

Chapter 13 confirmation
Controlled substance
Good faith
Medical marijuana
ORS 475.304(7)
ORS 475.316
11 USC § 1325

Michael McGinnis, Case No. 11-60010

6/9/2011

FRA

Unpublished

Debtor filed a Pre-Confirmation Amended Plan which depended on income for plan payments from three sources: 1) A business owned by the Debtor, in which warehouse space would be rented to medical marijuana growers, 2) Profits from the Debtor's own medical marijuana operation, and 3) Rental income from a commercial property in Arizona.

The court examined 11 USC § 1325(a)(3) and determined that in order for a plan to be confirmed, it must be in compliance with not only Title 11, but other applicable federal and state law. The Debtor's Plan depended on the cultivation and sale of marijuana, a Schedule 1 controlled substance, in violation of federal law. Even though the current Federal administration has stated that it will not generally interfere with medical marijuana operations that are in compliance with state law, it does not change the fact that those operations are still illegal under federal law. Section 1325(a)(3) prevents confirmation of a plan that depends on illegal activity.

The Plan also depended on income from the Debtor's own medical marijuana grow operation. Under Oregon law, a medical marijuana grower can only be reimbursed for supplies and utilities associated with the production of medical marijuana. A grower is not allowed to make a profit from his efforts. See ORS 475.304(7). Further, ORS 475.316 states that persons who deliver marijuana *for consideration* to any individual, even a registered card holder, are not exempt from Oregon's general drug laws. The proposed Plan is in violation of Oregon state law.

The court further discussed how the current illegality and future uncertainty of the major income streams provided for by the Plan raise a feasibility issue under § 1325(a)(6).

Based on the findings that the Plan violated both federal and state law, and the feasibility standard of § 1325(a)(6), the Plan could not be confirmed.

The court also examined the Debtor's actions as they relate to the good faith requirement. The Debtor undervalued certain property on his schedules, sold property of the estate, and used proceeds without court permission. However, because of the Debtor's equity in real property, he is required to pay unsecured creditors in full. If the Debtor can present a Plan that meets the requirements of the Bankruptcy Code, it may be confirmed.

E11-12

1 The Plan provides for the sale of the Arizona commercial property by December 31, 2012, but if it is not
2 sold prior to that date the Debtor will continue to make the scheduled plan payments to pay off his plan. The
3 Plan also provides for the sale of real property in Coos Bay adjacent to the property on which Debtor resides.
4 However, Debtor testified at the March 22 hearing that his mother is now living in that property and he no
5 longer plans to sell it.

6 Schedule A of Debtor's bankruptcy petition indicates that the Arizona commercial property is worth
7 \$1,000,000 with secured debt of \$6,922 and the real property adjacent to his residence has a value of
8 \$250,000 with secured debt of \$35,000. Unsecured claims per the Debtor's schedules total \$62,192.
9 Schedule B lists a 1959 El Camino and indicates that it is "in pieces, no value." On February 18, 2011
10 Debtor filed a notice of intent to sell the vehicle to a party in Connecticut for \$25,000. At the confirmation
11 hearing on March 1, 2011, Debtor's attorney indicated that the sale had been completed and that the Debtor
12 needed the sale proceeds for his business. I directed at that hearing that the sale proceeds be held and not
13 spent. At the March 22 hearing, Debtor testified that the vehicle had already been sold and \$14,079 of the net
14 proceeds of \$22,500 had been spent on the marijuana warehouse operation prior to the date the notice of
15 intent to sell was filed with the court on February 18.

16 At the end of the March 22 hearing I expressed some doubt as to whether a plan could be confirmed which
17 relied upon the cultivation and sale of a product (marijuana) which is still classified as a Schedule 1 drug, and
18 thus illegal for most purposes, under federal law. The Trustee and the Debtor were invited to brief this issue
19 and have done so.

20 // // //

21 // // //

22 // // //

23 // // //

24 // // //

25 // // //

26 // // //

DISCUSSION

11 U.S.C. § 1325(a)(3)¹

A. Debtor’s Proposed Operations Violate Federal Law

Section 1325(a)(3) requires that a chapter 13 “plan has been proposed in good faith and not by any means forbidden by law.” I interpret this as meaning, at least in part, that in order for a plan to be confirmed, it must be in compliance with not only Title 11, but other applicable federal and state law. See 8 Collier on Bankruptcy ¶ 1325.04[2] (16th ed. 2011). Because Debtor’s Plan depends on a product the cultivation and sale of which violates federal law², I cannot find that the Plan meets the requirements of § 1325(a)(3) . Debtor argues that the current Federal administration has stated that it will generally not interfere with medical marijuana operations that are in compliance with state law³; however, this does not change the fact that those operations are still illegal under federal law. While a medical marijuana grower who is in compliance with state law may find the risks acceptably small and of little deterrence to his operation, when that grower files bankruptcy, § 1325(a)(3) prevents confirmation of a plan depending on that operation.

///

///

///

¹Unless otherwise specified, all statutory references herein are to the Bankruptcy Code, 11 U.S.C. §§ 101 to 1532.

²See 21 U.S.C. § 812(c)(10) designating marijuana as a Schedule 1 controlled substance. 21 U.S.C. §§ 841 to 863 describe prohibited acts involving controlled substances and penalties therefor.

³The government’s posture may not be all that clear: On June 3, 2011, the United States Attorney for Oregon and 33 of Oregon’s 36 District Attorneys released a “Notice to Owners, Operators and Landlords of Oregon Marijuana Dispensaries” stating that “The sale of marijuana for any purpose – including as medicine – violates both Federal and Oregon law and will not be tolerated,” and that property used by anyone to cultivate marijuana for sale may be subject to forfeiture. As of the date this opinion was issued, the document could be viewed at http://www.justice.gov/usao/or/Indictments/06032011_Marijuana.pdf. The reader should understand, however, that the Court’s decision is based on the statutes cited in this Memorandum, and not the transient policies of agencies charged with enforcement of the criminal laws.

1 B. Debtor's Proposed Operations Violate State Law

2 Debtor's Plan depends heavily on projected annual net income of \$56,400⁴ from Debtor's own medical
 3 marijuana grow operation. The profit from this operation, however, is currently not allowed under Oregon's
 4 Medical Marijuana Act. O.R.S. 475.304(7) provides that "[a] registry identification cardholder or the
 5 designated primary caregiver of the cardholder may reimburse the person responsible for a marijuana grow
 6 site for the costs of supplies and utilities associated with the production of marijuana for the registry
 7 identification cardholder. No other costs . . . may be reimbursed."⁵ Under that provision, the Debtor could be
 8 reimbursed only for supplies and utilities, estimated by Debtor at \$15,600, and any additional payments would
 9 be illegal. O.R.S. 475.316 makes this explicit by providing at subsection (d) that no person authorized to
 10 possess, deliver, or produce marijuana for medical use under the Medical Marijuana Act is exempted from
 11 Oregon's general drug laws if that person "[d]elivers marijuana *for consideration* to any individual, even if the
 12 individual is in possession of a registry identification card." [emphasis added]. Debtor testified that he has
 13 been lobbying the Oregon legislature for changes in law that would allow for the sale of medical marijuana at
 14 a profit. I take judicial notice of the fact that the legislature has not made such changes to the law and that a
 15 ballot measure was defeated in November, 2010 that would have allowed for medical marijuana to be sold in
 16 dispensaries.

17 Feasibility - 11 U.S.C. § 1325(a)(6)

18 Code § 1325(a)(6) provides as a condition of confirmation that "the debtor will be able to make all
 19 payments under the plan and to comply with the plan." Because the sale and cultivation of marijuana as
 20 envisioned in Debtor's Plan is illegal under federal law, I cannot find that the predicted income stream from
 21 the marijuana operations is reasonably certain to produce sufficient income to fund the Plan, despite federal
 22 authorities' current position regarding medical marijuana operations. Moreover, Debtor's own medical

23 _____
 24 ⁴Annual gross income of \$72,000 less expenses of \$15,600 for supplies and utilities.

25 ⁵It is unclear whether rental expense is included in the term "costs of supplies and utilities associated
 26 with the production of marijuana"; if it is not, Debtor's business plan respecting the grow site rental operation
 is untenable, because his tenants would not be able to recoup the costs of renting space for growing.

1 marijuana grow operation would require a change in Oregon law before it would be in compliance with state
2 law. While Debtor has testified that he has been lobbying to have changes made to the Oregon Medical
3 Marijuana Act, there is no evidence that changes as sought by the Debtor are imminent.

4 Other Matters

5 The Debtor's undervaluing of the El Camino in his schedules⁶ and the sale of property of the estate and
6 use of the majority of the proceeds without court permission also have implications with regard to Debtor's
7 good faith. Debtor's testimony that he believed he had permission to sell the vehicle I find to be dubious.
8 However, because of Debtor's equity in real property, he is required to pay unsecured creditors in full. If
9 Debtor can propose an amended Plan of Reorganization which meets the requirements of the Bankruptcy
10 Code, I would be prepared to allow its confirmation.

11 CONCLUSION

12 For the reasons given, Debtor's Amended Plan of Reorganization dated February 1, 2011, cannot be
13 confirmed. An order will be entered denying confirmation and providing that an amended plan be filed within
14 28 days. Should Debtor fail to file an amended plan in the time allowed, the Court will enter an
15 order to show cause why the Debtor's bankruptcy case should not be dismissed or converted to one under
16 chapter 7.

17
18 

19
20 FRANK R. ALLEY, III
21 Chief Bankruptcy Judge
22
23
24

25 ⁶While the El Camino sold for \$25,000 shortly after Debtor filed bankruptcy, he testified at the March
26 22, 2011 hearing that he sold it at a bargain price to obtain a quick sale and, in fact, it could have been worth
twice what he received for it. Schedule B listed the vehicle as worth nothing.