Federal and State Law

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The nascent cannabis industry has presented unique and interesting insolvency issues, particularly given the tension between conflicting federal and state law. This article provides an overview of the current trends in bankruptcy for cannabis companies, as well as some bankruptcy alternatives for professionals to consider when counseling these companies.

### **I. What is Cannabis?**

Although it may seem immaterial, understanding the term “cannabis”—and the distinctions between types of cannabis—is critical to providing sound legal analysis. We begin with hemp and marijuana.

Botanically, hemp and marijuana come from the same species of plant, *Cannabis sativa*, but from different varieties or cultivars that have been bred for different uses.<sup>1</sup> In fact, hemp and marijuana are genetically distinct forms of cannabis that differ by their use, chemical makeup, and differing cultivation practices.<sup>2</sup> While marijuana generally refers to the psychotropic drug, growers cultivate hemp for use in production of many products, including foods and beverages, personal care products, nutritional supplements, fabrics, textiles, paper, construction materials, and other manufactured goods.

There are about 500 natural components found within the *Cannabis sativa* plant, of which over 100 have been classified as “cannabinoids”<sup>3</sup> (another word for chemicals unique to the plant). The two most well-known can-

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nabinoids are delta-9-tetrahydrocannabinol (“THC”) and Cannabidiol (“CBD”). THC is the main psychoactive cannabinoid that gives users the “high” feeling, while CBD is the main non-psychoactive cannabinoid in cannabis and constitutes up to 40% of the plant’s extracts.<sup>4</sup>

Although the data is mixed, CBD may have potential clinical effects on anxiety disorders, movement disorders, cognition, and pain.<sup>5</sup> CBD can be ingested in multiple different ways, including by inhalation of cannabis smoke or vapor, as an aerosol spray into the cheek, or by mouth. It may also be supplied as tinctures (essentially CBD infused alcohol), CBD oil containing only CBD as the active ingredient, capsules, or as a liquid solution. In 2017 and 2018, CBD products spread to natural food stores, beauty aisles, and cafes, and the industry continues to grow today.

### II. Applicable Non-Bankruptcy Federal Law

Understanding applicable non-bankruptcy law is equally critical to sound legal analysis when it comes to cannabis bankruptcies. First, and foremost, is the Controlled Substances Act (the “CSA”). Next, is the Agriculture Improvement Act of 2018 (the “2018 Farm Bill”). And, finally, the Federal Food, Drug, and Cosmetic Act (the “FD&C Act”).

#### A. *The Controlled Substances Act*

The CSA establishes a comprehensive federal scheme to regulate controlled substances.<sup>6</sup> Among other things, the CSA makes it unlawful:

- (i) to knowingly or intentionally “manufacture, distribute, or dispense, or possess with intent to manufacture, distribute or dispense, a controlled substance” (e.g., cultivators and dispensaries);<sup>7</sup>
- (ii) “for any person knowingly or intentionally to manufacture, distribute, export, or import any . . . equipment, chemical, product, or material which may be used to manufacture a controlled substance . . . knowing, intending, or having reasonable cause to believe, that it will be used to manufacture a controlled substance” (e.g., ancillary down-stream companies);<sup>8</sup>
- (iii) “to knowingly open, lease, rent, use, or maintain any place, whether permanently or temporarily, for the purpose of manufacturing, distributing, or using any controlled substance” (e.g., landlords);<sup>9</sup> and
- (iv) “to manage or control any place, whether permanently or temporarily, either as an owner, lessee, agent, employee, occupant, or mortgagee, and knowingly and intentionally rent, lease profit from, or make available for use, with or without compensation, the place for the purpose of unlawfully manufacturing, storing, distribution or using a controlled substance” (e.g., management companies).

Restrictions on the manufacture, distribution, and possession of a controlled substance depend on the “schedule” in which Congress has placed the drug.<sup>10</sup> From its inception, the CSA classified both “marijuana” and THC as Schedule I controlled substances.<sup>11</sup> Until 2018, the CSA defined “marijuana” in relevant part as “all parts of the plant *Cannabis sativa* L., whether

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growing or not; the seeds thereof; the resin extracted from any part of such plant; and every compound, manufacture, salt, derivative, mixture, or preparation of such plant, its seeds or resin.”<sup>12</sup> Under this definition, both marijuana and hemp were controlled substances.<sup>13</sup>

**B. *The Agriculture Improvement Act of 2018***

On December 20, 2018, the then-President signed into law the 2018 Farm Bill, which became effective on January 1, 2019.<sup>14</sup> Among other things, the 2018 Farm Bill amended certain federal laws relating to the production and marketing of hemp, as well as derivatives of the plant, including CBD. Most importantly, the 2018 Farm Bill expressly removed “hemp”<sup>15</sup> from the CSA definition of “marijuana.” It also carved-out an exception for the low levels of THC found in hemp. This means that, unlike marijuana, hemp is no longer an illegal, controlled substance under federal law. However, the 2018 Farm Bill explicitly preserved the FDA’s authority to regulate products containing cannabis or cannabis-derived compounds.

**C. *The Federal Food, Drug, and Cosmetic Act***

The FD&C Act establishes a comprehensive federal scheme to regulate food, drugs, and cosmetics, among other things.<sup>16</sup> Under the FD&C Act, the introduction of “new drugs” into interstate commerce without meeting certain regulatory approvals is prohibited.<sup>17</sup> In addition, the FD&C Act proscribes the introduction of adulterated or misbranded drugs into interstate commerce.<sup>18</sup> With the passing of the 2018 Farm Bill, the FDA issued a statement “clarifying” its position on the regulation of these products (the “Statement”).<sup>19</sup>

The Statement begins with the broad proposition that the FDA will “treat products containing cannabis or cannabis-derived compounds as we do any other FDA-regulated products” regardless of the source of the substance.<sup>20</sup> Despite this position, the Statement recognizes the “growing public interest in cannabis and cannabis-derived products, including [CBD],” as well as the “potential opportunities that cannabis or cannabis-derived products could offer”<sup>21</sup> The FDA then promises to “continue to take steps to make the pathways for the marketing of these products more efficient.”<sup>22</sup>

Substantively, the Statement provides that “[c]annabis and cannabis-derived products claiming in their marketing and promotion materials that they are intended for use in the diagnosis, cure, mitigation, treatment, or prevention of diseases (such as cancer, Alzheimer’s disease, psychiatric disorders and diabetes) are considered new drugs or new animal drugs and must go through the FDA drug approval process for human or animal use before they are marketed in the U.S.”<sup>23</sup> Similarly, “it’s unlawful under the FD&C Act to introduce food containing added CBD or THC into interstate commerce, or to market CBD or THC products as, or in, dietary supplements . . . because both CBD and THC are active ingredients in FDA-approved drugs (Epidiolex) and were the subject of substantial clinical investigations before they were marketed as foods or dietary supplements.”<sup>24</sup> So even though hemp is lawful under the 2018 Farm Bill, certain products, depend-

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ing on the delivery method of ingestion and how they are marketed, technically remain unlawful under the FD&C Act.

The rest of this article is available in the August 2022 issue of the Norton Journal of Bankruptcy Law and Practice in print and on Westlaw Edge and Westlaw Classic.