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Bankruptcy and Receivership

INVESTORS SUSPECT THEY WILL LOSE when a business is taken over by involuntary bankruptcy, receivership, or conservatorship. Certainly they will lose more than if promises were fulfilled, but there is a lack of information about how investors are affected by such takeovers. This chapter is intended to fill that vacuum. You may be distressed by what you learn, but there are actions that you—with others in your situation—can take to change the way government agencies misuse your trust and your money.

Bankruptcy is usually unavoidable when a company is insolvent. And there is no alternative to it if a company is completely fraudulent, as with Ponzi schemes; action must be taken to prevent the company from luring new victims. But receivership and its cousin, conservatorship, are such extreme actions they should never be ordered unless there are compelling reasons based on irrefutable evidence.

The objective of any of these forms of business takeover is to marshal all assets, liquidate them (convert them into cash), then develop and implement a plan to distribute the funds. As with class action lawsuits, the ostensible reason is to return money to investors. And just as with class action lawsuits, what actually happens is that lawyers get all the peanuts and investors get peanut shells.

About Bankruptcy

Voluntary bankruptcy occurs when an insolvent business files for bankruptcy protection.¹ Involuntary bankruptcy occurs when creditors with overdue accounts force a business into bankruptcy as a means of getting paid from the assets of the company.

Bankruptcy is by far the fairest of the three forms of business takeover. This is largely because bankruptcy courts are federal courts. They are governed by a group of federal laws known as the Bankruptcy Code. This creates uniformity throughout the United States. Whether the bankruptcy is filed in Utah, Florida, or Ohio, the same federal rules apply.²

The administrator of a bankrupt company is the trustee. Bankruptcy trustees usually are lawyers who specialize as full-time bankruptcy professionals. They are appointed by a bankruptcy court and charged with supervising the affairs of the business that is in bankruptcy. Trustees determine assets and debts, marshal (gather) and manage the assets if necessary, and report to the court. Other professionals such as attorneys, accountants, auctioneers, investment advisors, “turnaround specialists,” and real estate brokers may be hired to assist the trustee or the debtor-in-possession, if the debtor company is allowed to continue operating the business.³ All trustees and all hired professionals are paid from the estate of the debtors (the bankrupt company). The estate of the debtors may be referred to as “the bankruptcy estate” or “bankruptcy assets.”

Since the scope of a bankruptcy trustee’s authority as well as the amount of compensation are governed by federal law, it is not unusual for a bankruptcy court to exercise its power to reduce the compensation of trustees or other professionals if the court believes the amounts are excessive, unwarranted, or disadvantageous to the creditors.

About Receivership and Conservatorship

Bankruptcy is complicated, but it is a “cakewalk” compared to receivership and conservatorship. Receivership and conservatorship occur after a government agency petitions the court to have a company taken over. Receivership may be under the jurisdiction of either a state or a federal court; conservatorship occurs in a state court. A judge appoints a neutral person as receiver or conservator. In federal courts, receivers are attorneys or professional trustees. In state courts, where conservatorships occur, there is no requirement for receivers or conservators to be lawyers or professional trustees.

A receiver is an indifferent person appointed by the court to manage the property for the protection of its assets and for ultimate sale and distribution to creditors.⁴ The receiver’s and conservator’s duties are similar to those of a bankruptcy trustee: