

# Truth or Consequences

2018 NORTHERN DISTRICT OF TEXAS BENCH/BAR CONFERENCE

JUNE 8, 2018





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- ▶ Despite its fine reputation, OF had been experiencing cash flow problems and obtained loans from online hard money lenders which further exacerbated OF’s cash flow.



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- ▶ Organic Fertilizer, LLC (“OF”) is a Texas entity that is well known in the market for processing high quality fertilizer.
- ▶ OF obtains the bulk of its raw material from local farmers who have gone through a rigorous process of getting “organic certified.”
- ▶ Despite its fine reputation OF had been experiencing cash flow problems and obtained loans from online hard money lenders which further exasperated OF’s cash flow.
- ▶ To protect what little cash flow it had, OF retains you as counsel and you recommend that OF file bankruptcy under Chapter 11 on an emergency basis.

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- ▶ Upon further investigation you discover that this income stems from legal marijuana growing enterprises in those two states.



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- ▶ While working with the OF management team you learn that 35% of OF's gross income is generated in the states of Washington and Colorado.
- ▶ Upon further digging you discover that these customers are legal Marijuana growing enterprises in those two states.
- ▶ You vaguely remember that at a conference you attended some months ago, you learned of a new policy by the United States Trustee relating to marijuana.





# United States Trustee Policy

- ▶ To All Chapter 7 and Chapter 13 Trustees:
  - ▶ It is a violation of federal law to liquidate, receive proceeds from, or in any way administer marijuana assets.
  - ▶ It is the policy of the United States Trustee Program that United States Trustees shall move to dismiss or object in all cases involving marijuana assets on grounds that such assets may not be administered under the Bankruptcy Code even if trustees or other parties object on the same or different grounds.
  - ▶ Cases involving marijuana assets include cases in which the marijuana assets would leave the estate through exemption or abandonment.



# Research

- ▶ Controlled Substances Act (1970)
  - ▶ Makes marijuana a Schedule I drug – prohibited for every purpose (LSD, psilocybin, MDMA also in Schedule I)
  - ▶ Can't be prescribed by any DEA-licensed doctor
  - ▶ Significant criminal penalties for any cultivation, production, distribution, etc.



# Research

- ▶ Obama Administration Vacillation
  - ▶ Ogden Memorandum, 2009
    - ▶ Ordered DEA officials and US Attorneys to treat medical marijuana shops as top priorities for prosecutors and drug investigators.
  - ▶ Cole Memorandum, 2011
    - ▶ More Certainty – Cole Memorandum, August 29, 2013
    - ▶ States generally lead in drug law enforcement
    - ▶ Federal deference to state policy if 8 federal criteria are met
      - ▶ Kids, guns, transfer out of state, organized crime, other drugs, etc.
- ▶ January 4, 2018, AG Sessions rescinds the Cole Memo
  - ▶ Prosecutors are told to use their best judgment
- ▶ Federal Taxation (70+% effective tax rate)



# Model Rules of Professional Conduct Client-Lawyer Relationship

► **Rule 1.2(d) Scope Of Representation And Allocation Of Authority Between Client And Lawyer**

(d) A lawyer shall not counsel a client to engage, or assist a client, in conduct that the lawyer knows is criminal or fraudulent, but a lawyer may discuss the legal consequences of any proposed course of conduct with a client and may counsel or assist a client to make a good faith effort to determine the validity, scope, meaning or application of the law.

# Texas Disciplinary Rules of Professional Conduct (Effective May 1, 2018)

## ► Rule 1.02(d) Scope and Objectives of Representation

(c) A lawyer shall not assist or counsel a client to engage in conduct that the lawyer knows is criminal or fraudulent. A lawyer may discuss the legal consequences of any proposed course of conduct with a client and may counsel and represent a client in connection with the making of a good faith effort to determine the validity, scope, meaning or application of the law.



# Question

Having discovered the marijuana stream of income, can you continue with the representation?



# Questions

- ▶ Do you have a duty to specifically point out that there is a substantial amount of income generated from marijuana enterprises?

# Questions

- ▶ Do you have a duty to specifically point out that there is a substantial amount of income generated from marijuana enterprises? See Rule 3.3(b) of the Model Rules of Professional Responsibility.
  - ▶ (b) A lawyer who represents a client in an adjudicative proceeding and who knows that a person intends to engage, is engaging or has engaged in criminal or fraudulent conduct related to the proceeding shall take reasonable remedial measures, including, if necessary, disclosure to the tribunal.
  - ▶ If so, to whom?
    - ▶ Bankruptcy Court
    - ▶ United States Trustee





# Questions

- ▶ When preparing the Monthly Operating Report, must you highlight the fact that 35% of its gross income comes from marijuana growing enterprises?
  - ▶ If so, which parties should you notify?
    - ▶ Bankruptcy Court?
    - ▶ United States Trustee?
    - ▶ Creditors?
    - ▶ Parties in interest being impacted by the bankruptcy?



# Questions

- ▶ Can you advise OF to internally segregate the 35% of income derived from marijuana enterprises?
- ▶ And thereafter use the remaining 65% to reorganize and avoid any trouble with the United States Trustee?
- ▶ See Rule 1.2(d) of the Model Rules of Professional Conduct; Rule 1.02(d) of the Texas Disciplinary Rules of Professional Conduct.