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# SEC v. Byers

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> *If you owe your bank a hundred pounds, you have a problem. But if you owe a million, it has.*[1]

The financial crisis has exposed numerous fraudulent investment schemes affecting creditors and eroding society's confidence in investing institutions.[2] When Ponzi schemes collapse, it becomes necessary to take an accounting of any assets and create a plan for distribution to creditors and investors—liquidation is inevitable. A typical response by the government to investment fraud has been to immediately seek the appointment of a receiver to protect the dissipation of assets.[3] A district court and receiver can freeze the assets of the corporation involved in the investment scheme and issue anti-litigation injunctions that would prevent a drain of its assets before the scheme fully collapses.[4] However, this action opens the door to the equity receivers seeking to liquidate assets outside of the federal bankruptcy laws. Legal commentators have critiqued regulatory agencies for applying inconsistent approaches to recover and distribute assets from fraudulent investment schemes.[5] And protections granted under the bankruptcy laws are applied inconsistently or not at all when receivers conduct liquidation outside of the confines of bankruptcy laws.[6] Receivers are not compelled to follow bankruptcy laws, and receivers often ignore critical bankruptcy protections for creditors or use certain provisions in a piecemeal fashion.[7] When the purpose of a receivership is to seek the eventual liquidation of assets, the receiver should not be utilized "beyond the point necessary to get the estate into the proper forum for

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1. *See Down Communism's Sink*, The Economist, Feb. 13, 1982, at 11.

2. *See* Courtney J. Linn, *Recovering Assets in Investment Fraud Cases*, 45 Crim. L. Bull. 744 (2009).

3. > A receiver appointed by the court is a person who by such appointment becomes an officer of the court to receive, collect, care for, administer, and dispose of the property or the fruits of the property of another or other brought under the orders of the court by the institution of proper action or actions.

   Ralph Ewing Clark, A Treatise on the Law and Practice of Receivers § 11(a) (3d ed. 1959). "A primary purpose of appointing a receiver is to conserve the existing estate." Esbitt v. Dutch-American Mercantile Corp., 335 F.2d 141, 143 (2d Cir. 1964).

4. *See generally* Linn, *supra* note 2.

5. *See id.*

6. The United States has a long and storied history of bankruptcy jurisprudence, which reflects changing societal values and pragmatic considerations on the role of bankruptcy laws in mediating disputes among debtors and creditors. For a comprehensive historical overview of bankruptcy law, see generally Charles Warren, Bankruptcy in United States History (1935). Bankruptcy laws have been revised repeatedly, with the most sweeping changes coming in 1978 and 2005. *See generally* Elizabeth Warren & Jay Lawrence Westbrook, The Law of Debtors and Creditors: Text, Cases, and Problems 106 (6th ed. 2009) (discussing the Bankruptcy Reform Act of 1978 and the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005, which amended the 1978 Act). Title 11 of the U.S. Code is hereafter referred to as the Bankruptcy Code.

7. *See* SEC v. Am. Bd. of Trade, Inc., 830 F.2d 431 (2d Cir. 1987) (liquidating receivership criticized for selective application of bankruptcy rules and procedures); *see also* Marcus F. Salitore, *SEC Receivers v. Bankruptcy Trustees: Liquidation by Instinct or Rule*, Am. Bankr. Inst. J. (2003), *available at* http://www.martindale.com/members/Article_Atachment.aspx?od=1113797&id=39844&filename=asr-39846.pdf.

liquidation—the bankruptcy court."[8] While the right to file bankruptcy might not be a fundamental right,[9] it is unique in that establishing uniform laws on bankruptcy is one of the few enumerated powers that Congress has, provided in Article I, Section 8, of the U.S. Constitution.[10] Regardless of whether the right to file bankruptcy is a fundamental one, how far and under what circumstances may a court infringe on a creditor's right to force a debtor into bankruptcy?

In *SEC v. Byers*, the U.S. Court of Appeals for the Second Circuit in a case of first impression upheld the authority of a federal district court to issue an anti-litigation injunction precluding nonparty creditors from filing involuntary bankruptcy petitions in the context of a U.S. Securities and Exchange Commission (SEC) receivership.[11] This case comment contends that the Second Circuit's holding relies on reasoning from dissimilar cases, ignores a trend within the Second Circuit protecting the rights of debtors and creditors under the Bankruptcy Code, and circumvents congressional intent that entities be liquidated pursuant to, and with the protections afforded under, the Bankruptcy Code. Thus, the Second Circuit's holding vests district courts with too much discretion in administering SEC receivers past the point of marshaling the assets. When receivers liquidate assets outside of the consistent and unwavering protections provided under bankruptcy laws, the result leads to inconsistent protections for creditors and sporadic application of the bankruptcy laws.

On August 11, 2008, the SEC filed a complaint against Steven Byers, Joseph Shereshevsky, and multiple affiliates of Wextrust Capital, LLC, alleging their involvement in a complex Ponzi scheme[12] that involved over 240 Wextrust affiliates

8. Lankenau v. Coggeshall & Hicks, 350 F.2d 61, 63 (2d Cir. 1965) (citing Esbitt v. Dutch-American Mercantile Corp., 335 F.2d 141 (2d Cir. 1964)).

9. *See, e.g.*, United States v. Kras, 409 U.S. 434, 446 (1973) (the right to bankruptcy discharge is "hardly akin to free speech or marriage or to those other rights, so many of which are imbedded in the First Amendment, that the Court has come to regard as fundamental"). *But see* Sidney Goldstein, *If You Sue Me, I Will File Bankruptcy and You Can't Stop Me! Maybe Not!*, LexisNexis Corporate & Securities Law Community (Jan. 19, 2011, 9:39 AM), http://www.lexisnexis.com/community/corpsec/blogs/bus-law-analysis/archive/2011/01/19/if-you-sue-me-i-will-file-bankruptcy-and-you-can-t-stop-me-maybe-not.aspx ("The right to file bankruptcy is a fundamental right, provided in Article I, Section 8, of the Constitution."); Mark G. Douglas, *No Unwaivable Right to File an Involuntary Bankruptcy Petition*, Jones Day (Sept.-Oct. 2010), http://www.jonesday.com/files/Publication/604d1dca-ac8e-4554-be1e-4593fd75798b/Presentation/PublicationAttachment/ad410f61-1a0a-41cf-9135-45e94bde6201/JD_NYI_4300913_1_Involuntary%20petition%20injunction%20article%20for%20September_October%202.pdf ("The ability to file for bankruptcy protection and receive a discharge of debts is sometimes perceived, rightly or wrongly, as a fundamental (if not constitutional) entitlement under U.S. law.").

10. U.S. Const. art. I, § 8, cl. 4.

11. 609 F.3d 87 (2d Cir. 2010); *see also supra* note 3.

12. A Ponzi scheme typically involves a pyramid of business ventures that are unsupported by profit-making entities. *Ponzi Schemes—Frequently Asked Questions*, U.S. Sec. & Exch. Comm'n, http://www.sec.gov/answers/ponzi.htm (last visited Mar. 26, 2012). The operator of the scheme usually lures investors with promises of high yields. The operator then diverts money to itself, and occasionally to investors to create the illusion of success. *Id.* Once the scheme collapses, as it inevitably does, the victims are unable to recoup their initial investment. *See generally* Mitchell Zuckoff, Ponzi's Scheme: The True Story of a Financial Legend (2005); David A. Gradwohl & Karin Corbett, *Equity Receiverships for Ponzi Schemes*, 34 Seton Hall Legis. J. 181 (2010).

operating both in the United States and abroad.[13] The Wextrust affiliates controlled real estate investments, commodity funds, and diamond mine investments in South Africa.[14] The scheme allegedly defrauded investors out of approximately $255 million.[15] Because the scheme was so complex, involving many affiliates and types of assets, the SEC moved immediately to seek a restraining order freezing the assets of the defendant-debtors.[16] The district court issued a temporary restraining order and appointed a receiver to maintain the status quo while determining whether the Wextrust affiliates should file for bankruptcy.[17]

On October 24, 2008, the district court issued the preliminary injunction. The creditors' committees[18] argued that the district court did not have the authority to enjoin nonparty creditors from filing an involuntary bankruptcy petition.[19] Applying the reasoning of the Sixth and Ninth Circuits,[20] the district court denied the creditors' committees' motion to modify the order's provision that enjoined nonparty creditors from filing an involuntary bankruptcy petition.[21] In *Liberte Capital Group, LLC v. Capwill*, the Sixth Circuit held that a court has the power to enjoin nonparties from filing suits against assets of a receivership.[22] The circuit court reasoned that a court's jurisdictional basis to enjoin nonparties "arises from its power over the assets."[23] Similarly, in *SEC v. Wencke*, the Ninth Circuit upheld a district court's anti-litigation injunction barring suits against the receivership entities.[24] The Ninth

13. *Byers*, 609 F.3d at 89–90.

14. SEC v. Byers (*Byers II*), 637 F. Supp. 2d 166, 170–73 (S.D.N.Y. 2009).

15. *Byers*, 609 F.3d at 90.

16. *Id.*

17. *Id.* The August 11, 2008 order included the challenged provision that was subsequently incorporated into the October 24, 2008 preliminary injunction order. The order provides, in pertinent part, that

> no person or entity, including any creditor or claimant against any of the Defendants, or any person acting on behalf of such creditor or claimant, shall take any action to interfere with the taking control, possession, or management of the assets, including, but not limited to, the filing of any lawsuits, liens, or encumbrances, or bankruptcy cases to impact the property and assets subject to this order.

SEC v. Byers (*Byers I*), 592 F. Supp. 2d 532, 534–35 (S.D.N.Y. 2008).

18. The creditors' committees included the International Ad-Hoc Committee of Wextrust Creditors and the International Consortium of Wextrust Creditors.

19. *Byers I*, 592 F. Supp. 2d at 535. The Bankruptcy Code provides for procedures that enable creditors to, under certain conditions, force the debtor into Bankruptcy Court. *See* 11 U.S.C. § 303 (2006).

20. Liberte Capital Group, LLC v. Capwill, 462 F.3d 543 (6th Cir. 2006); SEC v. Wencke, 622 F.2d 1363 (9th Cir. 1980).

21. *Byers I*, 592 F. Supp. 2d at 537. The district court modified the order to allow any party or nonparty to request an order from the court permitting that party to file an involuntary bankruptcy petition upon showing that the petition would benefit the receivership estate. *Id.*

22. 462 F.3d at 552.

23. *Id.*

24. 622 F.2d at 1365.

Circuit reasoned that if a district court did not have authority to issue injunctions, receivers would be unable to protect assets under their administration.[25] The creditors' committees in *Byers* appealed the holding to the Second Circuit. Before the Second Circuit heard arguments, the district court was presented with a plan for liquidation of the receiver's assets.[26] In July 2009, the district court approved the receiver's plan to liquidate.[27]

On June 15, 2010, the Second Circuit affirmed the district court's holding, following a similar line of reasoning.[28] The Second Circuit reasoned that, although injunctions are to be used sparingly, the complex nature of the Wextrust Ponzi scheme, combined with the dispersed assets of the receiver's estate, created a situation in which an injunction would assist the district court and receiver in maintaining "maximum control over the assets" for the purpose of conserving the existing estate.[29] The court first established that district courts have broad equitable powers to appoint receivers in the context of violations of federal securities law.[30] The receiver is able to marshal the assets of the estate in order to prevent further collapse of the Ponzi scheme and dissipation of any remaining assets and to conduct an accounting of those assets. The court then reasoned that, even assuming an absolute right of creditors to file an involuntary bankruptcy petition, the receivership "accomplishes what a bankruptcy would," that is, the receivership acts as an automatic stay would in a bankruptcy proceeding.[31] But, as this case comment later points out, the Bankruptcy Code provides for many more protections. The circuit court nevertheless concluded by noting that the district court's power to issue anti-litigation injunctions barring

25. *Id*. at 1369–70.

26. *Byers II*, 637 F. Supp. 2d 166 (S.D.N.Y. 2009).

27. *Id*. at 184.

28. SEC v. Byers, 609 F.3d 87, 91–92 (2d Cir. 2010).

29. *Id*. at 92–93.

30. *See id*. at 92. While other statutory schemes allow district courts to appoint receivers, e.g., the Small Business Act, the federal securities law does not expressly provide for such relief and, as a result, the district court under federal securities law must use its equitable power to grant the use of a receiver when doing so is ancillary to other securities enforcement actions. *See* SEC v. Am. Bd. of Trade, Inc., 830 F.2d 431, 436–38 (2d Cir. 1987) ("Although neither the Securities Act of 1933 nor the Securities Exchange Act of 1934 explicitly vests district courts with the power to appoint trustees or receivers . . . [d]istrict courts possess broad equitable powers to grant 'ancillary relief . . . where necessary and proper to effectuate the purposes of' the securities laws."); *see also* George W. Dent, Jr., *Ancillary Relief in Federal Securities Law: A Study in Federal Remedies*, 67 Minn. L. Rev. 865, 867 (1983) ("Neither the language nor the legislative history of the securities laws expressly empowers the SEC to seek, or the courts to [grant] . . . ancillary relief.").

31. *Byers*, 609 F.3d at 92. Under section 362(a) of the Bankruptcy Code, the filing of a bankruptcy petition triggers the automatic stay. 11 U.S.C. § 362(a) (2006). The stay broadly halts all judicial, administrative, or other proceedings against the debtor. The goal is to maintain the status quo—that is, to cease all transactions so that the receiver or trustee may conduct a thorough accounting of the assets and liabilities of the underlying organization. *See* 3 Collier on Bankruptcy, ¶ 362.03 § 362(a) (Matthew Bender & Co., Inc. ed., 16th ed. 2011). However, certain express governmental actions are exempted from the automatic stay. *See* 11 U.S.C. § 362(b)(4).

debtors and creditors from exercising rights and remedies granted by the Bankruptcy Code is a "power to be exercised cautiously."[32]

This case comment contends that the court in *Byers* erroneously held that district courts have the authority to issue anti-litigation injunctions that preclude creditors from filing involuntary bankruptcy petitions in the context of SEC receivership cases for three reasons. First, the court improperly relied on the incongruent reasoning employed in Sixth and Ninth Circuit cases. Moreover, in a case of first impression, the court erred in rejecting more direct precedent in favor of cases that ultimately failed to address the novel issue presented in *Byers*. Second, the court ignored a clear trend in the Second Circuit of narrowing the circumstances in which federal receivers may circumvent the rights and procedures afforded to creditors under the Bankruptcy Code. Third, the court's holding frustrates the intent of Congress and the purpose of the Bankruptcy Code.

First, the *Byers* court's reliance on cases from the Sixth and Ninth Circuits was erroneous because those circuits did not decide the novel issue presented in *Byers*. The Sixth Circuit in *Liberte Capital Group, LLC v. Capwill* did not decide the court's ability to enjoin *bankruptcy* filings during the pendency of an anti-litigation injunction;[33] rather, the Sixth Circuit found that multiple insurance companies were in contempt of the court's blanket, or general, anti-litigation injunction when they sued for damages on claims of fraud.[34] In *Liberte*, Liberte Capital Group and Alpha Capital Group, both viatical settlement companies, were under the control of an Ohio district court-appointed receiver.[35] The Ohio district court issued an anti-litigation injunction. Three nonparty insurance companies requested declaratory relief against the viatical settlement companies now in control of the receiver, alleging that Liberte and Alpha fraudulently obtained insurance policies from them. The insurance companies filed suit in a Delaware court, naming the receiver as one defendant—the insurance companies sought pecuniary damages related to policies paid to the receiver.[36] The Ohio court held that filing the suit in Delaware was a violation of the Ohio court's blanket litigation injunction.[37] Although the language of the anti-litigation injunction in *Liberte* was similar to the injunction issued in *Byers*, the parties in *Liberte* did not seek to avail themselves of the rights and remedies of the Bankruptcy Code.[38] They were simply seeking to recover damages. *Liberte*, therefore, did not

32. *Byers*, 609 F.3d at 91.

33. 462 F.3d 543 (6th Cir. 2006).

34. *Id.* at 546–47.

35. A viatical settlement "allows you to invest in another person's life insurance policy. With a viatical settlement, you purchase the policy (or part of it) at a price that is less than the death benefit of the policy. When the seller dies, you collect the death benefit." *Viatical Settlements*, U.S. Sec. & Exch. Comm'n, http://www.sec.gov/answers/viaticalsettle.htm (last modified May 21, 2004).

36. *Liberte*, 462 F.3d at 555.

37. *Id.* at 557.

38. In *Liberte*, the parties were held in contempt for filing a common law fraud cause of action. *Id.* There is a distinction, however, between common law and court causes of action and involuntary bankruptcy

decide the narrow issue raised in *Byers*: whether a district court has the authority to issue an anti-injunction barring the filing of involuntary bankruptcy petitions by creditors of the corporation asserting their rights under the Bankruptcy Code.

In *Liberte*, the court implied that if the insurance companies sought to file an involuntary bankruptcy petition, as opposed to the common law fraud suit, the district court should defer to congressional intent as promulgated by "broad and detailed statutes to guide federal courts in the disposition of [bankruptcy] cases."[39] Indeed, the court distinguished cases in which district courts *may* exercise their equitable powers from cases in which they *may not*.[40] The Sixth Circuit noted, "There remains a class of cases, however, in which the federal courts may exercise their equitable powers and institute receiverships over disputed assets in suits otherwise falling within the federal court's jurisdiction, *but which fall outside the statutory bankruptcy proceedings* or other legislated domain."[41] Furthermore, the Sixth Circuit indicated that the court's power in the context of the bankruptcy "realm" is limited.[42] Thus, the Sixth Circuit did not address whether a district court may enjoin nonparty creditors from filing an involuntary bankruptcy petition in the context of a receivership.

The *Byers* court also erred in following the narrow holding of the Ninth Circuit in *SEC v. Wencke*, which did not involve creditors seeking to avail themselves of the protections afforded under the Bankruptcy Code and therefore also did not confront the novel issue presented in *Byers*.[43] In *Wencke*, Walter Wencke acquired control of a corporation, Sun Fruit, Ltd., through fraudulent means.[44] Mr. Wencke then began transferring assets from Sun Fruit to another of his corporations.[45] Next, Mr. Wencke successfully petitioned a Nevada state court to place Sun Fruit into receivership and appoint himself as receiver, requesting the appointment in order to be in a position to cover up his fraud.[46] He then immediately sought to hide his prior asset transfers.[47] In July 1976, the SEC brought an action against Mr. Wencke for violating federal securities law.[48] The district court issued a preliminary injunction barring further

petitions governed by Title 11 of the United States Code. Some authors argue that this distinction raises serious concerns over whether anti-litigation injunctions can be said to encompass the filing of a petition "governed *exclusively* by [the Bankruptcy Code]." *See* Richard D. Trenk & Adam Wolper, *Effects of* SEC v. Byers *on Creditors' Rights*, Law360 (Aug. 9, 2010), http://www.law360.com/realestate/articles/183372/effects-of-sec-v-byers-on-creditors-rights (emphasis added).

39. *Liberte*, 462 F.3d at 551.

40. *Id.*

41. *Id.* (emphasis added).

42. *See id.*

43. SEC v. Wencke, 622 F.2d 1363 (9th Cir. 1980).

44. *Id.* at 1365.

45. *Id.* at 1366.

46. *Id.*

47. *Id.*

48. *Id.*

proceedings against the federal receiver in order to take custody of the estate and audit Mr. Wencke's companies.[49] A nonparty sought possession of property under the control of Sun Fruit and sought to obtain a judgment in state court based on Sun Fruit's breach of a lease agreement.[50] Before the state court entered a final judgment against Sun Fruit (now under control of the SEC receiver), the federal district court entered the stay prohibiting any proceedings against entities or assets within the receiver's control.[51]

The Ninth Circuit held that, generally, district courts derive their authority to enjoin parties from bringing litigation from "the inherent power of a court of equity to fashion effective relief."[52] As in *Byers*, the court in *Wencke* issued a general anti-litigation injunction in the context of a securities fraud action. In *Wencke*, however, the Ninth Circuit remanded the case to the district court to "reexamine the necessity for a stay."[53] The circuit court specifically noted that even though the company in question was not insolvent or in bankruptcy, its *creditors* (here, the party suing on the lease) wanted to file claims against it.[54] Thus the Ninth Circuit implied, though it did not decide, that the circumstances in *Wencke*, i.e., creditors suing an entity in receivership, may not justify a continuation of the injunction.[55]

Second, the circuit court in *Byers* summarily rejected the Sixth Circuit's holding in *In re Yaryan Naval Stores Co*. that held that creditors were not held in contempt of an anti-litigation injunction where the creditors sought to declare the debtor bankrupt under the bankruptcy laws.[56] Instead, the *Byers* court found that a later case, *Royal Business*, which held that "a debtor subject to a federal receivership has no absolute right to file a bankruptcy petition," rejected the holding in *In re Yaryan*.[57] *Royal Business*, however, did not address the enjoining of creditors seeking to file an involuntary petition—a situation in which *In re Yaryan* specifically held that a court could not enjoin. In so holding, the Second Circuit, in a case of first impression,

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49. *Id.*

50. *Id.* at 1367.

51. *Id.* at 1366.

52. *Id.* at 1369.

53. *Id.* at 1375.

54. *Id.*

55. *See id.* (questioning whether the anti-litigation injunction maintained the status quo). "Although Sun Fruit is not now insolvent or in bankruptcy proceedings . . . *many creditors and other parties want to bring suit against it*. Accordingly, it is not apparent to us that the stay as applied to Superior simply maintains the status quo." *Id.* (emphasis added).

56. *See* SEC v. Byers, 609 F.3d 87, 92 (2d Cir. 2012) (rejecting the holding of *In re Yaryan*, 214 F. 563 (6th Cir. 1914)). Under the Bankruptcy Act of 1898, a debtor had to be declared "a bankrupt" by the court before the bankruptcy proceeding began. This provision did not survive the revisions of the Bankruptcy Reform Act of 1978. *See generally* Warren, *supra* note 6.

57. *See Byers,* 609 F.3d at 92 (quoting United States v. Royal Bus. Funds Corp., 724 F.2d 12, 15–16 (2d Cir. 1983)).

ignored more direct precedent, i.e., *In re Yaryan*, in favor of cases that failed to address the issue presented in *Byers*.

In *In re Yaryan,* the Sixth Circuit reviewed an Ohio district court order declaring Yaryan Naval Stores bankrupt.[58] In *In re Yaryan*, a district court in Georgia appointed a receiver to take control of the ailing corporation and issued an anti-litigation injunction barring any persons or entities from commencing proceedings against the receiver's estate.[59] Three unsecured creditors nevertheless filed an action in Ohio district court without obtaining leave from the Georgia district court presiding over the receivership, seeking to have the company declared bankrupt.[60] The Sixth Circuit held that these creditors were not in contempt of the Georgia district court's injunction.[61] The court pronounced that the Bankruptcy Act conferred "[r]ights and privileges so positively bestowed [that they] cannot be destroyed, denied, or abridged by any power save that which created and brought them into being."[62] The court further noted that the "creditors were also clearly within their rights when they applied for and obtained . . . an order adjudging the company a bankrupt. Indeed . . . the court of bankruptcy could not have denied the relief which it alone had jurisdiction and authority to grant."[63] The *Byers* court, however, did not find *In re Yaryan* controlling because it interpreted a subsequent Second Circuit case, *United States v. Royal Business Funds Corp.*, as standing for the circuit's explicit rejection of *In re Yaryan*.[64] This comment contends, however, that the *Byers* court erred in holding that *Royal Business* should be interpreted to reject *In re Yaryan*.

In *Royal Business*, the Second Circuit reviewed an appeal from the district court staying a Chapter 11 petition by the debtor-defendant Royal Business Funds Corp. ("Royal"), which received numerous loans from the Small Business Administration (SBA).[65] After several requests by Royal to the SBA to recapitalize the company were denied, insolvency appeared imminent.[66] The SBA requested that a receiver be appointed to administer the corporation.[67] In response, the board of directors voted to file for Chapter 11 bankruptcy protections.[68] However, before the district court, the parties entered into a stipulation and agreed to an order that gave the court, *inter alia*, exclusive jurisdiction over the assets of Royal and included a clause enjoining

58. *In re Yaryan*, 214 F. at 564.

59. *Id.* at 563–64.

60. *Id.* at 564.

61. *See id.*

62. *Id.* at 565.

63. *Id.*

64. *See* SEC v. Byers, 609 F.3d 87, 92 (2d Cir. 2010) (citing United States v. Royal Bus. Funds Corp., 724 F.2d 12, 15–16 (2d Cir. 1983)).

65. 724 F.2d at 13.

66. *Id.* at 14.

67. *Id.*

68. *Id.* at 15.

any other litigation, which, in relevant part, stated that "all Courts having any jurisdiction thereof are hereby enjoined from taking any further action until further Order of this Court."[69] Royal subsequently sought to file for bankruptcy despite consenting to the court's order. The Second Circuit held that "a *debtor* subject to a federal receivership has no absolute right to file a bankruptcy petition."[70] But the court's reasoning heavily relied on the fact that the liquidation under the receiver was already "substantially under way."[71]

Interestingly, and pertinent to a proper analysis of the facts in *Byers*, the court in *Royal Business* purposefully limited its holding by noting three "compelling" circumstances weighing in favor of affirming the district court's power to enjoin a bankruptcy filing by the debtor.[72] First, the SBA was the primary creditor and "no significant creditors other than SBA" existed.[73] The court reasoned that permitting the debtors to file for bankruptcy protection, after the SBA had relied on the receivership in issuing millions of dollars in new loans to the struggling company, would deter the SBA in the future from providing loans to struggling companies near insolvency.[74] Second, the debtor consented to the receivership after negotiations. Here, the court stated, citing *In re Yaryan*, that it "by no means intend[s] to disturb the general rules that a debtor may not agree to waive the right to file a bankruptcy petition."[75] Third, and most notably, the court distinguished the *Royal* case from situations where the bankruptcy petition may be filed by someone other than the debtor, implying a different analysis or standard would apply in those situations.[76]

Because the analysis in *Royal Business* applied to a case that involved a voluntary petition, the court's reasoning does not provide any guidance to cases involving involuntary petitions. In *Royal Business*, the court reasoned that because the receiver's primary purpose is to maintain the status quo and "improve the company's fortunes," the debtor had no absolute right to file a bankruptcy petition.[77] Additionally, the court qualified its holding by noting that *Royal* did not present any reasons, other than the entity's unqualified right, to file a voluntary petition and avail itself of the

69. *Id.* at 14 n.3.

70. *Id.* at 16 (emphasis added).

71. *Id.* "The receiver ha[d] been operating the company for over a year." *Id.*

72. *Id.*

73. *Id.* The fact that the SBA was the primary creditor is particularly important because, as a result of the negotiated decision to choose a federal receivership, Royal received an additional $3.5 million dollars in new SBA loans. *See id.*

74. *Id.* at 15.

75. *Id.*; *see also In re* Federal Shopping Way, Inc., 433 F.2d 144 (9th Cir. 1970); *In re* Weitzen, 3 F. Supp. 698 (S.D.N.Y. 1933) ("The agreement to waive the benefit of bankruptcy is unenforceable. To sustain a contractual obligation of this character would frustrate the object of the Bankruptcy Act."); *In re* Madison, 184 B.R. 686, 690 (Bankr. E.D. Pa. 1995) ("[A]n agreement not to file bankruptcy is unenforceable because it violates public policy.").

76. *Royal Business*, 724 F.2d at 16.

77. *Id.*

privileges and protections of the Bankruptcy Code. What is more, the court noted that "no public or private interest is served by allowing Royal to repudiate the arrangements it made with the SBA,"[78] emphasizing that the court based its holding on the fact that the SBA relied on the mutual agreement to appoint a receiver. Finally, the appointment of a federal receivership was expressly provided for by Congress in the Small Business Act to be an exclusive remedy—a distinction that should not be ignored. A provision of the Small Business Act states that the district court "may . . . take exclusive jurisdiction of the licensee . . . and the assets thereof, wherever located."[79] This language is noticeably absent in the securities laws.[80]

*Byers* is distinguishable from *Royal Business*. In *Byers*, none of the three "compelling" circumstances set out in *Royal Business* were present. In *Byers*, the Wextrust affiliates were beyond resuscitation and the purpose of the receiver did not involve improving the company's fortunes.[81] Additionally, in *Byers*, there was no reliance factor to justify precluding creditors from filing a bankruptcy petition. Moreover, the situation that the court in *Royal Business* implied would caution against enjoining the filing of a bankruptcy petition, i.e., the presence of creditors seeking to file an involuntary bankruptcy petition, *was* present in *Byers*. The Second Circuit in *Royal Business* effectively carved out a narrow exception to the "general rules that a debtor may not agree to waive the right to file a bankruptcy petition, that the pendency of an equitable receivership rarely precludes a petition in bankruptcy, or that equity receiverships should not 'perform the functions of the bankruptcy court.'"[82]

Third, the Second Circuit in *Byers* ignores a clear trend within the Second Circuit cautioning against the use of SEC receiverships as an alternative to bankruptcy because bankruptcy procedures "are much better designed to protect the rights of interested parties."[83] There is a line of cases in the Second Circuit—as well as a case in the Ninth Circuit—involving violations of securities law in which federal receivers move to liquidate assets outside of the procedures and protections of the Bankruptcy Code.[84] In

78. *Id.*

79. 15 U.S.C. § 687c(b) (2006).

80. *Compare id.* § 687c(b), *with* section 27 of the Securities Exchange Act of 1934 (granting the district court the power to issue injunctive relief, but not expressly providing for use of a receivership. In order to use a receivership, the SEC must seek "ancillary relief" from the district court). *See also* SEC v. Manor Nursing Ctrs., Inc., 458 F.2d 1082, 1105 (2d Cir. 1972) ("Despite the absence of explicit statutory authority, however, we repeatedly have upheld the appointment of trustees or receivers to effectuate the purposes of the federal securities laws."); Dent, *supra* note 30, at 867 ("Neither the language nor the legislative history of the securities laws expressly empowers the SEC to seek, or the courts to [find] justification for ancillary relief.").

81. *See* SEC v. Byers, 609 F.3d 87, 89 (2d Cir. 2010).

82. *Royal Business*, 724 F.2d at 15 (citations omitted) (quoting Esbitt v. Dutch-American Mercantile Corp., 335 F.2d 141, 143 (2d Cir. 1964)).

83. *Esbitt*, 335 F.2d at 143.

84. *See* Eberhard v. Marcu, 530 F.3d 122, 132 (2d Cir. 2008); SEC v. Am. Bd. of Trade, Inc., 830 F.2d 431, 437 (2d Cir. 1987); SEC v. S&P Nat'l Corp., 360 F.2d 741, 750–51 (2d Cir. 1966); Lankenau v. Coggeshall & Hicks, 350 F.2d 61, 63 (2d Cir. 1965); *Esbitt*, 335 F.2d at 143. *But cf.* SEC v. Credit

each instance, the court questioned the efficacy and jurisdiction of equity receivers operating into the congressionally legislated realm of debtor and creditor law.

In *Esbitt v. Dutch-American Mercantile Corp.*, the Second Circuit expressed strong reservations about using federal securities law receivers to liquidate corporations.[85] In *Esbitt*, the SEC receiver of an insolvent corporation brought suit to collect a debt owed from Dutch-American Mercantile Corp.[86] The SEC receiver was marshaling the assets of that the company, which was "hopelessly insolvent" and almost fully liquidated by the time the appeal reached the Second Circuit.[87] Dutch-American argued that the district court did not have jurisdiction to hear the case because the parties were not diverse.[88] The only way the court had jurisdiction was if the debt collection suit, normally brought in state court or under the Bankruptcy Code, was ancillary to the SEC action. The Second Circuit affirmed the district court's finding of proper jurisdiction.[89] The court noted, however, that "[w]e see no reason why violation of the Securities Act should result in the liquidation of an insolvent corporation via an equity receivership instead of the normal bankruptcy procedures, *which are much better designed to protect the rights of interested parties*."[90] In so doing, the court created a narrow exception to the use of SEC receivers presiding over estate liquidations when a corporation is insolvent and the liquidation is nearly completed.[91]

In a second case, *SEC v. S&P National Corp.*, the SEC filed suit against S&P National, alleging violations of the Securities Exchange Act and seeking the appointment of a receiver to prevent further fraud.[92] The court affirmed the appointment of an equity receiver, noting that the purpose of the receiver was not to promptly liquidate assets but "promptly to install a responsible officer of the court who could bring the companies into compliance with the law . . . and preserve the corporate assets."[93] Notably, the circuit court stated, "If the only purpose of the receivership were to bring about a quick liquidation, we might feel otherwise."[94] Thus the circuit court implied that bankruptcy court is the proper venue when liquidation

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Bancorp, Ltd., No. 99 civ. 11395, 2000 U.S. Dist. LEXIS 17171, at *89 (S.D.N.Y. Nov. 29, 2000); *Byers II*, 637 F. Supp. 2d 166, 176 (S.D.N.Y. 2009) (holding that, notwithstanding *Eberhard* and *Am. Bd. of Trade*, the approval of the liquidation plan in context of the SEC receivership was within the district court's equitable authority).

85. 335 F.2d at 143.

86. *Id.* at 142.

87. *Id.* at 143.

88. *Id.* at 142.

89. *Id.*

90. *Id.* at 143 (emphasis added) (citations omitted).

91. *See id.*; *see also* SEC v. Am. Bd. of Trade, Inc., 830 F.2d 431, 437 (2d Cir. 1987).

92. 360 F.2d 741, 743 (2d Cir. 1966).

93. *Id.* at 750–51.

94. *Id.* at 750.

is the purpose of the receivership. Unlike *Byers*, in *S&P National* there was no attempt by creditors to file an involuntary bankruptcy petition.

In another case, *Lankenau v. Coggeshall & Hicks*, the court stated that SEC receiverships "should not be continued, in a case involving insolvency, beyond the point necessary to get the estate into the proper forum for liquidation—the bankruptcy court."[95] More recently, the Second Circuit in *Eberhard v. Marcu* similarly stated that "the power of a securities receiver is not without limits."[96] The court in *Eberhard* espoused the principles that the SEC receivership is not an appropriate alternative to bankruptcy and that district courts should not use receivers to liquidate estates.[97] The *Eberhard* court noted that "because receivership should not be used as an alternative to bankruptcy, we have disapproved of district courts using receivership as a means to process claim forms and set priorities among various classes of creditors."[98]

Of particular guidance was the Second Circuit's pronouncement in *SEC v. American Board of Trade, Inc.*, holding that the appointment of a securities receiver was within the district court's discretion in order to protect the assets of the American Board of Trade (ABT) entities.[99] The district court also authorized the receiver to liquidate the assets.[100] Although the appellant did not appeal from the order authorizing the liquidation, the Second Circuit noted, in dicta, that the order was "sufficiently linked to the appointment of an interim receiver to warrant [an] . . . expression of [its] views on the liquidation."[101] The circuit court noted a trend in several Second Circuit cases criticizing the use of equity receivers as an alternative to bankruptcy.[102] Such criticisms include the "burden of processing proof-of-claim forms filed by thousands of noteholders and other creditors, of setting priorities among classes of creditors, and of administering sales of real property, all without the aid of either the experience of a bankruptcy judge or the guidance of the bankruptcy code."[103] The circuit court concluded by commanding that in future SEC actions involving receivers, the SEC should "bring [the Second Circuit's] views, as stated in [*SEC v. American Board of Trade*] and other decisions, to the attention of the district court before the court embarks on a liquidation through an equity receivership."[104] The circuit court reiterated that the only exception to using receivers

95. 350 F.2d 61, 63 (2d Cir. 1965) (citing *Esbitt*, 335 F.2d at 141, 143) (holding that the federal court may stay the attachment of assets of the equity receiver in concurrent state court proceeding).

96. 530 F.3d 122, 132 (2d Cir. 1965).

97. *See id.* (citing *Lankenau*, 350 F.2d at 63).

98. *Id.* (citing SEC v. Am. Bd. of Trade, Inc., 830 F.2d 431, 437–38 (2d Cir. 1987)).

99. 830 F.2d at 436.

100. *Id.*

101. *Id.*

102. *Id.* at 436–37; *see also supra* notes 84–108 and accompanying text (discussing the trend in several Second Circuit cases).

103. *Am. Bd. of Trade*, 830 F.2d at 438.

104. *Id.*

to liquidate assets outside of bankruptcy is when the liquidation is virtually completed,[105] which can be read as an attempt to reign in the transformation of federal district courts and receivers into quasi-bankruptcy courts.[106]

In addition to the Second Circuit, the Ninth Circuit in *Los Angeles Trust Deed & Mortgage Exchange v. SEC* has found that an SEC receiver's power to liquidate assets outside of the umbrella of the bankruptcy laws should be limited to very exceptional circumstances, holding that

> there is no apparent reason here why the violation of the [securities laws] should lead to a different type of final liquidation than that which is had for the normal corporate bankrupt. In true bankruptcy, procedures are better geared for creditors and depositors to give them a day in court and protect their rights.[107]

These cases demonstrate that where, as in *Byers*, the necessary purpose of the receiver was the eventual liquidation of the assets (once the receiver made a full accounting of the estate), the proper forum for liquidation is the bankruptcy courts. SEC receiverships "should not be continued, in a case involving insolvency, beyond the point necessary to get the estate into the proper forum for liquidation—the bankruptcy court."[108]

The Second Circuit in *Byers* ignored this trend of cases that raise serious doubts as to the appropriateness of using SEC receivers to circumvent the established procedures of the Bankruptcy Code in overseeing the liquidation of an entity. As a result, future SEC receivers have precedent supporting their authority to fully liquidate a debtor's assets under the receiver's management. Though the court framed the issue as driven by "equitable" considerations, this is undesirable because receivers could arbitrarily employ liquidation or other procedures in an ad hoc manner. In *Byers*, the SEC receiver concluded that filing for bankruptcy would be "inequitable."[109] The district court judge noted, "[a]lthough the [decision by the receiver that

105. "The reason we have acquiesced in the past . . . is that by the time the issue had reached us, the liquidation was usually near termination." *Id.* at 437. This exception is echoed by other circuits that make clear that liquidation outside of bankruptcy should not become standard practice. *See* SEC v. Lincoln Thrift Ass'n, 577 F.2d 600, 609 (9th Cir. 1978) ("Our decision is to a large extent controlled by the consideration that the liquidation proceedings were in an advanced stage before appeal was brought to this Court. We do not, therefore, view this case as a precedent for approving receivership liquidations under the supervision of the district court rather than under the jurisdiction of the court in bankruptcy."); SEC v. Bartlett, 422 F.2d 475, 480 (8th Cir. 1975) (upholding the district court's order refusing to vacate a receivership because the receiver had already made substantial progress toward liquidating the corporation and the district court had ordered an early pro rata distribution of the assets); *see also* Esbitt v. Dutch-American Mercantile Corp., 335 F.2d 141 (2d Cir. 1964).

106. *See Am. Bd. of Trade*, 830 F.2d at 438 ("[T]he court has taken upon itself the burden of processing proof-of-claim forms filed by thousands of noteholders and other creditors, of setting priorities among classes of creditors, and of administering sales of real property, all without the aid of either the experience of a bankruptcy judge or the guidance of the bankruptcy code.").

107. 285 F.2d 162, 182 (9th Cir. 1960).

108. Lankenau v. Coggeshall & Hicks, 350 F.2d 61, 63 (2d Cir. 1965) (citing *Esbitt*, 335 F.2d at 143).

109. *Byers II*, 637 F. Supp. 2d 166, 175 (S.D.N.Y. 2009).

bankruptcy would be inequitable] is a close one that gives me pause, in the end I agree."[110] By ignoring the Second Circuit trend, *Byers* changed the focus from congressional intent as understood under the Bankruptcy Code to considerations of equitable results for investors. The district court noted that it was guided by the principle that "equality is equity."[111] Equity, however, is a fleeting concept; surely not all creditors will approve of what the SEC receiver believes is an "equitable" distribution of assets. Besides, Congress has already balanced competing interests and created a "complete, coordinated and integrated mechanism for orderly liquidation."[112] And, as one commentator points out, the use of equity receivers results in incremental jurisdictional advances, such as liquidating assets outside of the Bankruptcy Code, into legislated schemes for which Congress has already weighed the competing interests.[113] Through ancillary relief, which provides the basis for federal receivers in the context of securities law, the district court is the sole promulgator of the receiver's powers.[114] In effect, the federal court places its wisdom and experience in front of Congress's, circumventing its intent to "establish . . . uniform Laws on the subject of Bankruptcies."[115]

In not permitting creditors to file an involuntary bankruptcy petition, the Second Circuit frustrates congressional intent that the liquidation or restructuring of the debtor corporation takes place pursuant to the Bankruptcy Code. The Bankruptcy Code's legislative history notes that "once a proceeding to liquidate assets has been commenced, the debtor's creditors have an *absolute right* to have the liquidation (or reorganization) proceed in the bankruptcy court under bankruptcy laws with all of the appropriate creditor . . . protections that those laws provide."[116]

The right to file bankruptcy is statutorily provided under the Bankruptcy Code. Contrast this to the lack of statutory relief that the SEC has in the context of federal securities law violations, which requires the SEC to seek ancillary relief from district courts.[117] The "twin" purposes of the Bankruptcy Code are to provide creditors with fair payment and to establish a "fresh start" for debtors.[118] The Bankruptcy Code

110. *Id.* at 175.

111. *Id.* at 176 (quoting Cunningham v. Brown, 265 U.S. 1, 13 (1924)).

112. Salitore, *supra* note 7.

113. *See id.*

114. *See id.*

115. U.S. Const. art. I, § 8, cl. 4.

116. H.R. Rep. No. 95-595, at 323–24 (1977), *reprinted in* 1978 U.S.C.C.A.N. 5963, 6280 (emphasis added); *see also supra* notes 25–31 and accompanying text.

117. *See* Gary L. Goodenow, *Litigating the SEC's Ancillary Enforcement Remedies Following Central Bank and its Progeny*, 21 Am. J. Trial Advoc. 67 (1997).

118. *See* IRS v. Energy Res. Co. (*In re* Energy Res. Co.), 871 F.2d 223, 230 (1st Cir. 1989), *aff'd*, 495 U.S. 545 (1990) (discussing the Bankruptcy Code's twin purposes, which are to ensure "fair payment to creditors *and* provide the [debtor] with an opportunity to make a 'fresh start'") (internal citation omitted); *In re* Whitfield, 290 B.R. 302, 306 (Bankr. E.D. Mich. 2003) ("The Bankruptcy Code reflects a careful balance of debtors' rights and creditors' remedies."); *In re* Cason, 190 B.R. 917, 927 (Bankr. N.D. Ala.

provides numerous provisions that evince congressional intent to give bankruptcy courts a plethora of tools to carry out the "twin" purposes of the Code.[119] This case comment is primarily concerned with the principle that creditors receive fair payment, yet the Second Circuit's holding in *Byers* gives too much discretion to district courts and leaves creditors subject to proceedings outside of a bankruptcy court, without adequate protection of their interests ensured by Congress under the Bankruptcy Act. In the context of an SEC receivership, the receiver's focus is on protecting investors.[120] Secured and unsecured creditor rights are noticeably absent in such a proceeding and receivership proceedings lack established bankruptcy protections and processes.[121] For instance, under receivership liquidation, notice and hearing requirements vary or are absent depending on the federal district in which the liquidation is proceeding.[122] Conversely, section 363 of the Bankruptcy Code requires a bankruptcy trustee to file a motion seeking the court's approval of a proposed asset sale, in addition to the subsequent "notice and a hearing" on the motion seeking a sale.[123] Receiverships also lack the creditor protections of the "absolute priority rule" outlined in Chapter 11 of the Bankruptcy Code.[124] In addition, the equity receivership may have difficulty voiding transfers and conveyances of assets on behalf of the debtor's creditors made prior to the appointment of the receiver, such as priority payments.[125] Under the Bankruptcy Code, section 548 permits a trustee to avoid fraudulent transfers that occur within two years before a bankruptcy filing.[126] Section 547 permits the bankruptcy trustee to "clawback" priority payments made within ninety days of a bankruptcy filing.[127]

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1995) ("The Bankruptcy Code as originally enacted carefully balanced creditors' property rights and debtors' fresh start.").

119. *See infra* notes 126–27, 131–39 (discussing additional protections and procedures noticeably absent in federal receiverships).

120. *See Byers II*, 637 F. Supp. 2d 166 (S.D.N.Y. 2009) ("The overriding goal . . . should be fairness to the defrauded investors, and forcing this case into bankruptcy would . . . be inconsistent with that goal.").

121. *See* Trenk & Wolper, *supra* note 38.

122. *See* Salitore, *supra* note 7.

123. 11 U.S.C. § 363 (2006). The bankruptcy court considers arguments for and against the proposed sale and either approves the sale or denies approval. *See generally* Timothy W. Walsh, *Section 363: A Useful Tool for Asset Sales in Bankruptcy*, DLA Piper (Aug. 24, 2009), http://www.dlapiper.com/section-363:a-useful-tool-for-asset-sales-in-bankruptcy/.

124. *See* 11 U.S.C. § 1129(b)(2) (2006); *see also* Motorola, Inc. v. Official Comm. of Unsecured Creditors (*In re* Iridium Operating LLC), 478 F.3d 452, 463 (2d Cir. 2007) ("This provision codifies the judge-made absolute priority rule, which provided that any plan of reorganization in which stockholders [a]re preferred before the creditor, [is] invalid.") (citations omitted) (internal quotation marks omitted). The absolute priority rule in the Code establishes a hierarchy of payment among competing classes of creditors and provides an avenue for dissenting creditors to reject a Chapter 11 reorganization plan if the creditors believe the plan is not "fair and equitable" with respect to their claims.

125. *See, e.g.*, Donell v. Kowell, 533 F.3d 762, 770–72 (9th Cir. 2008) (explaining rules under which a receiver may "claw back" money from investors in a Ponzi scheme).

126. 11 U.S.C. § 548(a)(1) (2006).

127. *Id.* § 547(b)(4)(A).

The *Byers* court reasoned that even if there was an "unwaivable" right for creditors to file an involuntary bankruptcy petition, the receivership accomplishes what bankruptcy proceedings would, i.e., the protection of the assets of the estate.[128] But that is only part of the value of bankruptcy proceedings; bankruptcy provides numerous protections for both debtors and creditors.[129] And courts have generally held that injunctions arising from such receiverships are improper to the extent that they prevent debtors and creditors from availing themselves of the rights and procedures afforded by the Bankruptcy Act.[130] What is more, the Bankruptcy Code expressly provides discretion for bankruptcy courts to remand a case back to the federal district court if "the interests of creditors and the debtor would be better served."[131] Therefore, the discretion to send a case back to federal district courts should be in the hands of the bankruptcy court rather than in the hands of the district court, where it can be used to arbitrarily pick what is equitable while circumventing the rights and procedures afforded to creditors under the Code.

The Bankruptcy Code unambiguously contemplates that the mere existence of an equity receiver does not preclude debtors or creditors from filing bankruptcy petitions.[132] Section 543 of the Code would otherwise be superfluous.[133] Section 543

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128. SEC v. Byers, 609 F.3d 87, 89 (2d Cir. 2010).

129. *See infra* notes 131–39 and accompanying text (discussing the protections and procedures available).

130. *See* Jordan v. Indep. Energy Corp., 446 F. Supp. 516, 529–30 (N.D. Tex. 1978) ("An order restricting access to the bankruptcy court, other than as specifically provided by Congress in the Bankruptcy Act, would not be in the public interest."); *see also In re* Naftalin & Co., 315 F. Supp. 463, 468 (D. Minn. 1970), *vacated on other grounds*, 469 F.2d 1166 (8th Cir. 1972) ("It has been directly held that the appointment of a receiver in an action by the [SEC] would not deter the liquidation of the entity in a bankruptcy proceeding."); *accord In re* Yaryan Naval Stores Co., 214 F. 563, 565 (6th Cir. 1914) ("[T]he intention of Congress [is] to confer the rights and privileges of the Bankruptcy Act upon all persons and all corporations except those expressly exempted from its operation."); *In re* Donaldson Ford, Inc., 19 B.R. 425, 428–29 (Bankr. N.D. Ohio 1982) ("It has generally been held in this circuit that the pendency of an equity receivership will not ordinarily prevent a corporation from filing a voluntary petition in bankruptcy."). Therefore, "[a]ny conflicting injunction order must yield to the Congressional intent to grant bankruptcy relief." *Jordan*, 446 F. Supp. at 527; *see also* Rafael Ignacio Pardo, Comment, *Bankruptcy Court Jurisdiction and Agency Action: Resolving the* NextWave *of Conflict*, 76 N.Y.U. L. Rev. 945 (2001).

131. 11 U.S.C. § 305(a)(1) (2006).

132. *See id.* § 543 (a)–(b). This section of the Code provides, in pertinent part, that:

> (a) A custodian with knowledge of the commencement of a case under this title concerning the debtor may not make any disbursement from, or take any action in the administration of, property of the debtor . . . in the possession, custody, or control of such custodian, except such action as is necessary to preserve such property.
>
> (b) A custodian shall (1) *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.

*Id.* (emphasis added).

133. Section 543 could be read as preempting a district court from precluding creditors from filing bankruptcy petitions. However, Bankruptcy courts are Article I courts under the Constitution. Further,

requires a receiver,[134] "with knowledge of the commencement of a case under [the Bankruptcy Code,]" to deliver any property of the debtor to the bankruptcy trustee.[135] Additionally, section 303(b) describes the specific requirements that creditors must meet in order to file an involuntary petition,[136] reflecting the American preference for voluntary petitions.[137] No other section of the Bankruptcy Code expressly precludes creditors from filing involuntary petitions, assuming the creditor meets the threshold demands of section 303. Section 305 grants bankruptcy courts the power to abstain a proceeding under Title 11 if "the interests of creditors and the debtor would be better served."[138] Section 105 gives the bankruptcy court broad power to "issue any order, process, or judgment that is necessary or appropriate to carry out the provisions of this title."[139] Congress deliberately provided bankruptcy courts with the power and capacity to sift through complex corporate reorganizations and structures.[140] But the *Byers* court reasoned that while injunctions are to be used sparingly, the complex nature of the debtor's estate—whereby the receiver needed to manage hundreds of entities spread over two continents arising out of a Ponzi scheme costing investors upwards of $255 million—is precisely the situation where an injunction may assist the district court and receiver in maintaining maximum control over the assets. However, the court's reasoning is inapposite. In fact, other circuits have reasoned that complex matters are precisely situations that bankruptcy laws are

courts have generally interpreted section 543 of the Code to preempt only state proceedings involving receivers and not federal receivers. *See, e.g.*, *In re* Watts, 190 U.S. 1 (1903).

134. Section 543 of the Code uses the term "custodian." However, "custodian" is defined in section 101(11) as meaning a "*receiver* or trustee of any of the property of the debtor, appointed in a case of proceeding not under this title." 11 U.S.C. § 101(11)(A) (emphasis added).

135. *Id.* § 543 (a)–(b).

136. *See id.* § 303 ("An involuntary case may be commenced only under chapter 7 or 11 of this title.").

137. *See* Warren & Westbrook, *supra* note 6, at 367 (discussing the differences in legal systems that result in Europeans filing more involuntary petitions than Americans who have always favored voluntary petitions). This is further reinforced by other subsections of 303 providing attorney's fees to debtors if the court dismisses an involuntary petition or punitive damages if an involuntary petition is deemed to be filed in "bad faith." *See* 11 U.S.C. § 303(i).

138. *Id.* § 305(a)(1). This is a provision in the Code that contemplates situations similar to the situation presented in *Byers*. The existence of this provision weighs in favor of precluding federal courts from enjoining creditors from filing involuntary petitions under the Code because Congress provided bankruptcy courts with the power to abstain and remand the case back to the district court where the estate would be subject to the receivership; it is an equitable safeguard that requires the bankruptcy judge to weigh burdens and benefits of abstention. *See, e.g.*, *In re* Euro-American Lodging Corp., 357 B.R. 700, 729 (Bankr. S.D.N.Y. 2007) (addressing seven factors for the court to weigh in determining whether abstention is appropriate).

139. 11 U.S.C. § 105(a) (2006).

140. *See* Gilchrist v. Gen. Elec. Capital Corp., 262 F.3d 295, 304 (4th Cir. 2001) (noting that Congress intended to favor the bankruptcy process because the bankruptcy court has better tools to deal with complex litigation).

meant to address.[141] *Byers* presents precisely the complex issues that are best addressed by the Bankruptcy Code.

The Second Circuit in *Byers* ignored a clear trend of cases narrowing the circumstances allowing for the use of receivers to circumvent the rights and procedures afforded creditors under the Bankruptcy Code. The Second Circuit's holding in *Byers* gives too much discretion to district courts and leaves creditors subject to proceedings outside of a bankruptcy court, without adequate protection of their interests ensured by Congress under the Bankruptcy Act. In the context of an SEC receivership, the receiver's focus is on protecting investors.[142] But secured and unsecured creditor rights are noticeably absent in such a proceeding[143] and receivership proceedings lack consistent and unwavering bankruptcy protections and processes.

141. Erti v. Paine Webber Jackson & Curtis, Inc. (*In re* Baldwin-United Corp. Litig.), 765 F.2d 343, 347 (2d Cir. 1985) ("[T]o whatever extent a conflict may arise between the authority of the Bankruptcy Court to administer this complex reorganization and the authority of the District Court to administer consolidated pretrial proceedings, the equities favor maintenance of the unfettered authority of the Bankruptcy Court.").

142. *See Byers II*, 637 F. Supp. 2d 166 (S.D.N.Y. 2009) ("The overriding goal . . . should be fairness to the defrauded investors, and forcing this case into bankruptcy would . . . be inconsistent with that goal.").

143. *See* Trenk & Wolper, *supra* note 38.