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Receiverships and their Interplay with the Bankruptcy Code

Companies facing financial distress have several restructuring options. They can file for Chapter 11 relief under the Bankruptcy Code or use other remedies available under state or other federal law, including receiverships. While a Chapter 11 may have its advantages, there may be reasons why Chapter 11 does not work, including exorbitant administrative fees and costs. In addition to these direct costs, a Chapter 11 restructuring may have certain indirect costs, including the potential for litigation brought by trustees or committees, stigmas associated with the very public Chapter 11 process and potential loss of skilled and talented employees.

While the direct and indirect costs may present a barrier to Chapter 11, certain companies facing distress may not use Chapter 11 as a restructuring option. Unless already shut down and no longer operating, Chapter 11 is not a viable option for higher education institutions, which could lose their accreditation and rights to federal funding if they file for Chapter 11. [1] Companies in the growing cannabis industry are generally prohibited from using Chapter 11 as cannabis remains a federal crime.

A receivership may provide an efficient, cost-effective alternative to restructuring the affairs of a company in distress. This article provides a general background on receiverships, including their advantages and disadvantages, and explores the use of receiverships as an alternative to Chapter 11 for those companies that cannot afford, or simply may not use, Chapter 11 to restructure. This article also reviews some of the issues that arise when a bankruptcy case is filed after a receiver is appointed.

I. Receiverships — What are They and How Do They Work?

Receivers are appointed by either federal [2] or state courts [3] and are typically appointed to take possession and preserve property or a business. The court appointing the receiver will determine the power, duties and responsibilities of the receiver, while the receivership order typically places the debtor's property under the dominion and control of the receiver.

a. Pros and Cons of Receiverships

A receivership is often a less expensive restructuring alternative to the Chapter 11 process due to less-stringent procedural requirements and fewer constituencies involved. The significant procedural requirements imposed by the Bankruptcy Code, the Bankruptcy Rules and applicable local rules, can translate into significant costs and expenses. In a Chapter 11 case, the debtor is required to pay the fees of its professionals and those hired by a duly appointed creditors' committee. These fees are not required in a receivership. A receivership proceeding is also typically shorter than a Chapter 11 case since there are fewer hearings and procedural requirements.

Moreover, careful drafting of the proposed receivership order can provide creditors with many of the protections and safeguards afforded by the Bankruptcy Code and may even offer additional control to creditors dealing with distressed

borrowers and their collateral. For example, the automatic stay afforded to debtors by section 362 of the Bankruptcy Code may be replicated in the receivership order in a provision enjoining creditor action against the borrower or its property during the pendency of the receivership. [4] Virtually all receivership proceedings typically include injunctive relief to prevent interference with the receiver's control, management, and administration of assets. In the federal context, statutory authority provides support for a receiver's control over receivership assets to the exclusion of others, regardless of where those assets may be located in the United States. [5]

Another potential advantage of a receivership over Chapter 11 is the level of transparency and publicity involved. Unlike a bankruptcy proceeding, a debtor under a receivership order is not required to file schedules of assets and liabilities, a statement of financial affairs and monthly operating reports. As such, a receivership may be preferable in circumstances where the stigma of a bankruptcy filing could result in the loss of customers and good will.

While a receivership may reduce the costs and potential public stigmas, there are disadvantages, including inconsistent state laws and the lack of jurisdiction by federal courts over the assets of a debtor. Although some states have enacted comprehensive receivership statutes, many have not. [6] Given the jurisdictional inconsistencies, receivership may be less practical in a case where a borrower maintains assets in various states. Moreover, in jurisdictions that do not have laws governing receivership proceedings, courts may not be receptive to this remedy, and acceptance may vary. Some state courts may be reluctant to approve the appointment of a receiver. As a result, a receivership may result in delay and costly litigation over whether a court has jurisdiction over the debtor and its property and whether it may appoint a receiver.

b. Appointing a Federal Receiver

Due to inconsistencies in state receivership laws, appointment of a federal receiver, if appropriate, may be beneficial for companies with businesses across state lines. [7] As a result of their broad equitable powers, federal district courts have the power and authority to appoint receivers. [8] When assessing whether a federal receivership is appropriate, federal courts first determine whether they may exercise jurisdiction and then consider the following factors: "(1) the probability that fraudulent conduct has occurred or will occur; (2) the validity of the claim by the party seeking the appointment; (3) whether there is an imminent danger that property will be concealed, lost, or diminished in value; (4) the inadequacy of [alternative] legal remedies; (5) the lack of a less drastic equitable remedy; and (6) the likelihood that appointing the receiver will do more good than harm." [9] Federal courts, however, have appointed receivers even in the absence of fraud when dire financial circumstances justify the appointment. [10]

While typically granted as an ancillary or tag-along remedy, [11] receivers have been appointed in the absence of a pending foreclosure action. [12] In *U.S. Bank N.A. v. Nesbitt Bellevue Prop. LLC, et al.*, [13] for example, the District Court for the Southern District of New York granted a secured lender's request for appointment of a receiver in the absence of pending foreclosure actions over real property spread over six states. [14] Although the secured lenders in *Nesbitt* had not commenced a foreclosure action, the court granted their receivership motion after finding that the secured lenders intended to commence a foreclosure action and established there was risk of substantial and preventable decline in value of the property. [15] The *Nesbitt* court noted:

> While receiverships should be 'be watched with jealous eyes lest their function be perverted,' and while the rule that a party may not simply bring a naked action for a receiver in the absence of some path to further, final relief (namely foreclosure and liquidation of the Collateral) serves that vigilance, it would not serve the purpose of equity to dismiss this case and force the plaintiff to file a foreclosure action in six different states before the appointment of a receiver. [16]

II. Use of Receiverships When Chapter 11 Not an Option

While the direct and indirect costs outlined above may prevent some companies from using Chapter 11, for certain companies a receivership may be the only viable alternative. For example, Chapter 11 is usually not an option for higher education institutions and cannabis companies, although technically eligible to file for Chapter 11 relief.

The Higher Education Act ("**HEA**") provides that a college filing for bankruptcy immediately and irrevocably loses access to the federal loans and grants authorized under Title IV of the HEA. [17] Under the HEA, a bankruptcy filing disqualifies an institution from participating in Title IV funding programs. [18] Filing for Chapter 11 may also result in the loss of accreditation by the higher education institution. These restrictions make filing for Chapter 11 relief prohibitive for most colleges.

In addition to higher education institutions, cannabis companies and companies that generate revenue from cannabis-related companies may be foreclosed from filing for Chapter 11. The legalization of marijuana in many states has caused a proliferation of companies in the cannabis industry or with connections to the cannabis industry. Marijuana, however, remains an illegal product under the federal Controlled Substances Act ("**CSA**") [19] and, as a result, using Chapter 11 or a federal receivership may be off limits for cannabis companies or companies with relations to cannabis companies. [20] The United States Trustee takes the position that "rather than make its own marijuana policy, the USTP will continue to enforce the legislative judgment of Congress by preventing the bankruptcy system from being used for purposes that Congress has determined are illegal." [21] As a result, bankruptcy courts have been careful to ensure that the bankruptcy process is not used to enable a debtor to continue to participate in a federal crime and, for the most part, dismiss cases for companies that are directly involved in the cannabis industry, including retailers, dispensaries, growers and their principals. [22] Companies with indirect connections to cannabis, e.g., landlords who lease space to a marijuana company, may also be barred from Chapter 11, depending on the knowledge of the insiders. [23]

ECA College — Practical Use of Receivership When Chapter 11 is Not an Option

Since Chapter 11 is not a viable option for higher education institutions, federal receiverships may be a viable alternative to restructuring their debts. At least with respect to higher education companies, [24] a federal receivership could avert a de-funding and loss of accreditation, while the institution seeks to implement a restructuring with the advantages of Chapter 11, but without the attendant costs.

Recently, Education Corporation of America ("**ECA**"), the parent company of Virginia College, LLC ("**VC**") and New England College of Business and Finance, LLC ("**NECB**") attempted a creative use of federal receivership to avoid Chapter 11. [25] After years of declining revenues and student enrollment, ECA determined to winddown its affairs by closing certain schools and selling the remaining schools to its secured lenders (the "**ECA Restructuring Proposal**"). As a condition to the ECA Restructuring Proposal, including additional financing to wind-down operations, ECA's lenders required the appointment of a receiver. The ECA Restructuring Proposal also provided for a "teach out" plan for students to complete their degrees at the closed locations. [26] On September 5, 2018, ECA informed the United States Department of Education (the "**DOE**") of its Restructuring Proposal, [27] and approximately one month later, on October 16, 2018, ECA filed a declaratory action against the DOE in the United States District Court for the Northern District of Alabama seeking an injunction and the appointment of a receiver (the "**Alabama Action**"). [28]

In the Alabama Action, ECA sought a declaration that the Restructuring Proposal would not interfere with the access and eligibility of ECA institutions that are expected to continue operating in the ordinary course under the Restructuring Proposal. The DOE opposed ECA's requested relief, arguing that the HEA does not give rise to a private cause of action

and the district court lacked jurisdiction to enter equitable relief requested by ECA, including the appointment of a federal receiver. According to the DOE, ECA was seeking federal court protection principally to prevent harm arising from state-court creditor actions. [29]

In an unpublished decision dated November 5, 2018, the Alabama District Court agreed with the DOE and dismissed the Alabama Action for lack of subject matter jurisdiction, finding that there was no case or controversy between ECA and the DOE. [30] The court found that ECA did not satisfy the proper grounds for either the issuance of an injunction or the appointment of a receiver and noted that "ECA did not cite any case in which a [party] sought a federal receivership to protect the [party's] interest in its own assets …, and the court has found no such case." [31]

While the Alabama Action was pending, ECA was sued for non-payment of rent by a landlord in the Georgia state court. Based on diversity jurisdiction, ECA successfully removed the state action to federal district court in the Northern District of Georgia (the "**Georgia Action**"). [32] Undeterred by the November 5, 2018 decision of the Alabama District Court, the next day ECA filed a motion in the Georgia District Court seeking injunctive relief and the appointment of a federal receiver. On November 14, 2018, the Georgia District Court, relying on *Nesbitt*, [33] granted ECA's request for appointment of a federal receiver. The receiver order granted the receiver broad authority to, among other things, operate ECA's business, sell assets and winddown the affairs of ECA. A subsequent order entered by the court authorized the ECA receiver to obtain financing from the secured lenders. In addition, the Georgia District Court granted broad injunctive relief staying all creditors from enforcing their rights and claims against ECA. [34]

Notwithstanding appointment of a receiver, ECA's Restructuring Proposal was essentially tabled after the Accrediting Council for Independent Colleges and Schools (ACICS) suspended accreditation for ECA schools other than NECB, which receives its accreditation from the New England Association of Schools and Colleges Inc. In December 2018, ECA announced it was closing all of its locations other than NECB. Although its restructuring efforts faltered, ECA's resourceful use of federal receivership may provide a roadmap for higher education institutions seeking to restructure outside of Chapter 11.

III. Filing of Bankruptcy When Receiver in Place

While a receivership may lead to a resolution of a debtor's restructuring, receiverships may also ultimately wind up before a bankruptcy court, either voluntarily or through an involuntary filing. When a post-receiver bankruptcy case is filed, bankruptcy courts are generally called to determine several issues, including (a) whether the debtor's filing was properly authorized, (b) whether the receiver may remain in possession of the debtor and avoid turnover of receivership property to the trustee or debtor in possession, and (c) whether the receiver may be paid.

A. Authority to File Chapter 11 Petition When Receiver in Place

Most receivership orders provide broad injunctive relief, typically divesting the debtor's former officers and directors from their positions and vesting all corporate authority with the receiver. [35] Although the receiver is in control, a filing by the debtor's former insiders may not necessarily result in a dismissal of the Chapter 11 case.

Recently, the Ninth Circuit addressed this issue in the Chapter 11 case filed by Sino Clean Energy, Inc. [36] In *Sino*, the Ninth Circuit upheld the state court order appointing the receiver and enjoining the debtor's former insiders from filing a Chapter 11 case on behalf of the debtor. Relying on applicable Nevada law, the Ninth Circuit held that the directors who were previously removed by the receiver had no authority to file the Chapter 11 case. The court emphasized that state law dictates who has the authority to make policy decisions on behalf of companies, including the filing for bankruptcy relief, and such decision-making authority is not preempted by federal law. [37] The Ninth Circuit relied in its prior ruling in *Oil & Gas Company v. Duryee,* [38] where the court upheld dismissal of a Chapter 11 case and enforced a state court

order appointing a rehabilitator to run an insurance company and enjoining the company's former president from filing a bankruptcy petition. [39]

The *Sino* decision called into question a 2006 decision in the Chapter 11 cases filed on behalf of *Corporate and Leisure Event Productions, Inc.* [40] In *Corporate and Leisure*, the bankruptcy court recognized the authority of the debtors' former insiders to file Chapter 11 cases and disregarded a state court receivership order that not only removed them, but expressly prohibited the filings by the former insiders. Relying on the preemption doctrine, the court concluded that state court receivership proceedings may not bar a debtor from seeking bankruptcy protection, despite the broad authority granted to the receiver in the appointment order. [41] While the *Corporate and Leisure* decision was subsequently followed by other bankruptcy courts, [42] the *Sino* decision appears to halt any attempt by former insiders to file a Chapter 11 if the receivership order removes, and enjoins a filing by, the former insiders. [43]

B. Whether the Receiver May Remain in Possession of the Debtor

In addition to the requisite filing authority, a bankruptcy court may be called to determine questions over who will control the debtor and its property in a bankruptcy case filed after a receiver is appointed. The Bankruptcy Code provides that the filing of a bankruptcy case after the appointment of a receiver places all the debtor's property under the jurisdiction of the bankruptcy court. [44] Section 543 provides that a "custodian" who has knowledge of the commencement of a bankruptcy case is generally barred from taking any further action in the administration of the debtor's property and must turnover any assets of the estate in its possession. [45] In addition, a custodian is directed to deliver the debtor's property to the bankruptcy trustee, and then file an accounting of the property, proceeds, products, rents, or profits. [46] A receiver is considered a "custodian" [47] and, unless excused by the bankruptcy court, must turnover any property of the debtor to the trustee or debtor in possession. [48] Section 543 also forbids the receiver from taking action except as necessary to preserve the property. [49] While sections 543(a) and (b) require turnover of the receivership property, section 543(d) allows a bankruptcy court to excuse a receiver from the turnover requirements if in the best interest of creditors. [50]

While a bankruptcy court may excuse a receiver from the turnover requirements of section 543, the Bankruptcy Code does not state whether a receiver may remain in possession and manage the debtor's affairs in a Chapter 11 case or otherwise provide for who should run the debtor if a receiver is excused from turnover. Decisions vary, with some courts leaving a pre-petition receiver in place to act as the debtor's manager, and others replacing the receiver with a chapter 11 trustee.

In the *Bayou Group LLC* Chapter 11 cases, [51] prior to the Chapter 11 filing, the District Court for the Southern District of New York determined that the debtor and various related entities were operating a Ponzi scheme and appointed a federal equity receiver. The order appointing the receiver also installed the receiver as the managing member of the debtor. After the receiver caused Bayou to file for Chapter 11, the United States Trustee filed a motion to appoint a Chapter 11 trustee, arguing that the former insiders were incapable of running the debtor and the receiver's role as manager ceased on the Chapter 11 filing. The bankruptcy court denied the motion and on appeal, the district court affirmed. In interpreting its own *receivership* order, the district court noted that while the receiver was appointed under the federal receivership statute, the court relied on different authority, i.e., federal securities laws and its general equitable power, to appoint him as corporate manager. [52] As a result, unlike its receivership role, the receiver's corporate management role did not end on the bankruptcy filing. [53] The district court construed the receiver as "the exclusive managing member of a debtor in possession" who was subject to the obligations imposed on debtors in possession under the Bankruptcy Code. [54] The Second Circuit affirmed, concluding that the receiver held "two hats—one as custodian, and one as 'sole and exclusive' managing member of Bayou. While [the receiver's] 'custodian' hat came off upon the commencement of the Chapter

11 proceedings, his 'managing member' hat remained." [55] In affirming, the Second Circuit was compelled to note the outstanding results achieved by the receiver and that the creditors were pleased and supported his continuation. [56]

Post-*Bayou*, courts have generally allowed a receiver to remain in possession, especially where the receiver was appointed by a federal district court. [57] Recently, however, the *Bayou* decision has been questioned and some courts have denied requests to maintain the receiver in possession, at least when the receiver was appointed by a state court. [58] These courts limit *Bayou* on the basis that (a) the plain language of section 543 requires turnover *to a trustee*, (b) federal receivership orders, unlike state orders, are entered by district courts, which have original jurisdiction over bankruptcy cases, [59] and (c) section 105(b) of the Bankruptcy Code expressly prohibits the appointment of a receiver in a bankruptcy case. [60]

In *In re Ute Lake Ranch, Inc.*, [61] the Bankruptcy Court for the District of Colorado refused to extend *Bayou* to a state receiver, even though the receivership order was similar to *Bayou* and vested the receiver with managerial power over the debtors. After the receiver caused the debtors to file for Chapter 11, he moved to remain in possession as debtor in possession. The United States Trustee opposed, arguing the receiver as a custodian was required to turn over possession to a trustee pursuant to section 543. Agreeing with the United States Trustee, the Bankruptcy Court distinguished *Bayou* on the basis that the federal receiver was appointed under federal securities laws as well as the district court's inherent equitable powers to act as managing member of the debtor. The court noted that the *Bayou* district court invoked separate sources of authority in appointing the receiver and corporate manager. The state receiver in *Ute Lake*, however, was appointed pursuant to a state receivership statute and only petitioned the state court for managerial power after he determined the debtor's assets should be liquidated. While acknowledging that the receiver was best suited to manage the Chapter 11 debtors, the court declined to extend *Bayou* on the basis that it could not ignore the plain meaning of section 543. It also cautioned against use of *Bayou*-type orders to state receiverships in the future:

> In this Court's view, applying the *Bayou* decision's reasoning to the facts of this case would create the proverbial 'exception that swallows the rule.' Any state court-appointed receiver or custodian could avoid the prohibitions of § 543 by simply asking the state court to change its title to 'manager' just prior to a bankruptcy filing. The wording of the July 1 Order would become a roadmap for court-appointed receivers and custodians to retain control of a debtor's assets in bankruptcy. This Court declines to adopt such an interpretation. [62]

These decisions show that allowing a pre-petition receiver to stay in possession remains uncertain unless the receiver was appointed by a federal receivership order that expressly provides for the continuation of the receiver as manager upon a filing, while the receiver's time as custodian, ends.

C. Whether Receivership Trumps — Abstention and Excusing Turnover

Another alternative for a receiver upon a bankruptcy filing is to seek abstention by the bankruptcy court pursuant to section 305(a) of the Bankruptcy Code. Section 305(a) authorizes dismissal or suspension of proceedings only if in the interest of both the creditors and the debtor. [63] In addition to abstention under section 305(a), section 543(d) of the Bankruptcy Code provides that a receiver may be excused from the turnover requirements. Essentially, section 543(d) is a modified abstention principle that echoes the abstention doctrine of section 305. [64] Unlike section 305, section 543(d) considers the concerns and interests of creditors, [65] and the interests of the debtor are not to be considered in the court's decision. [66]

Thus, despite the turnover requirements of section 543, sections 305(a) and 543(d) provide creditors and other parties in interest with an avenue to excuse compliance with turnover. [67] While section 543(d) may excuse a receiver from complying with the turnover provisions, the Bankruptcy Code does not provide guidance on the duties and obligations of a receiver if excused.

If the bankruptcy court excuses a receiver from turnover, the receiver remains subject to the terms of the pre-petition order appointing receiver, but the bankruptcy court may enter further orders to supervise the receiver and authorize payment of professionals. [68] Courts disagree over whether professionals engaged by a receiver must obtain bankruptcy court approval of their engagement if the receiver remains in possession. Some courts hold that the receiver becomes the functional equivalent of a trustee and bankruptcy court approval is a condition to payment of receiver's professionals. [69] In *In re 400 Madison Avenue Limited Partnership*, the bankruptcy court disagreed and held that the Bankruptcy Code does not require section 327(a) approval of a receiver-in-possession's professionals. [70] According to *400 Madison Avenue*, as long as the order appointing the receiver authorized the receiver to engage and pay professionals, no new retention application is required when a bankruptcy intervenes. [71]

D. Paying the Receiver and Receiver Professionals in Bankruptcy

Receivers are entitled to reimbursement for their expenses and to compensation for their services from the bankruptcy estate. Section 543(c)(2) states that the court "shall … provide for payment of reasonable compensation for services rendered and costs and expenses incurred by such custodian." [72] This compensation is entitled to administrative priority under section 503(b)(3)(E) of the Bankruptcy Code. [73] In addition to the expenses and compensation that may be awarded to a receiver under section 503(b)(3)(E), section 503(b) also allows compensation for a receiver's professionals. [74] Section 503(b)(4) grants an allowed administrative expense for "reasonable compensation for professional services rendered by an attorney or an accountant" of a receiver. [75] Even if a receiver has been superseded under section 543(d), it would be entitled to payment of its expenses and compensation under section 543(c)(2). [76]

Footnotes

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1 Loss of accreditation and federal funding may serve as a death knell for higher education institutions.

2 Pursuant to 28 U.S.C.A. § 959, a receiver is authorized to manage and operate the property in accordance with laws of state where the property is located, to extent that such laws do not conflict with federal statutes or place an undue burden on federal receiverships.

3 Most states have their own statutory framework for the appointment of a receiver. See e.g., Minn. Stat. § 576.21; Mo. Rev. Stat. § 515.500; N.Y. CPLR 5228; Wash. Rev. Code § 7.60. See also N.Y. RPL § 254(10) (provides a mortgagee with right to appointment of a receiver in mortgage foreclosure action if the mortgage documents contain "receiver clause", i.e., a clause providing that "the holder of this mortgage, in an action to foreclose it, shall be entitled to the appointment of a receiver."

4 Federal courts may also grant broad stays under receivership orders, which stay all actions, wherever commenced against the debtor. See, e.g., S.E.C. v. Wencke, 622 F.2d 1363, Fed. Sec. L. Rep. (CCH) P 97533 (9th Cir. 1980).

5 See 28 U.S.C.A. § 754; see also 28 U.S.C.A. § 1692 (providing that federal receivers appointed in one district have the statutory authority to execute process in any district in which receivership property is located).

6 For example, Michigan recently enacted the Uniform Commercial Real Estate Receivership Act, effective May 7, 2018, which applies to both real estate and personal property. The Uniform Act grants a receiver with authority similar to a bankruptcy trustee, including the ability to sell assets free and clear of certain liens, and permits a secured creditor to credit bid at the sale.

7 See, e.g., S.E.C. v. American Capital Investments, Inc., 98 F.3d 1133, 1144 (9th Cir. 1996) (abrogated on other grounds by, Steel Co. v. Citizens for a Better Environment, 523 U.S. 83, 118 S. Ct. 1003, 140 L. Ed. 2d 210, 46 Env't. Rep. Cas. (BNA) 1097, 28 Envtl. L. Rep. 20434 (1998)) ("we conclude that the power of sale is within the scope of a receiver's 'complete control' of receivership assets under sec. 754, a conclusion firmly rooted in the common law of equity receiverships.")

8 See 28 U.S.C.A. §§ 754 and 959 and Fed. R. Civ. P. 66. 28 U.S.C.A. § 754 provides:

> A receiver appointed in any civil action or proceeding involving property, real, personal or mixed, situated in different districts shall, upon giving bond as required by the court, be vested with complete jurisdiction and control of all such property with the right to take possession thereof.
>
> He shall have capacity to sue in any district without ancillary appointment, and may be sued with respect thereto as provided in section 959 of this title.
>
> Such receiver shall, within ten days after the entry of his order of appointment, file copies of the complaint and such order of appointment in the district court for each district in which property is located. The failure to file such copies in any district shall divest the receiver of jurisdiction and control over all such property in that district.

9 Aviation Supply Corp. v. R.S.B.I. Aerospace, Inc., 999 F.2d 314, 316–17 (8th Cir. 1993) (discussing the factors relevant to the receivership inquiry).

10 See D.B. Zwirn Special Opportunities Fund, L.P. v. Tama Broadcasting, Inc., 550 F. Supp. 2d 481, 491 (S.D. N.Y. 2008) (Courts "[have] appointed receivers even where there was no evidence of fraud."); see, e.g., U.S. Bank Nat. Ass'n v. Nesbitt Bellevue Property LLC, 866 F. Supp. 2d 247, 251–54, 82 Fed. R. Serv. 3d 1062 (S.D. N.Y. 2012) (appointing a receiver in the absence of fraud where target faced imminent risk of a loss of enterprise value).

11 Kelleam v. Maryland Cas. Co. of Baltimore, Md., 312 U.S. 377, 381, 61 S. Ct. 595, 85 L. Ed. 899 (1941) ("A receivership is only a means to reach some legitimate end sought through the exercise of the power of a court of equity. It is not an end in itself. … This Court has frequently admonished that a federal court of equity should not appoint a receiver where the appointment is not a remedy auxiliary to some primary relief which is sought and which equity may appropriately grant.")

12 New York law generally requires that the appointment of a receiver be ancillary to a main proceeding, e.g., a foreclosure action. Section 6401 of the New York CPLR provides that the appointment of a receiver must be ancillary to some other proceeding when there is danger that the property may materially lose its value. Similarly, Federal Rule 66 provides that "the appointment of a receiver in equity is not a substantive right but is a remedy that is ancillary to the primary relief prayed for in the suit."

13 U.S. Bank Nat. Ass'n v. Nesbitt Bellevue Property LLC, 866 F. Supp. 2d 247, 82 Fed. R. Serv. 3d 1062 (S.D. N.Y. 2012).

14 866 F.Supp.2d at 251–54.

15 866 F.Supp.2d at 256–57.

16 866 F.Supp.2d at 256 (quoting Kelleam, 312 U.S. at 381).

17 To generate revenue, colleges depend upon tuition and fees from their students, most of whom receive federal student loans authorized under Title IV of the HEA. Title IV of the HEA establishes federal

student financial aid programs through which the government forwards student loan proceeds to eligible higher education institutions. See 20 U.S.C.A. § 1070(a). To be eligible, an institution must meet the HEA Title IV definition of "institution of higher education," as defined in 20 U.S.C.A. §§ 1001, 1002. To participate in Title IV programs, an institution must establish, inter alia, that it is authorized to operate in the state in which it is located; that it is accredited by a recognized accrediting agency; and that it is administratively capable and financially responsible. See 20 U.S.C.A. § 1099c. To demonstrate financial responsibility, an institution must meet certain specified financial obligations and regulatory measures. See 34 C.F.R. §§ 668.171 to 668.173.

18 See 20 U.S.C.A. § 1002(a)(4)(A); see also 34 C.F.R. §§ 600.1 et. seq.

19 21 U.S.C.A. §§ 801 et seq. In January 2018, the Justice Department issued a memorandum (https://www.justice.gov/opa/pr/justice-department-issues-memo-marijuana-enforcement) designed to provide guidance on when it would pursue federal charges against marijuana businesses. In the memorandum, the Attorney General notes the CFA and other federal statutes that reflect "Congress's determination that marijuana is a dangerous drug and marijuana activity is a serious crime."

20 Among the activities prohibited by the CSA is knowingly leasing property to a cannabis grower or making a property available for the sale or distribution of marijuana regardless of how important or unimportant that particular parcel may be to a property owner's overall business. See 21 U.S.C.A. § 856(a).

21 Clifford J. White III and John Sheahan, Why Marijuana Assets May Not be Administered in Bankruptcy Amer. Bankr. Inst. J., Dec. 2017, p.34.

22 See In re Arenas, 535 B.R. 845, 852–53, 74 Collier Bankr. Cas. 2d (MB) 171, Bankr. L. Rep. (CCH) P 82870 (B.A.P. 10th Cir. 2015) (on motion of U.S. Trustee upholding dismissal of debtors' cases based on findings that debtors were unable to confirm plan without using proceeds of their marijuana business); Arm Ventures, LLC, 564 B.R. 77 (Bankr. S.D. Fla. 2017) (dismissing case of commercial property owner when the debtor was unable to propose plan that was not reliant on funding by a tenant engaged in manufacturing medical marijuana); In re Medpoint Management, LLC, 528 B.R. 178, 60 Bankr. Ct. Dec. (CRR) 248, 73 Collier Bankr. Cas. 2d (MB) 781 (Bankr. D. Ariz. 2015), vacated in part on other issue, 2016 WL 3251581 (B.A.P. 9th Cir. 2016) (involuntary petition dismissed because debtor provided management services and intellectual property to cannabis business); In re Rent-Rite Super Kegs West Ltd., 484 B.R. 799, 90 A.L.R. Fed. 2d 777 (Bankr. D. Colo. 2012) (dismissing case where rent from cannabis business comprised 25% of debtor's income).

Rent-Rite was the first reported decision to address the conflict between the CSA and the ability of a cannabis-related business to seek bankruptcy relief. In *Rent-Rite*, the debtor owned a warehouse and leased space to tenants for the cultivation of marijuana and filed a Chapter 11 case. The rent received from the cannabis tenant was only twenty-five percent of the debtor's income. Notwithstanding, the bankruptcy court dismissed the case upon the secured lender's motion, holding that, even though the debtor's business operation was legal under Colorado law, it had discretion to dismiss or convert the bankruptcy case due to the debtor's violation of the CSA.

23 See In re Olson, 2018 WL 989263 at *4–6 (B.A.P. 9th Cir. 2018). In *Olsen*, the bankruptcy court dismissed the case sua sponte concluding that the debtor was in violation of federal law for leasing property to, and collecting post-petition rent from a cannabis company, which was operating legally under applicable California law. In dismissing the case, the bankruptcy court was not persuaded by the debtor's attempts to distance herself from the cannabis business, having ceased to take rent from the dispensary and moving to reject the lease. Olsen, at *4. On appeal, the Bankruptcy Appellate Panel for the Ninth Circuit signaled that not all cannabis-related companies are excluded from federal bankruptcy protection. The BAP vacated a bankruptcy court's dismissal and remanded the case for further findings on the specific criminal activity and the legal standard for dismissing the case. Rather than adopting a rigid approach, the *Olsen* BAP focused on the specific "knowledge" requirement that the CSA imposed for prohibiting leasing space to a cannabis business and addressed the unique facts of this case. The *Olsen* debtor was a nearly blind, elderly debtor, residing in a nursing home and relying on others to operate her business.

24 Due to the CSA, cannabis companies are precluded from using federal receiverships and may only resort to relief under state receivership procedures.

25 ECA runs, among other schools, Virginia College, NECB, Brightwood College and Golf Academy of America. At the time it sought a receivership, about 20,000 students were enrolled in ECA schools at seventy-four campuses throughout the United States, including five campuses in Alabama.

26 In the event that an institution ceases operations or faces possible loss of its license, accreditation, or certification, the institution must submit a teach-out plan specifying how students will be able to complete their degrees. See 34 C.F.R. § 668.14(b)(31).

27 The DOE regulates colleges' eligibility for Title IV programs, and participation in the programs requires DOE approval.

28 See Educ. Corp. of America, et al. v. U.S. Dep't of Educ. et al., Case No. 18-cv-01698-AKK (N.D. Ala.), ECF Dkt. No. 58.

29 National Partnership Inv. Corp. v. National Housing Development Corp., 153 F.3d 1289, 1291 (11th Cir. 1998).

30 Educ. Corp. of America, et al. v. U.S. Dep't of Educ. et al., Case No. 18-cv-01698-AKK (N.D. Ala.), ECF Dkt. No. 58.

31 Educ. Corp. of America, et al. v. U.S. Dep't of Educ. et al., Case No. 18-cv-01698-AKK (N.D. Ala.), ECF Dkt. No. 58 at p. 15.

32 See VC Mason GA, LLC v. Virginia College, LLC and Educ. Corp. of America, Case No. 18-cv-00388-TES (M.D. Ga.) Certain landlords of ECA colleges have appealed the receivership order entered by the Georgia District Court on the basis that the court lacked authority and jurisdiction to appoint the receiver.

33 Nesbitt, 866 F.Supp.2d at 255–56.

34 Broad injunctive relief has been entered in state court orders providing for a receivership of an educational institution. See, e.g., In re Vatterott Educational Centers, Inc., et al., Circuit Court for St. Louis County, 21st Judicial Circuit, State of Missouri, Case No. 17SC-CC02316 (June 29, 2017).

35 Commodity Futures Trading Com'n v. FITC, Inc., 52 B.R. 935, Bankr. L. Rep. (CCH) P 70516 (N.D. Cal. 1985) (holding that "Once a court appoints a receiver, the management loses the power to run the corporation's affairs. The receiver obtains all the corporation's power and assets. Thus, it was the receiver, and only the receiver, who this court empowered with the authority to place FITC in bankruptcy."); First Sav. & Loan Ass'n v. First Federal Sav. & Loan Ass'n, 531 F. Supp. 251, 255–256 (D. Haw. 1981) (when a receiver is appointed, receiver obtains all powers and assets and company's directors lose power to run its affairs); Prairie States Petroleum Co. v. Universal Oil Sales Corp., 88 Ill. App. 3d 753, 43 Ill. Dec. 875, 410 N.E.2d 1008 (1st Dist. 1980) ("Upon appointment of a receiver, the functions of the corporation's managers and officers are suspended and the receiver stands in their place".)

36 In re Sino Clean Energy, Inc., 901 F.3d 1139, 66 Bankr. Ct. Dec. (CRR) 25 (9th Cir. 2018).

37 901 F.3d at 1141 (citing Price v. Gurney, 324 U.S. 100, 106–07, 65 S. Ct. 513, 89 L. Ed. 776 (1945) (state law determines who has authority to file bankruptcy for a debtor)).

38 Oil & Gas Co. v. Duryee, 9 F.3d 771, 24 Bankr. Ct. Dec. (CRR) 1303 (9th Cir. 1993).

39 9 F.3d at 773 (concluding that "[t]he only person then, who could go to court on behalf of Oil & Gas was [the rehabilitator]. And he not only failed to authorize these actions; he opposed them.")

40 In re Corporate and Leisure Event Productions, Inc., 351 B.R. 724, 729–731, 47 Bankr. Ct. Dec. (CRR) 9, 56 Collier Bankr. Cas. 2d (MB) 891 (Bankr. D. Ariz. 2006).

41 351 B.R. at 729–30.

42 See In re Orchards Village Investments, LLC, 405 B.R. 341, 349, 51 Bankr. Ct. Dec. (CRR) 152, 61 Collier Bankr. Cas. 2d (MB) 1585 (Bankr. D. Or. 2009) ("Allowing terms dictated in a state receivership or insolvency proceeding to determine the availability of federal bankruptcy relief is fundamentally inconsistent with the constitutional grant to Congress of the right to enact uniform laws on the subject of bankruptcy.")

43 In addition to the Ninth Circuit, former insiders may be barred in other circuits as well. See S.E.C. v. Byers, 609 F.3d 87, 53 Bankr. Ct. Dec. (CRR) 80, Bankr. L. Rep. (CCH) P 81788 (2d Cir. 2010) (upholding bankruptcy injunction contained in receivership order based on broad equitable powers in the context of a SEC receivership); Securities and Exchange Commission v. Spence & Green Chemical Co., 612 F.2d 896, 903, Fed. Sec. L. Rep. (CCH) P 97301, 29 Fed. R. Serv. 2d 698 (5th Cir. 1980)

("[A]s a general rule a receiver, standing in the shoes of management, holds the full right … to direct the litigation of the corporation whose care he is entrusted.")

44 See 11 U.S.C.A. § 543(a) & (b). These turnover provisions of section 543 of the Bankruptcy Code are designed to promote the congressional intent that a Chapter 11 debtor be permitted to operate and control its business during the reorganization process. The commencement of a bankruptcy case vests the district court with exclusive jurisdiction over property of the debtor. See 28 U.S.C.A. § 1334(e).

45 11 U.S.C.A. § 543(a). Section 543(a) provides, in part, that a "custodian" with knowledge of the case "may not make any disbursement from, or take any action in the administration of, property of the debtor, proceeds, product, offspring, rents or profits of such property, or property of the estate, in the possession, custody, or control of such custodian, except such action as is necessary to preserve such property."

46 11 U.S.C.A. § 543(b); see In re South Side House, LLC, 474 B.R. 391, 405 (Bankr. E.D. N.Y. 2012); see also In re Lizeric Realty Corp., 188 B.R. 499, 506–507 (Bankr. S.D. N.Y. 1995), as amended, (Nov. 28, 1995).

47 See In re Paren, 158 B.R. 447, 450 (Bankr. N.D. Ohio 1993); In re Snergy Properties, Inc., 130 B.R. 700, 703 (Bankr. S.D. N.Y. 1991); In re Foundry of Barrington Partnership, 129 B.R. 550, 557 (Bankr. N.D. Ill. 1991). Section 101(11) of the Bankruptcy Code defines "custodian" as a "(A) receiver or trustee of any of the property of the debtor, appointed in a case or proceeding not under this title ….") Courts have interpreted the term "custodian" broadly. See Matter of Cash Currency Exchange, Inc., 762 F.2d 542, 553, 13 Bankr. Ct. Dec. (CRR) 262, 12 Collier Bankr. Cas. 2d (MB) 1499, Bankr. L. Rep. (CCH) P 70561, 87 A.L.R. Fed. 255 (7th Cir. 1985).

48 Generally, in addition to possessing a debtor's property, a receiver maintains deposit accounts where pre-petition profits from the receivership property are deposited. Whether a pre-petition receivership account constitutes property of the estate is determined by state law. See In re Buttermilk Towne Center, LLC, 442 B.R. 558, 562, 54 Bankr. Ct. Dec. (CRR) 13, 64 Collier Bankr. Cas. 2d (MB) 1771 (B.A.P. 6th Cir. 2010) (citing Butner v. U.S., 440 U.S. 48, 54, 99 S. Ct. 914, 59 L. Ed. 2d 136, 19 C.B.C. 481, Bankr. L. Rep. (CCH) P 67046 (1979) (citing In re White, 851 F.2d 170, 173, 18 Bankr. Ct. Dec. (CRR) 60, Bankr. L. Rep. (CCH) P 72361 (6th Cir. 1988)); South Side House, 474 B.R. at 406 (applying New York law and holding that pre-petition rents are property of the estate even when the debtor lost possession of the rents to a receiver); In re Sam A. Tisci, Inc., 133 B.R. 857, 859 (N.D. Ohio 1991) (interpreting Ohio law); Matter of Pfleiderer, 123 B.R. 768, 769 (Bankr. N.D. Ohio 1987).

49 See South Side House, 474 B.R. at 405; see also Lizeric Realty, 188 B.R. at 506–507.

50 11 U.S.C.A. § 543(d). Section 543(d) provides that after notice and a hearing the Bankruptcy Court "may excuse compliance" with the turnover requirements if the interests of creditors would be better served "by permitting a custodian to continue in possession, custody, or control of such property …."

51 In re Bayou Group, L.L.C., 363 B.R. 674 (S.D. N.Y. 2007), judgment aff'd, 564 F.3d 541, 51 Bankr. Ct. Dec. (CRR) 155, 61 Collier Bankr. Cas. 2d (MB) 1627, Bankr. L. Rep. (CCH) P 81484 (2d Cir. 2009).

52 Bayou, 363 B.R. at 684.

53 363 B.R. at 684–85.

54 363 B.R. at 688. The district court acknowledged the role of the United States Trustee and that a federal district court's appointing a receiver to manage the debtor "contradicts the spirit" of the Bankruptcy Code. 363 B.R. at 689. The court noted, however, that its ruling was limited to the rare facts before it and found that the United States Trustee could take "solace in the fact that this chain of events will rarely occur. The necessary ingredients—corrupt management, inevitable bankruptcy, and a highly motivated group of creditors desirous of a particular individual to manage a troubled estate—will not often appear ensemble." 363 B.R. at 690. Nevertheless, the court found no express authority prohibiting the appointment of a receiver to manage a Chapter 11 debtor and called on Congress to make explicit changes if necessary. 363 B.R. at 690.

55 Bayou, 564 F.3d at 548.

56 564 F.3d at 544–45.

57 See In re Petters Co., Inc., 401 B.R. 391, 408, 51 Bankr. Ct. Dec. (CRR) 86 (Bankr. D. Minn. 2009), aff'd, 415 B.R. 391 (D. Minn. 2009), aff'd, 620 F.3d 847, 53 Bankr. Ct. Dec. (CRR) 167, Bankr. L. Rep. (CCH) P 81845 (8th Cir. 2010); Byers, 609 F.3d at 92.

58 See In re Briar Hill Foods, LLC, 2017 WL 4404274 at *2-3 (Bankr. N.D. Ohio 2017); In re Roxwell Performance Drilling, LLC, 70 Collier Bankr. Cas. 2d (MB) 1321, 2013 WL 6799118 (Bankr. N.D. Tex. 2013). In *Roxwell Performance*, the pre-petition state receiver, relying on *Bayou*, requested bankruptcy court authorization to continue in possession and manage the post-petition debtor's affairs. The receiver argued that his continued possession gave the debtor the best chance for a successful reorganization and was in the creditors' best interests. The bankruptcy court, however, distinguished and disagreed with *Bayou*. First, it noted that the receiver in *Bayou* was a federal receiver appointed by a federal district court, which has original jurisdiction over federal bankruptcy cases. 2013 WL 6799118 at *4. The court then rejected *Bayou*, relying principally on section 543(b) of the Bankruptcy Code, which obligates receivers to turnover receivership property to the trustee. 2013 WL 6799118 at *4. According to the court, section 543(b) obligates a receiver as custodian to turnover all debtor property to a trustee (or debtor in possession in Chapter 11). Accordingly, the receiver must be an entity separate from the trustee or debtor in possession. Refusing to leave the receiver in place, the court ultimately determined that "cause" existed to appoint a chapter 11 trustee under section 1112(b) of the Bankruptcy Code to avoid a "vacuum of authority going forward."

In *Briar Hill Foods,* the debtors owned real estate and operated several retail grocery stores in Ohio. After default on their secured loans, the debtors' bank commenced foreclosure actions and sought the appointment of a receiver to take possession and control the debtors' property. The receiver commenced a sale process, but was unable to close a sale transaction, partly due to the buyer's concerns over successor liability. As a result, the debtors filed for bankruptcy protection and filed a motion to excuse the receiver's compliance with the turnover provisions of section 543 of the Bankruptcy Code and to authorize the receiver to remain in possession of the receivership property. The debtors asserted that their estates and creditors would be best served by permitting the receiver to continue controlling and managing the receivership property through the sale process. Although no parties in interest objected, including the bank and potential buyer, the court denied the motion, ruling that the administration of a Chapter 11 case must be managed by a trustee or debtor in possession. According to the court, granting these powers to a person that is neither a Chapter 11 trustee nor a debtor in possession, and not a professional employed under section 327 of the Bankruptcy Code, is beyond the scope of the Bankruptcy Court's authority. In re Briar Hill Foods, LLC, 2017 WL 4404274 at *2 Bankr. N.D. Ohio 2017).

59 28 U.S.C.A. § 1334(a).

60 In re Briar Hill Foods, LLC, 2017 WL 4404274 at *1 (Bankr. N.D. Ohio 2017) (noting that allowing a blanket authorization of a receiver's possession of the debtor's assets and continued management of its affairs is the functional equivalent of the appointment of a receiver in the bankruptcy case, a result specifically proscribed by section 105(b) of the Bankruptcy Code); In re Roxwell Performance Drilling, LLC, 70 Collier Bankr. Cas. 2d (MB) 1321, 2013 WL 6799118 at *4 (Bankr. N.D. Tex. 2013) ("the authority under chapter 11 to manage the debtor's assets and affairs lies exclusively with either the debtor as DIP or a chapter 11 trustee.")

61 In re Ute Lake Ranch, Inc., 2016 WL 6472043 at *3–5 (Bankr. D. Colo. 2016).

62 2016 WL 6472043, at *5.

63 Foundry of Barrington P'ship v. Barrett, 129 B.R. at 555.

64 See In re Constable Plaza Associates, L.P., 125 B.R. 98, 103 (Bankr. S.D. N.Y. 1991) (citing In re Pine Lake Village Apartment Co., 17 B.R. 829, 833, 8 Bankr. Ct. Dec. (CRR) 1110, 6 Collier Bankr. Cas. 2d (MB) 83 (Bankr. S.D. N.Y. 1982)); see also Matter of WPAS, Inc., 6 B.R. 40, 43, 6 Bankr. Ct. Dec. (CRR) 1122 (Bankr. M.D. Fla. 1980).

65 In re Poplar Springs Apartments of Atlanta, Ltd., 103 B.R. 146, 150 (Bankr. S.D. Ohio 1989).

66 103 B.R. at 150 (citing In re Dill, 163 B.R. 221, 226 (E.D. N.Y. 1994); Foundry of Barrington P'ship, 129 B.R. at 557)).

67 Pursuant to § 543(d)(1), the court must consider whether the interest of creditors is better served by the receiver remaining in possession of the debtor's assets. Courts typically consider some of the following non-exhaustive factors: likelihood of reorganization; probability that funds required for reorganization will be available; whether there are instances of mismanagement by the debtor; whether the debtor will use the turnover property for the benefit of creditors; and the existence of avoidance

claims. See Poplar Springs, 103 B.R. at 150; In re Falconridge, LLC, 58 Collier Bankr. Cas. 2d (MB) 1415, 2007 WL 3332769 at *10 (Bankr. N.D. Ill. 2007) (citations omitted); Dill, 163 B.R. at 225 (citations omitted). Even if these factors are resolved in favor of the debtor, the court may still excuse compliance if turnover would be injurious to creditors. Poplar Springs, 103 B.R. at 150.

68 See In re 400 Madison Avenue Ltd. Partnership, 213 B.R. 888, 898–899, 31 Bankr. Ct. Dec. (CRR) 793, 38 Collier Bankr. Cas. 2d (MB) 1608 (Bankr. S.D. N.Y. 1997).

69 In re 245 Associates, LLC, 188 B.R. 743, 750, 34 Collier Bankr. Cas. 2d (MB) 866, Bankr. L. Rep. (CCH) P 76822 (Bankr. S.D. N.Y. 1995), corrected, (Nov. 9, 1995); In re Uno Broadcasting Corp., 167 B.R. 189, 201, 25 Bankr. Ct. Dec. (CRR) 1009 (Bankr. D. Ariz. 1994).

70 See In re 400 Madison Avenue Ltd. Partnership, 213 B.R. 888, 894, 31 Bankr. Ct. Dec. (CRR) 793, 38 Collier Bankr. Cas. 2d (MB) 1608 (Bankr. S.D. N.Y. 1997) (disagreeing with earlier case in same district.) The court specifically disagreed with the conclusion that once a receiver remains in possession the receiver becomes the equivalent of a trustee. 213 B.R. at 896 (citing disapprovingly, *245 Assocs.* and *Uno*).

71 213 B.R. at 896 ("Nowhere is there a provision in the Code stating that the term 'trustee' is to be read in Code § 327(a) or elsewhere to include a receiver retained in possession under Code § 543(d).")

72 11 U.S.C.A. § 543(c)(2); see also In re Montemurro, 581 B.R. 565, 572, 65 Bankr. Ct. Dec. (CRR) 67 (Bankr. N.D. Ill. 2018).

73 Section 503(b)(3)(E) provides for an allowed administrative expense for "the actual, necessary expenses … incurred by … a custodian superseded under § 543 of this title, and compensation for the services of such custodian." 11 U.S.C.A. § 503(b)(3)(E); see also Montemurro, 581 B.R. at 572. The court in *Montemurro* provides a thorough discussion on the different standards for compensation under sections 543 and 503. 581 B.R. at 572. ("Under section 543, a custodian is entitled to 'reasonable compensation for services rendered and costs and expenses.' Under section 503, the custodian may receive an administrative expense for 'actual, necessary expenses' and 'compensation for services.'") (quoting 11 U.S.C.A. §§ 543(c)(2) and 503(b)(3)).

74 If the receiver's only source of payment is property of the debtor's estate, the court must apply the heightened standard under section 503(b)(3)(E) to the receiver's application. Montemurro, 581 B.R. at 578. Under section 503(b), any expenses must be "actual and necessary." 581 B.R. at 575. Compensation and expenses under section 543 are subject to a "reasonableness" standard of review. 581 B.R. at 575. The reasonableness standard applies to extent that compensation is from another source or if custodian is excused from compliance under section 543(d). 581 B.R. at 576.

75 11 U.S.C.A. § 503(b)(4).

76 Montemurro, 581 B.R. at 577–78 ("Holding compliance with section 543(b) to be a prerequisite to payment under section 543(c)(2) would exclude from that payment custodians who have been excused from compliance under section 543(d). That does not appear to be the intent of Congress here.")

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