The Rise of Receiverships (and the Decline of Chapter 11)

Peter C. Blain

Shareholder

Reinhart Boerner Van Deuren sc

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Introduction

Background to Chapter 11 United States Bankruptcy Code

When enacted, Congress envisioned United States Bankruptcy Code[1] Chapter 11 (Chapter 11) to be a process by which a debtor is afforded a breathing spell to fix the structural problems of its troubled enterprise. The debtor would use this time to renegotiate its existing obligations with its creditors, culminating in the formulation of a proposed plan of reorganization. After reviewing a court-approved disclosure statement and the plan, creditors would be given the opportunity to vote to accept or reject the plan.

Assuming the creditors accepted the plan and the court found that the plan met the requirements of Code section 1129, the court would confirm the plan, which became a new contract between the debtor and its creditors. The equity owners of the debtor would retain their interests and the creditors, who were often paid over time under the plan, would have a stake in supporting the debtor post-confirmation to have their pre-bankruptcy obligations paid. For the most part, for the first decade and a half following the 1978 enactment of the Code, most successful Chapter 11 cases followed this pattern.

The Transition from Plans of Reorganization to Sales

After the mid-1990s, Chapter 11 cases began to follow a much different path. With experience, secured creditors discovered that for a debtor to meet all of Chapter 11's requirements to successfully confirm a plan, the secured creditor had to fund significant transaction costs in the form of administrative expenses, often over a protracted period of time. Many Chapter 11 debtors ultimately failed to confirm a plan, which resulted in the conversion to Code Chapter 7 (Chapter 7) cases and the liquidation of the enterprise. Moreover, in the period prior to the financial crises, financing was incredibly easy to obtain and many companies became over-leveraged, resulting in their assets being worth less than the aggregate secured indebtedness.

In small- to medium-sized companies, the debtor's principal secured lender also was often the debtor's largest unsecured creditor, making confirmation

[1] 11 U.S.C.A. §§101 to 1532 (the "Code").

of a plan impossible without the lender's consent.[2] Using the leverage created by this circumstance and the debtor's need for financing to continue the enterprise's operations post-petition, the lenders began demanding that in exchange for essential post-petition financing, the debtor must agree to sell substantially all of its assets under Code section 363[3] to capture the going concern value of the assets and maximize the lender's recovery, often in the first several months of the case.[4]

Chapter 11 and Sales of Substantially All of the Assets

Today, most cases result in a sale of substantially all of a debtor's assets under Code section 363[5] instead of a confirmed plan of reorganization. There is often little or no equity value in the debtor's assets above the amount of the secured debt. Consequently, the unsecured creditors committee, appointed to represent the interests of unsecured creditors in the case, rarely negotiates the terms of a plan of reorganization—the role Congress anticipated committees would play. Instead, committees today are usually relegated to negotiating for a "carve-out" from the sale proceeds to which the secured creditor is otherwise entitled. The unsecured creditors committee's leverage is to object to the sale process and make the process more time-consuming and expensive for the secured creditor.

In 2012, the American Bankruptcy Institute established a commission (the "Commission") to evaluate Chapter 11 of the Code as it is utilized today, and to make recommendations for proposed reforms. While the Commission's December 2014 report[6] (the "Report") addresses a myriad of issues relating to the administration of Chapter 11 cases, key sections of the

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[2] *See* 11 U.S.C.A. § 1129, the requirements for confirmation of a plan of reorganization.

[3] 11 U.S.C.A. § 363.

[4] For a discussion of the ways Chapter 11 proceedings have changed over time, *see* Peter C. Blain, "Chapter 11 of The Bankruptcy Code: As It Was, As It Is, and As It May Be," in *Inside the Minds: Chapter 11 Bankruptcy and Restructuring Strategies, 2016 ed.* (Thomson Reuters 2016).

[5] For a description of the sale process in insolvency proceedings, *see* Peter C. Blain, Michael D. Jankowski, and L. Katie Mason, "Buying & Selling Businesses in Insolvency Proceedings," J. Tax'n & Reg. of Fin. Institutions (May/June 2014, at 5); Peter C. Blain, "Let's Make a Deal: Sale of Distressed Businesses in Insolvency Proceedings," in *Inside the Minds: Buying and Selling Distressed Businesses, 2010 ed.* (Aspatore 2010).

[6] *American Bankruptcy Institute, Commission to Study the Reform of Chapter 11, 2012–2014 Final Report and Recommendations*, available at http://www.commission.abi.org/full-report.

Report recognize that the sale of substantially all of a debtor's assets (what the Commission calls "363x sales")[7] is the primary objective of many Chapter 11 cases today. The Commission also recognizes that sales of the assets of the enterprise, and not plan confirmation, have become the case objective because Chapter 11 cases are too expensive, especially for small- to medium-sized debtors,[8] and secured lenders have the leverage to force acceptance of the sale option.[9]

Alternatives to Chapter 11

Although Chapter 11 has become a recognized means of selling an operating enterprise, parties continue to seek even more efficient and expeditious ways to sell a business to preserve its going concern value. Assignments for the benefit of creditors, state court receiverships and, occasionally, federal receiverships are alternatives to Chapter 11 Code section 363[10] sales, which restructuring attorneys now should review with their clients. In the right circumstances, these alternatives may produce the same outcome achievable in Chapter 11 cases, but on a faster and less expensive basis.

Lessons Learned from Personal Experience in Chapter 11 Cases

While my experience is centered in Wisconsin, I have also worked with clients involved in receivership proceedings in Florida and Delaware, and in connection with assignments for the benefit of creditors (ABC) in Illinois. I am also a member of the Wisconsin State Bar committee charged with recommending revisions to Wisconsin's receivership statutes. In connection with that endeavor, I have examined receivership statutes from a number of states, including Minnesota and Washington. As a consequence, at the onset of a new engagement, I always inquire whether the debtor's state has a receivership statute that might be utilized. Although the American Bankruptcy Institute (ABI) Commission views receiverships, and particularly ABCs, as "subpar remedies"[11] to Chapter 11 cases, in the right circumstances

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[7] *Id.*, at 86.
[8] *Id.*, at 12, 56, 59.
[9] *Id.*, at 81-82.
[10] 11 U.S.C.A. § 363.
[11] *American Bankruptcy Institute, Commission to Study the Reform of Chapter 11, 2012–2014 Final Report and Recommendations*, available at http://www.commission.abi.org/full-report at 283.

I have found receiverships (as opposed to ABCs) often prove to be the best available alternative.

Assignments for the Benefit of Creditors

ABCs are non-statutory and not court supervised. The debtor assigns its assets to an assignee pursuant to a trust agreement.[12] The assignee liquidates the assets, often with the assistance of a financial advisor and through a competitive bid process, and distributes the proceeds, usually in accordance with the priorities of the Code. There is no stay against creditor actions and no tribunal to resolve interim disputes. Savvy creditors realize this and will often use the threat of litigation to try to force a better deal. Lenders, who expect the protection of a post-proceeding financing order to protect their new advances, may also be reluctant to finance the enterprise through the ABC sale process. Moreover, a purchaser of the business will receive no court order conveying the assets and no assurance that the assets are being conveyed free and clear of liens, claims, and encumbrances. While ABCs are sometimes used to convey the assets of a going concern business, in most cases they are better suited to liquidate the assets of companies that have ceased operations.

State Court Receiverships

Many states have statutes that provide for receiverships.[13] In states such as Wisconsin, the statute is quite short and the use of receiverships to sell

[12] Appendix A for example of a trust agreement and assignment for the benefit of creditors.

[13] Arizona—Ariz. Rev. Stat. §§ 44-1031 to 44-1047; Arkansas—Ark. Code Ann. §§ 16-117-401 to 16-117-407; Colorado—Colo. Rev. Stat. §§ 6-10-101 to 6-10-154 (West 2009); Delaware—Del. Code Ann. tit. 10, §§ 291 to 303; Florida—Fla. Stat. Ann. §§ 727.101 to 727.116; Georgia—Ga. Code Ann. §§ 18-2-41 to 18-2-59; Iowa—Iowa Code Ann. §§ 681.1 to 681.30; Kentucky—Ky. Rev. Stat. Ann. §§ 379.010 to 379.170; Massachusetts—Mass. Gen. Laws ch. 203, §§ 40 to 42; Michigan—Mich. Comp. Laws Ann. §§ 600.5201 to 600.5265; Minnesota—Minn. Stat. §§ 576.21 to 576.53; Mississippi—Miss. Code. Ann. §§ 85-1-1 to 85-1-19; Missouri—Mo. Ann. Stat. §§ 426.010 to 426.410; Montana—Mont. Code. Ann. §§ 31-2-201 to 31-2-230; New Jersey—N.J. Stat. Ann. §§ 2A:19-1 to 2A:19-50; New Mexico—N.M. Stat. Ann. §§ 56-9-1 to 56-9-55; New York—N.Y. Debt. & Cred. Law §§ 1 to 24; North Carolina—N.C. Gen. Stat. Ann. §§ 23-1 to 23-48; North Dakota—N.D. Cent. Code §§ 32-26-01 to 32-26-06; Ohio—Ohio Rev. Code Ann. §§ 1313.01 to 1313.59; Oklahoma—Okla. Stat. tit. 24, §§ 31 to 50; Pennsylvania—39 Pa. Cons. Stat. §§ 1 to 154; Rhode Island—R.I. Gen. Laws §§ 10-4-1 to 10-4-13; South Carolina—S.C. Code Ann. §§ 27-25-10 to 27-25-160; South Dakota—S.D. Codified Laws §§ 54-9-1 to 54-9-22;

businesses as going concerns has developed by custom and practice.[14] Minnesota has recently adopted a much more detailed receivership statute that provides for asset sales.[15] The case can be commenced voluntarily by an assignment of the assets of the debtor for the benefit of creditors[16] and the subsequent appointment by the state court of the assignee as the receiver. An involuntary case is commenced with a complaint and an emergency motion to appoint a receiver.[17] In some states, there is a statutory stay imposed.[18] In others, the order appointing the receiver contains a stay against creditor actions against the debtor. The first day orders also enumerate the duties of the receiver, which generally include the authority to obtain financing, operate the business in the ordinary course of business, hire financial advisors, attorneys, and accountants, and sell the assets subject to further order of the court.[19]

The sale process in a receivership closely follows a Chapter 11 Code section 363 sale process.[20] The financial advisor solicits potential purchasers' bids and the receiver selects a stalking horse bid, if possible. Bid procedures and the stalking horse bid (including any break-up fee and other bid protections) are approved by the court in a bid procedures order. If there is more than one interested purchaser, an auction is held and the highest or otherwise best bid is determined. Thereafter, the receiver asks the court to approve the sale at the sale approval hearing and the court enters an order authorizing the receiver to convey the assets to the purchaser free and clear of liens, claims, and encumbrances, with all liens, claims, and encumbrances attaching to the proceeds of sale in the order of their priority.[21]

Tennessee—Tenn. Code Ann. §§ 47-13-101 to 47-13-120;_Texas—Tex. Bus. & Com. Code Ann. §§ 23.01 to 23.33;_Utah—Utah Code Ann. §§ 6-1-1 to 6-1-20;_Vermont—Vt. Stat. Ann. tit. 9, §§ 2151 to 2158;_Virginia—Va. Code Ann. §§ 55-156, 55-167;_Washington—Wash. Rev. Code Ann. §§ 7.08.010 to 7.08.200;_West Virginia—W. Va. Code Ann. §§ 38-13-1 to 38-13-16;_Wisconsin—Wis. Stat. Ann. §§ 128.001 to 128.25; and_District of Columbia—D.C. Code §§ 28-2101 to 28-2110.

[14] The Bankruptcy, Insolvency and Creditors Rights section of the State Bar of Wisconsin has established a committee to recommend revisions to Wisconsin Statutes Chapter 128, which would specifically address sale issues.

[15] *See* Minn. Stat. §§ 576.21 to 576.53.

[16] Appendix B for example of an assignment for the benefit of creditors.

[17] Appendix C for example of a complaint and motion for the appointment of a receiver in an involuntary case.

[18] *See* Minn. Stat. § 546.42; Wash. Rev. Code Ann. § 7.60.110.

[19] Appendix D for example of an order appointing the receiver and an order establishing case management procedures that outline the duties of the receiver.

[20] *See supra* note 3.

[21] Appendix E for example of an order approving the sale.

Advantages of State Court Receiverships

The net result of a sale of a business under Chapter 11 of the Code or a state receivership statute is essentially the same—a court order authorizing the conveyance of the assets free and clear of liens, claims, and encumbrances. However, in many instances, state court receiverships may be a better choice. The principal advantages of a state court receivership include the following points as discussed below.

State Court Receiverships Are Generally Faster

State court receiverships generally proceed at a much more accelerated pace than a Chapter 11 case. There is no first meeting of creditors or section 341[22] hearing. Additionally the motion to approve bid procedures in connection with the sale process is often filed and heard in the first days of the case.

While the pace of sales under Chapter 11 has also gotten much quicker over time (so much so that the ABI Commission recommends that sales not be approved within the first sixty days of the case to allow creditors to assess alternatives),[23] proceedings in state courts occur even faster. This expedited time frame is often justified because the secured creditor and the debtor have thoroughly examined the alternatives pre-filing, and the enterprise may be hemorrhaging money, making speed essential.

State Court Receiverships Are Less Expensive

Because cases proceed more expeditiously with fewer hearings, state receiverships are often far less expensive than Chapter 11 cases. Additionally, there is usually no unsecured creditors' committee appointed in a receivership proceeding, which saves the estate the cost of the attorney, accountant, and financial advisor appointed to represent a Chapter 11 committee. The absence of a committee means there is rarely a request for a carve-out of the sale proceeds for the benefit of unsecured creditors. While this may appear to significantly disadvantage unsecured creditors, in many Chapter 11 cases, the large portion of the carve-out received is consumed by administrative expenses incurred by the committee's professionals appointed in the Chapter 11 case.

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[22] 11 U.S.C.A. § 341.

[23] American Bankruptcy Institute, *supra* note 5, at 79-80, 87.

State Court Receiverships May Include Automatic or Judicial Stay of Creditor Actions

In some states, the receivership statute contains a stay against creditor actions.[24] In others, the order appointing the receiver contains a judicial stay. Both are similar in breadth to the automatic stay under Code section 362[25] in a Chapter 11 case. This allows the sale process to proceed without disruptive creditor litigation, which could derail the effort. This breathing spell is often essential to allow sufficient time for the receiver and the financial advisor to generate robust interest in the assets, thereby maximizing their value.

State Court Receiverships Are Court Supervised

Unlike ABCs, state court receiverships are court supervised. While there are often fewer hearings in a receivership proceeding, the presence of a supervising court to approve the sale process, including bid protections and the ultimate sale, is an essential requirement for most sophisticated purchasers. The ultimate objective is an order conveying the debtor's assets free and clear of liens, claims, and encumbrances, with such liens, claims, and encumbrances attaching to the proceed of sale in the order of priority. While some state statutes specifically provide for sales free and clear of liens, claims, and encumbrances,[26] in other states, the court order approving the sale conveys the assets lien free.[27] The availability of a court is also useful in resolving disputes with utilities,[28] landlords, and creditors holding the debtor's property,[29] who could also potentially disrupt the sale process. Senior lenders often insist upon a court order approving liens granted in connection with post-receivership financing.[30] Additionally, some receivership statutes have provisions for the recovery of avoidable preferences,[31] and almost every state

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[24] *See supra* note 3.
[25] 11 U.S.C.A. § 362.
[26] *See* Minn. Stat. § 576.46.
[27] *See supra* note 18.
[28] *See* Minn. Stat. § 576.43; Wash. Rev. Code § 7.60.120 (regarding continuation of utility service).
[29] *See* Minn. Stat. § 576.40; Wash. Rev. Code § 7.60.070; Fla. Stat. Ann. § 727.106 (regarding the turnover of property to the receiver).
[30] *See* Minn. Stat. § 576.44; Wash. Rev. Code § 7.60.140; *infra* note 28.
[31] *See* Wis. Stat. § 128.07. *But see Sherwood Partners, Inc. v. Lycos, Inc.*, 394 F.3d 1198 (9th Cir. 2005) which holds that the preference provisions of the Code preempt state preference statutes. *Sherwood Partners* has not been widely followed. The U.S. District Court for the Western District of Wisconsin has rejected the *Sherwood Partners*

has a statute addressing fraudulent transfers.[32] These actions are usually tried in the court with supervision over the receivership proceeding. Note that in receiverships, these causes of action are often pledged to a secured creditor as additional collateral in connection with post-receivership financing.[33] This contrasts with Chapter 11 cases, where avoidance actions are rarely pledged.[34] Finally, the receivership court also serves as a central forum to collect the debtor's accounts receivable and to adjudicate objections to claims.[35]

State Receiverships Include Clearly Designated Priority of Distributions of Estate Assets

In ABCs, distributions to creditors informally follow the priority scheme of the Code and are therefore subject to challenge by creditors who disagree with the proposed distribution scheme. By contrast, many state receivership statutes provide for clear priority schemes for the distribution of estate assets to creditors.[36]

The Debtor or Moving Creditor Can Recommend the Receiver

The debtor assigning its assets, or the moving party in an involuntary proceeding, can recommend to the court the person it designates to serve as the receiver. This is a significant benefit and assures the parties that the party administering the case and supervising the sale process is experienced.

Disadvantages of State Court Receiverships

While there are often significant benefits that argue in favor of a state court receivership instead of a Chapter 11 case, there are some disadvantages as well. They include the following points as discussed below.

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preemption analysis and upheld use of Wisconsin's preference statute by a receiver. *See Ready Fixtures Co. v. Stevens Cabinets,* 488 F. Supp. 2d 787 (W.D. Wis. 2007).

[32] *See* Wis. Stat. §§ 242.01 et seq.

[33] Appendix G for example of a post-receivership financing motion pledging avoidance actions as additional collateral.

[34] *See In re Texas General Petroleum Corp.,* 58 B.R. 357 (Bankr. S.D. Tex. 1986). (assignments of avoidance actions are prohibited). *But see Mellon Bank, N.A. v. Dick Corp.,* 351 F.3d 290 (7th Cir. 2003). (where a pledge of preferences to a lender to secure debtor in possession financing was found to be enforceable).

[35] *See* Minn. Stat. § 546.50; Wash. Rev. Code § 7.60.220; Fla. Stat. Ann. § 727.113.

[36] *See* Minn. Stat. § 546.51; Wash. Rev. Code. § 7.60.230; Wis. Stat. § 128.17; Fla. Stat. § 727.114.

State Versus Federal Court

Chapter 11 is a federal statute with nationwide applicability. Receiverships are governed by state statutes. Many sophisticated purchasers have considerable experience with bankruptcy and bankruptcy courts but are understandably less familiar with a particular state's receivership statute and proceedings. Unless purchasers can be persuaded that the outcome in a receivership will be roughly equivalent to that which can be had in Chapter 11 case, they may decline to participate with the result being a tepid sale process.

Even where there is a statutory or court-imposed stay against creditor actions, if the debtor has substantial assets in states other than the forum state, it may be difficult to enforce the stay against out-of-state creditors with respect to out-of-state assets. Consequently, a debtor who has significant assets in other states may be better off with a Chapter 11 case (or, if there are affiliate debtors, several Chapter 11 cases jointly administered in a single forum),[37] as opposed to two or more state court receivership proceedings.

Finally, unlike federal bankruptcy judges who are experienced in insolvency issues, including Code section 363[38] sales, state court judges are tasked to handle a variety of civil, commercial, and criminal matters, and may have little or no experience with receiverships under their respective state's statutes. While, in my experience, these judges tend to heavily rely upon an experienced receiver, it is much harder to predict how a particular state court judge may approach the case.

State Court Receiverships and Executory Contracts and Unexpired Leases

Code section 365[39] provides that executory contracts and leases may be assumed and assigned to a third party purchaser, even over the objection of the counterparty, so long as the requisites of the section are met. Additionally, Code section 365 prohibits automatic termination of the contract or lease upon insolvency of the debtor or the appointment of a receiver. There is no analog in most state court receivership statutes.

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[37] *See* 28 U.S.C.A. § 1408 regarding the appropriate venue of title 11 cases.
[38] 11 U.S.C.A. § 363.
[39] 11 U.S.C.A. § 365.

Consequently, the purchaser of the business must obtain the consent to any assignment from the counterparty.[40] While this can be a significant issue in some cases, such as those involving multitenant shopping centers, for example, in most situations the counterparty is happy to have a solvent party assume the obligations of the financially distressed debtor.

Additionally, with respect to key contracts, purchasers routinely make counterparty consent a condition to the closing of any sale. Nonetheless, the risks of failing to obtain consent for the assignment and assumption of key contracts may militate in favor of a Chapter 11 case and the protections of Code section 365.

State Court Receiverships and Secured Creditor Consent to the Proceeding

In Chapter 11 cases, the court has jurisdiction over secured creditors, who are subject to the provisions of the Code and the automatic stay. Assuming that the provisions of Code section 363(f)[41] are complied with, the assets can be sold over the objection of secured creditors. While in Washington any creditor receiving written notice of the receivership is bound by the acts of the receiver,[42] in Wisconsin, secured creditors cannot be forced to participate in a receivership proceeding or a receivership sale if they do not consent.[43] In Minnesota, the receiver has the burden of proving that the amount to be realized by the sale is equal to or greater than what an objecting creditor could reasonably expect to receive within a reasonable time from the liquidation of its assets in the absence of a sale.[44] While the senior secured creditor is often the moving party in involuntary cases and the party pushing for the sale (although usually reserving the right to

[40] *See* Minn. Stat. § 576.45 (which provides for assignment and delegation of an executory contract to a third party, under the same conditions as the debtor was able to do under the terms of the executory contract and applicable law. Presumably, if consent to assignment was required in the contract, the statute would preclude assignment without consent in the receivership). *See also* Wash. Rev. Code § 7.60.130 (which provides for assumption by the receiver but not expressly for the assignment to a third party).

[41] 11 U.S.C.A. § 363(f).

[42] *See* Wash. Rev. Code § 70.60.190 (which provides that any creditor receiving written notice of the receivership is bound by the acts of the receiver).

[43] *See BNP Paribas v. Olsen's Mill, Inc.*, 2011 WI 61, 335 Wis. 2d 427, 799 N.W.2d 792 (2011).; *Wisconsin Brick & Block Corp. v. Vogel,* 54 Wis. 2d 321, 195 N.W.2d 664 (1972). (secured creditors cannot be forced to participate in the receivership).

[44] *See* Minn. Stat. § 576.46.

consent or not consent to the sale depending upon the results of the sale process), in those jurisdictions where consent is required, there is no guarantee that a hostile senior secured lender, or a lienor with a lien in key assets, will participate in the case or agree to the sale.

State Court Receiverships May Lead to Potential Displacement of the Receiver by a Bankruptcy Proceeding

Notwithstanding the commencement of an involuntary receivership, the debtor may file a voluntary bankruptcy petition under Code section 301.[45] In a voluntary receivership case, creditors may file an involuntary bankruptcy proceeding against the debtor under Code section 303.[46] Both actions automatically vest jurisdiction of the case in the bankruptcy court, notwithstanding the pending state court receivership.[47] Upon the filing, the receiver is required to turn over to the bankruptcy estate the property in his or her possession to be administered in the federal case.[48]

Code section 305[49] provides that upon notice and a hearing, the bankruptcy court may abstain from taking jurisdiction and dismiss the bankruptcy case, allowing the receivership to proceed in state court. The bankruptcy court's decision to abstain is not appealable.[50] In my experience, if the receivership case is moving expeditiously toward a sale, and especially if the receivership has been pending for some period of time before the bankruptcy case is filed, bankruptcy courts will usually decide to abstain. However, there is always a risk that the bankruptcy court will exercise jurisdiction and the sale process be disrupted, or at least suspended.

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[45] 11 U.S.C.A. § 301.
[46] 11 U.S.C.A. § 303.
[47] The stay imposed by a state receivership court against creditor actions will not stay the filing of a voluntary or involuntary bankruptcy proceeding. *See Matter of Cash Currency Exchange, Inc.*, 762 F.2d 542, 544, 87 A.L.R. Fed. 255 (7th Cir. 1985). (Title 11 suspends the operation of state insolvency laws.); *see also* the supremacy clause of the U.S. Constitution, Article. VI, Section 1, clause 2. The answer may be different with federal receiverships, which are discussed below. *See S.E.C. v. Byers,* 609 F.3d 87 (2d Cir. 2010). (an injunction against an involuntary bankruptcy proceeding upheld); *Securities and Exchange Commission v. Lincoln Thrift Ass'n,* 577 F.2d 600 (9th Cir. 1978) (leave of the district court required before creditors can file a bankruptcy petition).
[48] *See* 11 U.S.C.A. § 543.
[49] 11 U.S.C.A. § 305.
[50] *See* 11 U.S.C.A. § 305(c).

Despite these disadvantages, practitioners should always place state court receiverships high on the list of options to consider in connection with a distressed sale of a going concern enterprise. In the right situations, state court receiverships can offer substantially all of the benefits of a Chapter 11 case at a fraction of the cost, and usually on a much faster timetable.

Federal Receiverships

Another alternative to a Chapter 11 case or a state court receivership is a federal receivership. In my experience, this "third way" is rarely used, perhaps because of the jurisdictional requirements and the concern that relief will not be promptly available given the federal courts' caseload. Nonetheless, it should be included among the alternatives to be considered, especially in states where there is no receivership statute that might be utilized.

In a federal receivership, jurisdiction is established by the filing of a complaint for breach of contract and demonstrating federal court jurisdiction, usually diversity of citizenship and the minimum amount in controversy.[51]

Once the case is commenced, the court has ancillary jurisdiction to appoint a receiver and ancillary subject matter jurisdiction over suits the receiver brings in connection with his or her duties.[52] The complaint is usually accompanied by a motion for the appointment of a receiver.[53]

The act of appointing a receiver is considered an extraordinary remedy, akin to entry of an injunction, and should be employed "...with the utmost caution and granted only in cases of clear necessity to protect a plaintiff's interest in property."[54] The factors courts consider in deciding whether to appoint a receiver include:

- The existence of a valid claim by the moving party;
- Fraudulent conduct on the part of the defendant;
- Imminent danger that property would be lost, concealed, injured, diminished in value, or squandered;

[51] *See* 28 U.S.C.A. § 1332.
[52] *See Haile v. Henderson Nat. Bank,* 657 F.2d 816 (6th Cir. 1981).
[53] Appendix F for example of a motion to appoint a federal receiver.
[54] *See Midwest Sav. Ass'n v. Riversbend Associates Partnership,* 724 F. Supp. 661, 662 (D. Minn. 1989).

- An inadequacy of the available legal remedies;
- The probability that harm to the plaintiff by denial of the appointment would be greater than the injury to the parties opposing the appointment;
- The plaintiff's probable success in the action; and
- The possibility of irreparable injury to the plaintiff's interest in the property.[55]

Once appointed, the receiver, who is usually nominated by the moving party, becomes an officer of the appointing court and operates the debtor's property in accordance with the laws of the state in which the property is located.[56] Although he or she is an independent officer of the court, the receiver usually takes instruction from the moving party. Upon his or her appointment and the posting of a bond, the receiver has complete jurisdiction and control over all of the debtor's real and personal property, wherever located.[57] Within ten days, the receiver is required to file a copy of the complaint and order appointing him or her in each federal district in which property is located.[58] Although 28 U.S.C. § 754 provides that failure to file the complaint and order in a district within the ten-day period divests the receiver of jurisdiction over property located in that district, most courts hold that failing to timely file the required pleadings is not fatal and can be cured.[59]

The provisions of 28 U.S.C. §§ 2001, 2002, and 2004[60] govern the sale of the debtor's assets. Section 2001, which deals with the sale of real property but also covers the sale of personal property pursuant to section 2004,

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[55] *See Waag v. Hamm,* 10 F. Supp. 2d 1191, 1193 (D. Colo. 1998).; *Commodity Futures Trading Commission v. Comvest Trading Corp.*, 481 F. Supp. 438, 441 (D. Mass. 1979).

[56] *See* 28 U.S.C.A. § 959(b).

[57] *See* 28 U.S.C.A. § 754. *See also Select Creations, Inc. v. Paliafito America, Inc.*, 852 F. Supp. 740, 780 (E.D. Wis. 1994). (federal receivers are empowered to collect assets anywhere in the United States); *but see U.S. v. Franklin National Bank,* 512 F.2d 245,251 (2d Cir. 1975) (there must be independent jurisdictional grounds to maintain a suit in a district other than one in which the receiver is appointed); *see also International Shoe Co. v. State of Wash., Office of Unemployment Compensation and Placement,* 326 U.S. 310, 66 S. Ct. 154, 90 L. Ed. 95, 161 A.L.R. 1057 (1945) (holding that minimum contacts are required for jurisdiction).

[58] *See* 28 U.S.C.A. § 754.

[59] *See, for example, Securities and Exchange Commission v. Equity Service Corp.*, 632 F.2d 1092, 57 A.L.R. Fed. 615 (3d Cir. 1980).; *U.S. v. Arizona Fuels Corp.*, 739 F.2d 455 (9th Cir. 1984).

[60] 28 U.S.C.A. §§ 2001, 2002, 2004.

provides for public and private sales of property. Unless the court orders otherwise, public sales must be conducted in the district in which the receiver was appointed and pursuant to terms and conditions that the court directs. The sales must be noticed at least once a week for at least four weeks in a newspaper of general circulation in the county, state, or district in which the property is located.[61] Private sales must be supported by appraisals and noticed in a newspaper of general circulation not less than ten days before the confirmation hearing.[62] However, apart from these general requirements, the statute offers little guidance with respect to the conduct of sales, allowing parties flexibility in structuring the sale process.

The federal receiver will have jurisdiction over property of the debtor located in multiple locations, which is a definite benefit in situations where a debtor's assets are scattered over several states. Additionally, there is precedent holding that the filing of a subsequent Chapter 11 case may be properly enjoined[63] by the federal receivership court, although there are cases holding to the contrary.[64] Despite these benefits, the required legal standards akin to the requirements for an order for a temporary injunction, the necessity of meeting the federal jurisdictional requirements, and the possible difficulty of getting on a district court's busy calendar often militate in favor of a state court receivership (or even a Chapter 11 case), especially where a debtor is losing money and time is of the essence. Perhaps even more important in some situations, while Code section 365 prohibits the enforceability of *ipso facto* clauses—which provide that a contract may terminate, automatically or upon notice, upon insolvency of the debtor or the appointment of receiver—there is no analog in a federal receivership.[65] This could prove to be a substantial impediment if the debtor has key executory contracts or leases.

Conclusion

Most Chapter 11 cases today result in a sale of the debtor's assets under Code section 363 rather than in confirmation of a plan of reorganization.

[61] *See* 28 U.S.C.A. § 2002.
[62] *See* 28 U.S.C.A. § 2001.
[63] *See supra* note 26.
[64] *See Gilchrist v. General Elec. Capital Corp.*, 262 F.3d 295 (4th Cir. 2001).
[65] *See Golden City Restaurant, Inc. v. Pike*, 246 F.2d 684 (D.C. Cir. 1957). (ruling that a license agreement was validly terminated when the licensee was determined to be insolvent and a receiver was appointed).

However, Chapter 11 cases can be quite expensive and time-consuming, and may not be the best alternative method of maximizing the value of the assets of a going concern business. In the right circumstances, receiverships—especially state court receiverships—may provide most of the benefits of a Chapter 11 case, but will prove to be a much faster and less expensive solution. A state or federal receivership may not be the best choice if there are numerous executory contracts or leases that must be assumed and assigned as part of the transaction. Additionally, if the debtor has significant assets in several states, a Chapter 11 case, or perhaps a federal receivership, may be the better choice. However, given the significant advantages outlined above, state court receiverships should be at the top of the list of options to be seriously considered to accomplish the sale of the assets of an operating business.

Key Takeaways

- Consider that sales of assets in a Chapter 11 case under Code section 363 may not be the optimal way to maximize the value of the debtor's assets. Be sure to explain this to your clients.
- Look into whether common law assignments for the benefit of creditors are an option for your client. They may be hard to utilize in connection with the sale of a going concern business because they are not court supervised and there is no stay against creditor actions to permit the parties to conclude the transaction.
- Thoroughly research the advantages and disadvantages of state court receiverships and evaluate whether this option would be optimal for your clients.
- Consider federal receiverships as another option for your clients. Federal receiverships are court supervised and federal receivers have jurisdiction over property, wherever located. However, the plaintiff creditor must meet the requirements for federal diversity jurisdiction and for obtaining a temporary injunction. Given the case load of most district courts, it may be difficult to proceed quickly, especially if the debtor is losing money and time is of the essence.
- If pursuing a state or federal receivership, consider the debtor's contracts or leases and the impact of a receivership on these contracts and leases when advising clients.

Peter C. Blain is a shareholder and the chair of Reinhart Boerner Van Deuren sc's Business Reorganization Practice Group. He also served as vice president and director of the firm from 1992 to 2005. Mr. Blain regularly represents financial institutions, creditors, debtors, creditor's committees, trustees and others in bankruptcy proceedings, receiverships, and workouts. A fellow in the American College of Bankruptcy, Mr. Blain has been listed in Woodward and White's Best Lawyers in America continuously since 1987, and was selected as Milwaukee's Bankruptcy and Creditor's Rights Lawyer of the Year in 2011. Since 2005, Mr. Blain has been selected as a Wisconsin Super Lawyer by Law and Politics, *and has been recognized as one of the top fifty super lawyers in the state.*

Mr. Blain is a graduate of Georgetown University Law Center and Wisconsin State University at Stevens Point. Prior to law school, Mr. Blain served for two years as a US Army lieutenant. While attending law school he worked in the Office of the Controller at the Veteran's Administration in Washington, DC.

Dedication: *To Kas, for all that you do and have done.*