A LOOK AT ARIZONA V. UNITED STATES: IT IS TIME FOR CONGRESS TO ADDRESS FEDERAL BANKRUPTCY PREEMPTION

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A LOOK AT ARIZONA V. UNITED STATES: IT IS TIME FOR CONGRESS TO ADDRESS FEDERAL BANKRUPTCY PREEMPTION

Hannah-Kaye Fleming[*]

Abstract

Many states have expanded and modified their state receivership and ABC laws to look like "mini" bankruptcy codes. This Article analyzes the bankruptcy-like provisions included in Arizona's Commercial Real Estate Receivership Statute through the lens of the Supreme Court's Arizona v. United States decision. Since before the first Bankruptcy Act was adopted in 1800, states have legislated in the realm of debtor-creditor relationships. Historically, preemption challenges to state bankruptcy-like laws have failed so long as the law did not provide a debtor with a discharge. State debtor-creditor laws, like Arizona's Commercial Real Estate Receivership Statute, have evolved in questionable ways since the Supreme Court last considered bankruptcy preemption nearly 80 years ago. Congress should use its legislative powers to clarify when states tread upon federal bankruptcy jurisdiction.

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INTRODUCTION

Congress has the power to "enact uniform laws . . . on the subject of bankruptcies."[1] While the Bankruptcy Clause gives Congress broad authority to enact legislation regulating debtor-creditor relationships, this power is not exclusively federal. For hundreds of years, and long before the federal Bankruptcy Code,[2] states regulated debtor-creditor relationships.[3] Traditionally, state debtor-creditor laws governed the formation and enforcement of contracts underlying the relations between creditors and debtors, as well as the basic rights and remedies of creditors upon default by a debtor.[4]

Common state law debtor-creditor remedies include receiverships and "assignments for the benefit of creditors" ("ABC"). A state receivership is an equitable remedy in which a court appoints a receiver to take control of a debtor's assets for the benefit of its creditors and/or equity holders.[5] The receiver typically runs the debtor's business and conducts a sale following court approval, then distributes the proceeds equitably among creditors with any surplus going to equity holders.[6] Similarly, an ABC is a business liquidation device where an assignee is appointed to liquidate a debtor's assets.[7] The assignor (debtor company) transfers its property to an assignee who then distributes the assignor's assets pro rata among creditors.[8]

State debtor-creditor laws, like receiverships and ABCs, are important remedies that provide creditors and debtors several advantages over formal bankruptcy proceedings. ABCs and receiverships are both generally cheaper,

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[1] U.S. CONST. art. 1, § 8, cl. 4.

[2] 11 U.S.C §§ 101–1532 (2022) ("Bankruptcy Code").

[3] Charles Tabb, *The History of the Bankruptcy Laws in the United States*, 3 AM. BANKR. INST. L. REV. 5, 12 (1995).

[4] Michelle Harner, *Rethinking Preemption and Constitutional Parameters in Bankruptcy*, 59 WM. & MARY L. REV. 147, 185 (2017).

[5] Keri Wintle, *State Receivership: An Alternative to Bankruptcy*, ABFJOURNAL (July 18, 2022), https://www.abfjournal.com/%3Fpost_type%3Darticles%26p%3D72054 [https://perma.cc/CZT3-HB7Q].

[6] *Id.*

[7] David Kupetz, *Assignment for the Benefit of Creditors: Effective Tool for Acquiring and Winding Up Distressed Businesses*, AMERICAN BAR ASSOCIATION (July 19, 2022), https://www.americanbar.org/groups/business_law/publications/blt/2015/11/05_kupetz/#:~:text=Kupetz,advantageous%20and%20graceful%20exit%20strategy [https://perma.cc/5Z2W-PAG9].

[8] *See* Harner, *supra* note 4, at 166.

faster, and more flexible than bankruptcy because the parties involved do not need to seek court approval for every out of the ordinary course of action.[9] These state-law alternatives may also lack the stigma that often comes with filing for bankruptcy.[10]

While the federal government has always recognized that state laws governing debtor-creditor relationships may coexist with federal bankruptcy law, state laws that mimic the Bankruptcy Code raise constitutional concerns.[11] The Supreme Court has not addressed the extent of state power over debtor-creditor relationships in over 80 years. Congress should intervene and clarify the boundaries of the Bankruptcy Clause.

In recent years, states have dramatically expanded their ABC and receivership statutes to mimic the Bankruptcy Code, allowing a receiver or assignee to assume or reject executory contracts, conduct going concern sales free of all liens and interests, and avoid fraudulent transfers and preferences.[12] Yet, these statutes do not provide the same protections as the Bankruptcy Code and may conflict with bankruptcy's goals of equitable distribution and balancing the interests of debtors and creditors.

While this Article questions provisions of Arizona's Commercial Real Estate Receivership Act, the Author respects that state law has a rightful place in the field of debtor-creditor relationships. There are many benefits to state bankruptcy-alternatives not discussed in this Article. Arizona's Commercial Real Estate Receivership Act was chosen as an example because it contains similar provisions to state laws, like Washington's Receivership Act, that have been analyzed by other scholars.[13]

Part I of this article discusses the history, purpose, and goals of the Bankruptcy Clause. Part II discusses the current bankruptcy preemption landscape. Part III discusses the Supreme Court's most recent preemption analysis in *Arizona*

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[9] Carly Landon, *Making Assignments for the Benefit of Creditors as Easy as A-B-C*, 41 FORDHAM URB. L. J. 1451, 1466 (2014) (stating ABCs are faster and cheaper than bankruptcy because they occur outside of court and do not have to follow many administrative or procedural guidelines).

[10] *Id.* at 1467.

[11] Butner v. United States, 440 U.S. 48, 55 (1979) (holding courts should look to state law to determine property rights in bankruptcy).

[12] *See* MINN. STAT. § 577.18 (2016); *see also* WASH. REV. CODE. § 7.08.030 (2017); MO. REV. STAT. § 515.500-665 (2016); OHIO REV. CODE. ANN. § 2735.04(D) (2017); FLA. STAT. § 714.06 (2020).

[13] *See* Harner, *supra* note 4, at 188.

v. United States. Finally, Part IV analyzes Arizona's Commercial Real Estate Receivership Act through the lens of *Arizona v. United States*.[14]

I. HISTORY OF THE BANKRUPTCY CLAUSE

Article I, section 8, clause 4 of the Constitution grants Congress the power to "establish uniform laws . . . on the subject of bankruptcies." However, before the first federal Bankruptcy Act in 1800,[15] states were responsible for enacting legislation regulating debtor-creditor relationships.[16] It was not until 1898 that Congress enforced a permanent federal bankruptcy regime when it enacted the 1898 Bankruptcy Act ("1898 Act").[17] Before the 1898 Act, Congress only enacted federal bankruptcy laws for short periods, normally in response to economic downturns.[18] State and federal laws regulating debtor-creditor relationships have co-existed ever since the 1898 Act.[19]

A. The Need for a Uniform Federal Bankruptcy System

The Constitutional Framers recognized the need for a federal bankruptcy system, partly because states could not effectively grant a debtor a discharge.[20] The Constitutional Framers also feared that due to the limited capabilities of the states and the variety of state laws, states would be biased toward their citizens, and inequitable results would follow.[21] In discussing the need for a federal bankruptcy system, James Madison wrote:

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[14] This article is not meant to challenge the Arizona UCRERA statute in its entirety but only uses it as an example to showcase the types of bankruptcy-like provisions it, and many other state laws, contain that raise constitutional concerns.

[15] Bankruptcy Act of 1800, ch. 19, 2 Stat. 19, *repealed by* Act of Dec. 19, 1803, ch. 6, 2 Stat. 248.

[16] *See* Tabb, *supra* note 3, at 13.

[17] *See* Tabb, *supra* note 3, at 23.

[18] *Id*.

[19] *See id*. at 24 (explaining that allowance for state exemptions "did not run afoul of the Bankruptcy Clause mandate for uniform laws.").

[20] Int'l Shoe Co. v. Pinkus, 278 U.S. 261, 263–64 (1929) ("A State is without power to make or enforce any law governing bankruptcies that impairs the obligation of contracts or extends to persons or property outside its jurisdiction or conflicts with the national bankruptcy laws.").

[21] *See* Tabb, *supra* note 3, at 13.

> The power of establishing uniform laws of bankruptcy is so intimately connected with the regulation of commerce and will prevent so many frauds where the parties or their property may lie or be removed into different States, that the expediency of it seems not likely to be drawn into question.[22]

The Bankruptcy Act of 1800 and subsequent federal bankruptcy laws were designed to have a uniform effect in all states and eliminate any opportunity for fraud based on the location of the bankruptcy proceeding.[23] In discussing the need for uniformity, the Supreme Court has acknowledged that the Bankruptcy Clause provides Congress with the flexibility to address geographic and economic issues, "but does not permit arbitrary geographically disparate treatment of debtors."[24]

B. What Is Bankruptcy?

The language of the Bankruptcy Clause is broad. The Supreme Court has recognized that the "subject of bankruptcies is incapable of final definition." It includes "nothing less than 'the subject of the relations between . . . [a] debtor and his creditors.'"[25] The Court has also interpreted the Bankruptcy Clause as "grant[ing] plenary power to Congress over the whole subject of 'bankruptcies.'"[26] In *Hanover Nat'l. Bank v. Moyses*, the Court stated that the language of the Bankruptcy Clause placed no limit on the scope of Congress's power.[27] In 2022, the Supreme Court reaffirmed this broad understanding of Congress's authority in *Siegel v. Fitzgerald.*[28]

Although the Supreme Court has not defined the limits of Congressional power under the Bankruptcy Clause, the Court has attempted to explain what the subject of bankruptcy encompasses. In *Ry. Labor Executives' Ass'n. v. Gibbons*, the Court stated that Congress's power through the Bankruptcy Clause "contemplates an adjustment of a failing debtor's obligations."[29] The power to create uniform bankruptcy laws "extends to all cases where the law causes to be

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[22] JAMES MADISON, THE FEDERALIST NO. 42.

[23] *See* Ry. Lab. Executives' Ass'n v. Gibbons, 455 U.S. 457 (1982).

[24] Siegel v. Fitzgerald, 142 S. Ct. 1770, 1780 (2022).

[25] Wright v. Union Cent. Life Ins. Co., 304 U.S. 502, 513–14 (1938).

[26] Hanover Nat'l Bank v. Moyses, 183 U.S. 181, 187 (1902).

[27] *Id.*

[28] *Siegel*, 142 S. Ct. at 1779.

[29] Ry. Lab. Executives' Ass'n. v Gibbons, 455 U.S. 457, 466 (1982).

distributed, the property of the debtor among his creditors."[30] Accordingly, the scope of bankruptcy, and Congress's authority to regulate bankruptcy, is extensive and opaque. In *Cont'l Illinois Nat'l Bank & Trust Co.*, the Supreme Court stated that there is no real, identifiable difference between state debtor-creditor laws and bankruptcy.[31]

While the distinguishing line between state debtor-creditor laws and federal bankruptcy laws is murky, Congress, courts, and scholars have clearly defined the goals of the federal bankruptcy system.

C. Goals of the Federal Bankruptcy System

The perception that states were unequipped to equitably resolve issues among a debtor and her creditors prompted the need for federal bankruptcy legislation.[32] The federal bankruptcy system was designed with the goal of discharging a debtor's debts and equitably distributing the debtor's property among creditors.[33] The discharge injunction provides a debtor with the opportunity to start "fresh," free of any preexisting debt. Without this discharge, debtors remain entangled in the financial woes they entered bankruptcy to escape. The Supreme Court in *Stellwagen v. Clum* noted that the opportunity for a debtor to be free from debt following bankruptcy is "of great public interest in that it secures . . . a new opportunity in life." The Court's bankruptcy jurisprudence places great emphasis on the debtor's "fresh start."[34]

The federal bankruptcy system balances a debtor's fresh start with the fair treatment of creditors. Bankruptcy attempts to provide creditors with an equitable distribution of a debtor's assets by treating similarly situated creditors equally. In *Williams v. United States Fid. & Guar. Co.*, the Supreme Court noted that "it is the purpose of the Bankrupt Act to convert the assets of the bankrupt into cash for distribution among creditors."[35] The equitable distribution of the debtor's property was an important goal of Congress and at the forefront of congressional debate

[30] *See Hanover Nat'l Bank*, 18 U.S. at 186.

[31] Cont'l Illinois Nat'l Bank & Trust Co. v. Chicago R. I. & P. R. Co., 294 U.S. 648, 667–68 (1935).

[32] *See* Tabb, *supra* note 3, at 13.

[33] Stellwagen v. Clum, 245 U.S. 605, 617 (1918).

[34] *Id.*; Neal v. Clark, 95 U.S. 704, 709 (1877); Traer v. Clews, 115 U.S. 528, 541 (1885); *Hanover Nat'l Bank*, 186 U.S. at 192; Wetmore v. Markoe, 196 U.S. 68, 77 (1904); Burlingham v. Crouse, 228 U.S. 459, 493 (1913).

[35] Williams v. United States Fid. & Guar. Co., 236 U.S. 549, 554 (1915).

when it enacted the 1898 Act.[36] Much of the 1898 Act is directed at facilitating the equitable and efficient administration of the debtor's estate.[37] Congress, the Supreme Court, and other courts across the country have highlighted the importance of equitable distribution to the federal bankruptcy system. As a result, state debtor-creditor laws that work to accomplish the goal of equitable distribution generally pass muster.[38]

The Bankruptcy Clause's history, scope, and goals are fundamental to understanding Congress's purpose and intent in implementing a federal bankruptcy regime and will serve as the backbone for the preemption analysis in section IV. The following section lays out the basic preemption framework and discusses the current bankruptcy preemption landscape.

II. FEDERAL PREEMPTION DOCTRINE AND THE BANKRUPTCY CLAUSE

A. Overview of Preemption

The Supremacy Clause provides the clear rule that federal law preempts state law.[39] There are three types of preemption: express, field, and conflict. Express preemption occurs when Congress states the supremacy of federal law over state law in the statute itself.[40] There are very few specific instances where courts have applied express preemption in the bankruptcy context.[41] For example, in *Pacific Gas & Electric Co. v. California ex rel.,* the Ninth Circuit found that the "notwithstanding" clause in § 1123(a)[42] of the Bankruptcy Code confirmed the

[36] *See* Tabb, *supra* note 3, at 25.

[37] *Id*.

[38] *See* Haberbush v. Charles and Dorothy Cummins Fam. Ltd. P'ship, 43 Cal. Rptr. 3d 814, 818 (Ct. App. 2006); Pobreslo v. Joseph M. Boyd Co., 287 U.S. 518 (1933); Stellwagen v. Clum, 245 U.S. 605 (1918); *see also* Boese v. King, 108 U.S. 379 (1883).

[39] U.S. CONST. art. VI, § 2 ("Th[e] Constitution, and the laws of the United States . . . shall be the supreme Law of the Land, and the Judges in every State shall be bound thereby, any Thing in the Constitution or Laws of any State to the Contrary notwithstanding.").

[40] *See, e.g.*, *In re* Schaefer, 689 F.3d 601, 613–14 (6th Cir. 2012) (citing R.R. Ventures, Inc. v. Surface Transp. Bd., 299 F.3d 523, 561 (6th Cir. 2002)).

[41] Dylan Lackowitz, *Federal Preemption and the Bankruptcy Code: At What Point Does State Law Cease to Apply During the Claims Allowance Process*, 9 ST. JOHN'S BANKR. RESEARCH LIBR. NO. 14 (2017); s*ee, e.g., In re* Pacific Gas & Elec. Co. v. California *ex rel.*, 350 F.3d 932, 937 (9th Cir. 2003).

[42] Unless indicated otherwise, statutory citations refer to the Bankruptcy Code.

express preemptive effect of a reorganization plan over otherwise applicable non-bankruptcy laws.[43]

In the bankruptcy context, the Supreme Court places significant focus on field and conflict preemption when determining if federal bankruptcy law supersedes a state debtor-creditor law. Field preemption applies in two scenarios. First, federal law preempts state law where the federal law "is sufficiently comprehensive to make reasonable the inference that Congress left no room for supplementary state regulation."[44] Second, federal law preempts state law where the "federal interest is so dominant, the federal system will be assumed to preclude enforcement of state laws on the same subject."[45] Conflict preemption can be broken down into "impossibility preemption" and "obstacle preemption." Impossibility preemption is present when compliance with both federal and state regulations is a physical impossibility.[46] Obstacle preemption, however, exists when state law "stands as an obstacle to the accomplishment and execution of the full purposes and objectives of Congress."[47] The attempt to achieve the same goal as federal law does not automatically save a state law from a conflict preemption challenge.[48]

B. The Current Bankruptcy Preemption Landscape

i. Supreme Court Precedent

To date, the Supreme Court has only preempted state debtor-creditor laws that granted a debtor a discharge. In *Boese v. King*, the Supreme Court assessed New Jersey's ABC law which provided, among other things, that a debtor must assign his estate of real or personal property, or both, in trust to an assignee for the benefit of all creditors.[49] As a result of the assignment, the debtor was immune from any future liability to the creditors who participated in the assignment.[50] The Supreme Court held that New Jersey's law was "undoubtedly inoperative in so far as it provided for the discharge of the debtor from future liability to creditors who came in under the assignment and claimed to participate in the distribution of the

[43] *In re Pacific Gas & Elec. Co.*, 350 F.3d at 934.
[44] *See, e.g.,* Rice v. Santa Fe Elevator Corp*.,* 331 U.S. 218, 230 (1947).
[45] *Id.* (citing Hines v. Davidowitz, 312 U.S. 52 (1941)).
[46] *See* Florida Lime & Avocado Growers, Inc. v. Paul*,* 373 U.S. 132, 142–43 (1963).
[47] *See* Crosby v. Nat'l Foreign Trade Council, 530 U.S. 363, 377–80 (2000).
[48] *See* Gade v. Nat'l Solid Waste Mgmt. Assn., 505 U.S. 88, 103 (1992).
[49] Boese v. King, 108 U.S. 379, 380 (1883).
[50] *Id.* at 381.

proceeds of the assigned party."[51] The Court, however, reasoned that the law, apart from the discharge, was valid.[52] The Court explained that because the assignment was made "without intent to hinder, delay or defraud creditors," it was valid "at least for the purpose of securing an equal distribution of the estate among all the creditors of [the debtor]."[53]

Following the Supreme Court's decision in *Boese*, the Court utilized similar reasoning to decide *Pobreslo v. Joseph M. Boyd Co.*[54] There, Wisconsin's ABC statute granted a discharge to the assignor.[55] The Court held that federal bankruptcy law preempted the discharge provision of Wisconsin's ABC.[56] The Court reasoned that the other portions of Wisconsin's ABC were "in harmony with the purposes of the federal Bankruptcy Act, given the other "provisions of [the state law] . . . serve to protect creditors against each other and go to assure equality of distribution unaffected by any requirement or condition in respect of discharge."[57] Similarly, in *Int'l Shoe Co. v. Pinkus*,[58] the Supreme Court held that Arkansas's receivership statute,[59] incentivizing creditors to consent to a discharge, was preempted and "imposed conditions which trammeled and made against equal distribution of [the debtor's] property."[60]

ii. Ninth Circuit Precedent

In 2005, the Ninth Circuit extended the bankruptcy preemption landscape, finding that federal bankruptcy law occupied the field of equitable distribution of a debtor's property to creditors.[61] In *Sherwood Partners Inc. v. Lycos Inc*., the Ninth Circuit considered whether the Bankruptcy Code preempted California's

[51] *Id.* at 385.

[52] *Id.* at 387.

[53] *Id.*

[54] Pobreslo v. Joseph M. Boyd Co., 287 U.S 518, 521 (1933).

[55] *Id*.

[56] *Id.* at 526.

[57] *Id.*

[58] Int'l Shoe Co. v. Pinkus, 278 U.S. 261 (1929).

[59] Arkansas's statute required the debtor to surrender all unexempt property, which would be transferred to a trust and held by a receiver to pay the debtor's creditors. The law also "classifie[d] creditors, prescribe[d] the order of payment for their claims and [gave] preference to those fully discharging the debtor in consideration of pro rata distribution." *Id.* at 264.

[60] *Id.* at 266.

[61] Sherwood Partners Inc. v. Lycos Inc., 394 F.3d 1198, 1203 (2005).

ABC statute, which gave an assignee the power to avoid preferential transfers.[62] The court held that, like discharge, equitable distribution of a debtor's assets is reserved for and controlled by federal law because equitable distribution of property is "one of the principal requisites of a true bankruptcy law."[63] The court reasoned:

> What goes for state discharge provisions also holds true for state statutes that implicate the federal bankruptcy law's other major goal, namely equitable distribution. Bankruptcy law accomplishes equitable distribution through a distinctive form of collective proceeding. This is a unique contribution of the Bankruptcy Code that makes bankruptcy different from a collection of actions by individual creditors.[64]

Further, the court held that California's ABC law could affect the incentives creditors may have for bringing an involuntary bankruptcy proceeding against a debtor and certainly would prevent a trustee from recovering preferential transfers that an assignee had already recovered.[65] Thus, the court found that federal bankruptcy law preempted California's preference recovery provision because it interfered with a trustee's ability to recover preferential transfers on behalf of the bankruptcy estate.

The Ninth Circuit's expansion of bankruptcy preemption in *Sherwood* is not without criticism.[66] In fact, California district courts have repeatedly declined to adopt the reasoning used in *Sherwood*, agreeing with the dissent that the majority's preemption analysis was overly broad, placing all state ABC or receivership laws on the chopping block.[67] Despite this sharp criticism, the Ninth Circuit arguably reached the correct outcome. While the Supreme Court never addressed bankruptcy preemption outside of the discharge context, its reasoning in *Boese*, *Probreslo*, and *Pinkus* emphasized the importance of the goal of equality

[62] *Id.* at 1200.

[63] *Id.* at 1203.

[64] *Id.*

[65] *Id.* at 1204–05.

[66] *See id.* at 1206 (Nelson, D., dissenting); Credit Managers Ass'n of Cal. v. Countrywide Home Loans, Inc., 50 Cal Rptr. 3d 259 (Ct. App. 2006); Haberbush v. Charles & Dorothy Cummins Fam. Ltd. P'ship., 43 Cal. Rptr. 3d 814 (Ct. App. 2006).

[67] *See Sherwood Partners Inc.*, 394 F.3d at 1206 (Nelson, D., dissenting) (explaining the majority is wrong in holding that bankruptcy's goal of equitable distribution effectively preempts any state law that seeks to achieve the same goal).

of distribution and suggested that state laws conflicting with this goal may be unconstitutional.

Post *Sherwood*, the Supreme Court in *Arizona v. United States* adopted a broader preemption analysis in the context of federal immigration. Given the development of the Court's preemption analysis and the expansion of state-debtor creditor laws, it is possible that, if properly challenged, the Supreme Court would view bankruptcy preemption differently and adopt reasoning similar to the Ninth Circuit's analysis in *Sherwood*.

III. ARIZONA V. UNITED STATES

A. The Bankruptcy Clause and the Naturalization Clause

The federal government's broad power to regulate immigration and alien status is derived from the Naturalization Clause found in Article I, Sec. 9, Cl. 4 of the Constitution. While the federal government has historically governed the admission, removal, and naturalization of aliens in the United States, the Supreme Court has acknowledged that not every state law "which in any way deals with aliens is a regulation of immigration and thus per se preempted" by the Naturalization Clause.[68] Nonetheless, the framers recognized that the power to enact uniform rules of naturalization is exclusively federal.[69]

The power to enact bankruptcy laws, like the power to regulate immigration, is derived from the Commerce Clause.[70] While states, not the federal government, have historically regulated debtor-creditor relationships, such regulation generally focused on creditor remedies, including the liquidation of a debtor's assets.[71] Since the Bankruptcy Reform Act of 1978, the federal government's breadth of regulation and control over bankruptcy is similar to its breadth of control over immigration.[72]

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[68] De Canas v. Bica, 424 U.S. 351, 354–55 (1976).

[69] Horace Cooper, *Article 1, Section 08, Clause 04 of the United States Constitution*, CONSTITUTING AMERICA (Sept. 19, 2022), https://constitutingamerica.org/march-23-2011-article-1-section-8-clause-4-of-the-united-states-constitution-%E2%80%93-guest-essayist-horace-cooper-legal-commentator-and-a-senior-fellow-with-the-heartland-institute/ [https://perma.cc/EY3U-8KY3].

[70] U.S. CONST. art. I, § 8, cl. 4.

[71] *See* Harner, *supra* note 4, at 186.

[72] The 1978 Act granted bankruptcy courts expanded jurisdiction over debtor-creditor relationships and is the bankruptcy law largely in effect today. *See* Robert

Congress enacted complex, pervasive statutory regimes to govern both immigration and bankruptcy with similar policy goals in mind. One important policy goal was to establish uniformity in treatment—of aliens under the Naturalization Clause and of debtors and creditors under the Bankruptcy Clause.[73] Both bankruptcy and immigration have a national impact on the economy, trade, investment, and tourism. Special executive agencies oversee the enforcement of immigration and bankruptcy laws in this Country.[74] Given these similarities, the Supreme Court's preemption analysis in *Arizona v. United States* should inform courts, policymakers, and Congress when considering bankruptcy preemption issues.

B. An Expanded Preemption Analysis

In *Arizona v. United States,* the Supreme Court considered whether federal immigration law preempted Arizona's "Support Our Law Enforcement and Safe Neighborhoods Act" ("S.B. 1070") which sought to discourage and deter the presence and economic activity of unlawful aliens in Arizona. Looking closely at principles of conflict and field preemption, the Supreme Court held that federal law preempted §§ 3, 5(C), and 6, of S.B. 1070.[75]

Addressing § 3, which made the failure to comply with the federal alien-registration requirements a state misdemeanor, the Court noted that Congress intended the federal government to have exclusive power to regulate the field of alien registration.[76] The Court held that "[w]here Congress occupies an entire field . . . even complementary state regulation is impermissible."[77] The Court reached this decision by examining federal law, which addresses various aspects of alien registration. The Court stated that the federal scheme was "designed as a

Jacobvitz, *A Relatively Short History of the Bankruptcy Laws in the United States*, NCBJ 93RD ANNUAL CONFERENCE BLOG (Feb. 27, 2019), https://ncbjmeeting.org/2019blog/2019/02/27/a-relatively-short-history-of-the-bankruptcy-laws-in-the-united-states/ [https://perma.cc/6BYT-MH2W].

[73] *See* Ry. Lab. Executives' Ass'n v. Gibbons, 455 U.S. 457, 458; *see also* Arizona v. United States, 567 U.S. 387, 395 (2012).

[74] The Department of Homeland Security Agencies and the Department of Homeland Security play an important role in enforcing the country's immigration laws. While to a different extent, but similarly, the United States Trustee Office oversees the enforcement of bankruptcy laws in the United States.

[75] *Arizona*, 567 U.S. at 416.

[76] *Id.* at 400.

[77] *Id.* at 401.

'harmonious whole'" and "provide[d] a full set of standards regarding alien registration."[78]

Next, the Court analyzed § 5(C) of S.B. 1070, which made it a state misdemeanor for "an unauthorized alien to knowingly apply for work, solicit work in a public place or perform work as an employee or independent contractor."[79] Federal immigration law similarly makes it illegal for employers to "knowingly hire, recruit, refer, or continue to employ unauthorized workers."[80] While violations of the federal law imposed only civil penalties, § 5(C) imposed criminal penalties.

The Supreme Court held that the structure of the federal legislation made clear Congress's decision not to impose criminal sanctions on the unauthorized employee. The Court reasoned that a "[s]tate law is preempted where it stands as an obstacle to the accomplishment and execution of the full purposes and objectives of Congress."[81] Section 5 of S.B. 1070, while attempting to achieve the same result, interfered with the "careful balance struck by Congress with respect to the unauthorized employment of aliens."[82] The Court held that a state law contrary to federal law "is an obstacle to the regulatory system Congress chose."[83]

Similarly, the Court held § 6 of S.B. 1070 was preempted because it "creat[ed] an obstacle to the full purposes and objectives of Congress."[84] Section 6 gave state officers power to arrest an unauthorized alien without a warrant if the officer had probable cause to believe the individual had committed any public offense, which made him removable from the United States.[85] The Court found that the federal statutory immigration scheme instructs when it is appropriate to arrest an alien during the removal process and sets out detailed instructions on the procedure to be followed.[86]

The Court's decision in *Arizona v. United States* seems to suggest that both state laws that parallel or mimic federal law and state laws that impede the purpose and objective of federal law may be preempted. The reasoning of *Arizona v. United States* calls into question the constitutional validity of state ABC and receivership laws that mimic the Bankruptcy Code.

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[78] *Id.*
[79] *Id.* at 403.
[80] *Id.* at 404.
[81] *Id.* at 406.
[82] *Id.*
[83] *Id.*
[84] *Id.* at 410.
[85] *Id.* at 407.
[86] *Id.*

IV. THE PROPRIETY OF STATE BANKRUPTCY-LIKE LAWS: ARIZONA'S COMMERCIAL REAL ESTATE RECEIVERSHIP STATUTE

The National Conference of Commissioners on Uniform State Laws ("ULC") passed the Uniform Commercial Real Estate Receivership ("Model Act") in July 2015.[87] The ULC designed the Model Act with the intention that all 50 states would adopt it. Today 12 states have adopted versions of the Model Act.[88] In 2019, Arizona adopted the Uniform Commercial Real Estate Receivership Act ("UCRERA") with only a few modifications.[89]

Arizona's UCRERA generally applies to any persons who have an "interest" in most types of commercial real estate and personal property related to commercial real property.[90] Under the Act, a receiver is appointed by a state court judge to protect and manage receivership property and may operate the receivership property business.[91] In the ordinary course of business, the receiver may use, sell, or lease receivership property, and file and prosecute a cause of action or claim related to receivership property.[92] Outside of the ordinary course, and with court approval, the receiver may: obtain financing on behalf of the receivership; use, sell, or transfer receivership property; reject burdensome contracts and assume beneficial contracts; and make improvements to receivership property.[93]

Given these unique and useful powers, commentators acknowledge that Arizona's UCRERA appears to grant the receiver comparable powers to those of a bankruptcy trustee or debtor-in-possession ("DIP").[94] In fact, the comments to

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[87] Unif. Commercial Real Estate Receivership Act (2015).

[88] Michigan, Rhode Island, Connecticut, Maryland, West Virginia, Tennessee, North Carolina, Florida, Arizona, Utah, Oregon, and Nevada have all adopted versions of the Model Act. *Commercial Real Estate Receivership Act*, UNIFORM L. COMM'N (Nov. 27, 2022), https://www.uniformlaws.org/committees/community-home?CommunityKey=f8e2d89b-f300-40eb-a419-ad41902fcad2 [https://perma.cc/8QEG-RPDL].

[89] *See* ARIZ. REV. STAT. §§ 33-2601–33-2626 (2019).

[90] *See* ARIZ. REV. STAT. § 33-2603.

[91] *See* ARIZ. REV. STAT. § 33-2605.

[92] ARIZ. REV. STAT. § 33-2611(A).

[93] ARIZ. REV. STAT. § 33-2611(B).

[94] *See* Ogonna M. Brown, Rob Charles & Susan Freeman, *How the Uniform Commercial Real Estate Receivership Act May Be an Option for Business Creditors*

the Model Act direct state court judges and lawyers to consult and interpret the Bankruptcy Code in applying certain provisions of the UCRERA, prompting the question of when state laws encroach too closely upon Congress's power to establish uniform bankruptcy laws.[95]

A. AZ UCRERA's Bankruptcy-Like Provisions

i. Obtaining Financing Outside the Ordinary Course of Business

Similar to the Bankruptcy Code, a receiver under Arizona's UCRERA may, with court approval, obtain financing outside of the ordinary course of business.[96] Arizona's UCRERA is, however, silent as to the specific requirements to obtain financing outside of the ordinary course of business and the protections afforded to existing creditors.

The ability to obtain debtor financing is often the "life jacket" of a chapter 11 reorganization and is crucial to the ongoing operations of the debtor. Congress enacted § 364 to support the express purpose of chapter 11, which is to prevent premature liquidations and provide a mechanism by which a debtor can successfully reorganize.[97] Section 364 provides a detailed statutory scheme, establishing specific grounds for authorizing debtor financing and providing protections for existing creditors.[98] For example, § 364(d) allows a trustee to give a DIP lender a priming lien after the trustee has exhausted all other possible avenues for securing debtor financing under § 364.[99] Importantly, § 364 requires the trustee to provide the existing lienholder—the primed lien—adequate protection.[100] Congress's intent with respect to § 364 is clear. Section 364 strikes an equitable balance between helping ensure the debtor's fresh start or

Affected by the COVID-19 Pandemic, LEWIS ROCA BLOG (April 22, 2020), https://www.lewisroca.com/blog/how-the-uniform-commercial-real-estate-receivership-act-may-be-an-option-for-business-creditors-affected-by-the-covid-19-pandemic [https://perma.cc/AZU6-3L9T].

[95] Unif. Commercial Real Estate Receivership Act (2015).

[96] ARIZ. REV. STAT. § 33-2611(B)(1).

[97] NLRB v. Bildisco, 465 U.S. 513, 528 (1984).

[98] 11 U.S.C. § 364(c) (stating if the trustee is unable to obtain unsecured credit as an administrative expense, "the court, after notice and a hearing, may authorize the obtaining of credit or the incurring of debt—(1) with priority over any or all administrative expenses . . . (2) secured by a lien on property of the estate that is not otherwise subject to a lien; or (3) secured by a junior lien on property of the estate that is subject to a lien.").

[99] 11 U.S.C. § 364(d).

[100] *Id.*

reorganization is possible and protecting existing creditors with a secured interest in the debtor's property.[101] "Though the creditor might not receive his bargain in kind . . . [§ 364] ensure[s] that the secured creditor receives in value essentially what he bargained for."[102]

Arizona's UCRERA's debtor financing provision, as drafted, appears to interfere with the careful balance struck by Congress in enacting § 364. While the comments to the Model Act state that the ability to obtain financing outside of the ordinary course does not give a court "a blank check to authorize the receiver to borrow funds and grant priming loans . . . *except as necessary to preserve the property*.". The Model Act, its commentary, and Arizona's UCRERA are silent as to how granting a "priming loan" would affect existing creditors or the equality of distribution. For example, suppose a receiver seeks to borrow $4 million from First Bank post-receivership. The receiver in return proposes to grant First Bank a priming lien, putting Second Bank in second position. Under § 364(d), Second Bank would be entitled to adequate protection, which could take the form of cash payments, a replacement lien, or the "indubitable equivalent."[103] Yet, under Arizona's UCRERA it is unclear whether Second Bank would be entitled to the same protections, or any protections at all.

Given that two of the Bankruptcy Code's fundamental objectives are the equitable treatment of creditors and the equitable distribution of property, Arizona's UCRERA arguably "stands as an obstacle to the accomplishment and execution of the full purposes of Congress."[104] Further, § 364's pervasive and fundamentally important statutory scheme suggests that Congress has chosen to occupy the field of debtor financing. Where Congress has chosen to occupy a field, "even complementary state regulation is impermissible."[105] The Arizona's UCRERA and similar state statutes that expand a receiver or assignee's power in this regard should be questioned under principles of conflict preemption and field preemption.

[101] *See In re* Wark, 542 B.R. 529 (Bankr. Kan. 2015).

[102] H.R. REP. NO. 95-595, at 339 (1977), *reprinted in* 1978 U.S.C.C.A.N. 5963, 6295.

[103] 11 U.S.C. § 361.

[104] Arizona v. United States, 567 U.S. 387, 406 (2012).

[105] *Id.* at 401.

ii. Executory Contracts

Arizona's UCRERA also vests in a receiver the power to assign, adopt, or reject an executory contract with court approval.[106] The power to assume or reject executory contracts and unexpired leases is a unique bankruptcy power given to a DIP or trustee under § 365.[107] Section 365 is a very detailed and complicated statutory scheme, replete with special-interest provisions and exceptions to general rules. Section 365 furthers the goal of rehabilitating troubled debtors while protecting the interests of all parties.[108]

Provisions of A.R.S. § 33-2601 appear to conflict with Congress's goal of furthering a debtor's rehabilitative efforts while protecting creditor interest.[109] Unlike § 365, the AZ UCRERA does not provide a timeframe by which the receiver must adopt or reject an executory contract.[110] Arizona did not adopt the Model Act provision that requires a receiver to reject an executory contract within a reasonable time after the receiver's appointment, otherwise the contract is deemed rejected.[111] Arizona's UCRERA also does not specify the requirements for the assumption of an unexpired lease or executory contract.[112] Rather, a court may condition a receiver's assumption of an existing contract based on the "terms appropriate under the circumstances."[113]

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[106] ARIZ. REV. STAT. § 33-2616 (2019).

[107] 11 U.S.C. § 365.

[108] *See* Eagle Ins. Co. v. BankVest Capital Corp. (*In re* BankVest Capital Corp.), 360 F.3d 291, 296 (1st Cir. 2004); *see also* Data-Link Sys., Inc. v. Whitcomb & Keller Mortgage Co., Inc. (*In re* Whitcomb & Keller Mortgage Co., Inc.), 715 F.2d 375, 379 (7th Cir. 1983) ("[G]eneral principles governing contractual benefits and burdens do not always apply in the bankruptcy context.").

[109] Not only do state bankruptcy-like executory contract provisions raise constitutional preemption questions, but also should prompt concern regarding a state's power to interfere with contracts under the contract clause. *See* Harner, *supra* note 4.

[110] The Bankruptcy Code sets forth special rules regarding the time by which the trustee must act and the effect of not acting. For example, leases of nonresidential real property must be assumed or rejected within 120 days of the filing of the bankruptcy petition. *Compare* ARIZ. REV. STAT. § 33-2616, *with* 11 U.S.C § 365.

[111] Clark Hill PLC, *2019 Arizona Legislative Updates Affecting Commercial Real Estate and Lending*, JDSUPRA (June 14, 2019), https://www.jdsupra.com/legalnews/2019-arizona-legislative-updates-16115/ [https://perma.cc/B2JK-8YYW].

[112] *Compare* ARIZ. REV. STAT. § 33-2616, *with* 11 U.S.C. § 365(b)(1).

[113] ARIZ. REV. STAT. § 33-2616(A).

Furthermore, many provisions of A.R.S. § 33-2601 directly mimic the Bankruptcy Code. For example, Arizona's UCRERA copies § 365(i) in its entirety.[114] It also renders ipso facto clauses ineffective.[115] Because § 365 is vital to the goals of bankruptcy reorganization and is, therefore, a fundamental principle of bankruptcy law, state receivership and ABC laws like Arizona's UCRERA should be questioned. From § 365's statutory scheme, it seems clear that Congress intended to occupy the entire field of assuming/rejecting executory contracts. Any provision of Arizona's UCRERA directly mimicking the Bankruptcy Code's statutory framework could be found unconstitutional on field preemption grounds under the Supreme Court's reasoning in *Arizona v. United States*.

iii. Automatic Stay

Under A.R.S. § 33-2613(A), any action to enforce a judgment or a receivership lien over property or obtain possession or control over receivership property is automatically stayed upon the appointment of a receiver, subject to five delineated statutory exceptions. Before UCRERA, the court had to approve any attempt to stay actions against receivership property.[116] A party seeking to stay an action had to seek an injunction from the receivership court. While state courts have the power to enter injunctions, an automatic injunction upon the appointment of a receiver raises constitutional concerns.[117]

Arizona's UCREA's "mini" automatic stay arguably conflict with § 362 in many regards and may stand as "an obstacle to the regulatory system Congress chose."[118] First, Arizona's UCRERA does not equally apply to all creditors. Under A.R.S. § 33-2613(D)(1), the automatic stay does not apply to any act or proceeding "to foreclose or otherwise enforce a mortgage by the person seeking appointment of the receiver." The purpose of the bankruptcy automatic stay is to provide the debtor a breathing spell and prevents a "race to the courthouse" by the debtor's

[114] *Compare* ARIZ. REV. STAT. § 33-2616(F), *with* 11 U.S.C. § 365(i).

[115] *Compare* ARIZ. REV. STAT. § 33-2616(c), *with* 11 U.S.C. § 365(b)(2).

[116] *See* Brown, *supra* note 94.

[117] *See* Christopher Kaup, *Arizona's New Receivership Statute: Reviewed, Interpreted and Applied*, TIFFANY AND BOSCO (Oct. 10, 2020), https://www.tblaw.com/arizonas-new-receivership-statute-reviewed-interpreted-and-applied-part-xxii/ [https://perma.cc/3AV8-VWKY] (discussing due process concerns regarding nonparties and persons not subject to the jurisdiction of the court and property not located in Arizona).

[118] Arizona v. United States, 567 U.S. 387, 406 (2012).

creditors to collect the debtor's outstanding debts.[119] The Bankruptcy Code does not elevate certain creditors over others when it comes to the protection of the automatic stay but places all creditors on equal footing.[120]

Second, the Arizona's UCRERA treats violations of the "automatic stay" differently than Congress intended under § 362. Arizona's UCRERA treats acts in violation of the automatic stay as voidable.[121] Notably, Congress intended for violations of § 362's automatic stay to be void, rather than voidable.[122] "[T]he Bankruptcy Code does not burden the debtor with a duty to take additional steps to secure the benefit of the automatic stay."[123]

Third, the standard for violating Arizona's UCRERA's automatic stay is more stringent than the Bankruptcy Code. The *mens rea* for damages for violations of A.R.S. § 33-2613 is "knowingly," while the Bankruptcy Code requires a less stringent *mens rea*.[124] Under § 362, a creditor does not have to intend to violate the automatic stay or have knowledge he is violating the stay so long as he intended the action that violated the stay.[125]

Similar to the discharge injunction under § 524, the automatic stay is a fundamental tool afforded to a debtor and the debtor's creditors upon filing a bankruptcy.[126] Such automatic relief from the pressure of creditor demands should arguably only be available for a debtor who avails itself of the restrictions and protections set forth in the Bankruptcy Code.

iv. Treatment of After-Acquired Property

Finally, Arizona's UCRERA arguably conflicts with Congress's treatment of after-acquired property under the Bankruptcy Code. Under A.R.S. § 33-2609, a secured lender's pre-appointment security agreement covering after-acquired property is effective against property acquired after the receiver's appointment. By contrast, the filing of a bankruptcy petition terminates the effectiveness of an after-

[119] Dean v. Trans World Airlines, Inc., 72 F.3d 754, 755–56 (9th Cir. 1995).

[120] *See* Harner, *supra* note 4, at 195.

[121] ARIZ. REV. STAT. § 33-2613(E).

[122] *In re* Schwartz, 954 F.2d 569, 571 (9th Cir. 1992).

[123] *Id.* at 572.

[124] *Compare* ARIZ. REV. STAT. § 33-2613(f), *with* 11 U.S.C. § 362(k).

[125] *See* City of Chicago v. Fulton, 141 S. Ct. 585 (2021); Taggart v. Lorenzen, 139 S. Ct. 1795 (2019).

[126] *In re* Pioneer Commercial Funding Corp., 114 B.R. 45, 48 (Bankr. S.D.N.Y. 1990) (holding the automatic stay is crucial for the benefit and protection of creditors and the central bankruptcy objective of equal treatment of creditors).

acquired property clause contained in any pre-petition security agreement entered into by the debtor.[127] This one small difference may provide secured creditors in a state proceeding a unique advantage and sufficiently worsen the position of unsecured creditors; whereas, under the Bankruptcy Code, any excess value in property may inure the benefit of unsecured creditors.[128]

B. Why It Matters

Arizona is not the only state to expand its receivership and/or ABC laws to look more like mini bankruptcy codes. Similar remedies available under Arizona's UCRERA are available in Minnesota, Missouri, Washington, and Florida.[129] Although the automatic stay, ability to assume and reject contracts, and obtain debtor financing, like the discharge injunction, are "hallmarks" of the Bankruptcy Code, there have been few, if any, legal challenges to the validity of these state bankruptcy-like laws.

The Supreme Court made clear in *Pinkus* that "[s]tates may not pass or enforce laws to interfere with or complement the Bankruptcy Act or to provide additional or auxiliary regulations."[130] However, as the law stands today, the only clear boundary states have is the discharge restriction.[131] The Supreme Court has not considered bankruptcy preemption since 1933.[132] To what extent state bankruptcy-like laws, like Arizona's UCRERA, would withstand preemption challenges under modern jurisprudence is uncertain. Congress should more clearly define the relationship between the Bankruptcy Clause and state debtor-creditor laws. The failure to do so risks the defederalization of bankruptcy, imperiling the goals the Constitutional Framers sought to achieve through the Bankruptcy Clause, namely uniformity and the equitable treatment of creditors.

CONCLUSION

There is no question or debate that state debtor-creditor laws, like receiverships and ABCs, are beneficial tools and are generally valid. It is also settled that state statutes providing a discharge of a debtor are unconstitutional so

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[127] *Compare* ARIZ. REV. STAT. § 33-2609, *with* 11 U.S.C. § 522.

[128] Harner, *supra* note 4, at 199–200.

[129] *See* MINN. STAT. § 577.18 (2016); *see also* WASH. REV. CODE. § 7.08.030 (2017); MO. REV. STAT. § 515.500-665 (2016); FLA. STAT. § 714.06 (2020).

[130] Int'l Shoe Co. v. Pinkus, 278 U.S. 261, 265 (1929).

[131] *See generally* Boese v. King, 108 U.S. 379 (1883).

[132] *See* Pobreslo v. Joseph M. Boyd Co., 287 U.S. 518, 525–26 (1933).

long as a federal bankruptcy system is in effect. Based on the Supreme Court's reasoning in bankruptcy preemption cases, like *International Shoe Co v. Pinkus*, the presence of a discharge provision should not be the sole determining factor of whether a state debtor-creditor law passes constitutional muster. However, what additional criteria should be considered are matters of uncertainty and confusion. After nearly 125 years of continuous federal bankruptcy legislation, the parameters of state law power in the area of debtor-creditor relationships remain unclear.

Provisions of Arizona's UCRERA, like many states' receivership and ABC laws, while addressing precisely the same subject matter as the Bankruptcy Code, do not provide the same protections and, in some instances, appear to conflict with the goals of the Bankruptcy Code. If a receiver or assignee may achieve similar results and gain similar powers under a state ABC or receivership statute as a DIP or trustee in bankruptcy, and thus essentially have a choice of whether to rehabilitate under federal law or state law, the Constitution's goal of creating a uniform bankruptcy system is at risk.

Congress should amend the Bankruptcy Code to define the breadth of the Bankruptcy Clause and the power of states to legislate in the field of debtor-creditor relationships. The current failure to question these expanding state laws puts at risk the fundamental purposes of the Bankruptcy Code, including the equitable treatment of similarly situated creditors, and undermines the Bankruptcy Code, the role of federal bankruptcy judges, and the Supremacy Clause.