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Claims Chat

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The Limits of Receivership Estates, *In Rem* Jurisdiction and Receivers' Settlement Authority

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In 2009, the U.S. Securities and Exchange Commission (SEC) uncovered the Stanford International Bank (SIB) Ponzi scheme.[1] For almost 20 years, SIB issued fraudulent certificates of deposit with fixed interest rates purportedly based on returns from "a well-diversified portfolio of marketable securities."[2] However, there was no such portfolio and — as with all Ponzi schemes — existing investors' "returns" were actually new investors' fraudulently obtained funds.[3] As one court stated, "The massive [SIB] Ponzi scheme defrauded more than 18,000 investors who collectively lost over $5 billion."[4]

After discovering the fraud, the SEC brought suit against SIB, and the district court appointed a receiver over SIB, related entities and all of their assets (collectively, the "receivership estate").[5] The district court's order appointing the receiver vested him with "exclusive control of the Receivership Estate and any assets traceable to it [and] the full power of an equity receiver under common law."[6] The district court held that "a group of insurance policies [(the "policies")] and their proceeds ... cover[ing] losses and defense costs for [SIB] entities and their officers, directors and certain employees" constituted property of the receivership estate. Thus, the district court had exclusive jurisdiction over "claims related to the [policies]."[7] After extensive litigation, the receiver and underwriters for the policies ultimately reached a global settlement requiring "orders barring all actions against [the] Underwriters relating to the [policies]," SIB and the receivership estate.[8]

On the receiver's motion, the "district court approved the settlement and bar orders, denied all objections, and approved the payment of $14 million of attorney fees to Receiver's counsel."[9] Various parties-in-interest appealed,[10] and the Fifth Circuit vacated the district court's orders approving the settlement and bar orders, and remanded for further proceedings because "the settlement and bar orders violated fundamental limits on the authority of the court and Receiver."[11]

This article (1) provides an overview of federal receiverships and the general principles underlying such proceedings; (2) examines the Fifth Circuit's holding in *Stanford Int'l Bank Ltd.*; (3) discusses the underlying jurisdictional issues animating the Fifth Circuit's holding; and (4) concludes that practitioners should be aware that a receiver's settlement authority is limited to property of the estate, and practitioners should therefore be prepared to litigate about what claims constitute property of a receivership — or bankruptcy — estate when receivers (or bankruptcy trustees or debtors in possession) seek authority to settle claims.

Federal Receiverships in a Nutshell

A receivership is an equitable remedy that courts may impose on specific property in extraordinary

1 *See Janvey v. GMAG LLC*, 925 F.3d 229, 231 (5th Cir. 2019) (*Janvey II*). *See also SEC, et al. v. Stanford Int'l Bank Ltd., et al.*, 927 F.3d 830 (5th Cir. 2019).
2 *Janvey II*, 925 F.3d at 231.
3 *Id.*
4 *Stanford Int'l Bank Ltd.*, 927 F.3d at 836.
5 *Id.* at 835-36.
6 *Id.* at 836 (internal citations and quotation marks omitted).
7 *Id.*
8 *Id.* at 838.
9 *Id.*
10 *Id.*
11 *Id.* at 848 (quotation); 851 (vacating and remanding).
12 *See, e.g., Waag v. Hamm*, 10 F. Supp. 2d 1191, 1193 (D. Colo. 1998).

circumstances when there is no adequate remedy at law, or no less-drastic equitable remedy, available.[12] Like filing a bankruptcy petition, the appointment of a receiver creates an estate comprised of property specified in the court's order appointing the receiver.[13] A court may appoint a receiver over an entity or its assets in "accord with the historical practice in federal courts."[14]

Federal courts possess broad authority to place assets into a receivership "to preserve and protect the property pending its final disposition."[15] To that end, and subject to the specific scope of the appointment order, receivers appointed by federal courts are "vested with complete jurisdiction and control of all [receivership] property with the right to take possession thereof."[16] Federal courts have "broad powers and wide discretion to determine ... appropriate relief" in a receivership.[17] Such discretion arises both from the statutory grant of power and the inherent equitable powers of federal courts.[18] Receivership courts, like bankruptcy courts, therefore possess discretion to approve settlements of disputed claims against receivership assets, provided that such settlements are "fair and equitable and in the best interests of the estate."[19]

Because federal common law governing equity receiverships is relatively sparse, courts often look to bankruptcy authorities for guidance.[20] This makes sense, because the purposes of bankruptcy and equity receiverships are "essentially the same — to marshal assets, preserve value, equally distribute to creditors, and either reorganize, if possible, or orderly liquidate."[21] After all, the Bankruptcy Code and its predecessors are largely based on the equitable principles developed by federal courts on receiverships.[22] Thus, federal courts often apply authorities under § 541 of the Bankruptcy Code by analogy when considering what interests constitute property of a receivership estate.[23]

The Fifth Circuit's Holding in *Stanford Int'l Bank Ltd.*

In *Stanford Int'l Bank Ltd*., the receiver obtained district court approval to enter a global settlement with the underwriters, which required the entry of a bar order enjoining all later claims against the underwriters, policies and receivership estate. Barred claims included direct claims of nonconsenting third parties against the underwriters and against proceeds of the policies. The district court's bar orders also prohibited the affected, nonconsenting third parties from asserting claims against the receivership estate under the ordinary claims administration process applicable to all other claimants. Certain nonconsenting third parties whose rights were impacted by the bar order appealed to the Fifth Circuit.[24]

On appeal, the Fifth Circuit grappled with "two interrelated limitations" on receivership proceedings: (1) "the receiver's standing" to enter a global settlement with the underwriters; and (2) what property comprised the receivership estate and, therefore, was subject to a district court's *in rem* jurisdiction.[25] With respect to the first issue, the Fifth Circuit emphasized the established principle that a receiver may only settle claims that it has standing to assert.[26] As the court explained, "Like a trustee in bankruptcy ... an equity receiver may sue only to redress injuries to the entity in receivership, corresponding to the debtor in bankruptcy."[27] Turning to the scope of the assets of the receivership estate, the court noted that a "court may not exercise unbridled authority over assets belonging to third parties to which the receivership estate has no claim."[28]

With these limitations and the general principles governing equity receiverships in mind, the court explained that "a district court's *in rem* jurisdiction over [a receivership] estate may [not] serve as a basis to permanently bar and extinguish independent, non-derivative third-party claims that do not affect the *res* of the receivership estate."[29] Therefore, the Fifth Circuit held that the district court lacked jurisdiction to "authorize a ... settlement with liability insurers that enjoins independent third-party claims against the insurers" when those claims were made against proceeds that were "truly *not* property of the Estate."[30] As a result, the Fifth Circuit vacated the district court's settlement and bar orders, and remanded for further proceedings.[31]

A Receiver's Settlement Authority Is Limited to the Appointing Court's *In Rem* Jurisdiction

As the Fifth Circuit explained, "The prohibition on enjoining unrelated, third-party claims without the third parties' consent ... is a maxim of law not abrogated by the district court's equitable power to fashion ancillary relief measures."[32] As the court emphasized, "federal district courts have no greater authority in equity receiverships to ignore these bedrock propositions, because a court in equity

13 Unlike the Bankruptcy Code, *see* 11 U.S.C. § 541, no statute defines the scope of property of a receivership estate.

14 Fed. R. Civ. P. 66. For a discussion of the relative benefits of imposing a receivership over a debtor, as opposed to the placing the debtor into bankruptcy, *see* Jack Tanner, "Equitable Receivership as an Alternative to Bankruptcy," 40 *The Colo. Lawyer* 41 (December 2011).

15 *Gordon v. Washington*, 295 U.S. 30, 37 (1935); *see also Gilchrist v. Gen. Elec. Capital Corp.*, 262 F.3d 295, 302 (4th Cir. 2001) ("[T]he district court has within its equity power the authority to appoint receivers and to administer receiverships.") (citing Fed. R. Civ. P. 66).

16 28 U.S.C. § 754.

17 *SEC v. Safety Fin. Serv. Inc.*, 674 F.2d 368, 372-73 (5th Cir. 1982) (citing *SEC v. Lincoln Thrift Assoc.*, 577 F.2d 600, 606 (9th Cir. 1978)).

18 *See SEC v. Stanford Int'l Bank Ltd.*, 424 F. App'x 338, 340 (5th Cir. 2011) ("It is axiomatic that a district court has broad authority to issue blanket stays of litigation to preserve the property placed in receivership pursuant to SEC actions."). *See also Louisville Joint Stock Land Bank v. Radford*, 295 U.S. 555 (1935); *Mellen v. Moline Malleable Iron Works*, 131 U.S. 352, 357 (1889) (noting that "the removal of alleged liens or [e]ncumbrances upon property, the closing up of affairs of insolvent corporations, and the administration and distribution of trust funds are subjects over which courts of equity have general jurisdiction.").

19 *Ritchie Capital Mgmt. LLC v. Kelley*, 785 F.3d 273, 278 (8th Cir. 2015) (citing *Tri-State Fin. LLC v. Lovald*, 525 F.3d 649, 654 (8th Cir. 2008)).

20 *See Pennsylvania Steel Co. v. New York City. Ry. Co.*, 198 F. 721, 738-39 (1912); *Conklin v. United States Shipbuilding Co.*, 136 F. 1006, 1007-09 (C.C.D. N.J. 1905).

21 *Janvey v. Alquire*, No. 3:09-cv-0724, 2014 WL 12654910, at *17 (N.D. Tex. July 30, 2014); *see also SEC v. Wealth Mgmt. LLC*, 628 F.3d 323, 334 (7th Cir. 2010) ("The goal in both securities-fraud receiverships and liquidation bankruptcy is identical — the fair distribution of the liquidated assets.").

22 *Duparquet Huot & Moneuse Co. v. Evans*, 297 U.S. 216, 221, 56 S. Ct. 412, 414, 80 L. Ed. 591 (1936).

23 *See Stanford Int'l Bank Ltd.*, 927 F.3d at 840-42.

24 *See id.* at 837-39.

25 *Id.* at 841-42.

26 *Id.* at 841.

27 *Id.* (quoting *Scholes v. Lehmann*, 56 F.3d 750, 753 (7th Cir. 1995)). *See also DSQ Prop. Co. Ltd. v. DeLorean*, 891 F.2d 128, 131 (6th Cir. 1989) ("[A] trustee, who lacks standing to assert the claims of creditors, equally lacks standing to settle them.").

28 *Stanford Int'l Bank Ltd.*, 927 F.3d at 841.

29 *Id.* at 843.

30 *Id.* at 841-42 (citing *Matter of Zale Corp.*, 62 F.3d 746 (5th Cir. 1995); *In re Vitek*, 51 F.3d 530, 536 (5th Cir. 1995); *In re SportStuff Inc.*, 430 B.R. 170, 175 (8th Cir. B.A.P. 2010)) (internal quotation marks omitted; emphasis in original).

31 *Id.* at 851.

32 *Id.* at 842.

may not do that which the law forbids."[33] These bedrock propositions prevent district courts from granting receivers "unbridled discretion to terminate the third-party claims against a settling party that are unconnected to the *res* establishing jurisdiction."[34]

When vesting control over an entity and/or its assets pursuant to 28 U.S.C. § 754 and Rule 66 of the Federal Rules of Civil Procedure, district courts often model the scope of the receivership estate along the outlines of property of a bankruptcy estate under the Bankruptcy Code.[35] Section 541 of the Bankruptcy Code defines "property of the estate" to include "all legal or equitable interests of the debtor in property as of the commencement of the case" wherever located and by whomever held.[36] Although the powers of a federal court to fashion appropriate relief — including the scope of assets, powers and rights vested in the receiver and receivership estate — are broad, "[n]either a receiver's nor a receivership court's power is unlimited."[37]

Per the Fifth Circuit, a district court's power to fashion and impose relief without the express consent of all affected parties is limited to the *res* over which the court has jurisdiction.[38] Of course, parties may voluntarily agree to release and waive their rights to assert claims, and a district court may approve and enforce a consensual agreement. Likewise, a court may fashion appropriate relief over the objections of nonconsenting third parties, provided that such relief is "fair and equitable and in the best interests of the receivership estate."[39] However, such relief is only fair and equitable where the claims are property of the estate, as in the case of general or derivative claims.[40] "Equity must follow the law, which ... constrains the court's and Receiver's authority to protecting the assets of the receivership and claims directly affecting those assets."[41]

Conclusion

When presented with the issue, circuit courts have held that a district court's power to authorize a receiver to settle claims is limited to the claims in the receiver's possession. As a result, receivers have no power to settle independent, non-derivative claims belonging to a nonconsenting third party.[42]

Practitioners should carefully draft proposed receivership orders to specifically identify assets included in the receivership estate and the receiver's powers with respect to estate assets. In addition, practitioners should understand the applicable law of the receivership jurisdiction when negotiating and seeking approval of settlements, particularly with insurers that almost always require bar orders to insulate themselves from further exposure, and consider the possibility and associated burdens of protracted litigation over the issues of standing and property of the receivership estate when seeking authority to settle estate claims that could impair the rights of third parties.

Failing to take these various issues into account could result in a "catch-22" for receivers and receivership estates. While a receiver most often settles claims to promote the interests of the estate by limiting further litigation expenses, a protracted dispute with third parties impacted by the settlement may cause the estate to incur additional, substantial litigation expenses while ultimately not receiving the benefit of its bargain under the settlement (*i.e.*, the settlement proceeds) — the exact opposite result that the receiver intended to achieve by entering into the settlement in the first place.

These authorities could also prove influential in the bankruptcy context, where their reasoning could apply with equal force to nonconsensual third-party releases.[43] After all, if a district court lacks the jurisdiction and equitable power to approve a settlement of such claims by a receiver, how can a bankruptcy court with more limited equitable power approve nonconsensual releases of third-parties' claims against nondebtors?[44] abi

33 *Id.* at 842-43 (quoting *United States v. Coastal Ref. & Mktg. Inc.*, 911 F.2d 1036, 1043 (5th Cir. 1990)) (internal quotation marks omitted).
34 *Id.* at 843.
35 *See, e.g., VC Macon GA LLC v. Va. College LLC, et al.*, Case No. 5:15-cv-00388-TES, ECF No. 26 (M.D. Ga.) (order appointing receiver).
36 11 U.S.C. § 541(a).
37 *Stanford Int'l Bank Ltd.*, 927 F.3d at 840 (citing *Whitcomb v. Chavis*, 403 U.S. 124, 161 (1971) ("The remedial powers of an equity court must be adequate to the task, but they are not unlimited.")).
38 *Id.* at 844.
39 *Id.* at 840 (quoting *Ritchie Capital Mgmt. LLC*, 785 F.3d at 278).
40 *Id.* at 847-48 ("As discussed above, the Receiver lacked standing to settle independent, non-derivative, noncontractual claims of these Appellants against the Underwriters.").
41 *Id.* at 848.
42 Notably, the only other circuit court to tackle this issue agreed with the Fifth Circuit's *SIB* holding. *See Digital Media Solutions LLC, et al. v. S. University of Ohio LLC, et al.*, 59 F.4th 772 (6th Cir. 2023). In *Digital Media Solutions LLC*, the Sixth Circuit reversed and remanded the district court's order approving a settlement of the nondebtors' claims and order barring the assertion of those claims by nondebtors, holding that "[t]he district court lacked *in rem* jurisdiction over the nondebtor assets that its Bar Order covered." *Id.* at 790.
43 *See Harrington v. Purdue Pharma LP*, 69 F.4th 49 (2d Cir. 2023), *cert. granted*, 144 S. Ct. 44 (Aug. 10, 2023).
44 *See Norwest Bank Worthington v. Ahlers*, 485 U.S. 197, 206 (1988) ("[W]hatever equitable powers remain in the bankruptcy courts must and can only be exercised within the confines of the Bankruptcy Code.").