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Custodians of Estate Property

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JUST GOT PAID: CUSTODIANSHIPS, PAYMENT AND BANKRUPTCY

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JUST GOT PAID: CUSTODIANSHIPS, PAYMENT AND BANKRUPTCY

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Custodianships and bankruptcy often present conjoined yet competing interests, including whether the custodian or the debtor is vested with the authority to commence a bankruptcy, and whether the custodian should remain in such capacity notwithstanding the bankruptcy filing. A trilogy of recent decisions brings to the forefront yet another conflicting overlap between bankruptcy and custodianships – compensation and other payment issues after a debtor subject to a custodianship becomes the subject of a bankruptcy case. *See In re Stainless Sales Corp*., 579 B.R. 836 (Bankr. N.D. Ill. 2017) ("*Stainless Sales I*"); *In re Montemurro*, 581 B.R. 565 (Bankr. N.D. Ill. 2018); *In re Stainless Sales Corp*., 583 B.R. 717 (Bankr. N.D. Ill. 2018) ("*Stainless Sales II*").[2] While challenging to digest and synthesize, all three decisions thoughtfully probe and articulate the legal standards for payment under sections 503 and 543 when custodianships enter the bankruptcy world.

[1] Neither the author nor the Bankruptcy Court for the Western District of Michigan express any opinion regarding the decisions discussed in this article. The article is by no means comprehensive. Practitioners are encouraged to review the actual decisions in order to thoroughly understand the issues and holdings. A version of these materials were published in the Federal Bar Association for the Western District of Michigan – Bankruptcy Section newsletter in the Spring 2018 edition. The FBA has confirmed it retains no rights with respect to the article and has no objection to their publication as part of the Hon. Steven W. Rhodes Consumer Bankruptcy Conference, American Bankruptcy Institute.

[2] A "custodian" includes an assignee for the benefit of creditors, a state or federal court-appointed receiver, and similar agents under applicable law. 11 U.S.C. § 101(11); *see also* 11 U.S.C. § 543.

A. Creditor to Whom Custodian Obligated Prepetition Was Entitled to Administrative Expense

In *Stainless Sales I*, the court considered whether the claim of a creditor to whom the custodian (but not the debtor) was obligated could be satisfied after the debtor filed for bankruptcy. Prepetition, the debtor made an assignment for the benefit of creditors under Illinois law. The assignee thereafter scheduled an auction of the debtor's assets. Prior to the auction, one of the debtor's creditors requested that the assignee return a forklift that the creditor had leased to the debtor. Before the assignee could return the forklift, however, the auction occurred and the forklift was sold to a third party for approximately $15,000.

One day after the auction and before the assignee could distribute the proceeds, certain creditors of the debtor filed an involuntary bankruptcy petition against the debtor. After the court entered an order for relief, the creditor filed an application for an administrative expense for the value of the forklift. The chapter 7 trustee objected to the application because there was allegedly no benefit to the debtor's estate.

The court began its analysis by rejecting the creditor's argument that *Reading Co. v. Brown*, 391 U.S. 471 (1968) provides a basis to award an administrative expense to a creditor for the acts of a custodian. In *Reading*, a decision under the Bankruptcy Act, the United States Supreme Court considered whether to grant the equivalent of an administrative expense to a party who suffered damages due to a fire that occurred after the commencement of the bankruptcy case but while a receiver remained in possession of the debtor's property. The Supreme Court awarded the administrative expense because "costs that form 'an integral and essential element of the continuation of business' are necessary expenses even though priority is not necessary to the continuation of the business."

The *Stainless Sales I* court found that *Reading* did not provide a basis to award an administrative expense under the circumstances before it. According to the court, *Reading* was distinguishable in at least two respects. First, the court noted that *Reading* was rendered prior to the enactment of the Bankruptcy Code, which specifically addresses the overlap between custodians and receivers in sections 503 and 543. Second, the court observed that *Reading* appears to be limited to post-petition conduct, as other courts have held.

The court was also unpersuaded by the creditor's argument that section 503(b)(3)(E) supports its request. Section 503(b)(3)(E) provides that the court shall allow an administrative expense for "the actual, necessary expenses . . . incurred by a custodian superseded under section 543" of the Bankruptcy Code. According to the creditor, because a custodian is entitled to an administrative expense under section 503(b)(3)(E), a party to whom a custodian is obligated should be afforded the same relief. The court found such an interpretation attenuated, deeming such a reading to be inconsistent with the overall priority scheme of the Bankruptcy Code. In concluding that the creditor was not entitled to an administrative expense under section 503(b)(3)(E), the court explained that the better reading is to limit relief under section 503(b)(3)(E) to the party expressly named therein – the custodian.

The court did not end its analysis with section 503(b)(3)(E), however. During the hearing on the application, the court questioned whether section 543 might provide some recourse for the creditor. Section 543(c)(1) states that the court "shall protect all entities to which a custodian has become obligated with respect to such property or proceeds, product, offspring, rents, or profits of such property." Applying this standard, the court noted that there is little doubt that the assignee was liable to the creditor for conversion of the forklift, thereby satisfying an essential element

under section 543(c)(1). The court also concluded that there was no issue as to whether the proceeds from the sale of the forklift became property of the bankruptcy estate.

The court identified the more difficult issue as being the nature of protection contemplated by section 543(c)(1). The court noted that the term "protection" is undefined in the Bankruptcy Code, and the statute itself provides little context to aid in the interpretation. The court also observed that while other courts have equated "protection" with "payment," such an approach is a "convenient shorthand" without analysis. *See In re 400 Madison Avenue Ltd. P'ship*, 213 B.R. 888 (Bankr. S.D.N.Y. 1997); *In re Wayne Engineering Corp.*, 2007 WL 704521 (Bankr. N.D. Iowa Mar. 5, 2007); *see also* COLLIER ON BANKRUPTCY, 543.04 (16th ed. 2017) (generally relying on *400 Madison Avenue* and *Wayne Engineering*).

Feeling compelled to address whether and to what extent protection should be equated with payment, the court commented that requiring payment under section 543(c)(1) would create a superpriority status that is not required or authorized under the Bankruptcy Code. Moreover, if the court were to require payment under section 543(c)(1), it would be inconsistent with section 543(c)(2), a subsection which does in fact require *payment* as opposed to *protection*. The court recognized that Congress knew how to direct payment as it expressly did under section 543(c)(2). Congress did not do so under section 543(c)(1).

The court also considered whether a creditor to whom a custodian is obligated might be relegated to the status of a general unsecured creditor. However, the court concluded that such a claim might be worthless and thus provide no "protection" whatsoever. Finally, the court rejected the argument that a claim under section 543(c)(1) could be elevated to a super-priority. Section 507, which provides a list of priority claims, is exhaustive and does not include any claims or protection under section 543.

With all of that said, the court returned to section 503(b). Citing to *Mediofactoring v. McDermott (In re Connolly N. Am., LLC)*, 802 F.3d 810 (6th Cir. 2015) and other decisions, the court emphasized that the list of administrative expenses under section 503(b) is non-exhaustive. The court thus stated:

> Here, there is a compelling justification to afford these parties administrative expense reimbursement. Section 543 requires the court to protect innocent parties, such as [the creditor], to whom a custodian has become obligated. They may not assert section 503(b)(3)(E) expenses directly, and the custodian who is obligated to them may not do so at all. Allowing the court to fashion a remedy appears to be precisely what Congress intended, and the use of the term protection itself – a term otherwise without specific meaning in bankruptcy parlance, appears intended to allow the court the maximum amount of flexibility in so doing.

In sum, the court held that "protection" under section 543(c)(1) can take the form of an administrative expense under section 503(b) to be paid by the debtor's estate. The court reasoned that although expansion of the list of express administrative expenses under section 503(b) should be undertaken sparingly, the facts and circumstances in *Stainless Sales I* justified such relief.

B. Two Avenues for Compensation of Custodian for Prepetition Services

In the second decision, *Montemurro*, the court waded into a statutory morass when it considered how a custodian might be awarded compensation or otherwise paid for prepetition services. Prior to the debtors' bankruptcy filing, the Illinois state court appointed a receiver to demolish a building on a parcel of property individually owned by the debtors. After the building had been razed, the debtors filed for relief under chapter 11. The receiver did not continue to function in such capacity post-petition. Nonetheless, the receiver filed an application for an administrative expense under section 543(c)(2) for the prepetition services he rendered. The debtors objected.

The court began by explaining the different standards created for compensation under sections 543 and 503(b)(3)(E). Under section 543(c)(2), a custodian is entitled to "reasonable compensation for services rendered and costs and expenses." However, under section 503(b)(3)(E), a custodian is eligible to receive an administrative expense, but only for actual and necessary compensation and related expenses.[3] Accordingly, the court noted, it is less than clear which section of the Bankruptcy Code is controlling. Or, might they both be applicable?

Undertaking a careful analysis, the court distinguished section 543(c)(2) from section 503(b)(3) by noting that section 503(b)(3)(E) expressly applies to only those custodians who are superseded under section 543. Therefore, a superseded custodian (*i.e.*, one who is functioning in such capacity as of the petition date but does not continue in such role post-petition) is eligible to have his or her claim paid as an administrative expense if the services and related expenses are actual and necessary. A custodian who continues in such capacity post-petition, however, is not eligible to have its claim paid as an administrative expense under section 503(b)(3)(E). The court further observed that section 543(c)(2) also provides for compensation to custodians. The compensation need not be actual and necessary. Instead, section 543(c)(2) only requires that it be "reasonable."

The court next addressed who is eligible for relief under section 543(c)(2). In order to avoid redundancy with section 503(b)(3)(E), the court noted that "such custodian" in section 543(c)(2) relates to those custodians with knowledge of the case under section 543(a), regardless of whether the custodian has been superseded. The court concluded that section 543(c)(2) allows

[3] At one point, *Montemurro* seems to state that the "actual and necessary" modifiers apply only to expenses, and not compensation, of the custodian under section 503(b)(3)(E). *In re Montemurro*, 581 B.R. at 573. However, later in the opinion, the court explained that any compensation awarded to a custodian under section 503(b)(3)(E) is subject to the "actual and necessary" requirement. *Id*. at 575-76. Any inconsistency in *Montemurro* appears to have been implicitly addressed in *Stainless Sales II*, when the court reaffirmed that any administrative expense under section 503(b)(3) must be actual and necessary. *See Stainless Sales II*, 583 B.R. at 725 (citing *In re Montemurro*, 581 B.R. at 575-76).

a court to provide for "reasonable compensation" to a custodian, regardless of whether the custodian has been superseded.

Keeping in mind that section 503(b)(3)(E) provides an administrative expense only for superseded custodians, the court grappled with the means by which to compensate custodians who are not superseded. The court turned to section 543(c)(2), noting that its express language states that the court shall "provide for the payment" of compensation to a custodian. According to the court, the passive wording of "provide for the payment" allows the court to permit a custodian to seek payment through non-bankruptcy means, such as by obtaining payment from a non-debtor party who is obligated under the receivership order or non-bankruptcy law. Although a custodian cannot seek compensation under section 543(c)(2) against the debtor or property of the estate, the court hypothesized that a custodian might nonetheless have recourse against a non-debtor or even a debtor's property that does not constitute property of the estate.

Distilling the aforementioned thicket of statutory interpretation, the court somewhat apologetically summarized the legal standards as follows:

> If and to the extent the compensation requested of the custodian is to be paid from estate property, the heightened standard of actual and necessary as set forth in section 503(b)(3)(E) should be applied. To the extent compensation is from another source, the reasonableness standard in section 543(c)(2) should apply. If a custodian is excused from compliance under section 543(d), however, only the section 543(c)(2) reasonableness standard would apply.
>
> * * *
>
> While the court will adopt the reading set forth herein despite the odd result, it is not without reservations and the overall impression that the entire scheme as set forth in the Bankruptcy Code is in desperate need of revision.

With the general statutory analysis complete, the court returned to the specific facts at issue in *Montemurro*. After finding that the receiver had turned over the property to the debtors post-petition in compliance with his obligations under section 543(b), the court deemed the receiver to

have been superseded. As such, the court held that a superseded custodian can be compensated under either section 503(b)(3)(E) *or* section 543(c)(2). The court declined to render a decision on the application before it, however, because the standard to be applied to the proofs was less than clear at the outset.[4]

C. Professionals of Custodians Have Three Statutory Means to Seek Compensation

In the most recent decision in the trilogy, *Stainless Sales II*, the same court was again confronted with payment issues relating to a custodianship. This time, the fees and expenses of the custodian's legal counsel for pre- and post-petition services were at issue.

In *Stainless Sales II*, legal counsel for an assignee for the benefit of creditors was retained by the assignee prepetition and given a retainer in the amount of $155,000. After certain creditors filed an involuntary petition for relief against the debtor under chapter 11, the assignee filed a motion to continue in such capacity post-petition under section 543, which the court granted. The court ultimately entered an order for relief, but converted the case to chapter 7.

Approximately eight months after the bankruptcy petition was filed, legal counsel for the assignee filed its first fee application in which it sought an administrative expense for services it provided to the assignee pre- and post-petition. The chapter 7 trustee objected.

Drawing from *Stainless Sales I* and *Montemurro*, the *Stainless Sales II* court concluded that the professionals of a custodian potentially have three means by which to seek compensation for the pre- and post-petition services they provide to a custodian. First, section 543(c)(1) states that the court shall protect all persons to whom a custodian has become obligated. According to

[4] The court narrowed the issue further for the final hearing by noting that there was no source of funds with which to pay the receiver under section 543(c)(2). Because the only source of payment was from property of the estate, the court identified the sole remaining issue as whether the receiver was entitled to an administrative expense under section 503(b).

the court, legal counsel for the assignee was certainly a party to whom the assignee had become obligated. Unlike section 503(b)(4), the court reasoned, section 543 does not contain a separate provision for payment of a custodian's professionals. As such, Congress intended to ensure that professionals have the ability to be paid as a protection mechanism under section 543(c)(1). And, in order to provide protection under section 543(c)(1), it might be appropriate to award the custodian's professionals an administrative expense under section 503(b), as the court did in *Stainless Sales I*.

Second, the court observed that section 543(c)(2) could also be implicated. That section requires the court to "provide for the payment of reasonable compensation for *services* rendered and *costs* and *expenses* incurred by" a custodian. Section 543(c)(2) is different than section 503(b)(3)(E), the latter of which only covers compensation and expenses, but not costs. By including "costs" under section 543(c)(2), Congress intended to capture professional services of a custodian.

Third, the court noted that section 503(b)(4) expressly addresses the fees and expenses of an attorney or accountant of an entity whose expense is allowable under certain subsections of section 503(b)(3). Because a custodian's fees and expenses are allowable under section 503(b)(3)(E), the fees and expenses of legal counsel to the assignee could be eligible for an administrative expense under section 503(b)(4).[5]

Next, the court addressed the means by which to compensate the custodian's legal counsel for three distinct periods: (i) prepetition, (ii) post-petition in chapter 11, and (iii) post-petition in chapter 7. With respect to the prepetition period and citing to *Stainless Sales I*, the court explained

[5] The court further explained that allowance of the fees and expenses of a custodian is not a prerequisite to allowance under section 503(b)(3)(E) because "allowable" and "allowed" are different concepts.

that although legal counsel could potentially be eligible for an administrative expense, an expansion of section 503(b) beyond the subsections expressly enumerated therein should be employed with restraint. Section 543(c)(1) and section 543(c)(2) could also provide a basis for compensation paid to a custodian's legal counsel or accountant for prepetition services.[6]

With respect to post-petition compensation in chapter 11 and chapter 7, the court deemed the standard to be the same. *See* 11 U.S.C. § 503(b); *see also* 11 U.S.C. § 726(b). Because neither the trustee nor legal counsel identified any source of payment other than property of the estate that might afford relief under section 543 for post-petition services, the court proceeded under section 503(b)(4).

The court first rejected the trustee's contention that legal counsel for the custodian was not eligible for compensation because it had not been retained. The court explained that section 327 does not apply to custodians:

> Because [legal counsel] was not employed under section 327, the general compensation provisions under section 330 did not, by their express terms, apply to it. *See* 11 U.S.C. § 330(a)(1); *cf*. 11 U.S.C. § 330(a)(4)(B) (providing an alternative standard for compensating counsel in chapter 13 matters, where professionals are not retained and thus not subject to section 330(a)(1)). Here, professionals providing services to custodians have an alternative standard for compensation codified in section 503(b) and 543. They need not look elsewhere.

The court next explained that notwithstanding the trustee's argument to the contrary, section 503(b)(4) applies to both pre- and post-petition professionals of a custodian. In a fairly summary fashion, the court turned to the express language of section 503(b)(4), which makes no mention of the prepetition or post-petition nature of such services. *Compare* 11 U.S.C. § 503(b)(1)(A)(i) ("after the commencement of the case") *with* 11 U.S.C. § 503(b)(9) ("before the

[6] Because the parties failed to sufficiently address these prepetition compensation issues in their briefing and the court ultimately afforded relief under section 503(b)(4), the court elected not to address prepetition compensation under sections 543(c)(1), 543(c)(2) and 503(b).

date of commencement of a case"). Legal counsel for the assignee was thus entitled to an administrative expense under section 503(b)(4) for its pre- and post-petition services.[7]

The decisions in *Stainless Sales I, Montemurro*, and *Stainless Sales II* address important issues concerning the relationship between custodianships and bankruptcy. As noted in *Montemurro* and *Stainless Sales II*, the statutory framework is less than ideal. Nonetheless, when carefully reviewed, all three decisions provide thoughtful guidance and analysis for use in future cases.

[7] The *Stainless Sales II* court undertook a thorough analysis of the fees and expenses, which need not be discussed as part of this article. Of particular note, however, is the court's conclusion that unusual circumstances existed which justified counsel's request for fees and expenses related to the preparation and litigation of the fee application. The court deviated from its general rule that fees related to preparation of a fee application should not exceed 3-5% of the total compensation requested. The court also concluded that *Baker Botts L.L.P. v. ASARCO LLC*, ___ U.S. ___, 135 S.Ct. 2158, 2164 (2015) was inapplicable because legal counsel's fees and expenses were sought under section 503, not section 330.

RECEIVERS AND BANKRUPTCY

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Introduction

It is difficult to ascribe a certain result for a hypothetical bankruptcy case which involves a receiver. Access to the bankruptcy courts is sacrosanct, but whether a receiver can assume corporate governance is not. The case law appears to offer clarity where in certain aspects, there is little. Ultimately, a bankruptcy court will likely look to exercise its authority under 11 USC §105(a) which permits it to: "...issue any order, process, or judgment that is necessary or appropriate to carry out the provisions of this title." As stated by Supreme Court Justice Potter Stewart in his *Jacobellis v. Ohio,* 378 U.S. 184 (1964) concurrence:

> I shall not today attempt further to define the kinds of [permissible receiverships in bankruptcy] I understand to be embraced within that shorthand description; and perhaps I could never succeed in intelligibly doing so. But I know it when I see it...
> *Jacobellis Id* at 197.

A. *MCL 600.2926 and 600.6104(4)*[1]

Whenever you are confronted with addressing a receivership, it is important to first evaluate the order appointing the receiver. MCL 600.2926 directs that the circuit court: "...shall define the receiver's power and duties where they are not otherwise spelled out by law." If it is not in the order, it is unlikely that the receiver's powers will be identified elsewhere.

Though district courts are devoid of the circuit court's equitable powers, they too are permitted to appoint a receiver. For a district court to appoint a receiver, it must be: "After

[1]There are a number of Michigan statutes, in addition to those cited, which authorize the appointment of a receiver. For example, a receiver can be appointed to operate a cemetery MCL 456.529(6), manage an insurance company MCL 500.8104(3), a credit union MCL 490.232(1) or in construction lien litigation MCL 570.1122(1).

judgment for money has been rendered in an action in any court of this state...". This permits the court under MCL 600.6104(4) to: "Appoint a receiver of any property the judgment debtor has or may thereafter acquire."

MCR 2.622 is the Michigan court rule which governs the operation of a receivership under a court's supervision. It was drafted with the intention of codifying best practices which were already in use by receivership practitioners. Under MCR 2.622(A),

> Upon the motion of a party or on its own initiative, and for good cause shown, the court may appoint a receiver as provided by law. A receiver appointed under this section is a fiduciary for the benefit of all persons appearing in the action or proceeding. For purposes of this rule, "receivership estate" means the entity, person, or property subject to the receivership.

B. *What Powers are Included in the Order Appointing the Receiver and is the Receivership Property: In Rem or In Personam?*

The order appointing the receiver may establish that the appointment is to be *in rem* (the property) or *in personam* (the person or entity), or both.[2] The difference isn't always apparent to the parties, their counsel or the state court. In my receivership orders, I always seek to be appointed *in personam* rather than *in rem*. This insures that I have authority over the person or entity, and not just control of their property. Without *in personam* authority, the ability to obtain information or investigate matters personal to the party under receivership may be hobbled. I also include language which insures there is no question of my authority to seek bankruptcy relief:

> Initiate, petition, compromise, adjust, defend, appear in, intervene in, dispose of, or become a party to any action or proceeding, including those under Title 11 of the United States Code, in state, federal or foreign courts as is necessary to carry out the Receiver's duties.

[2]Don't expect to find it labeled.

A bankruptcy filing by a receiver, where the order appointing the receiver is *in rem* and not *in personam* would be ultra vires. Further, one should scrutinize the order to determine whether it specifically contemplates and authorizes a bankruptcy filing. This makes for fertile ground to explore with the bankruptcy court should the receiver herself attempt to file a petition for relief.

An example of an *in rem* provision from a lender's commercial receivership order appears below:

> This Court appoints Mary Roe (the "Receiver"), whose address is 123 Main St., Detroit, Michigan, *as receiver for the Plaintiff, Lender's collateral as described in this order appointing receiver*.

Most orders involving a lender limit the receiver's authority to the administration to the bank's collateral. Lenders are typically concerned that the receiver will become enmeshed in business matters unrelated to the administration and liquidation of their collateral. By limiting the receiver's authority to the collateral, this obviates this risk.

C. *The Michigan Commercial Receivership Act, MCL 554.1011 et seq.*

Much of the Michigan Commercial Real Estate Receivership Act (the "Act"), MCL 554.1011 et. seq. was patterned on the bankruptcy code.[3] Unfortunately, state courts are ill prepared to manage the notice requirements and intricacies of the Code. Consideration of the Act is beyond the scope of our seminar. One section is of great import to both receivers and bankruptcy practitioners. A receiver appointed under MCL 554.1019 is perfected upon appointment, without any notice or required perfection:

[3]See e.g. MCL 554.1019(a) and (b) lien creditor, 554.1021(1)(b) turnover, 554.1021(3) adequate protection, 554.1022(2)(g) and 554.1027(2) assumption or rejection of executory contracts, 554.1024 automatic stay, 554.1025(1) court approval for retention of professionals; 554.1026(3) sale, use or lease of property of the estate, 554.1028 receiver's immunity and the Barton Doctrine, 554.1030 notice of appointment, 554.1031 compensation and 554.1033 discharge.

> 554.1019 Status of receiver as lien creditor.
>
> (1) On appointment of a receiver, the receiver has the status of a lien creditor under both of the following:
>
> (a) Article 9 of the uniform commercial code, 1962 PA 174, MCL 440.9101 to 440.9809, as to receivership property that is personal property or fixtures.
>
> (b) The recording statutes of this state as to receivership property that is real property.

A commercial real estate receiver's lien perfection is automatic and without notice. What if there is a refinance after the receiver's appointment and before a bankruptcy? Is the receiver's lien interest, property which is turned over to the trustee under §543(b)(1)? As a lien creditor, is the receiver entitled to adequate protection? This is a giant title headache that the drafters of the Act may not have envisioned. Though perfection is automatic, the receiver still has duties under MCR 2.622(D)(2):

> Unless otherwise ordered, within 28 days after the filing of the acceptance of appointment, the receiver shall provide notice of entry of the order of appointment to any person or entity having a recorded interest in all or any part of the receivership estate.

D. *May a bankruptcy court appoint a receiver?*

It has been argued that since the Bankruptcy Reform Act of 1978, a bankruptcy court is precluded from appointing a receiver. 11 U.S.C. §105(b)'s language is not so restrictive: "Notwithstanding subsection (a) of this section, *a court may not appoint a receiver in a case under this title.*" (italics supplied). The limitation of §105(b), is the power to appoint a receiver for the bankrupt estate, that is, a receiver in lieu of the bankruptcy trustee. (e.g., if a receiver was appointed to enforce an adversary complaint judgment, it would not be a: *"a case under this*

title." However, if the receiver was sought to be appointed in a core proceeding under 28 USC §157(b)(2) or to subsume the role of the trustee, the outcome would likely be different. See also *In re Memorial Estates, Inc.*, 797 F.2d 516 (7th Cir., 1986) and *In re Cassidy Land and Cattle Co., Inc.,* 836 F.2d 1130 (8th Cir., 1987).

E. *Assumption of Corporate Authority by Receiver*

The Court in the case *In re Corporate and Leisure Event Productions, Inc.*, 351 B.R. 724 (Bankr. D. Ariz. 2006), the state court receiver moved to dismiss the bankruptcy filing as unauthorized (by him). The bankruptcy court disagreed:

> "if removal of corporate officers and directors by a receivership order were sufficient to prevent a bankruptcy filing, creditors who seek their state court remedies to the exclusion of all others would routinely obtain receivership orders with such boilerplate language. This is a tactic that bankruptcy law has prevented at least since 1867." *Id* at 732, n.26.

The receiver contended that because the courts look to state law to determine corporate governance, only he was authorized to file for relief. "While bankruptcy case law generally refers to state law to determine who has eligibility to file the petition, it unanimously refuses to do so (in the absence of an intracorporate dispute) when state law has provided a creditor's remedy to vest that authority in a receiver." *Id* at 732.

In 2017, Judge Thomas Tucker had to consider two competing first day motions in a newly filed Chapter 11. In the case *In re Packard Square, LLC,* 575 B.R. 768 (2017), a receiver had been in possession for 10 months prior to the filing. The debtor sought to compel turnover under §543(b)(1) and the receiver resisted by requesting relief under §543(d)(1):

> (a) First Day Emergency Motion for Order Directing Receiver to Turn Over All Property to Chapter 11 Debtor-in-Possession and Related Relief; and

(b) Motion To: (1) Excuse Receiver from Turnover Provisions; and (2) Suspend the Bankruptcy Case.

Judge Tucker began his analysis by noting that:

> 'The bankruptcy court has discretion under § 543(d)(1) to excuse a state court receiver from its mandatory turnover obligation under § 543(b)(1).' *Id* at 778 (internal citation omitted). He also examined the tension between: 'Reorganization policy generally favors turnover of business assets to the debtor in a [C]hapter 11 case.' as opposed to abstention under §305(a)(1).

Judge Tucker's decision was heavily effected by the length of time the receiver had been in place. He noted that the state court receiver had been in control of the debtor's assets for ten months prior to the bankruptcy filing. He ultimately found that it was in the best interests of creditors and equity security holders under §543(d)(1) for the receiver to remain in possession:

> As with § 543(d)(1), where the custodian is a receiver appointed by a state court, courts have considered the length of the time that the receiver has acted under a receivership order, what the receiver has done, and the impact of these considerations on the other relevant factors. See, e.g., *In re Starlite Houseboats, Inc.*, 426 B.R. 375, 389 (Bankr. D. Kan. 2010) (dismissing the bankruptcy case under § 305(a)(1) where a "state court receivership had been pending for approximately eight months when [the bankruptcy] case was filed," the court finding that "the interests of creditors and the [d]ebtor would be served by dismissal of the case" because "continuation of the state court receivership proceeding, which [was] well underway, [was] preferable to starting anew in [the bankruptcy] court");

The Court's excused the receiver from turnover, and dismissed the case on abstention grounds in accord with §305(a)(1).

In the case, *In re Sino Clean Energy, Inc.,* 901 F.3d 1139 (9th Cir., 2018), the Ninth Circuit took a different approach. In *Sino,* the company's board of directors had been removed in the order which appointed the receiver. Their removal was due to their nonfeasance and gross

mismanagement of the debtor. The state court specifically empowered the receiver to reconstitute the board. Thereafter, the original board members authorized a bankruptcy filing without the consent of the receiver or the new board.

The *Sino Clean Energy* Court specifically abrogated the holding in *Corporate & Leisure* and it established what appears to be a hard and fast rule:

> No matter the equitable considerations, state law dictates which persons may file a bankruptcy petition on behalf of a debtor corporation. We understand *Corporate & Leisure* as announcing the more limited holding that, where a state court purports to enjoin a corporation from filing bankruptcy altogether, federal law preempts that injunction.

Though unstated, it appears that the real reason for the Court's ruling was the length of time which had transpired since the appointment of the receiver. The filing had taken place more than one year after the state court, appointed the receiver to take over the company's affairs. In addition, the filing was seven months after receiver removed company's directors from their for mismanagement of the company. The bottom line is whether the debtor is truly seeking refuge from its creditors or whether it is a last gasp attempt to obviate its long standing fate.

F. *Receiver's Authority to File for Bankruptcy Relief*

Courts have determined that a receiver is permitted to file for relief under Chapter 11 to preserve and defend the assets of the receivership estate. See *In re Monterey Equities-Hillside*, 73 B.R. 749 (Bankr. N.D. Cal. 1987) and *In re State Park Building Group, LTD*, 316 B.R. 466 (Bankr. N.D. Tex. 2004). Commencement of a case under the Bankruptcy Code "is a specific act requiring specific authorization." *N2N Commerce*, 405 B.R. 34, 41 (Bankr. D. Mass 2009) (internal quotation marks omitted). "As an officer of the court, the receiver's powers are coextensive with his order of appointment ..."); *Resolution Trust Corp. v. Bayside Developers*, 43

F.3d 1230, 1241 n. 8 (9th Cir.1994).

It also is well-settled that applicable state law determines whether a bankruptcy filing was authorized. See *Price v. Gurney*, 324 U.S. 100, at 106, 65 S.Ct. 513 (holding that those "who purport to act on behalf of the corporation" must have "been granted authority by local law to institute the proceedings") *In re ComScape Telecommunications, Inc.*, 423 B.R. 816, 830 (Bkrtcy. S.D.Ohio, 2010). See also *In re Petters Company,* 401 B.R. 391 Bkrtcy. D. Minn. (2009), receiver not disqualified to serve as Chapter 11 trustee.

In the case *In re Bayou Group, LLC*, 363 B.R. 674 (S.D. N.Y. 2007), the Bankruptcy Court considered the authority of a U.S. District Court appointed a federal equity receiver to file for relief. The District Court had appointed the receiver in a ponzi case:

> *Corporate Governance*: Pursuant to 28 U.S.C. § 959(b), [Marwil shall] succeed to be the sole and exclusive managing member and representative of each of the Bayou Entities with the sole and *exclusive power and authority to manage* and direct the business and financial affairs of the Bayou Entities, including without limitation, the *authority to petition for protection under the Bankruptcy Code*, 11 U.S.C. §§ 101 et seq. (the "Code"), for any or all of the Bayou Entities and in connection therewith be and *be deemed a debtor-in-possession* for any or all of the Bayou Entities in proceedings under Chapter 11 of the Code, and prosecute such adversary proceedings and other matters as may be permitted under the Code and/or applicable law.
> *Bayou Id* at 680 (italics supplied)

The Office of the United States Trustee's office opposed the filing by the receiver and sought the appointment of a Chapter 11 trustee under §1104. Its argument was that the receiver's role as a pre-petition custodian brought his authority to an end. Unsurprisingly, the Bankruptcy Court deferred to the ruling of the District Court and held that the receiver's appointment included his substitution as management of the debtor.

On appeal, both the District Court and the Second Circuit, 564 F.3d 541 2nd. Cir. (2009), held that a prepetition receiver appointed by the district court under federal law was not a "custodian" under the Code and upheld the denial of the UST's motion to dismiss or convert. However, some courts have limited the application of *Bayou's* holding. They have contended that the receiver's appointment in *Bayou* was based on its authority under the securities laws. They have noted the *Bayou* court's comment that: "Had I appointed him solely pursuant to these receivership statutes, then the U.S. Trustee would be correct that his corporate management powers ceased the moment he caused Bayou to file for bankruptcy. See 11 U.S.C. § 543." *Id* at 684. See also *In Re: Ute Lake Ranch, Inc.,* 2016 WL 6472043 (Bkrtcy. D. Col. 2016), "[the district court] had also appointed him as corporate manager pursuant to different authority—namely "*federal securities laws and the court's inherent authority.*". (italics supplied)

G. *A Receiver's State Law Corporate Authority and a State Court's Denial of Access to the Bankruptcy Courts*

Federal common law holds that a state court cannot deny a debtor's right to seek relief in the bankruptcy courts.[4] [5] Eligibility to seek relief in the bankruptcy courts is determined by Section 11 U.S.C. § 109, not state law. A state court injunction cannot restrict the ability to file a bankruptcy petition and to pursue bankruptcy relief under the Bankruptcy Code.

State courts can enter orders prohibiting officers and directors from interfering with the receiver's management of the company. Yet, those same officers and directors may still file a

[4]U.S.C.A. Const. Art. I § 8, cl. 4; The Congress shall have Power . . . To establish an uniform Rule of Naturalization, and uniform Laws on the subject of Bankruptcies throughout the United States;

[5]U.S.C.A. Const. Art. VI cl. 2; This Constitution, and the Laws of the United States which shall be made in Pursuance thereof; and all Treaties made, or which shall be made, under the Authority of the United States, shall be the supreme Law of the Land; and the Judges in every State shall be bound thereby, any Thing in the Constitution or Laws of any State to the Contrary notwithstanding.

bankruptcy petition without the consent of the state court appointed receiver. See, e.g., *In re Cash Currency Exchange, Inc. v. Shine* (*In re Cash Currency Exchange, Inc.*), 762 F.2d 542, 552 (7th Cir. 1985); *Struthers Furnace Co. v. Grant*, 30 F.2d 576, 577 (6th Cir. 1929); *In re Greater Apartment Hunter's Guide, Inc.*, 40 B.R. 29, 31 (Bankr. N.D. Ga. 1984) ("a state court receivership cannot operate to deny a corporate debtor access to this nation's federal Bankruptcy Courts"); *In re S & S Liquor Mart, Inc.*, 52 B.R. 226, 227 (Bankr. D.R.I. 1985) (corporate principals retain the right to initiate voluntary bankruptcy notwithstanding receivership); *In re Donaldson Ford, Inc.*, 19 B.R. 425, 430 (Bankr. N.D. Ohio 1982) (restraint of ability to file due to state court receivership would be an unconstitutional deprivation of the right to federal bankruptcy relief).

In *Struthers Furnace Co. v. Grant*, 30 F.2d 576, 577 (6th Cir.1929), it was contended that corporations should be barred from instituting bankruptcy proceedings for the purpose of ending state court receiverships to which they have voluntarily submitted. The Sixth Circuit held a state court receivership order could not restrict a debtor from seeking relief in bankruptcy, even if it had consented to the receivership. Also see, e.g., *In re Mt. Forest Fur Farms of Am., Inc.*, 103 F.2d 69, 71 (6th Cir., 1939); *In re Klein's Outlet, Inc.*, 50 F.Supp. 557, 559 (S.D.N.Y.1942) ("The appointment by a state court of a permanent receiver with full power to act for the corporation does not affect the right of directors to act on behalf of the corporation in federal bankruptcy proceedings.").

H. *Can a State Court Receivership Order Restrict Access to the Bankruptcy Court?*

In *Corporate & Leisure*, supra, the state court's order appointed a receiver and expressly

authorized him to remove the officers, directors and other persons from the management of the corporate debtor (and related corporate entities). As here, the receivership order enjoined the defendants from doing any act to interfere with the receiver's custody and management of the receivership assets and specifically enjoined them from filing any petition without permission of the state court. Nonetheless, a petition was filed on behalf of the debtor. The Bankruptcy Court explained that:

> [T]here is a federal common law exception to this reliance on state law when the state law is in the form of a receivership order that attempts to preclude any of the original constituents of the organizational entity from filing a petition on its behalf, in order to maintain the state court remedy that has been obtained by the creditors. It makes no difference whether the corporate officers and directors were actually removed by the receiver or the receivership order merely enjoins their interference or filing of a petition. In either case, state law withdraws their authority to file for bankruptcy relief yet in both cases the unanimous federal common law holds that they are nevertheless entitled to do so. *Id* at 731.

Even where directors and officers have been removed or have been enjoined from interfering with the receiver's administration of the company, they can nevertheless undo this ouster by filing a Chapter 11 bankruptcy case. A successful filing by management would put it back in control again. See 11 U.S.C. §§ 543(b)(1) and 1107(a).

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UNIFORM COMMERCIAL REAL ESTATE RECEIVERSHIP ACT (EXCERPT)
Act 16 of 2018

554.1028 Defenses and immunities of receiver.

Sec. 18. (1) A receiver is entitled to all defenses and immunities provided by law of this state other than this act for an act or omission within the scope of the receiver's appointment.

(2) A receiver may be sued personally for an act or omission in administering receivership property only with approval of the court that appointed the receiver.

History: 2018, Act 16, Eff. May 7, 2018.

UNIFORM COMMERCIAL REAL ESTATE RECEIVERSHIP ACT (EXCERPT)
Act 16 of 2018

554.1030 Notice of appointment; claim; distribution of receivership property.

Sec. 20. (1) Except as otherwise provided in subsection (6), a receiver shall give notice of appointment of the receiver to creditors of the owner by both of the following:

(a) Deposit for delivery through first-class mail or other commercially reasonable delivery method to the last known address of each creditor.

(b) Publication as directed by the court.

(2) Except as otherwise provided in subsection (6), the notice required by subsection (1) must specify the date by which each creditor holding a claim against the owner that arose before appointment of the receiver must submit the claim to the receiver. The date specified must be at least 90 days after the later of notice under subsection (1)(a) or last publication under subsection (1)(b). The court may extend the period for submitting the claim. Unless the court orders otherwise, a claim that is not submitted timely is not entitled to a distribution from the receivership.

(3) A claim submitted by a creditor under this section must satisfy all of the following requirements:

(a) The claim must state the name and address of the creditor.

(b) The claim must state the amount and basis of the claim.

(c) The claim must identify any property securing the claim.

(d) The claim must be signed by the creditor under penalty of perjury.

(e) The claim must include a copy of any record on which the claim is based.

(4) An assignment by a creditor of a claim against the owner is effective against the receiver only if the assignee gives timely notice of the assignment to the receiver in a signed record.

(5) At any time before entry of an order approving a receiver's final report, the receiver may file with the court an objection to a claim of a creditor, stating the basis for the objection. The court shall allow or disallow the claim according to law of this state other than this act.

(6) If the court concludes that receivership property is likely to be insufficient to satisfy claims of each creditor holding a perfected lien on the property, the court may order both of the following:

(a) That the receiver need not give notice under subsection (1) of the appointment to all creditors of the owner, but only such creditors as the court directs.

(b) That unsecured creditors need not submit claims under this section.

(7) Subject to section 21, both of the following apply to a distribution of receivership property:

(a) If the distribution is to a creditor holding a perfected lien on the property, the distribution must be made in accordance with the creditor's priority under law of this state other than this act.

(b) If the distribution is to a creditor with an allowed unsecured claim, the distribution must be made as the court directs according to law of this state other than this act.

History: 2018, Act 16, Eff. May 7, 2018.

564 F.3d 541, 51 Bankr.Ct.Dec. 155, Bankr. L. Rep. P 81,484
(Cite as: 564 F.3d 541)

H

United States Court of Appeals,
Second Circuit.
In re BAYOU GROUP, LLC, Debtor.
Diana G. Adams, United States Trustee, Appellant,
v.
Receiver Jeff J. Marwil, for the Bayou Group Official Committee of Unsecured Creditors, and Bayou Group, LLC, Appellees.FN*

FN* The Clerk of Court is directed to amend the official caption as set forth above.

Docket No. 07-1508-bk.

Argued: Sept. 17, 2008.
Decided: May 1, 2009.

Background: United States Trustee (UST) moved for appointment of Chapter 11 trustee in bankruptcy cases commenced by third party appointed, by prepetition order of district court, to act as both receiver and corporate manager of group of hedge funds and related entities that had been misused by their principals as vehicle for perpetrating massive Ponzi scheme. The United States Bankruptcy Court for the Southern District of New York, Adlai S. Hardin, J., denied motion, and UST appealed. The District Court, Colleen McMahon, J., 363 B.R. 674, affirmed, and UST appealed.

Holdings: The Court of Appeals, John M. Walker, Jr., Circuit Judge, held that:
(1) UST failed to demonstrate that "cause" existed for appointment of a trustee or that removal of individual appointed as receiver/manager was in the interests of creditors;
(2) while individual's "custodian" role ceased upon commencement of the Chapter 11 proceedings, his role as "managing member" of debtors remained;
(3) the district court had authority to place individual in a management position from which he could file and manage entities' Chapter 11 proceedings; and
(4) allowing individual to prosecute debtors' Chapter 11 proceedings was not contrary to the Bankruptcy Code.

District court's judgment affirmed.

West Headnotes

[1] Bankruptcy 51 3782

51 Bankruptcy
51XIX Review
51XIX(B) Review of Bankruptcy Court
51k3782 k. Conclusions of Law; De Novo Review. Most Cited Cases
Where a district court acts in its capacity as an appellate court in a bankruptcy case, the district court's decisions are subject to plenary review by the Court of Appeals.

[2] Bankruptcy 51 3782

51 Bankruptcy
51XIX Review
51XIX(B) Review of Bankruptcy Court
51k3782 k. Conclusions of Law; De Novo Review. Most Cited Cases

Bankruptcy 51 3786

51 Bankruptcy
51XIX Review
51XIX(B) Review of Bankruptcy Court
51k3785 Findings of Fact
51k3786 k. Clear Error. Most Cited Cases
Court of Appeals reviews independently the factual findings and legal conclusions of the bankruptcy court, accepting its findings of fact unless they are clearly erroneous and reviewing its conclusions of law de novo.

[3] Bankruptcy 51 3624

51 Bankruptcy
51XIV Reorganization
51XIV(D) Administration
51k3623 Appointment of Trustee or Examiner
51k3624 k. Necessity or Grounds. Most Cited Cases

Bankruptcy court may appoint a Chapter 11 trustee only in certain circumstances, as set forth in the Bankruptcy Code. 11 U.S.C.A. § 1104(a)(1, 2).

[4] Bankruptcy 51 ⚿3626

51 Bankruptcy
51XIV Reorganization
51XIV(D) Administration
51k3623 Appointment of Trustee or Examiner
51k3626 k. Proceedings. Most Cited Cases

Standard for appointment of a Chapter 11 trustee is very high: the United States Trustee (UST) has the burden of showing by "clear and convincing evidence" that the appointment is warranted. 11 U.S.C.A. § 1104.

[5] Bankruptcy 51 ⚿3624

51 Bankruptcy
51XIV Reorganization
51XIV(D) Administration
51k3623 Appointment of Trustee or Examiner
51k3624 k. Necessity or Grounds. Most Cited Cases

In determining whether appointment of a Chapter 11 trustee is warranted or in the best interests of creditors, the bankruptcy court must bear in mind that the appointment may impose a substantial financial burden on a hard-pressed debtor seeking relief under the Bankruptcy Code, by incurring the expenditure of substantial administrative expenses caused by further delay in the bankruptcy proceedings. 11 U.S.C.A. § 1104.

[6] Bankruptcy 51 ⚿3624

51 Bankruptcy
51XIV Reorganization
51XIV(D) Administration
51k3623 Appointment of Trustee or Examiner
51k3624 k. Necessity or Grounds. Most Cited Cases

United States Trustee (UST) failed to demonstrate that "cause" existed for appointment of a Chapter 11 trustee or that removal of the individual previously appointed to act as receiver and corporate manager of group of hedge funds and related entities that had been misused by their principals as vehicle for perpetrating massive Ponzi scheme was in the interests of creditors; there were no allegations that individual had engaged in fraud, dishonesty, or gross mismanagement, or that he was incompetent to manage debtors' affairs, the record was, instead, quite to the contrary, as individual, who had caused each entity to file a petition for Chapter 11 relief, had brought more than 125 adversary proceedings and recovered more than $20 million for debtors' creditors, UST did not show how replacing individual would facilitate the bankruptcy proceedings, no creditor supported UST's motion for appointment of a trustee, and creditors committee opposed motion. 11 U.S.C.A. § 1104.

[7] Bankruptcy 51 ⚿3624

51 Bankruptcy
51XIV Reorganization
51XIV(D) Administration
51k3623 Appointment of Trustee or Examiner
51k3624 k. Necessity or Grounds. Most Cited Cases

When considering whether to appoint a Chapter 11 trustee for cause, a court's focus is on the debtor's current management, not the misdeeds of past management. 11 U.S.C.A. § 1104.

[8] Bankruptcy 51 ⚿3621

51 Bankruptcy
51XIV Reorganization

51XIV(D) Administration
51k3621 k. In General; Judicial Supervision. Most Cited Cases
Where individual, who was appointed prepetition by the district court to act as receiver and corporate manager of group of hedge funds and related entities that had been misused by their principals as vehicle for perpetrating massive Ponzi scheme, subsequently filed Chapter 11 petitions on behalf of these entities, although individual's "custodian" role ceased upon commencement of the Chapter 11 proceedings, his role as "managing member" of debtors remained; individual's dual role was specifically contemplated and intended by both creditors committee in requesting individual's appointment and the district court in granting it.

[9] Securities Regulation 349B 182

349B Securities Regulation
349BI Federal Regulation
349BI(E) Remedies
349BI(E)3 Receivership
349Bk182 k. In General. Most Cited Cases
District court, which had entered prepetition order appointing individual to act as receiver and corporate manager of group of hedge funds and related entities that had been misused by their principals as vehicle for perpetrating massive Ponzi scheme, had authority to place individual in a management position from which he could file and manage entities' Chapter 11 proceedings; district court's authority to appoint individual as corporate manager stemmed from its inherent authority to fashion remedies for violations of federal securities laws and, had the court chosen to, it could have appointed individual pursuant to state law as well.

[10] Bankruptcy 51 3621

51 Bankruptcy
51XIV Reorganization
51XIV(D) Administration
51k3621 k. In General; Judicial Supervision. Most Cited Cases
Where the district court had entered prepetition order appointing individual to act as receiver and corporate manager of group of hedge funds and related entities that had been misused by their principals as vehicle for perpetrating massive Ponzi scheme, and individual subsequently filed Chapter 11 petitions on behalf of these entities, allowing individual to prosecute debtors' Chapter 11 proceedings was not contrary to the Bankruptcy Code; nothing in the Code prevented creditors committee from moving the district court prepetition to appoint corporate governance for these entities, individual's appointment was within both the spirit and letter of the Code, which contemplated appointment of a Chapter 11 trustee under circumstances not present in this case, and, should questions of malfeasance or incompetence on the part of individual arise, United States Trustee (UST) was free to move for appointment of a trustee. 11 U.S.C.A. § 1104.
***543** Michael E. Robinson, (William Kanter, of counsel), Attorneys, Appellate Staff, Civil Division, Department of Justice, Washington, D.C., (Peter D. Keisler, Assistant Attorney General, Ross E. Morrison, Assistant United States Attorney, on the brief), for Michael J. Garcia, United States Attorney for the Southern District of New York, New York, N.Y., (Roberta A. DeAngelis, Acting General Counsel, Walter W. Theus, Jr., Department of Justice Executive Office for United States Trustees, Lisa L. Lambert, Assistant United States Trustee, of counsel), for Appellant.

Gary J. Mennitt, (H. Jeffrey Schwartz, Elise Scherr Frejka, Jonathan D. Perry, of counsel), Dechert LLP, New York, N.Y., for Appellee Bayou Group LLC et al.

Richard A. Kirby, (Scott P. Lindsay, Marla Goodman, of counsel), Kirkpatrick & Lockhart Preston Gates Ellis LLP, Washington, D.C., for Appellee Official Committee of Unsecured Creditors.

Before: WALKER, KATZMANN, GIBSON,[FN**] Circuit Judges.

FN** The Honorable John R. Gibson, of the United States Court of Appeals for the Eighth Circuit, sitting by designation.

JOHN M. WALKER, JR., Circuit Judge:

Appellant Diana G. Adams, United States Trustee (the "U.S. Trustee"), appeals from a judgment of the District Court for the Southern District of New York (Colleen McMahon, *Judge*) that affirmed a decision of the Bankruptcy Court (Adlai S. Hardin, *Bankruptcy Judge*) rejecting the U.S. Trustee's application under 11 U.S.C. § 1104 to appoint a trustee to manage the Bayou entities ("Bayou," or "the Bayou entities") after the Bayou entities filed for Chapter 11 protection. Prior to the bankruptcy, the district court had appointed Jeff J. Marwil ("Marwil") as receiver to manage Bayou. On appeal, the U.S. Trustee argues, as she did below, that ***544** Marwil's duties as receiver ended upon Bayou's filing for bankruptcy protection, and therefore the bankruptcy court should have appointed a trustee.

We agree with the district court that the district court's pre-petition order effectively appointed Marwil as both receiver and manager of Bayou, and thus conclude that there was no management vacancy for the U.S. Trustee to fill. Because the U.S. Trustee has provided no reason, based on Marwil's performance or qualifications, to replace him, we affirm the judgment of the district court that affirmed the bankruptcy court's denial of the U.S. Trustee's petition.

BACKGROUND

The Bayou entities are a group of hedge funds and related entities that were operated as fraudulent schemes, and are now debtors-in-possession in Chapter 11 proceedings under the Bankruptcy Code. Following Bayou's collapse in August 2005, Bayou's managers pled guilty to various federal criminal fraud charges, and were ordered to forfeit Bayou's assets.

On March 27, 2006, the Unofficial On-Shore Creditors' Committee (the "Committee"), Bayou creditors holding more than $130 million in claims, sought to "mitigate the massive losses suffered by the creditors and others" through the appointment of a "federal equity receiver" to pursue the litigation claims. *See Adams v. Marwil (In re Bayou Group, L.L.C.)*, 363 B.R. 674, 678 (S.D.N.Y.2007) (internal quotation marks omitted). The Committee asked the district court to appoint Marwil as both "non-bankruptcy federal equity receiver and exclusive managing member" for the Bayou entities. *Id.* at 680 (internal quotation marks and emphasis omitted). Following a two-day hearing that fully discussed "the subject of [Bayou's] corporate governance," *id.* at 679-80, the district court, without objection,[FN1] entered an order (the "Order") "authoriz[ing], empower[ing], and direct[ing]" Marwil to perform a number of "duties and responsibilities," including the responsibility for "Corporate Governance." Order ¶ 7(e). Marwil was directed to be "the sole and exclusive managing member and representative of each of the Bayou Entities [,] [possessing] ... without limitation, the authority to petition for protection under the Bankruptcy Code, 11 U.S.C. §§ 101 *et seq*." *Id.* The Order specified that the appointment was "warranted under Section 10(b) of the Securities Exchange Act of 1934 and SEC Rule 10b-5 thereunder, state law claims of fraud and breach of a fiduciary duty, Federal Rule of Civil Procedure 66, and the facts and circumstances of this case." *Id.* at Introduction, ¶ 3. The Order further stated that the district court's authority to appoint Marwil was "[p]ursuant to 28 U.S.C. §§ 754 and 959, Federal Rule of Civil Procedure 66 and [the] [c]ourt's inherent authority." *Id.* ¶ 1.

FN1. The United States received notice of the Committee's action, and witnessed the finalization of the Order. *See Bayou*, 363 B.R. at 678. Numerous government agencies attended the district court hearings, including the U.S. Attorney, the SEC, and the Commodity Futures Trading Commis-

> sion. None objected to the terms of the Order, or to the appointment of Marwil. *See id*. at 680.

Following the April 28 order, Marwil undertook his responsibilities as managing member of Bayou. On May 30, Marwil caused each Bayou entity to file a separate voluntary petition for relief under Chapter 11 of the Bankruptcy Code. 363 B.R. at 680. Thereafter Marwil brought more than 125 adversary proceedings seeking disgorgement from redeeming investors that have resulted in excess of $20 million in recovered assets. Marwil's efforts have ***545** been endorsed by all of Bayou's creditors, including the Official Committee of Unsecured Creditors (the "Official Creditors' Committee"), which was organized by the U.S. Trustee shortly after Marwil's appointment.

On June 20, approximately eight weeks after Marwil's appointment, the U.S. Trustee moved in the bankruptcy court for an order appointing a Chapter 11 trustee to replace Marwil and oversee Bayou's bankruptcy proceedings. The bankruptcy court orally denied the U.S. Trustee's motion, both as an impermissible collateral attack on the Order, and because the district court had appointed Marwil not only as receiver of the Bayou entities, but also as "new management of the[ ] debtors" with the authority and capacity to manage the bankruptcy proceedings as the debtor-in-possession. 363 B.R. at 682 (internal quotation marks omitted). The bankruptcy court said:

> Mr. Marwil is not simply a custodian.... [I]t is crystal clear that the purpose of Judge McMahon's order was to appoint somebody who was in fact and law the equivalent of a new board of directors, new CEO, new president, new CFO as a debtor-in-possession.... [I]t is perfectly clear to me that he's really not just a receiver or a custodian
>
> ....

Id. (alterations and second and third omissions in original, and internal quotation marks omitted).

On February 2, 2007, the district court, affirming the bankruptcy court, held that the Order "clearly contemplated appointing Marwil as both a receiver and as Bayou's corporate management," and that Marwil's "corporate management appointment was not merely derivative of his receivership appointment" but instead was made pursuant to "federal receivership statutes" as well as "federal securities law[s] and [the district] court's inherent authority." *Id*. at 683. The district court found that Marwil, as the "sole and exclusive managing member and representative of [Bayou]," had the "sole and exclusive power and authority to manage and direct the business and financial affairs of [Bayou], including without limitation, the authority to petition for protection under the Bankruptcy Code ... and in connection therewith be and be deemed a debtor-in-possession for [Bayou]." Order ¶ 7(e). The district court further held that, by filing for bankruptcy, Marwil transformed his status from "corporate governor" to debtor-in-possession, and therefore, that 22 Marwil was "under no obligation to turn over Bayou's property to 23 a bankruptcy trustee." 363 B.R. at 687.

The U.S. Trustee then appealed to this court.

DISCUSSION

On appeal, the U.S. Trustee argues that the district court misinterpreted its own order by permitting Marwil to continue as managing member of Bayou after he caused the Bayou entities to file for Chapter 11 protection. According to the U.S. Trustee, "both the bankruptcy court and the district court were wrong to conclude that Marwil was not a 'custodian' merely because he had been granted the 'corporate governance powers' of a 'managing member and representative' of the Bayou Entities." Appellant Br. 18. The U.S. Trustee further contends that, because Marwil was only appointed by the district court to be the custodian of the Bayou entities, and because custodians are prohibited under the Bankruptcy Code from managing a debtor's property after commencement of a bankruptcy proceed-

ing, ***546** *see* 11 U.S.C. § 543(a),[FN2] there was a "vacuum of lawful management" at Bayou to oversee the bankruptcy proceedings, Appellant Br. 9, and therefore, appointment of a bankruptcy trustee is necessary in this case. For the following reasons, we disagree.

FN2. Section 543(a) provides that:

> A custodian with knowledge of the commencement of a case under [the Bankruptcy Code] concerning the debtor 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.
>
> 11 U.S.C. § 543(a).

I. Standard of Review

[1][2] Where, as here, a district court acts in its capacity as an appellate court in a bankruptcy case, the district court's decisions are subject to plenary review by this court. *Dairy Mart Convenience Stores, Inc. v. Nickel (In re Dairy Mart Convenience Stores, Inc.),* 411 F.3d 367, 371 (2d Cir.2005). We thus review independently the factual findings and legal conclusions of the bankruptcy court, accepting its findings of fact unless they are clearly erroneous and reviewing its conclusions of law de novo. *Babitt v. Vebeliunas (In re Vebeliunas),* 332 F.3d 85, 90 (2d Cir.2003).

As an initial matter, the parties dispute whether the interpretation of the Order by the courts below constituted a finding of fact or conclusion of law. The U.S. Trustee claims that, because the case hinges on a legal interpretation of the Order, the bankruptcy and district court conclusions must be reviewed de novo, *see* Appellant Br. 11 (citing *Lebovits v. Scheffel (In re Lehal Realty Assocs.),* 101 F.3d 272, 276 (2d Cir.1996)), while the Official Creditors' Committee asserts that the scope of Marwil's authority is a question of fact, reviewable under the clearly erroneous standard, *see* Br. of Appellee Official Committee of Unsecured Creditors in Opp'n ("Official Creditors' Committee Br."), at 14-15 (citing *Fisher v. First Stamford Bank & Trust Co.,* 751 F.2d 519, 522 (2d Cir.1984)). We have no need to resolve this dispute, however, because we agree with the determinations of the courts below.

II. Appointment Of A Trustee Is Not Warranted Under 11 U.S.C. § 1104(a).

[3] Upon request of the U.S. Trustee, "the court shall order the appointment of a trustee" to oversee Chapter 11 proceedings. 11 U.S.C. § 1104(a). However, the court may appoint a trustee "only in certain circumstances." *See Smart World Techs., LLC v. Juno Online Servs., Inc. (In re Smart World Techs., LLC),* 423 F.3d 166, 174 n. 10 (2d Cir.2005). Specifically, a trustee may only be appointed pursuant to a § 1104 motion "for cause, including fraud, dishonesty, incompetence, or gross mismanagement of the affairs of the debtor by current management," or "if such appointment is in the interests of creditors." 11 U.S.C. § 1104(a)(1)-(2).

[4][5] "[T]he standard for § 1104 appointment is very high...." *In re Smart World,* 423 F.3d at 176; see *also* 7 *Collier on Bankruptcy,* ¶ 1104.02[2][a] (noting that appointment of a trustee in a Chapter 11 case is an "extraordinary" remedy). The U.S. Trustee has the burden of showing by "clear and convincing evidence" that the appointment of a trustee is warranted. *In re Adelphia Commc'ns Corp.,* 336 B.R. 610, 656 (Bankr.S.D.N.Y.2006). In determining whether a § 1104 appointment is warranted or in the best interests of creditors, the bankruptcy court must bear in ***547** mind that the appointment of a trustee "may impose a substantial financial burden on a hard pressed debtor seeking relief under the Bankruptcy Code," by incurring the expenditure of "substantial administrative expenses" caused by further delay in the bankruptcy

proceedings. *See Midlantic Nat'l Bank v. Anchorage Boat Sales, Inc. (In re Anchorage Boat Sales, Inc.)*, 4 B.R. 635, 644 (Bankr.E.D.N.Y.1980).

[6][7] In the instant case, the U.S. Trustee has not met the "very high" standard for a § 1104 appointment. The U.S. Trustee has not attempted to show that Marwil has engaged in "fraud, dishonesty, incompetence, or gross mismanagement of" Bayou's affairs. In fact, the record is quite to the contrary. As Bayou's managing member, Marwil has brought more than 125 adversary proceedings and recovered more than $20 million for Bayou's creditors. In her brief, the U.S. Trustee effectively concedes the absence of any reason to doubt Marwil's competence to manage Bayou's bankruptcy proceedings. *See* Appellant Br. 25 ("It is also important to note that Marwil's service as a custodian, standing alone, did not automatically disqualify him from being appointed or elected as a Chapter 11 trustee."); *see also* Appellees Br. 15 n. 6 (describing Marwil's extensive credentials and expertise in bankruptcy proceedings). Section 1104 motions have been denied even where the U.S. Trustee has demonstrated some potentially questionable conduct by existing management of a debtor, *see In re North Star Contracting Corp.*, 128 B.R. 66, 69-70 (Bankr.S.D.N.Y.1991); here, there is none.[FN3] Nor has the U.S. Trustee shown, or even attempted to show, that the removal of Marwil is "in the interests of creditors." No creditor supports the motion,[FN4] and the Official Creditors' Committee, which first petitioned for Marwil's appointment, opposes it. While appellees have pointed out ways in which Marwil's removal would hamper the bankruptcy proceedings, *see* Appellees Br. 18-19, the U.S. Trustee has not indicated how replacing Marwil would facilitate them, *see, e.g., In re North Star*, 128 B.R. at 70 (denying appointment of trustee where creditors' committee supported continued operations by current management).

FN3. The U.S. Trustee makes no attempt to impute the pre-petition fraudulent activity of Bayou's former management to Marwil. Such an imputation would be improper, as "[w]hen considering whether to appoint a trustee for cause, a court's focus is on the debtor's current management, not the misdeeds of past management." *In re The 1031 Tax Group, LLC*, 374 B.R. 78, 86 (Bankr.S.D.N.Y.2007).

FN4. Two original investors who withdrew all of their money out of Bayou before its collapse, and who were defendants in an adversary proceeding commenced by Marwil, were the only parties to file a statement in support of the U.S. Trustee's § 1104 motion. *See Bayou*, 363 B.R. at 681.

[8] The U.S. Trustee's motion boils down to a claim that because the district court's order only appointed Marwil as custodian for the Bayou entities, once Marwil caused Bayou to file for bankruptcy, Marwil's custodial relationship with Bayou ended as a matter of law and there was no manager to run the entities under Chapter 11. The U.S. Trustee argues that, unless a trustee is appointed, Bayou lacks management to prosecute the bankruptcy proceedings. We are not persuaded.

First, from a purely practical perspective, Bayou has been effectively managed since Marwil was appointed by the district court in April 2006. The U.S. Trustee has produced no evidence that Marwil failed to fulfill this role either pre- or post-petition. ***548** Thus, there has been no *de facto* management vacuum at Bayou.

Next, we agree with the district and bankruptcy courts that the Order appointed Marwil to be *both* Bayou's custodian *and* its corporate manager. The Order provided Marwil with two hats-one as custodian, and one as "sole and exclusive" managing member of Bayou. While Marwil's "custodian" hat came off upon commencement of the Chapter 11 proceedings, his "managing member" hat remained. This dual role was specifically contemplated and intended by both the Committee in requesting Marwil's appointment, and the district court in granting

it.[FN5]

> FN5. *See Bayou,* Apr. 18, 2006 Hearing Tr. at 33:7-34:20; *id*. at 10:22-12:20 ("We anticipate that there is likely to be a bankruptcy necessary for a number of the Bayou entities.... There is still nobody to represent the Bayou entities in that process and we believe the simplest way to go forward is to have [Marwil] ... administer the bankruptcy.").

[9] The U.S. Trustee next contends that, although the district court had the authority to provide Marwil with "management powers to run the affairs of" Bayou "prior to bankruptcy," it lacked the authority to appoint Marwil as bankruptcy receiver under federal law, and therefore, Marwil could not assume the responsibilities as bankruptcy receiver after filing a Chapter 11 petition. *Cf*. *Eberhard v. Marcu,* 530 F.3d 122, 132 (2d Cir.2008) ("[R]eceivership should not be used as an alternative to bankruptcy...."). However, Marwil's authority to manage the bankruptcy proceedings stems not from his position as "federal equity receiver" but from the language in the Order specifically appointing Marwil as Bayou's "sole and exclusive managing member," thereby vesting him with the authority to file and manage Bayou's bankruptcy proceedings. The district court plainly had authority to place Marwil in a management position from which he could file and manage a Chapter 11 petition. *See SEC v. Manor Nursing Ctrs., Inc.,* 458 F.2d 1082, 1103 (2d Cir.1972) ("[15 U.S.C. §§ 77v(a) and 78aa] confer general equity powers upon the district courts [to fashion remedies for securities laws violations]."); *id*. ("Once the equity jurisdiction of the district court has been properly invoked by a showing of a securities law violation, the court possesses the necessary power to fashion an appropriate remedy."). The award of such ancillary relief was fully within the district court's authority.

The U.S. Trustee also argues, for the first time in its reply, that the district court lacked authority to appoint Marwil because he is not authorized under Connecticut law to govern Bayou. This argument was made too late, and in any event, it is similarly unavailing. The district court's authority to appoint Marwil as corporate manager stemmed from its inherent authority to fashion remedies for violations of federal securities laws. Moreover, as the district court noted, it could have appointed Marwil as managing member of Bayou under Connecticut law, had it chosen to do so. *See Bayou,* 363 B.R. at 685-86 (citing *Morrow v. Prestonwold, Inc.,* No. CV-445844S, 2002 WL 652369, at *6 (Conn.Super.Ct. Mar. 22, 2002) (appointing custodian of corporation and ordering that the "custodian shall exercise all the powers of the board of directors and officers of [the subject corporation] to the extent necessary to manage the affairs of the corporation in the best interests of its stockholders")).

[10] Finally, we reject the U.S. Trustee's claim that allowing Marwil to prosecute Bayou's Chapter 11 proceedings "override[s] the scheme contemplated by the Bankruptcy Code by supplanting the authority of the U.S. Trustee in Chapter ***549** 11 cases." Appellant Br. 21. As the district court noted, "nothing in the Code ... precluded [the Committee] from moving th[e] court to appoint corporate governance for the Bayou entities, pre-petition." 363 B.R. at 690. Marwil's appointment was within both the spirit and letter of the Bankruptcy Code, which contemplates appointment of a trustee under circumstances not present in this case. Should questions of malfeasance or incompetence on the part of Marwil arise, the U.S. Trustee is free to move for appointment of a trustee. Until that time, however, Marwil remains the corporate manager of the debtor-in-possession pursuant to the district court's order.

CONCLUSION

For the foregoing reasons, the district court's judgment affirming the bankruptcy court's denial of the U.S. Trustee's motion to appoint a trustee pursuant to 11 U.S.C. § 1104 is hereby AFFIRMED.

564 F.3d 541, 51 Bankr.Ct.Dec. 155, Bankr. L. Rep. P 81,484
(Cite as: 564 F.3d 541)

C.A.2 (N.Y.),2009.
In re Bayou Group, LLC
564 F.3d 541, 51 Bankr.Ct.Dec. 155, Bankr. L. Rep. P 81,484

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901 F.3d 1139
United States Court of Appeals, Ninth Circuit.

IN RE SINO CLEAN ENERGY, INC., Debtor.
Sino Clean Energy, Inc., acting by and through Baowen Ren, Peng Zhou, Wenjie Zhang, Zhixin Jing, and Paul Chui; and Huiqin Chen, Li Han, Guangjon Huang, Xiaodong Jiang, Xueling Jing, Yufeng Li, Haicho Li, Lanying Li, Liang Wang, Zhen Wu, Ting Xte, Heshun Yang, Chunyun Zhang, Tiekuan Zhang, personally and as shareholders, Plaintiffs-Appellants,
v.
Robert W. Seiden, in his capacity as Receiver over Sino Clean Energy Inc., Defendant-Appellee.

No. 17-15316
|
Argued and Submitted July 9, 2018
|
Filed August 27, 2018

Synopsis

Background: More than one year after state court appointed a receiver to take over company's affairs and seven months after receiver removed company's directors from their board positions for mismanaging the company, former directors filed Chapter 11 petition on behalf of company. Receiver moved to dismiss, arguing that former directors lacked authority to file petition. The United States Bankruptcy Court for the District of Nevada granted the motion, and former directors appealed. The District Court, Jennifer A. Dorsey, J., 565 B.R. 677, affirmed. Former directors appealed.

[Holding:] The Court of Appeals, Lemelle, Senior District Judge, sitting by designation, held that under Nevada law, holding company's former directors, who had been removed from their board positions by state-court appointed receiver for their nonfeasance and gross mismanagement of corporation, no longer had authority, following their removal, to file a Chapter 11 petition on company's behalf; abrogating *In Re Corporate & Leisure Event Prods., Inc.*, 351 B.R. 724.

Affirmed.

West Headnotes (5)

[1] Bankruptcy
Conclusions of law; de novo review

Court of Appeals reviews de novo district court's decision on appeal from bankruptcy court.

Cases that cite this headnote

[2] Bankruptcy
Conclusions of law; de novo review

Bankruptcy
Clear error

On appeal from district court's decision in its bankruptcy appellate capacity, the Court of Appeals applies same standard of review to bankruptcy court decision as district court: findings of fact are reviewed under the "clearly erroneous" standard, while conclusions of law are reviewed de novo. Fed. R. Bankr. P. 8013.

Cases that cite this headnote

[3] Bankruptcy
Who May Institute Case

State law determines who has authority to file a voluntary bankruptcy petition on behalf of putative debtor.

Cases that cite this headnote

[4] Bankruptcy
Representatives of corporations

Nevada state law, of kind governing who had ability to file Chapter 11 petition on Nevada corporation's behalf, included the decisions of its state courts.

Cases that cite this headnote

[5] Bankruptcy
Representatives of corporations

Under Nevada law, holding company's former directors, who had been removed from their board positions by state-court appointed receiver

for their nonfeasance and gross mismanagement of corporation, no longer had authority, following their removal, to file a Chapter 11 petition on company's behalf; Nevada law vested the authority to make important decisions, including whether to file for bankruptcy, in corporation's current board of directors; abrogating *In Re Corporate & Leisure Event Prods., Inc.*, 351 B.R. 724.

Cases that cite this headnote

Attorneys and Law Firms

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Katherine R. Catanese (argued) and Douglas E. Spelfogel, Foley & Lardner LLP, New York, New York; Ryan J. Works, McDonald Carano LLP, Las Vegas, Nevada; for Defendant-Appellee.

Appeal from the United States District Court for the District of Nevada, Jennifer A. Dorsey, District Judge, Presiding, D.C. No. 2:15-cv-01781-JAD

Before: Susan P. Graber and Richard C. Tallman, Circuit Judges, and Ivan L.R. Lemelle, * Senior District Judge.

OPINION

LEMELLE, Senior District Judge:

***1140** Former board members of Sino Clean Energy, Inc. (collectively, "Appellants"), appeal the district court's order affirming the bankruptcy court's dismissal of their Chapter 11 bankruptcy petition. The bankruptcy court dismissed the petition because it found that the petition lacked the requisite authority from the corporation's board of directors. The district court agreed, ruling that the individuals attempting to file the petition lacked authority where a receiver appointed by the Nevada state court already had removed them from the corporation's board of directors. We affirm. The bankruptcy court correctly dismissed the action because Appellants lacked corporate authority when they filed the rogue bankruptcy petition.

BACKGROUND AND PROCEDURAL HISTORY

Sino Clean Energy, Inc. ("SCEI"), is a Nevada holding company that, through various subsidiary entities, produces coal-water slurry in China. SCEI wholly owns Wiscon Holdings Limited which, in turn, owns 100% of the interests in Tongchuan Suoke Clean Energy Company. Both subsidiaries are entities of the People's Republic of China.

Until the legal troubles described here, SCEI had been under control in major part by former chairman and CEO Baowen Ren. Starting in 2011, SCEI became the subject of much legal controversy. In May 2012, the Securities and Exchange Commission deregistered SCEI after it abruptly stopped filing certain required forms and financial information. In September 2012, SCEI was suspended from the NASDAQ stock exchange.

By October 2013, a group of forty-three shareholders had filed a Nevada state-court petition in an attempt to acquire financial information from SCEI, including books and records regarding the money invested with SCEI. The shareholders also sought certain declaratory relief under Nevada Revised Statute section 78.345. SCEI was properly served with the complaint, but SCEI opted not to offer any responsive pleadings in the Nevada state-court action. After more than a year of SCEI's disregard for the Nevada state-court action, the plaintiffs filed for entry of default, which the state court granted. A few months after an entry of default, on March 17, 2014, the shareholder plaintiffs filed a motion for the appointment of a receiver. The Nevada state court granted the motion on May 12, 2014.

The order appointing a receiver held that SCEI, through its board of directors (at that time), was liable for nonfeasance and gross mismanagement pursuant to Nevada Revised Statutes section 78.650. After finding that SCEI's board of directors "failed to properly manage SCEI's ***1141** affairs," the state court appointed a receiver and granted him many powers, including the power to reconstitute SCEI's board of directors. The receiver eventually replaced the SCEI board of directors, effective in December 2014, with current and sole director, Gregg Graison.

In July 2015, former chairman and CEO Ren purported to "reconstitute" the former SCEI board of directors, and thereafter attempted to file a voluntary petition for Chapter 11 bankruptcy on behalf of SCEI. The bankruptcy court

dismissed the action on August 26, 2015, holding that, at the time the petition was filed by Ren and the former board members, the petition "was filed without corporate authority" because SCEI's board of directors "had been replaced by the Receiver." The district court affirmed.

STANDARD OF REVIEW

[1] **[2]** We review de novo the district court's decision on an appeal from bankruptcy court. *Educ. Credit Mgmt. Corp. v. Coleman (In re Coleman)*, 560 F.3d 1000, 1003 (9th Cir. 2009). "We apply the same standard of review to the bankruptcy court decision as does the district court: findings of fact are reviewed under the clearly erroneous standard, and conclusions of law, de novo." *Id.* (internal quotation marks and brackets omitted).

DISCUSSION

[3] The Bankruptcy Code defines the term "petition" to mean a "petition filed under section 301, 302, 303 and 1504" of the Act. 11 U.S.C. § 101(42). A voluntary petition for bankruptcy under § 301 is commenced by the filing of a bankruptcy petition by an entity that may be a debtor. *Id.* § 301. State law determines who has the authority to file a voluntary bankruptcy petition on behalf of a debtor. *Price v. Gurney*, 324 U.S. 100, 106–07, 65 S.Ct. 513, 89 L.Ed. 776 (1945); *see also Keenihan v. Heritage Press, Inc.*, 19 F.3d 1255, 1258 (8th Cir. 1994) ("A person filing a voluntary bankruptcy petition on a corporation's behalf must be authorized to do so, and the authorization must derive from state law.").

[4] **[5]** The corporation involved here, SCEI, was formed under Nevada state law, which vests decision-making authority in a corporation's current board of directors. *See* Nev. Rev. Stat. § 78.315. In regard to actions taken by a Nevada corporation,

> [u]nless the articles of incorporation or the bylaws provide for a greater or lesser proportion, **a majority of the board of directors** of the corporation **then in office**, at a meeting duly assembled, is **necessary** to constitute a quorum **for the transaction of business, and the act of directors holding a majority of the voting power** of the directors, present at a meeting at which a quorum is present, is the act of the board of directors.

Id. § 78.315(1) (emphases added). The statute also provides that action may be taken with "written consent" that is "signed by all the members of the board," in lieu of a meeting. *Id.* § 78.315(2). Nevada state law includes the decision of its state courts. *Tenneco W., Inc. v. Marathon Oil Co.*, 756 F.2d 769, 771 (9th Cir. 1985). Applying Nevada law to the facts in the record, the individuals who filed the bankruptcy petition were not members of the board of directors of SCEI at the time they filed the petition, and they were not authorized to file a bankruptcy petition on behalf of SCEI.

Our decision in *Oil & Gas Co. v. Duryee*, 9 F.3d 771 (9th Cir. 1993), is directly on point. In *Duryee*, an Ohio state court placed Oil & Gas Insurance Company into rehabilitation and appointed a rehabilitator. *Id.* at 772. The bankruptcy court ultimately dismissed a petition pursuant to ***1142** the Bankruptcy Code's preclusion of insurance companies' ability to seek bankruptcy relief. *Id.* Nevertheless, an "initial difficulty" for us was deciding **who** the appellant was. *Id.* at 773. We ruled that, pursuant to the rehabilitation order, the rehabilitator was the only person authorized to commence bankruptcy proceedings on behalf of Oil & Gas. *Id.* As a result, we held that the individual not authorized by the rehabilitation order who was purporting to file bankruptcy on behalf of the corporation was an "impostor," and the action was "null and void" as "fraudulently filed." *Id.* That same logic applies in this instance.

In asserting a contrary conclusion, Appellants rely heavily on *In Re Corporate & Leisure Event Prods., Inc.*, 351 B.R. 724 (Bankr. D. Ariz. 2006). To the extent that *Corporate & Leisure* contradicts our decision in *Duryee*, it is wrong. No matter the equitable considerations, state law dictates which persons may file a bankruptcy petition on behalf of a debtor corporation. We understand *Corporate & Leisure* as announcing the more limited holding that, where a state court purports to enjoin a corporation from filing bankruptcy altogether, federal law preempts that injunction. Here, however, SCEI was and is fully able to file for bankruptcy through valid filings made by its eligible board of directors. *Corporate & Leisure* is inapposite.

AFFIRMED.

All Citations

901 F.3d 1139, 66 Bankr.Ct.Dec. 25, 18 Cal. Daily Op. Serv. 8603, 2018 Daily Journal D.A.R. 8607

Footnotes

* The Honorable Ivan L.R. Lemelle, Senior United States District Judge for the Eastern District of Louisiana, sitting by designation.

IN THE CUSTODY OF THE COURT OFFICER
by Charles J. Schneider

It is common for bankruptcy cases to be commenced when there has been a repossession of a vehicle or other personal property belonging to a debtor by a court officer pursuant to a writ of execution. If the goal of the debtor is to retain the personal property, the outcome may vary depending upon whether counsel's advice to the debtor is to file a chapter 7 or a chapter 13. It is important to weigh the benefits of each and the rights of the court officer and the debtor relative to the seized personal property.

Debtor Files Chapter 7 Case

Upon the filing of the chapter 7 bankruptcy, a court officer owes a duty to both the Trustee and to the debtor. The duty owed to a trustee is as a "custodian" under 11 U.S.C. § 101(11)(c). *In re Ohakpo*, 494 BR 269, 281 (Bankr ED Mich, 2013) The court officer is thereafter charged with the responsibility to "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". 11 U.S.C. § 543 (a). As a custodian, the court officer has the further duty "to deliver to the trustee any property of the debtor held by or transferred to such custodian... that is in such custodian's possession, custody, or control on the date that such custodian acquires knowledge of the commencement of the case" and "file an accounting of any property of the debtor, or proceeds, product, offspring, rents, or profits of such property, that, at any time, came into the possession, custody, or control of such custodian". 11 U.S.C. § 543 (b)(1) and (2).

If the court officer as "custodian" has a responsibility to "not... take any action in the administration of, ...property of the estate, in his possession, except such action as is necessary to

preserve such property", then it would appear to be axiomatic that returning the property to the debtor would be a violation of this duty. The custodian's retention of the seized personal property is no different from that of the Trustee. Although the debtor is protected by the automatic stay and the creditor who initiated the writ of execution has an affirmative duty to stop the enforcement of a debt, *In re McCall-Pruitt*, 281 B.R. 910, 911-912 (Bankr. E.D. Mich. 2002), the debtor may be confronted with the fact that there is no automatic stay violation by a court officer's retention of seized property. He must retain the property for delivery to the Trustee.

Except for the fact that the court officer is informed under 11 U.S.C. § 543(b) that he must deliver seized estate property to the chapter 7 Trustee and then provide an accounting of the same, the court officer is not informed of the manner in which delivery and accounting should occur. The court officer is only informed what must not be done under 11 U.S.C. § 543(a). The "accounting" assumes a disposition of the seized property, but there is no road map of how the disposition is accomplished. In any event, the debtor and the court officer share a continuing dilemma as storage costs are being incurred daily. The debtor is without the essential use of a vehicle or other personal property required for daily living. The court officer may be liable to the estate for the value of the vehicle or other personal property if lost.

If the court officer acts in accordance with his statutory duties and immediately contacts the Trustee to deliver the seized vehicle, the Trustee may decline to assume any responsibility and accept the delivery of the vehicle or otherwise not authorize the court officer to make any disposition of the vehicle. The Trustee may cite that his status as being only a "temporary" until the 341 Meeting of Creditors. Schedules may not have been filed identifying the seized personal property or stating its value. The Trustee may also indicate that a 341 Meeting of Creditors has not taken place to make a determination of the seized property's disposition. The Trustee's lack of motivation in making a

decision as to the disposition of the seized vehicle is understandable as the Trustee may only be receiving the nominal fee that is part of the court's filing fee, if not otherwise waived.

There appears to be mutual grounds for debtor's counsel and the court officer to cooperate and agree to a disposition of the seized personal property as the cost of storage accumulates daily and the debtor is without the use of the vehicle or other personal property. If these parties cannot cooperate, then either the court officer or the debtor must act and seek their own remedy to compel a chapter 7 Trustee to do something.

The Court Officer as a Secured Creditor

In *Ohakpo* at 281, the Court recognized that the court officer had a secured possessory interest in the vehicle once seized:

> There is no doubt in the Court's mind that the process of execution and levy in Michigan, and the resultant "binding" of seized property, constitutes a charge upon the seized property to pay a debt evidenced by a judgment. This process has all of the attributes of a lien, except for the name, but that is its essence. The lien in such circumstances arises upon the taking of possession of the judgment debtor's property. It is a possessory lien attaching to the seized personal property to pay the judgment debt. The conception of the execution levy as a possessory lien is consistent with case law in Michigan which repeatedly refers to the execution by levy as an "execution lien." See *In re Ann Arbor Mach. Co.*, 278 F. 749, 750 (E.D. Mich. 1922) (describing how the "petitioner obtained a writ of execution upon said judgment, and said execution was, on the same day, levied by the sheriff . . . upon certain personal property belonging to the bankrupt, by seizure thereof under such writ of execution, which then and thereby became a lien on such property")

The Court Officer as an Administrative Claimant

In addition to the secured claim of the court officer, the Court recognized that as a custodian the court officer may have an administrative claim for "the actual, necessary expenses, other than compensation and reimbursement specified in paragraph (4) of this subsection, incurred by a custodian superseded under section 543 of this title, and compensation for the services of such custodian". 11 U.S.C. 503(b)(3). However, to the extent that compensation is reasonable, 11 U.S.C.

503(b)(4) permits compensation for the attorney representing the court officer as a "custodian":

> An administrative expense priority is available under section 503(b)(4) only to an entity whose expenses are allowable under subsection (A), (B), (C), (D) or (E) of section 503(b)(3). Read literally, an eligible section 503(b)(3) entity seeking administrative expense status for its attorney or accountant fees under section 503(b)(4) would have to also incur reimbursable expenses, other than professional fees, allowable under section 503(b)(3), because professional fees are not reimbursable under section 503(b)(3). Courts specifically addressing this issue have properly rejected the literal reading and allowed entities described in section 503(b)(3)(A) through (E) to seek administrative expense treatment for professional fees and costs under section 503(b)(4) even if the entity had not incurred any nonprofessional expenses reimbursable under section 503(b)(3). 4 Collier on Bankruptcy P 503.11 (16th 2019)

In *Ohakpo*, however, the Court did not discuss the compensation of attorney fees for the court officer as there was no claim for attorney fees and, in any event, the court officer did not sustain his burden of proof by proving that he actually provided any benefit to the estate from the property seized. Citing *Pension Benefit Guaranty Corp. v. Sunarhauserman, Inc. (In re Sunarhauserman, Inc.)*, 126 F.3d 811 (6th Cir. 1997), the Court stated that "a party requesting allowance of an administrative expense claim must still demonstrate that the asserted expense provided a 'benefit to the estate'". *Ohakpo* at 285

If the seized property is of value or benefit to the estate, then the court officer can move for a protective order as 11 U.S.C. § 543 provides that:

> (c) The court, after notice and a hearing, shall--
>
> (1) protect all entities to which a custodian has become obligated with respect to such property or proceeds, product, offspring, rents, or profits of such property;
>
> (2) provide for the payment of reasonable compensation for services rendered and costs and expenses incurred by such custodian;

In most cases where the debtor is electing to file a chapter 7 bankruptcy case, the chapter 7 Trustee will not be administering the vehicle as an asset to be liquidated for the benefit of the estate as there are either liens (including the court officer's claims) and/or exemptions claimed by the

debtor which exceed the value of the seized property.

In the event that the seized property is of inconsequential value and benefit to the estate, then the remedy of either the court officer or the debtor can be to compel the Trustee under 11 U.S.C. § 554(b) to abandon it. The debtor and/or court officer should be armed with appraisals to be able to prove to the Court that the seized property is of inconsequential value or benefit to the estate. The court officer can simultaneously seek to lift the automatic stay to enforce his statutory possessory lien. The court officer should also seek to "excuse compliance" with § 543(a) & (b) as permitted by § 543(d)(1) and perhaps establish the extent of his lien pursuant to § 543(c). The solution between the debtor and court officer may involve encumbering the title of the seized vehicle with a security interest in favor of the court officer. This could secure the amount of fees owed to him from the seizure and provide a basis for a payment plan with the debtor so that the debtor may gain possession of the seized property.

Debtor Files Chapter 13 Case

The filing of a chapter 13 bankruptcy by a debtor may present a different set of obligations to a court officer. Obviously, there is no chapter 7 Trustee. The debtor in a chapter 13 case is a "debtor in possession" pursuant to 11 U.S.C. § 1306(b). A chapter 13 debtor is entitled to possession of the seized property. The question is whether the obligation owed by the court officer to a chapter 7 Trustee under 11 U.S.C. § 543 is owed to the chapter 13 "debtor in possession". Normally, on issues of turnover a chapter 13 debtor would proceed under 11 U.S.C. § 542(a) as that section specifically references powers granted to a Trustee to "use , sell, or under section 363 of this title." 11 U.S.C. § 1303(a) states that "the debtor shall have, exclusive of the trustee, the rights and powers of a trustee under sections 363(b), 363(d), 363(e), 363(f), and 363(l), of this title." Section 1303 does not specifically state that a chapter 13 debtor in possession have the right to compel turnover of

estate property under § 542(a) . It is generally accepted that the chapter 13 debtor has standing to compel turnover of property of the estate. As set forth in Judge Lundin's treatise, this conclusion does have its problems of interpretation under the Bankruptcy Code:

> Sections 542, 1303 and 1306 conspire to create a very odd situation. Turnover under § 542(a) is conditioned that the property to be recovered must be property that the trustee may use, sell or lease under § 363 or that the debtor may exempt. The predicate for the trustee's use of § 542 is precluded in a Chapter 13 case by § 1303. However, the debtor's exclusive power to use, sell and lease property of the Chapter 13 estate is not supported by a statutory grant of power to recover such property under § 542. Literal application of the turnover power in § 542 produces nonsense in a Chapter 13 case: delivery of property to the trustee will never be required because the Chapter 13 trustee is prohibited from using or possessing estate property, at least until entry of a contrary confirmation order; the Chapter 13 debtor is exclusively empowered to use, sell and lease estate property but cannot compel turnover except to protect an exemption under § 522, and then the exempt property is delivered to the trustee, who is forbidden to possess it. Keith M. Lundin & William H. Brown, Chapter 13 Bankruptcy, 4th Edition, § 52.1, at ¶ 9, Sec. Rev. Aug. 16, 2004, www.Ch13online.com.

The court officer's possession of seized estate property exacerbates the statutory interpretation of what a chapter 13 debtor should do because the power to compel turnover under 11 U.S.C. §542 does not apply to property that is in control of a "custodian". He is specifically excluded. Likewise, the debtor's exclusive power to use, sell and lease property of the chapter 13 estate is not supported by a statutory grant of power to recover seized estate property from a custodian under 11 U.S.C. § 543. However, the statutory language of 11 U.S.C. § 543 is that of a direction of what a "custodian" must do rather than what a "debtor in possession" can compel to be done, although the latter has been inferred. In *Foust v McNeill (in Re Foust)*, 310 F3d 849, 854 (CA 5, 2002), the Court states that, "Section 543(b) imposes a straightforward turnover obligation: The custodian must "deliver" to the estate "any property of the debtor . . . that is in such custodian's possession, custody or control on the date that the custodian acquires knowledge of the commencement of the case." 11 U.S.C. § 543(b)(1)." Although the Court in *Foust* states that Section

543(b) "imposes a straightforward turnover obligation" it does so without discussing the distinction between delivering property of the estate to a "debtor in possession" and to a Trustee in a chapter 13 case.

The Court Officer as a Secured Creditor

If it follows that a court officer must deliver the seized property to the "debtor in possession" under 11 U.S.C. § 543, then how should the court officer protect his possessory lien as recognized in *Ohapko* above? The answer would be for the court officer to seek a protective order under 11 U.S.C. § 543(c). First, the court officer's request would be that the Court compel the debtor to protect his possessory lien by placing the court officer's name as a secured party on the title to a seized vehicle as adequate protection pursuant to 11 U.S.C. § 361. Adequate protection is required because otherwise the debtor, once he acquired possession of the vehicle, could just voluntarily dismiss his chapter 13 case and the court officer would lose his lien.

The Court Officer as an Administrative Claimant

Secondly, the court officer should seek to be granted the status as an administrative claimant pursuant to 11 U.S.C. 503(b)(3). This can only be accomplished by filing a motion for an administrative claim as 11 U.S.C. 503 provides:

> (a) An entity may timely file a request for payment of an administrative expense, or may tardily file such a request if permitted by the court for cause.
> (b) After notice and a hearing, there shall be allowed administrative expenses …

It would be a strange circumstance where a court officer would not be able to sustain his burden of proof proving that he actually provided a benefit to the estate if the debtor retains the property seized in his chapter 13 case. Vehicles, in particular, are essential to an effective reorganization of a debtor and benefits the estate:

> This Court applies a two-part test to determine whether a claim is entitled to

> administrative expense priority status under § 503(b). A debt constitutes an actual, necessary administrative expense "'only if (1) it arose from a transaction with the bankruptcy estate and (2) [it] directly and substantially benefitted the estate.'" In re Eagle-Picher Indus., Inc., 447 F.3d 461, 464 (6th Cir. 2006) (quoting *Pension Benefit Guar. Corp. v. Sunarhauserman, Inc. (In re Sunarhauserman, Inc.*), 126 F.3d 811, 816 (6th Cir. 1997)). *McMillan v LTV Steel, Inc*, 555 F3d 218, 225-26 (CA 6, 2009)

A court officer will not be limited to just the statutory fees pursuant to Mich. Comp. Laws Ann. § 600.2559(1)(h) and 503(b)(3)(E). As indicated above to the extent that compensation is reasonable, 11 U.S.C. 503(b)(4) permits compensation for the attorney or accountant representing the court officer as a "custodian" identified under 503(b)(3)(E). As an administrative claimant under 503(b)(3)(E), the custodian fees and expenses and his attorney's fees should be prioritized pursuant to 11 U.S.C. § 507(a)(2) for payment in the debtor's proposed chapter 13 plan when awarded by the court.

It is apparent that the claim for attorney fees for the custodian follows from the direct reference to 11 U.S.C. 503(b)(3)(E):

> Since section 503(b)(4) refers to the entities described in section 503(b)(3), it would appear that the right to request compensation belongs to the client and not to the professional. Under this view, adopted in some cases, the client may request that the professional seek reimbursement on the client's behalf, but the professional may not seek an award of compensation on its own behalf. It is seeking reimbursement on behalf of the client, and the award only determines what portion of the client's payment obligation will be compensable from the estate as an administrative expense.4 Collier on Bankruptcy P 503.11 (16th 2019)

There are cases that indicate that the attorney may independently seek approval of his own fees and not through the custodian. *In re R.L. Adkins Corp*., 505 B.R. 770, 779 (Bankr. N.D. Tex. 2014); *In re Mirant*, 354 B.R. 113, 140 (Bankr. N.D. Tex. 2006); *In re Western Asbestos Co.*, 318 B.R. 527 (Bankr. N.D. Cal. 2004) (counsel can seek reimbursement under section 503(b)(4) even if client has not paid and is not obligated to pay the fees); see also *In re Community Home Fin. Servs., Inc*., 571 B.R. 714 (Bankr. S.D. Miss. 2017) (adopting view in *Adkins* and *Mirant* that

professionals may file an application under section 503(b)(4) but denying application because the client was not a creditor who made a substantial contribution). 4 Collier on Bankruptcy P 503.11 (16th 2019)

Since the language permitting an attorney fee claim pursuant to 11 U.S.C. § 503(b)(4) is similar to 11 U.S.C. § 330, the factors determining reasonableness thereunder have been determined to be relevant. 4 Collier on Bankruptcy P 503.11 (16th 2019)

Can the debtor set aside the custodian's possessory lien as a judicial lien pursuant to 11 U.S.C. § 522(f)(1)(a) as a judicial lien? A judicial lien is defined under 11 U.S.C. § 101(36) as follows:

> The term "judicial lien" means lien obtained by judgment, levy, sequestration, or other legal or equitable process or proceeding.

A statutory lien under 11 USCS § 101(53) is defined as follows:

> The term "statutory lien" means lien arising solely by force of a statute on specified circumstances or conditions, or lien of distress for rent, whether or not statutory, **but does not include** security interest or **judicial lien**, whether or not such interest or lien is provided by or is dependent on a statute and whether or not such interest or lien is made fully effective by statute.

Arguably, the court officer's possessory lien arises by force of a statute as indicated in *Ohakpo* above. The claim of the court officer is independent of the judgment creditor and only created by his seizure. It is not a surcharge upon the creditor's judgment. It exists by force of statute. It is, therefore, akin to a statutory lien and may not be set aside by a debtor under § 522(f)(1)(a) as a judicial lien.

For a thorough discussion of what can be charged by a court officer see *Harbour Towne Marina Ass'n v Geile (In re Fees of Court Officer)*, 222 Mich App 234; 564 NW2d 509 (1997).