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UNITED STATES DISTRICT COURT
WESTERN DISTRICT OF WASHINGTON
AT TACOMA

In re
COOK INVESTMENTS NW, SPNWY,
LLC., et al.,

Debtors,

GAIL BREHM GEIGER, Acting United
States Trustee for Region 18,

Appellant,

v.

COOK INVESTMENTS NW, SPNWY,
LLC., et al.,

Appellees.

CASE NO. 17-5516 BHS

Bankruptcy No. 16-44782

ORDER AFFIRMING
BANKRUPTCY COURT

This matter comes before the Court on Appellant Gail Brehm Geiger’s, Acting United States Trustee for Region 18, (“Trustee”) appeal. The Court has considered the pleadings filed in support of and in opposition to the appeal and the remainder of the file and hereby affirms the bankruptcy court for the reasons stated herein.

I. PROCEDURAL AND FACTUAL BACKGROUND

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2 On November 21, 2016, Cook Investments NW, SPNWY, LLC filed a Chapter 11
3 voluntary petition in the Western District of Washington United States Bankruptcy Court.
4 Dkt. 12, Excerpts of Record (“ER”) at 2. On December 15, 2016, the bankruptcy court
5 ordered joint administration of related bankruptcy cases joining the voluntary bankruptcy
6 petitions of Cook Investments NW, DARR, LLC (“Darrington”); Cook Investments NW,
7 FERN, LLC; Cook Investments NW, LLC (“Cook Investments”); and Cook Investments
8 NW, ARL, LLC (collectively, with Cook Investments NW, SPNWY, LLC, referred to as
9 “Debtors”). ER 43–44.

10 Michael Cook owns and manages the Debtors. In 2006, Cook Investments
11 secured a loan from Columbia State Bank (“Bank”). Mr. Cook personally guaranteed the
12 loan and the note was also secured by Debtors’ properties. Each of the four debtors,
13 exclusive of Cook Investments, owns a commercial business property. Cook Investments
14 defaulted on the loan, the Bank obtained a judgment against Cook Investments, and the
15 Bank sought to enforce the judgment forcing the Debtors to file for bankruptcy
16 protection.

17 In 2015, Darrington leased part of its property to N.T. Pawloski LLC, d\b\ a Green
18 Haven. The lease term is for five years with an option to renew for an additional five
19 years and requires Green Haven to pay \$10,000 per month. Relevant to the appeal, Green
20 Haven is a state-licensed grower of marijuana and the lease prohibits Green Haven from
21 using the premises for any purpose other than growing marijuana.
22

1 On January 18, 2017, the Trustee moved to dismiss the petition for cause. ER 45–
2 51. The Trustee argued that the petition should be dismissed for gross mismanagement
3 of the estate because leasing premises to an entity that grows marijuana violates the
4 Controlled Substances Act, 21 U.S.C. § 801 *et seq.* *Id.* On March 9, 2017, the
5 bankruptcy court denied the motion with leave to renew because Debtors asserted that
6 they could propose a plan that specifically rejected the Green Haven lease. ER 139–145.

7 On March 28, 2017, Debtors filed a second amended plan of reorganization
8 (“Plan”). ER 155–72.

9 On April 3, 2017, Debtors filed a motion for order authorizing rejection of
10 unexpired lease requesting that the bankruptcy court reject the Green Haven lease. ER
11 173–76.

12 On April 27, 2017, the Trustee filed an objection to the Plan arguing that “any
13 confirmation order and related plan injunctions entered in this case would tacitly promote
14 ongoing criminal conduct” regardless of whether the Plan accepted or rejected the Green
15 Haven lease. ER 193–99. The Trustee sought rejection of the Plan because it did “not
16 meet the confirmation requirements of 11 U.S.C. § 1129(a)(3).” ER 194. Section
17 1129(a)(3) requires that the “plan has been proposed in good faith and not by any means
18 forbidden by law.”

19 On May 22, 2017, the bankruptcy court granted the motion to reject the Green
20 Haven lease and deemed the lease “rejected pursuant to Bankruptcy Code § 365(a),
21 effective immediately.” ER 200–201.
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1 On June 21, 2017, the bankruptcy court confirmed the Plan. ER 234–243. In
2 confirming the Plan, the bankruptcy court considered the interpretation of § 1129(a)(3).
3 The bankruptcy court rejected Debtors’ narrow interpretation of the section where a
4 bankruptcy court “should not look to the content of the plan at all in analyzing
5 compliance” with the code. ER 239. Instead, the bankruptcy court concluded that,
6 “when [it] is presented with an undisputed, known criminal violation, the Court cannot
7 ignore [the violation] and fail to consider whether [the court] is confirming a plan that is
8 premised on known illegal behavior.” ER 241. Under this interpretation of § 1129(a)(3),
9 the bankruptcy court found and concluded as follows:

10 Debtors are presenting a plan based on income of all other Debtors.
11 Payments under the plan will be made from non-marijuana related income.
12 The lease to Green Haven is not only not assumed in the Second Amended
13 Plan, it has been specifically rejected. The secured creditor has agreed to
14 its treatment, and unsecured creditors are to be paid in full within five
15 months of confirmation. The Court concludes Debtors’ Plan is proposed
16 “in good faith and not by any means forbidden by law” as required by
17 Section 1129(a)(3).

18 ER 242. This appeal followed.

19 On July 27, 2017, the Trustee filed a motion to stay the confirmation pending
20 appeal. Dkt. 5. The Trustee argued that “section 1129(a)(3) of the Bankruptcy Code
21 prohibits the confirmation of a chapter 11 plan that invites the violation of federal
22 criminal law” and that courts of equity should not be used to “facilitate illegal conduct.”
Id. at 8. On August 24, 2017, the Court denied the motion concluding, in part, that the
Trustee had failed to establish a likelihood of success on the merits. Dkt. 10.

II. DISCUSSION

The Trustee appeals the bankruptcy court's confirmation of the Plan and denial of its motion to dismiss.

A. Confirmation of the Plan

1. Standard of Review

"The bankruptcy court's findings of fact are reviewed under the clear-error standard, and its conclusions of law are reviewed de novo." *In re Adamson Apparel, Inc.*, 785 F.3d 1285, 1289 (9th Cir. 2015).

2. Section 1129(a)(3)

The Bankruptcy Code provides that the "court shall confirm a plan only if . . . [t]he plan has been proposed . . . not by any means forbidden by law." 11 U.S.C. § 1129(a)(3). The Court is unaware of, and the parties fail to provide, binding authority on the interpretation of this section. Thus, this appears to be a matter of first impression in this circuit.

The Trustee proposes an extremely broad interpretation. Specifically, the Trustee contends that "the plain meaning of section 1129(a)(3) is that the court cannot confirm a plan whose substance envisions or perpetuates illegal activity." Dkt. 11 at 27. The Trustee fails to cite any case that supports this expansive interpretation. Instead, the Trustee cites cases where courts rejected plans that incorporated or depended upon illegal activities. For example, *In re Arenas*, 514 B.R. 887, 894 (Bankr. D. Colo. 2014), *aff'd*, 535 B.R. 845 (10th Cir. BAP (Colo.) 2015), the court considered a chapter 13 personal bankruptcy plan wherein the debtor listed his pension, social security income, and income

1 from both his own cultivation of marijuana and rental payments from property leased to a
2 marijuana grower. The evidence established that “the Debtors cannot, under the present
3 circumstances, feasibly propose a chapter 13 plan that does not depend upon income from
4 sources that are illegal under the CSA for the plan’s execution.” *Id.* Thus, the proposed
5 plan depended on a means forbidden by federal law.

6 Interpreting section 1129(a)(3) to reject plans that depend upon violations of law
7 protects all parties involved whereas expanding its scope to plans that “envision” or
8 “perpetuate” illegal activity lacks a reasonable basis. Both “perpetuate” and “envision”
9 go beyond the scope of the phrase “by any means forbidden by law.” In essence, the
10 Trustee is attempting to turn the bankruptcy court into a regulatory or criminal court. The
11 Court has already rejected this argument when the Trustee proposed a rule based on the
12 word “facilitate.” Dkt. 10. The Trustee’s new words fail to overcome the underlying
13 proposition that the bankruptcy court need not concern itself with “alleged tangential
14 violations of nonbankruptcy law.” *Id.* at 7. Similar rules of law have been rejected
15 because they “def[y] both law and logic.” *In re Food City, Inc.*, 110 B.R. 808, 813
16 (Bankr. W.D. Tex. 1990). “[A] rule which requires a debtor to affirmatively represent in
17 its plan and disclosure statement that the plan does not violate any law imposes an
18 unrealistic due diligence burden upon both the debtor and debtor’s counsel.” *Id.*

19 Therefore, the Court concludes that, at most, section 1129(a)(3) requires the
20 bankruptcy court to review the proposed plan to ensure that it does not depend upon any
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1 violation of law.¹ This is consistent with the bankruptcy court's interpretation of the
2 code. ER 241 (the court must consider "whether it is confirming a plan that is premised
3 on known illegal behavior."). Limiting the bankruptcy court's review to the four corners
4 of the Plan is consistent with the bankruptcy code and provides a consistent rule for
5 continuous application. The Court **AFFIRMS** the bankruptcy court on this interpretation
6 of section 1129(a)(3).

7 **3. Confirmation**

8 It is unclear whether the Trustee objects only to the bankruptcy court's
9 interpretation of the law or whether the Trustee also objects to the bankruptcy court's
10 confirmation of the Plan under that interpretation. To the extent that the Trustee raises
11 the latter objection, the Court agrees with the bankruptcy court that nothing within the
12 four corners of the Plan establishes that the Plan is based upon illegal activity. Therefore,
13 the Court **AFFIRMS** confirmation of the Plan.

14 **B. Trustee's Motion to Dismiss**

15 **1. Standard of Review**

16 An order granting or denying a motion to convert or dismiss a chapter 11 case is
17 reviewed for abuse of discretion. *In re Marsch*, 36 F.3d 825, 828 (9th Cir. 1994).

18 **2. Gross Mismanagement of the Estate**

19 Under section 1112(b), a "court shall convert a case under this chapter to a case
20 under chapter 7 or dismiss a case under this chapter, whichever is in the best interests of

21 ¹ The Court declines to consider whether the interpretation should be restricted only to the means
22 of proposal of the Plan as Debtors propose because rejecting the Trustee's expansive interpretation is
sufficient to dispose of this appeal.

1 creditors and the estate, for cause.” 11 U.S.C. § 1112(b)(1). “[C]ause” includes “gross
2 mismanagement of the estate.” 11 U.S.C. § 1112(b)(4)(B). Chapter 11 debtors in
3 possession have a fiduciary duty to their creditors to protect and conserve the assets of
4 the estate. *Ford Motor Credit Co. v. Weaver*, 680 F.2d 451, 461 (6th Cir. 1982). The
5 failure to do so is gross mismanagement under section 1112(b). *In re Congaree Triton*
6 *Acquisitions, LLC*, 492 B.R. 843, 852 (Bankr. D.S.C. 2012).

7 In this case, the Trustee argues that the bankruptcy court abused its discretion
8 when it denied the Trustee’s motion to dismiss Darrington’s petition for gross
9 mismanagement of the estate. The Trustee’s argument fails for numerous reasons. First,
10 the Court is hesitant to conclude that the bankruptcy court abused its discretion when the
11 Trustee essentially waived its right to refile its motion. The bankruptcy court denied the
12 Trustee’s motion without prejudice and with leave to renew. ER 148. The Trustee failed
13 to renew the motion or subsequently raise the gross mismanagement argument. Although
14 the Debtors fail to raise waiver, it seems to be plain error for this Court to reverse the
15 bankruptcy court’s denial when the Trustee failed to renew its motion.

16 Second, the Trustee’s motion fails on the merits. The bankruptcy court found that
17 the Debtors “may be able to propose a plan that does not rely on the income from the
18 marijuana operation lease.” ER 144. In the context of this case, it was not an abuse of
19 discretion to deny the Trustee’s motion on that basis. It is undisputed that the Debtors
20 seek protection from a single creditor and that, as a group, the Debtors’ monthly income
21 exceeds the monthly liabilities. ER 167 (income of \$54,204 versus payments of
22 \$39,941.25). While the Trustee’s argument carries more weight if Darrington was an

1 individual entity as opposed to one entity in a group of joint Debtors, the group as a
2 whole appears to be solvent without either the marijuana-related monthly income or the
3 non-marijuana-related monthly income from Darrington. Under these facts, the
4 bankruptcy court did not abuse its discretion in finding that Debtors were not grossly
5 mismanaging the estate. Therefore, the Court **AFFRIMS** the bankruptcy court's
6 dismissal with leave to renew.

7 **III. ORDER**

8 The decisions of the bankruptcy court are **AFFIRMED**.

9 Dated this 18th day of December, 2017.

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BENJAMIN H. SETTLE
12 United States District Judge