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Dealing with Financial Distress for Cannabis Companies

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- > (Un)Availability of Relief Under the U. S. Bankruptcy Code
 - > But maybe... *United Cannabis Case*
- > So Where Can You Turn? State Law Remedies
 - > Assignments for the Benefit of Creditors
 - > Receiverships
- > Best Bet: Out of Court Work-Outs
 - > Composition Agreements
 - > Forbearance Agreements
- > Hybrid Solutions: *Green Growth Brands Case*
- > Lending to Cannabis Companies

- The U. S. Bankruptcy Code is Federal Law
 - Affords Debtors the Broadest Protections and Greatest Opportunity for Rehabilitation
 - Automatic Stay
 - Covers property throughout the U.S. and the world
 - Forces all creditors into a single forum designed to protect debtors
- To date, Cannabis-Related Businesses have been denied access to Federal Bankruptcy Courts
 - Courts have dismissed filings because cannabis remains a Schedule 1 narcotic under the CSA, even though it is legal under the law of many states
 - Bankruptcy Courts have ruled that federal relief is not available to entities conducting business in violation of federal law
 - The filings fail to satisfy the “good faith” standard necessary to sustain a bankruptcy case
 - Also, it would require a federal agent, i.e. a court-appointed Trustee to engage in an illegal activity
- Being challenged in the United Cannabis Corp. Chapter 11 filing in Colorado

- There are alternative state law remedies
 - Remedies vary from state to state and only apply within the state
 - Assets beyond the reach of the state courts can't be protected
 - Protections are generally less robust
 - Opportunity for rehabilitation much more limited
 - Usually provide only for the orderly liquidation or sale of the assets
- State Court Receiverships
 - Court supervision, some more protections against creditors, may be able to reorganize
 - State licensing authority must usually approve the receiver
- Assignments for the Benefit of Creditors
 - Typically no court supervision
 - In effect this is a liquidation

- Non-Court Solutions are always advisable albeit difficult to achieve
 - Work best with < 25 creditors
 - Must get agreement from >80-90% of creditors to make it feasible
 - Dissenters can't be forced to participate
 - May need regulatory approval
- Composition Agreements
 - Binding Agreements, assented to by overwhelming majority of creditors, under threat of a liquidation where nobody gets anything
 - Typically involve some combination of reduction of indebtedness, stretching of payment terms, management/shareholder sacrifices (“skin in the game”), agreement to independent oversight or management, debt to equity conversion, and milestones
- Forbearance Agreements
 - Lenders/Creditors agree to standstill for a set period of time to allow specified restructuring plan to occur, usually a sale of some or all of the business

- Green Growth Brands situation demonstrates an “All of the Above” debtor/creditor scheme
 - Parent company filed for federal relief under the CCAA
 - Canadian version of Chapter 11
 - Cannabis is legal in Canada and therefore federal relief is available
- But not so, for its U.S. businesses
 - Nevada properties have been placed in State Receivership Proceedings
 - Florida subsidiaries have entered into forbearance agreements with their major creditors
- This hybrid approach necessitated by the disconnect between federal and state law in the U.S.

- Non-traditional area of lending
 - No federally chartered bank lenders, deposit accounts
 - Simple loan documents, quick and basic
 - No credit card receivables
 - Insurers limit coverage for cannabis operations
 - Representations and covenants must exclude usual compliance with federal laws
 - No financial tests; basic covenants
- Enforcement of remedies is difficult
 - Cannot foreclose on the pledged equity, government license or cannabis inventory without state government approval
 - Cannot replace executives in borrower (including with a receiver) except after extensive state government background checks and approval
- Consider “Ring Fencing”
 - Compartmentalize cannabis-touching assets into a legal entity separate from non-cannabis operations
 - Segregate real estate, IP and cannabis-touching assets



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