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Supplemental Jurisdiction – A Receiver's Best Friend in the Age of Crypto Receiverships

By Jonathan Groth

The Practitioner's Corner is a regular feature where NAFER members can contribute their personal perspective on issues facing receivers.

It has been an inauspicious year in the world of cryptocurrency.

One of the world's largest crypto exchanges, FTX, filed for bankruptcy amid allegations of misappropriation and fraud. The NFT craze came crashing down to Earth as investors lost millions in value. Large trading and lending firms Celsius and Voyager Digital filed for bankruptcy while other funds such as the Miami-based BKCoin and Nevada- based Prime Trust were put into receivership. In addition, the increased regulatory crackdown continued as the U.S. Securities and Exchange Commission filed lawsuits against Binance and Coinbase signaling a significant step by regulators to classify cryptocurrency assets as a security requiring registration and regulation.

With this uptick in insolvency proceedings and regulatory activity, it is reasonable to expect that the crypto world will continue to see an increase in asset freezes, temporary restraining orders, and, naturally, the appointment of receivers to locate and marshal assets for the benefit of investors and creditors.

Although every receivership has its own challenges, crypto cases present a particularly complex challenge when tracing and locating digital assets, and accessing digital wallets for the purposes of freezing assets and initiating fraudulent transfer actions. Identifying and locating targets that may have received digital assets will undoubtedly require a heavy lift from the receivers' teams, particularly forensic accounting specialists. But once these assets have been located—with many likely to be out of the jurisdiction of the court appointing the receiver—the receiver must consider where and how to file an action to retrieve these assets while avoiding jurisdictional challenges that may derail the receiver's efforts. And while many cryptocurrency receivership

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cases to date have yet to address issues of supplemental jurisdiction in depth, receivers can certainly expect to see this issue become more common with crypto insolvency cases on the rise. For example, if a Florida district court appoints a receiver over a cryptocurrency fund based in Miami and the receiver discovers that the estate's coins were hidden away in cold wallets that passed through accounts in New York, Chicago, and ultimately ended up in Los Angelas, the receiver can bring a fraudulent transfer action in the appointing court in Florida under a theory of supplemental jurisdiction to expedite recovery and avoid the procedural and jurisdictional complexities, and corresponding costs, associated with recovering the assets in a California court.

The best resource for the receiver to consult on the subject of jurisdictional authority will always be the appointment order as it may include terms for the venue to bring such actions. But sometimes the appointment order is silent on this issue and the decision on where to file rests with the receiver. At times, this has proven to be a key pitfall as choosing an improper venue to pursue these claims will undoubtedly result in the case facing scrutiny over jurisdictional questions, which can result in costly speedbumps for the receiver from both a time and monetary perspective. But this problem is easily avoidable by seeking relief using the provisions of supplemental jurisdiction found in 28 U.S.C. §1367(a).

Supplemental jurisdiction, or ancillary jurisdiction as it was once known, provides federal courts with a basis for exercising jurisdiction over matters brought by receivers carrying out their duties under their appointment orders. Supplemental jurisdiction is a statutory creation that has been expanded by the U.S. Supreme Court and federal courts across the country.

Simply put, a receiver can use supplemental jurisdiction under 28 U.S.C. §1367(a) to bring claims in the district court that appointed the receiver. The language of 28 U.S.C. §1367(a) provides that, "in any civil action over which U.S. district courts have original jurisdiction, the district court shall have supplemental jurisdiction over other claims that are so related to claims in the action within such original jurisdiction that they form part of the same case or controversy."[1] Courts have long held that their exercise of supplemental jurisdiction under this statute applies to actions filed by a court-appointed receiver when such an action is intended to accomplish the ends sought and is consistent with the appointment order. The Supreme Court has continuously applied this standard since the 1899 case, *Pope v. Louisville, N.A. & C. Ry.*, and a number of federal Circuit Courts of Appeals have followed suit.[2]

By exercising supplemental jurisdiction over such a matter, the appointing court need not rely on an independent basis to hear the case.[3] The initial action which results in the appointment of the receiver is the primary action. Any action which the receiver

thereafter brings in the appointing court in order to accomplish his or her duties and obligations is considered ancillary to the primary action, and jurisdiction is therefore proper.[4]

Unsurprisingly, the Courts of Appeals have followed suit. One long-standing example comes from the Seventh Circuit Court of Appeals in *Tcherepnin v. Franz,* 485 F.2d 1251, 1255-56 (7th Cir. 1973). In *Tcherepnin*, the United States District Court for the Northern District of Illinois appointed a receiver over City Savings Association ("City Savings") following an action initiated by a group of shareholders alleging fraudulent solicitation.[5] The receiver filed claims on behalf of City Savings in the same district court, alleging that the claims were ancillary to the principal receivership action in which he was appointed.[6] The receiver alleged, among other things, fraud by certain officers and employees of City Savings, as well as third parties, and sought the imposition of a constructive trust.[7] The district court ruled in favor of the receiver and the defendants appealed to the Seventh Circuit, arguing that the District Court lacked subject matter jurisdiction over the receiver's claims.[8] The Seventh Circuit, consistent with Supreme Court's ruling in *Pope* held that:

"[T[he ancillary jurisdiction of federal courts over actions incident to a receivership established by a federal court has long been recognized. So long as an action commenced by a court-appointed receiver seeks 'to accomplish the ends sought and directed by the suit in which the appointment was made, such action or suit is regarded as ancillary so far as the jurisdiction of the… court of the United States is concerned.'"[9]

Other courts have further expanded on the types of ancillary actions brought by court-appointed receivers over which the appointing district court in the main action has supplemental jurisdiction. In particular, consistent with the ruling and spirit of the *Pope* decision, courts have ruled that the district court

will have supplemental jurisdiction over actions filed by a federal court-appointed receiver that are ancillary to the primary receivership action *even when such claims are based entirely on state law*. These cases hold that the receiver does not need an independent basis for subject matter jurisdiction in cases filed to accomplish the ends of the receivership, and some even suggest that the appointing court is the only court that has jurisdiction over such ancillary matters.[10]

As insolvency and receivership matters increase in the crypto world and in the normal course, receivers will undoubtedly continue to face challenges in working to locate and marshal assets of the receivership estate. Many cryptocurrency owners try to stay ahead of authorities in making it more difficult to trace the transfer of assets especially with the continually advancing technology for storing them—such as through use of a cryptocurrency mixer which mixes crypto transactions from different sources together in a pool, then sends the transactions to the intended addresses, effectively comingling and concealing senders and recipients. Using cold storage methods to remove assets from the digital realm and make them difficult to trace and locate is another method that will continue to present challenges to receivers and fiduciaries. But once these assets are locked down and the receiver brings a fraudulent transfer action to recover assets, any challenges to jurisdiction over third-party claims brought by the receiver that are related to the primary action and that are brought to accomplish the receiver's duties and obligations should be easily defeated if the receiver adheres to the principles of supplemental jurisdiction set forth in 28 U.S.C. §1367(a), as interpreted by the Supreme Court in the *Pope* case and subsequent rulings adopting the *Pope* standard.

ENDNOTES

[1] 28 U.S.C. §1367(a).

[2] *See Pope v. Louisville, N.A. & C. Ry.*, 173 U.S. 573, 577, 19 S. Ct. 500, 43 L. Ed. 814 (1899); *see also Oils, Inc. v. Blankenship,* 145 F.2d 354, 356 (10th Cir. 1944) ("A federal court, which has appointed a receiver in a proceeding of which it has jurisdiction, has jurisdiction to entertain a suit or proceeding to collect or recover assets.").

[3] *See id*.

[4] *See Haile v. Henderson Nat. Bank*, 657 F.2d 816, 822 (6th Cir. 1981); *see also S.E.C. v. Bilzerian*, 378 F.3d 1100, 1107 (D.C. Cir. 2004); *U.S. Small Bus. Admin. v. Integrated Envtl. Solutions, Inc.*, CIV.A. H-05-3041, 2006 WL 2336446, at *2 (S.D. Tex. Aug. 10, 2006); *Quilling v. Cristel*, CIV.A. 304CV252, 2006 WL 316981, at *4 (W.D.N.C. Feb. 9, 2006); *see also S.E.C. v. Ross*, 504 F.3d 1130 (9th Cir. 2007). Furthermore, the court that appoints the receiver has "ancillary subject matter jurisdiction of every such suit irrespective of diversity, amount in controversy or any other factor which would normally determine jurisdiction." *Crawford v. Silette*, 608 F.3d 275, 278 (5th Cir. 2010).

[5] *See* 485 F.2d at 1251.

[6] *See id*. at 1253-54.

[7] *See id*.

[8] *See id*. at 1255.

[9] *Id*., *citing Pope*, 173 U.S. 573, 19 S. Ct. 500, 43 L. Ed. 814 (1899). Other Courts of Appeals have adopted this position and followed the United States Supreme Court's ruling in *Pope*. *See Eberhard v. Marcu*, 530 F.3d 122, 128-29 (2d Cir. 2008); *Am. Freedom Train Found. v. Spurney*, 747 F.2d 1069, 1073 (1st Cir. 1984); *Merrill Scott & Associates, Ltd. v. Concilium Ins. Servs.*, 253 F. App'x 756, 761 (10th Cir. 2007).

[10] *See United States v. Franklin Nat'l Bank*, 512 F.2d 245, 249-52 (2d Cir. 1975) (concluding that an ancillary action can be brought by a federal court-appointed receiver only in the court that appointed the receiver); *Donell v. Braun*, 546 F. Supp. 2d 1013, 1016 (D. Nev. 2008) ("It is very well established that a receiver does not need an independent basis for subject matter jurisdiction in cases filed to accomplish the ends of the receivership within the court of appointment. However, the receiver's ancillary or supplemental subject matter jurisdiction exists only in the appointing court.") (citations omitted); *see also* 12 Charles Alan Wright et al., *Federal Practice and Procedure* § 2985 (3d ed. 2014) ("[I]t is clear that the mere fact that the appointment of a receiver was by a federal court does not make all actions by or against him or her cases arising under the Constitution or laws of the United States for subject-matter jurisdiction purposes in courts other than the appointing tribunal.").