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## Pot Co.'s Ch. 11 Again OK'd Over US Trustee's Protest

By **Alex Wittenberg**

Law360 (September 22, 2023, 9:31 PM EDT) -- A California bankruptcy judge has rejected the Office of the U.S. Trustee's second attempt to dismiss the Chapter 11 case of cannabis company The Hacienda Co., saying the watchdog's claims that the case is a conspiracy to pay creditors using funds from criminal activity shouldn't prevent Hacienda from using bankruptcy to liquidate assets.

U.S. Bankruptcy Judge Neil W. Bason said in an opinion filed Wednesday that the Office of the U.S. Trustee's argument belies the fact that federal law doesn't restrict companies engaged in illegal activity from making payments to legitimate creditors. Even if Hacienda is engaged in post-petition criminal activity — which it may not be — that doesn't make it appropriate to dismiss the bankruptcy case, Judge Bason's denial of the dismissal request says.

"It would be odd to read the Bankruptcy Code as implicitly barring any payments to legitimate creditors when that is what federal criminal law itself provides," Judge Bason said.

The U.S. Trustee's Office has argued that even after Hacienda filed for bankruptcy, it continued to violate the Controlled Substances Act by holding stock worth about \$35 million in a Canadian weed company to which it transferred assets after ceasing operations in February 2021. Hacienda wants to sell that stock in Chapter 11 to fund payouts to creditors, a plan the U.S. Trustee's Office said would violate federal criminal laws and money laundering statutes.

Yet even if Hacienda is breaking the law, it's unclear that dismissing the bankruptcy case would be justified, Judge Bason said in his opinion. Congress has shown a willingness to avoid punishing a debtor that may have violated law when "the real victims would be innocent creditors," the opinion says.

"This court is not persuaded that, in the circumstances of this case, any federal court policy of not condoning illegality should override Congress' mandates to administer bankruptcy cases, with all of the resulting benefits to innocent creditors and other parties in interest," the opinion says. "Dismissal of this bankruptcy case is not warranted on this ground."

Judge Bason's decision Wednesday marks a second victory for Hacienda and signals a potential shift in how bankruptcy courts treat debtors in the cannabis industry. In December, the judge shot down the Office of the U.S. Trustee's first motion to dismiss the case, a move that **some observers said** could make it easier for cannabis companies to engage in the bankruptcy process.

In his January opinion on the first dismissal motion, Judge Bason recognized the Ninth Circuit Bankruptcy Appellate Panel's 2020 statement in *In re: Burton* that "the mere presence of marijuana near a bankruptcy case does not automatically prohibit a debtor from bankruptcy relief."

Hacienda — which manufactured and sold cannabis products to dispensaries in California under the brand name Lowell Herb Co. — hit Chapter 11 more than a year after ceasing operations in 2021, according to the case background in the decision. That year, Hacienda sold intellectual

property to a publicly traded Canadian cannabis company that changed its name to Lowell Farms Inc. following the sale.

Hacienda received a 9.4% share of Lowell Farms' stock after selling the intellectual property. In Chapter 11, it planned to sell off the shares in an "orderly fashion" and use the proceeds to pay creditors, according to the opinion.

The U.S. Trustee's Office then filed a motion to dismiss the case in November, arguing Hacienda was "effectively engaged in the sale of cannabis products, or a conspiracy to do so," according to the opinion. Judge Bason was not persuaded that the U.S. Trustee had offered a preponderance of evidence for Hacienda's apparent post-petition criminal activity.

In May, the U.S. Trustee's Office filed its second motion to dismiss, arguing that Hacienda's Chapter 11 plan violated money laundering statutes and citing "authority that debtor has not taken sufficient steps to withdraw from an ongoing conspiracy to violate the CSA," according to the opinion.

While rejecting the U.S. Trustee Office's second motion to dismiss, Judge Bason said he would also approve Hacienda's Chapter 11 plan. The judge also provided reasons that the U.S. Trustee's Office shouldn't appeal the decision, saying the matter does not involve a pure question of law.

"This bankruptcy court is not certifying any direct appeal at this time," Judge Bason's opinion says.

Counsel for Hacienda declined to comment Friday. A spokesperson for the U.S. Department of Justice also declined to comment.

Hacienda is represented by David L. Neale, Juliet Y. Oh and Lindsey L. Smith of Levene Neale Bender Yoo & Golubchik LLP.

The U.S. Trustee's Office is represented in-house by Russell Clementson, Dare Law and Kelly L. Morrison.

The case is In re: The Hacienda Company LLC, case number 2:22-bk-15163-NB, in the U.S. Bankruptcy Court for the Central District of California.

--Editing by Amy French.