

NY Debt Enforcement Alternatives For Cannabis Lenders

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Lenders in many industries are often impeded in enforcement efforts by a borrower's bankruptcy filing, but not so in the cannabis space. As a consequence of the federal government's continued criminalization of cannabis, protection under the U.S. Bankruptcy Code is likely out of reach for marijuana-related businesses, or MRBs.

In fact, bankruptcy courts tend to dismiss cases where any proposed plan would be funded by money received from MRBs. As a result, struggling MRBs, as well as their lenders and other creditors, must turn to state alternatives.

Lenders must therefore stay acutely aware of enforcement procedures under these state law alternatives, set realistic expectations, and draft their agreements to maximize potential recoveries.

New York's Debt Enforcement Options

In New York, as the cannabis regulatory landscape continues to develop, lenders engaged in or contemplating extending credit to MRBs should be familiar with their enforcement options and the risks unique to lenders in the cannabis space.

Two avenues of potential debt enforcement relief are receiverships and assignments for the benefit of creditors.

Receiverships

There are several types of receiverships in New York. Under New York Civil Practice Law and Rules, Section 5228, a receiver can be appointed upon a judgment creditor's motion to enable the creditor to apply assets of the debtor to satisfy its judgment. Receiver appointments with the consent of the judgment debtor will generally, but not always, be approved.

In determining whether to approve an involuntary receivership, courts will generally consider (1) the available alternative remedies; (2) the degree that the likelihood of satisfaction of the judgment will be increased; and (3) the risk of fraud or insolvency in the absence of the appointment.[1]



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Receiverships are flexible tools and give significant discretion to receivers to dispose of a company's assets in satisfaction of a debt. In fact, a receiver is authorized to administer, collect or sell any property of a debtor to satisfy a monetary judgment, "or to do any other acts designed to satisfy the judgment." [2]

Under New York Business Corporations Law, Section 1202, a statutory receiver may be appointed in certain scenarios, including dissolution. Here, too, courts have discretion to appoint receivers and generally do so in the absence of consent of the debtor only where necessary to protect the applicant's interests in the debtor's property. [3]

The Business Corporations Law requires notice to the public, a meeting of creditors, turnover of property to the receiver and presentation of claims against the company. The receiver must file statements of the company's assets spent and money received, among other requirements. The receiver has discretion to choose a private or public sale, and the terms of sale are not prescribed.

Assignments for the Benefit of Creditors

In contrast to receiverships, in an assignment for the benefit of creditors, or ABC, a company assigns its assets to a third-party assignee that then liquidates the assets.

ABCs in New York, governed by New York's Debtor and Creditor Law, Sections 2-24, are heavily regulated. They require sales of estate property to be public — although private sales are permitted upon good cause — and the filing of interim and final reports with the court. The court has ample power and may hold parties in contempt for violating its orders.

While some creditors may generally dislike ABCs because a debtor institutes the proceeding and chooses the assignee, these concerns are generally less pronounced in New York, where there is heavy court oversight and detailed rules govern the process, versus states with little court supervision.

In addition, priorities of claims are not heavily prescribed, which may benefit some creditors that would not fare as well in bankruptcy or certain receiverships. However, the substantial disclosure requirements may cut into the privacy of the proceedings.

Comparison With Bankruptcy

Overall, receiverships and ABCs can be more flexible and less costly than the bankruptcy process. New York's relatively robust regulations could further benefit participants by eliminating some uncertainty and providing for court involvement to ensure fair processes.

Moreover, sales under these provisions are generally not free and clear of existing liens and other encumbrances, as is the case with sales under Section 363 of the U.S. Bankruptcy Code, potentially leaving certain lienholders with the ability to enforce unsatisfied claims against the purchaser of the property. Similarly, the lack of the automatic stay may enable creditors to pursue other debt collection methods while these proceedings are ongoing.

On the other hand, receiverships and ABCs are not a method for reorganizing debts and instead typically result in liquidation, or, in some cases, going concern sales. Creditors that could benefit from the continued operations of an MRB may consider this a disadvantage compared to Chapter 11 bankruptcy.

Further, the onerous disclosure requirements of ABCs and receiverships may impact the attractiveness of these processes.

Compliance With Licensing and Other Requirements

We are still in the early days of cannabis legalization in New York, so it is difficult to predict how these debt enforcement methods will play out in practice. But as we've seen in other states, cannabis licensing restrictions could potentially clash with the debt enforcement process.

Dispositions and Licensing

One major issue that has arisen in other states — and that New York, too, will likely face — is the potential need for receivers, assignees and/or third-party sellers to meet cannabis licensing requirements. If an MRB's assets include cannabis, then receivers and assignees may be limited by the provisions of New York's cannabis law that require a license to "distribute, deliver or dispense cannabis within this state for sale"[4] and to operate an MRB's business.

Some states have addressed this problem with legislation. For example, following the reversal of a receiver appointment on grounds that the receiver lacked a license necessary to sell cannabis assets of the business,[5] Colorado updated its laws on medical cannabis licensing to permit receivers to apply for temporary licenses.[6]

New York has not yet addressed this issue.

Changes of Ownership or Control and Licensing

Approval by the New York Cannabis Control Board is required for a company to amend its license to reflect a change in ownership, control or location.[7] As a result, an MRB's license may become void following a going concern sale of its business — as this would likely result in a change of ownership of the MRB — if this provision is ignored. Meeting this requirement may potentially slow down enforcement processes for creditors.

While regulations permit the control board to issue regulations that permit certain types of changes in ownership without prior approval,[8] it remains to be seen whether the control board will do so.

Lenders should also be on the lookout for provisions in their agreements that could trigger these rules; for example, a provision that provides a lender the right to stock of an MRB, if executed upon, could trigger a change in ownership endangering the company's license under state law.

Furthermore, although federal courts have upheld lending agreements with MRBs, these and other provisions could prevent enforcement by federal courts of lending agreements that enable lenders to profit from cannabis sales, or otherwise mandate violation of federal law.[9]

Conclusion

Lenders typically expecting borrower bankruptcies to disrupt their collection efforts and deny implementation of contractual remedies need to shift their thinking in the cannabis space. Contractual rights and remedies and the know-how to execute on them in compliance with the applicable law and

the framework of any state liquidation proceeding will become paramount concerns should a borrower default.

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[1] See *Hotel 71 Mezz Lender LLC v. Falor*, 14 N.Y.3d 303, 317 (2010).

[2] CPLR § 5228(a).

[3] See *Lamarena v. Malloy*, 2020 NY Slip Op 31927(U), ¶ 6 (Sup. Ct. N.Y. County).

[4] NY CLS Cannabis § 61(1).

[5] *Yates v. Hartman*, 488 P.3d 348 (Colo. App. Ct. 2018).

[6] See Colo. Rev. Stat. § 44-10-401.

[7] See NY CLS Cannabis § 67(3).

[8] See *id.*

[9] See *Bart St., III v. ACC Enters., Ltd. Liab.*, No. 17-00083, 2020 U.S. Dist. LEXIS 58003 (D. Nev. Mar. 31, 2020).