2015

Casenote: Arenas v. United States Trustee--Bankruptcy Plans Go Up in Smoke

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I. Introduction

In *Arenas v. United States Trustee*,[1] the court was confronted with an effort by individuals engaged in a marijuana business to convert their Chapter 7 bankruptcy case to a Chapter 13 reorganization, and a motion by the case trustee to dismiss the Chapter 7 case.[2] Citing the United States Supreme Court decision in *Marrama v. Citizens Bank of Mass.*[3] (holding that a debtor who cannot meet the good faith requirement for confirmation of a Chapter 13 plan has no right to convert from Chapter 7 to Chapter 13[4]), in *Arenas* the Tenth Circuit Bankruptcy Appellate Panel (BAP) affirmed the bankruptcy court, holding that the Chapter 7 debtors could not convert their case to Chapter 13 because it violates the duty of good faith to propose requiring the trustee to engage in transactions illegal under federal law.[5] The court also held that the same lack of good faith permitted dismissal of the debtor's Chapter 7 case pursuant to Bankruptcy Code section 707(a)(1).[6]

II. Facts, Legal Issues and Case History

The primary debtor (Frank Arenas) was licensed by the state to grow and dispense medical marijuana in Colorado.[7] Along with co-debtor Sarah Eve Arenas (together, the debtors), Frank owned a commercial building in Denver. One unit was used by Frank to grow and sell marijuana; the other unit was leased to a marijuana dispensary (Denver Patients Group, LLC, or DPG).[8] These are lawful activities under Colorado law, but not under federal law.[9]

The reader may wonder (as one of your author's academic colleagues did, in discussing this case) how a marijuana business can go broke and need bankruptcy protection. The answer in the case apparently was the cost of litigation: The debtors sought to evict DPG from the debtors' building in the process suffering an adverse judgment for $40,000 in attorney fees; they also faced a pending counterclaim for $120,000 in damages.[10] The debtors responded by filing a Chapter 7 bankruptcy petition.[11]

However, a Chapter 7 case contemplates liquidation of a debtor's non-exempt assets,[12] and in this case

1. *In re* Arenas, 535 B.R. 845 (10th Cir. BAP 2015).
2. *Id.*, at 847.
3. 549 U.S. 365 (2007).
4. *See* Bankruptcy Code § 1325(a)(3), 11 U.S.C. § 1325(a)(3).
5. *Arenas*, 535 B.R. at 854. There is some disagreement as to the binding effect of a BAP decision. *See, e.g.*, Maya P. Hill & Thomas A. Hill, *Bankruptcy Code Section 1325: 910 Creditor Claims in the Post-BAPCPA Environment*, 61 Consumer Fin. L.Q. Rep. 587, at 596 n. 80 (2007) [hereinafter Hill & Hill].
6. *Arenas*, 535 B.R. at 853 - 54, citing 11 U.S.C. § 707(a)(1).
7. *Arenas*, 535 B.R. at 847.
8. *Id.*
9. *Id.* (citing the federal Controlled Substances Act, 21 U.S.C. §§ 801 *et seq.*, or CSA). *See also* the CSA implementing regulations at 21 CFR §§ 1300 *et seq.* It should be noted, however, that the United States Department of Justice has formally announced a deference to state laws authorizing the production, distribution and possession of marijuana in the states of Colorado and Washington. *See, e.g.*, Department of Justice, Justice News, Justice Department Announces Update to Marijuana Enforcement Policy, Aug. 29, 2013, *available at* http://www.justice.gov/opa/pr/justice-department-announces-update-marijuana-enforcement-policy. Moreover, state legalization of medical marijuana has increased dramatically. *See, e.g.*, U.S. News, U.S. Watch, Pennsylvania, *Medical-Marijuana Program Is Approved*, Wall Str. J., April 18, 2016, at A9 ("Pennsylvania has become the 24th state to legalize a comprehensive medical marijuana program.").
10. *Arenas*, 535 B.R. at 847 - 48.
11. *Id.*
12. *See, e.g.*, Bankruptcy Code § 726, 11 U.S.C. § 726 (distribution of property of the estate). *See generally* FRED H. MILLER & ALVIN C. HARRELL, THE ABCs OF THE UCC [-] RELATED INSOLVENCY LAWS 22 - 28 (2nd ed. 2006).

the primary creditor (DPG) expressed an interest in buying the debtors' commercial building.[13] In addition, the case trustee (trustee) sought guidance from the United States Trustee (UST) as to whether the trustee could administer the assets of the bankruptcy estate[14] without violating federal law.[15] Possibly in an effort to avoid loss of the building (which might be retained while unsecured debts are discharged pursuant to a Chapter 13 plan[16]), the debtors moved to convert their Chapter 7 liquidation case to a Chapter 13 reorganization case.[17] The bankruptcy court denied the debtors' motion to convert and granted the motion of the UST to dismiss the Chapter 7 case.[18] The debtors appealed.

III. Appeal to the BAP

The "pivotal issue" on appeal, as framed by the BAP, was whether the debtors' operation of a marijuana business (as noted, legal under state but not federal law) precluded them from meeting the good faith requirements for Chapter 7 and 13 cases.[19] This is part of an interplay of issues involving the relation between state and federal law, some of which have been previously covered in this journal.[20] However, while the more familiar cases dealing with this interplay are focused on the extent to which relatively narrow federal laws may preempt (and thereby fit within the matrix of) a much broader system of state law,[21] and therefore implicate issues of federalism rather than questioning the enforceability of federal law, the debtors in *Arenas* had the misfortune to be appearing before federal judges, who are expressly sworn to uphold federal law, and asking those judges to ignore federal criminal law in a federal court case.[22] Inasmuch as the debtors were engaged in a business that is a crime under federal law, their effort to receive bankruptcy protection in federal court was inherently an uphill battle.

Nonetheless, as the BAP took pains to point out,[23] it "oversimplifies the [bankruptcy] court's reasoning" to characterize this case as holding that "debtors who are engaged in the marijuana business are not eligible for bankruptcy relief."[24] Instead, as noted below, the BAP's analysis digs deeper into the requirements of the Bankruptcy Code, leaving at least a small crack or two to suggest a possibility of opening the door to bankruptcy relief for some marijuana businesses.

IV. The Motion to Convert to Chapter 13

A. Introduction

The BAP concluded that, by growing and selling marijuana, "the debtors have not engaged in intrinsically evil conduct,"[25] but nonetheless also concluded that the debtors were not eligible for bankruptcy relief. The court first considered the debtors' motion to convert the case from Chapter 7 to Chapter 13.

B. Conversion to Chapter 13

The BAP initially focused on Bankruptcy Code subsections 706(a) and (d),[26] which allow a Chapter 7 debtor to convert the case to Chapter 13 if "the debtor may be a debtor under such chapter."[27] The court then noted that "[m]any courts consider a debtor's good faith to be a condition of Chapter 13 eligibility."[28] Although good faith is not a stated requirement for conversion under section 706, it is a requirement for confirmation of a Chapter 13 plan, pursuant to section 1325(a)(3), and a lack of good faith justifies dismissal of a Chapter 13 case under Bankruptcy Code section 1307(c).[29] Moreover, the United States Supreme Court has equated these statutory requirements with a rule that good faith is required in order to qualify as a Chapter 13 debtor.[30]

Thus, the BAP quite easily concluded that the *Arenas* debtors were required to meet the test of good faith in order to be eligible for conversion of their case to Chapter 13.[31] The bankruptcy court then concluded that the *Arenas* debtors failed to meet the test at section 1325(a)(3) for confirmation of a Chapter 13 plan that is "proposed in good faith *and not by any means forbidden by law*."[32] This failure was judged to be cause for dismissal under section 1307(c) and

13. *Arenas*, 535 B.R. at 848.

14. *See* Bankruptcy Code § 541, 11 U.S.C. § 541.

15. *Arenas*, 535 B.R. at 848.

16. *See* Bankruptcy Code §§ 1322 & 1325, 11 U.S.C. §§ 1322 & 1325.

17. *Arenas*, 535 B.R. at 848.

18. *Id.*

19. *Id.*, 535 B.R. at 849. *See also supra* this text and notes 3 - 9.

20. *See, e.g.*, Christopher L. Allen, Timothy R. Macdonald, John N. Nassikas, Evelina J. Norwinski, Thomas W. Soever, Jr., & Beach Weiss, *Reefer Madness — New Treasury Guidance for Banks Providing Financial Services to Marijuana Sellers*, 68 Consumer Fin. L.Q. Rep. 28 (2014); *and see infra* note 76.

21. *See, e.g.*, Debra Lee Hovatter, *Preemption Analysis under the National Bank Act: Then and Now*, 67 Consumer Fin. L.Q. Rep. (Continued in next column)

(Continued from previous column)

5 (2013); Roland E. Brandel & Jeremy R. Mandell, *Preemption under the Consumer Financial Protection Act*, 64 Consumer Fin. L.Q. Rep. 307 (2010). *See also, e.g.*, Michael C. Tomkies & Susan Manship Seaman, *Stay Far from the* Madden-*ing Crowd: When Preemption Meets Contract Law*, in this issue.

22. *See Arenas*, 535 B.R. at 854.

23. And even though the BAP also summarized its holding as saying "the debtors cannot obtain bankruptcy relief because their marijuana business activities are federal crimes," *Arenas*, 535 B.R. at 849 - 50.

24. *Id.*, at 852 n. 37 (rejecting the debtors' characterization, in their Opening Brief, of the bankruptcy court's holding).

25. *Id.* at 849. Indeed, as cited *supra* at note 9, federal enforcement authorities have expressly deferred to the legality of the conduct under state law.

26. 11 U.S.C. § 706(a) & (d).

27. *Id.* at 706(d).

28. *Arenas*, 535 B.R. at 850 [citation omitted]. *See also id.* at 851 - 52; *and see* Bankruptcy Code § 1325(a)(3), 11 U.S.C. § 1325(a)(3) (good faith requirement for confirmation of a Chapter 13 plan).

29. 11 U.S.C. § 1307(c). *See Arenas*, 535 B.R. at 851 (noting that section 1307(c) provides for dismissal "for cause," and includes a nonexclusive list of examples. Although a lack of good faith is not *specified* in the list, in *Arenas* the BAP also noted that it had previously held that a debtor's lack of good faith "amounts to cause for dismissal under § 1307." *Id.* at 850.

30. *Arenas*, 535 B.R. at 850 (citing and quoting *Marrama*, 549 U.S. at 375).

31. *Id.* at 850 - 53. The *Arenas* court also noted that under section 1307(c)(1) a likelihood of "unreasonable delay by the debtor that is prejudicial to creditors," such as delay by reason of an inability to confirm a Chapter 13 plan, would be a basis for dismissal and therefore would bar conversion. *Id.* at 850 - 51 (citation omitted).

32. *Id.* at 851 (quoting the bankruptcy court's Appealed Order at 5 - 6, in App. at 233 - 34) (emphasis in original).

therefore a basis for denying conversion of the case under section 706.[33]

There is little to quarrel with in the court's basic analysis on these points. However, an interesting aside is the emphasis in the court's language quoted immediately above, on the requirement that a Chapter 13 plan be proposed by "means [not] forbidden by law."[34] This seemingly shifted the emphasis from the issue of good faith (the other prong in the court's test, and the focus of most of the BAP's analysis) to a potentially different requirement that receives relatively little attention from the court. Moreover, it is not immediately apparent what this additional requirement precisely means, as a plain reading could even relate the requirement to the means of proposing the plan and not the contents of the plan itself.[35] In any event, the BAP's opinion proceeds to focus on the requirement for good faith.

C. The Good Faith Requirement

In measuring a debtor's good faith, the BAP's opinion notes that courts in the Tenth Circuit apply the eleven factors articulated in *Flygare v. Boulden*.[36] Of these factors, the court noted, the ones relevant in *Arenas* are the requirements for: "(1) the debtor's employment history, ability to earn and likelihood of future increases in income; (2) the burden the plan's administration would place on the trustee; and (3) the debtor's motivation and sincerity in seeking Chapter 13 relief."[37] Although the BAP agreed with the bankruptcy court that these factors indicated a lack of good faith in *Arenas*,[38] an interesting point (as explained below) is that these factors would not seem to necessarily bar Chapter 13 eligibility or mandate dismissal of the case for a debtor in the marijuana business.[39]

As to the first factor, in *Arenas* the court was troubled that the debtors' income from sources other than rental of their building to the marijuana dispensary was not enough to fund a Chapter 13 plan, and even with that rental income the plan was barely feasible (yielding a proposed $8 per month for creditors).[40] The court also noted that future increases in the debtors' income were unlikely, given the debtors' ages, physical condition and employment history.[41] While the BAP agreed with the bankruptcy court that these factors meant the Chapter 13 plan was not feasible, it can be noted that in other marijuana-related cases these factors might be sufficiently different to warrant conversion to Chapter 13 and confirmation.

Regarding the second applicable *Flygare* factor, the *Arenas* court concluded that:

> Nothing could be more burdensome to the Trustee's administration than requiring him to take possession, sell and distribute marijuana assets in violation of federal criminal law. There is no way the Trustee could administer the plan without committing one or more federal crimes.[42]

This was a major factor in the court's analysis, and is surely an important consideration, and yet it is not clear to your author that the trustee in a Chapter 13 case is required to, or ordinarily does, directly conduct the business of the Chapter 13 debtor.[43] So, the BAP may have overstated this point if it intended to mean that the trustee would be required to hand out marijuana to retail customers. Surely even the necessary supervision could be handled in large part by professionals retained for this purpose, assuming the economics were right. On the other hand, most certainly the trustee would have supervisory responsibilities for the business under Bankruptcy Code section 1302(c), thereby triggering some potential concerns.[44]

Still, it is not your author's impression that a bankruptcy trustee becomes responsible for criminal acts of bankruptcy debtors, or has an enforcement role in such matters outside the Bankruptcy Code, beyond a referral to other authorities.[45] In any event, as pointed out by the debtors in *Arenas*, and noted by the BAP, the U.S. government has announced that it will not prosecute certain aspects of the marijuana business in Colorado.[46] All of this suggests that the *Arenas* court's concerns about case administration may be overblown, despite an obvious and reasonable aversion to operating an illegal business, which is likely to be widely shared.

Finally, as regards the third set of *Flygare* factors, the bankruptcy court found the *Arenas* debtors to be sincere and credible and without any improper

33. *Id.* at 851 & n. 31.

34. *Id.*

35. *Id.* The court's approach works well in requiring that the plan be proposed in good faith, but does not seem as clear as regards the requirement that the plan be proposed by a means not prohibited by law. Later in the *Arenas* opinion, the BAP specifically disclaims any reliance on this additional requirement. *See id.* at 853.

36. *Id.* at 851 - 52 (citing *Flygare*, 709 F.2d 1344 (10th Cir. 1983)).

37. *Id.* at 852.

38. *Id.*

39. The BAP seemed to recognize this. *See supra* this text and notes 23 - 25.

40. *Arenas*, 535 B.R. at 852. Among other things, the CSA prohibits the receipt of funds that are proceeds of marijuana-related transactions, thus criminalizing the receipt of rent from the DPG. *See, e.g.*, Allen, Macdonald, Nassikas, Norwinski, Soever & Weiss, *supra* note 20.

41. *Arenas*, 535 B.R. at 852. Ms. Arenas was disabled. *Id.*

42. *Id.*

43. *See, e.g.*: Bankruptcy Code § 1302, 11 U.S.C. § 1302 (duties of trustee); *id.* § 1304, 11 U.S.C. § 1304 (debtor engaged in business).

44. *See* Bankruptcy Code § 1302(c), 11 U.S.C. § 1302(c) (incorporating the duties of a Chapter 11 trustee as specified at 11 U.S.C. § 1106(a)(3) & (4)). Moreover, as noted *supra* at note 40, receiving the proceeds of marijuana transactions is a federal crime, and clearly the bankruptcy trustee would be administering such funds. *See also Arenas*, 535 B.R. at 852 ("...short of exposing him to physical harm, nothing could be more burdensome to the Trustee's administration than requiring him to take possession, sell and distribute marijuana assets in violation of federal criminal law."). *But see* Allen, MacDonald, Nassikas, Norwinski, Soever & Weiss, *supra* note 20 (noting that handling routine financial transactions is not considered a significant violation of federal law); and *see supra* notes 9 & 25 (noting federal deference to state law on these issues).

45. A Chapter 13 trustee is required to perform the duties specified at Bankruptcy Code § 1106(a)(3) & (4). *See id.* § 1302(c), 11 U.S.C. § 1302(c). Bankruptcy Code § 1106(a)(3) & (4) requires the trustee to "investigate the acts, conduct, assets, liabilities and financial conditions of the debtors...and any other matters relevant to the case...." and "file a statement of any [such] investigations...including any fact ascertained pertaining to fraud, dishonesty, incompetence, misconduct, mismanagement, or irregularity in the management of the affairs off the debtor...." While it appears that the focus of this requirement is financial irregularities, your author concludes that the trustee's report should include information on the debtor's illegal marijuana activities. That being said, however, it would seem that filing this report would constitute discharge of the trustee's duties in the matter. *See generally, supra* note 44.

46. *Arenas*, 852, n. 39. *See also supra* notes 9 & 44.

motive.[47] The BAP did not disagree.[48] Nonetheless, applying what the BAP characterized as an "objective rather than subjective meaning" of the good faith requirement, the court concluded that the debtors' motion was "objectively unreasonable" because their lack of good faith made them unable to propose a confirmable Chapter 13 plan.[49]

D. Author's Comments

It does not seem clear that the BAP's analysis in *Arenas*, as summarized above, fully supports its conclusion that the debtors' Chapter 13 plan could not be confirmed due to a lack of good faith. At an intuitive level, of course, it does not seem appropriate for a business that constitutes a federal crime should be eligible for federal bankruptcy protection. But as the *Arenas* court readily conceded, the issue is not that simple.

The BAP relied on application of the three relevant *Flygare* factors in determining whether the *Arenas* debtors met the obligation of good faith.[50] However, it does not seem apparent that the court's analysis of these factors supports its conclusion. Your author does not like zero-payment Chapter 13 plans (where payments to unsecured creditors are zero or nominal, essentially what the *Arenas* debtors proposed[51]); but such plans have been confirmed in other cases and certainly are not unknown.[52] Thus, some might not agree that the debtors' plan was unfeasible and that this was an adequate basis for a finding that the debtors were acting in bad faith. Nor does the debtors' lack of prospects for future income growth (given that one debtor is disabled), or their reliance on real estate rental income (even if the tenant dispenses marijuana) seem sufficient as evidence of bad faith.[53]

As suggested above at Part III.C, the BAP's concerns about requiring a bankruptcy trustee to sell marijuana are understandable, and perhaps would be of paramount concern for many in this type of case, but nonetheless may be overstated as a basis for the court's holding that the debtors were not acting in good faith. Your author's reading is that a fair number of businesses have been permitted to reorganize in bankruptcy despite engaging in practices that others might find distasteful or even illegal (especially given the recent, dramatic expansion of the types of conduct deemed criminal under federal law[54]). Of course, there is a distinction between cases where a debtor may have previously violated a federal law (where the violation has now ceased) and a case like *Arenas* where the criminal conduct is ongoing and a foundation for the plan of reorganization. But there is also a distinction between criminal conduct that is considered serious, as compared to that where the violation is largely a technicality and not subject to prosecution. The recent, vast expansion of federal criminal law may make these distinctions important, even essential. Absent such distinctions, this may not be a workable test of good faith for bankruptcy purposes.[55]

The *Arenas* court essentially conceded that the debtors met the test of the third set of *Flygare* factors ("motivation and sincerity"), leaving the first two factors as the sole bases of support for the court's conclusion that there was a lack of good faith. As indicated above, the court's analysis of these factors is not entirely convincing in this regard, notwithstanding the BAP's statement that "[p]lenty of evidence supports the bankruptcy court's finding of lack of good faith."[56] Moreover, the court's analysis of the first two factors suggests that, with some modest changes in the factual context, a marijuana business (or the operator of such a business) could meet the eligibility requirements for Chapter 13.

V. Dismissal of the Chapter 7 Case

A. BAP Analysis

The next question for the BAP in *Arenas* was whether the bankruptcy court abused its discretion in granting the UST's motion to dismiss the Chapter 7 case for cause under Bankruptcy Code section 707(a).[57] "Cause" is not defined in the Bankruptcy Code, although section 707(a) states that it includes "unreasonable delay that is prejudicial to creditors."[58] The court also noted that a bankruptcy discharge is a privilege, not a constitutional right.[59]

As the BAP observed: "The bankruptcy court concluded that it would be impossible for the Chapter 7 Trustee to administer the Arenases' estate because selling and distributing the proceeds of the marijuana assets would constitute federal offenses."[60] As a result, the creditors would receive no distribution and yet would be stayed from enforcing their state law rights, while the debtors would receive a discharge.[61] Thus, the

47. *Arenas*, 535 B.R. at 852.

48. *Id.*

49. *Id.*

50. *See supra* Part III.C.

51. *See supra* this text at note 40.

52. *Arenas* been the case for a fair number of years. *See e.g.*, Virginia M. Hunt, *The Bankruptcy Good Faith Issue*, 47 Consumer Fin. L.Q. Rep. 402 (1993) [hereinafter Hunt].

53. *See supra* this text and notes 41 - 45.

54. *See, e.g.*, Alvin C. Harrell, Casenote, Elonis v. United States – *Supreme Court Opines on Federal Criminal Law Standards Governing Violent Internet Speech*, 68 Consumer Fin. L.Q. Rep. 464, at 464 n. 1 (2014) (noting the proliferation of federal criminal laws).

55. In *Marinoff*, 549 U.S. 365, for example (relied on by the *Arenas* court), the Supreme Court limited its reference of wrongful acts to instances of bankruptcy crime.

56. *Arenas*, 535 B.R. at 853.

57. *Id.* (citing 11 U.S.C. § 707(a)).

58. *Id.* The court also cited various "[d]ismissal factors": "the best interests of both debtors and creditors; trustee's consent or objection; potential to delay creditor payments; good or bad faith in seeking dismissal; and the possibility of payment priority becoming recorded outside of bankruptcy." *Id.*, quoting *In re* Ishii, 2013 WL 1386208, at *3 (10th Cir. BAP April 5, 2013).

59. *Arenas*, 535 B.R. at 853. The *Arenas* court observed that: "[t]here is no constitutional right to obtain a discharge of one's debts in bankruptcy." *Id.* (quoting United States v. Kras, 409 U.S. 434 (1973)).

60. *Id. See also supra* notes 41 - 45.

61. *Arenas*, 535 B.R. at 853. "This is the epitome of prejudicial delay." *Id.* at 854. Again it can be observed, however, that this result is not uncommon in bankruptcy cases. *See, e.g.*, Hunt, *supra* note 52; Michael W. Dunagan, *The Impact of Chapter 13 on Car Creditors*, 59 Consumer Fin. L.Q. Rep. 172 (2005). So the question remains: What is different about this case? One answer is that normally estate property is abandoned by the trustee because it is economically burdensome, *i.e.*, it has no value to the estate. This indicates that there is no

(*Continued on next page*)

bankruptcy court essentially concluded that the "impossibility of lawfully administering the estate constituted cause for dismissal under [section] 707(a)."[62]

On appeal the debtors argued that this was an incorrect application of the requirements for dismissal, essentially arguing that any marijuana assets could be abandoned and that "cause" should be limited to cases "where the debtors' actions have frustrated the administration of the estate or a bankruptcy purpose" (actions not evident here).[63] The BAP responded that administering the estate would require the trustee to sell the debtors' marijuana plants and building, and this "would require the Trustee to violate federal law."[64] The court reasoned that, even if the trustee abandoned these assets, "the debtors would retain their business after exposing the Trustee to grave risks, . . ."[65] Of course, if the assets were abandoned, and the stay was lifted as to those assets, lien creditors could pursue their state law remedies against those assets, ameliorating any such problems and probably meaning that the debtors would not retain those assets.[66] However, in *Arenas* the primary creditor apparently had no lien for its largest claim, and no means to acquire one if the debtors were allowed to continue in bankruptcy. The BAP concluded that this "is the epitome of prejudicial delay."[67] Partly on this basis, the BAP affirmed the bankruptcy court's dismissal of the Chapter 7 case.[68]

B. Author's Comments

Arguably, the BAP analysis of the Chapter 7 dismissal does not adequately explain the result, and leaves several important issues unresolved. The basic conclusion, that dismissal was warranted because allowing the bankruptcy case to go forward would mean prejudicial delay to creditors while providing the debtor a discharge, applies to some extent in every Chapter 7 case. Admittedly, in *Arenas* there were some unusual factors (as noted above) that weigh in favor of the court's analysis. However, it is not entirely clear that the court's decision represents an optimal solution under the Bankruptcy Code. While there are cases where a bankruptcy debtor "games the system" to create egregious delays for creditors while seeking a discharge, the BAP did not cite any specific example of this in *Arenas*, beyond that noted above.

The BAP seemed to address the debtors' argument that the trustee could simply abandon any unlawful (marijuana) assets, but then disclaimed any opinion on the issue because it was not raised in the court below.[69] This leaves open an important issue: What if the debtors had raised the argument on abandonment in a timely manner, and the argument had been fully considered by both courts? After this case decision, one can presume that the next marijuana debtor will not fail to make this argument in a full and timely manner, and then some of the issues in *Arenas* will need to be revisited in the context of that argument.

Assuming the trustee's abandonment of unlawful assets (as burdensome to the estate), precisely what is there in a case like *Arenas* to warrant dismissal? There does not seem to be much left, in the BAP's *Arenas* opinion, as a basis for dismissal. The fact that a Chapter 7 case causes a delay to creditors and results in discharge of the debtor's liability, and that the newly-discharged debtor can continue post-petition to engage in the same trade, business or profession (inherent in the goal of a "fresh start" for the debtor), is surely not enough for dismissal (unless bankruptcy law is to be dramatically changed).

In the end, one is left with the impression that the BAP was persuaded that bankruptcy protection should not be available to debtors engaged in activities that violate federal law. While that may seem to many a reasonable conclusion, there are at least two problems with this approach: (1) the Bankruptcy Code does not say this, at least not explicitly (and maybe not even implicitly); and (2) this approach seemingly requires bankruptcy judges and trustees to ascertain whether and to what extent each debtor is engaged in activities outside of bankruptcy that are violative of federal law. Given the vast and expanded scope of federal crimes,[70] this could be a massive task, and could exclude huge numbers of debtors from bankruptcy protection and create a new wave of bases for motions to dismiss or to deny the discharge.

VI. Conclusion

In the conclusion to its *Arenas* decision, the BAP states that the debtors were unfortunate to be engaged in a business that, while expressly legal under state law, is a crime under federal law ("laws that every United States Judge swears

61. *(Continued from previous page)*

loss or prejudice to creditors of the estate, or enrichment of the debtor. In a case like *Arenas*, however, abandonment of valuable property, merely because it is technically illegal, together with discharge of the debtors' liability, could leave the debtors enriched by reason of their own illegal activity, at the expense of creditors. As a court of equity, the bankruptcy court obviously should not abet unjust enrichment in this way. However, perhaps this suggests a need to administer the property (in Chapter 7 or 13) or to fashion an equitable remedy (e.g., by lifting the stay so as to allow creditors to pursue their state law remedies after abandonment). *Cf., e.g.*, the treatment of certain undersecured liens under Bankruptcy Code § 1325(a). *See, e.g.*: Hill & Hill, *supra* note 5; Alvin C. Harrell, *Did the Seventh Circuit Make the "Wright" Decision in Resolving the BAPCPA "Hanging Paragraph?"*, 61 Consumer Fin. L.Q. Rep. 598 (2007).

62. *Arenas*, 535 B.R. at 853 (citing bankruptcy court Appealed Order at 5, in App. at 233).

63. *Id.*

64. *Id. See also supra* note 40. *But see supra* note 61.

65. *Arenas*, 535 B.R. at 853. As noted above, it seems to your author that this may overstate the risk, given the federal non-enforcement policy with respect to marijuana crimes. *See supra* this text and notes 20, 25, & 45 - 46. The BAP also cited as reasons for dismissal that allowing the case to proceed would provide the debtors a discharge while allowing creditors little or no recovery. However, as noted *supra* at note 61, this is not an insurmountable problem in bankruptcy cases, and alone may not be an adequate basis for dismissal. The BAP also stated that the debtors did not raise the abandonment argument at trial, thereby precluding its consideration. *Arenas*, 535 B.R. at 854 & n. 50.

66. The debtors would retain their ability to engage in that type of business post-bankruptcy, but would lose their non-exempt pre-petition assets. Again, however, that is the nature of a Chapter 7 bankruptcy, and perhaps not a reason for dismissal.

67. Again, however, this seems to be the epitome of bankruptcy. *See supra* note 61.

68. *Arenas*, 535 B.R. at 854.

69. *See supra* note 65.

70. *See, e.g.*, Harrell, *supra* note 54.

to uphold.").[71] Although the BAP made a credible effort to find support in the Bankruptcy Code for this factor as the basis for its decision, its difficulty in doing so (perhaps surprisingly, given the grant of broad equitable discretion to bankruptcy judges[72]) lends support to the conclusion that the language quoted immediately above indicates the basic rationale for the courts' *Arenas* decisions. And one cannot help having sympathy for the conundrum faced by these judges: What federal judge wants to be on record upholding federal bankruptcy protection for an illegal drug dealer engaged in conduct that is a crime under federal law?[73]

Nonetheless, an issue remains: The *Arenas* decision may be understandable, but is it good law? The statutory analysis in *Arenas* seems weak in places, perhaps because the drafters of the Bankruptcy Code did not anticipate this issue, and therefore did not provide for it (at least expressly) in the statute. As a result, the courts' supportive analyses leave something to be desired, and also leave various questions unanswered (and perhaps ripe for future litigation). To some extent, by leaving open these issues, both the bankruptcy court and BAP kicked the can down the road for the next court.

Beyond this, a more fundamental question is whether the courts' basic supposition is correct, *i.e.*, should debtors be denied bankruptcy relief because they are violating another (non-bankruptcy) federal law? In your author's reading, the Bankruptcy Code does not expressly say this[74] and, although one can sympathize with the hesitancy of a federal judge to protect a person guilty of federal crimes, there is also the point that bankruptcy courts have a limited purpose and jurisdiction with regard to prosecutions for violations of federal criminal law. Perhaps, as a policy matter, an even more important point is that denial of bankruptcy relief to all debtors violating federal criminal laws could dramatically restrict the eligibility for bankruptcy relief and create a massive new wave of litigation over debtors' alleged activities.[75]

The *Arenas* case illustrates merely one facet of the new legal issues created by the lifting of some state law prohibitions against the personal use of marijuana.[76] In this regard, it is not your author's intent to justify or defend marijuana production, distribution or use.[77] But our beliefs relating to such issues should not obscure the relevant legal issues. Otherwise, it may be more than the bankruptcy plans of these debtors that goes up in smoke.

71. *Arenas*, 535 B.R. at 854.

72. *See, e.g.*, Bankruptcy Code § 502, 11 U.S.C. § 502.

73. One can only imagine the potential newspaper headlines and social media tweets.

74. *Compare* the explicit provisions of Bankruptcy Code section 523, 11 U.S.C. § 523.

75. *See, e.g.*, Harrell, *supra* note 54. And what of state criminal laws? And the targets of federal administrative prosecutions? Note that this is an entirely different issue from whether a particular type of debt is nondischargeable pursuant to the specific statutory provisions at Bankruptcy Code § 523(a), 11 U.S.C. § 523(a).

76. *See, e.g.*: G.M. Filisko, *Weed-Whacked*, ABA Journal, Dec. 2015, at 46 ("Employers and workers grapple with laws permitting recreational and medical marijuana use"); Conrad de Aenlle, *Legalized. Sure. But Good Luck Filing the Paperwork*, N.Y. Times, Feb. 21, 2016, at 10 ("... sellers face complex tax rules.").

77. On these narrow points, at a personal level, your author is inclined to agree with Nancy Reagan, whose views were well articulated in a Wall Street Journal editorial republished in part the day after her death on March 6, 2016. *See Notable & Quotable: Nancy Reagan*, Wall Str. J., Mar. 7, 2016 at A15 (expressing concern over the impact of drugs on society and people's lives). On the other hand, marijuana is not the only such problem, and if bankruptcy courts are to be tasked with such issues it could drastically change the nature of bankruptcy relief.

Treasury Department Seeks Information on Online Marketplace Lending

by Alan S. Kaplinsky, Peter N. Cubita, Jeremy T. Rosenblum and Scott M. Pearson*

In July 2015 the U.S. Department of the Treasury published a request for information (RFI) regarding online marketplace lending.[1] The RFI reflects the Treasury Department's recognition that online marketplace lending "is a rapidly developing and fast-growing sector that is changing the credit marketplace" even though it "is still a very small component of the small business and consumer lending market." This is

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1. *See* Department of the Treasury, Public Input on Expanding Access to Credit Through Online Marketplace Lending, 80 Fed. Reg. 42806 (July 20, 2015). Comments were due on or before August 31, 2015.