

RECEIVERSHIP ISSUES: What you need to know now!

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The Essentials: FAQ's

Q. What is a Receiver?

A. A neutral person who is appointed by a Court to take temporary possession of property belonging to one or more litigants.

Q. Does there have to be a lawsuit filed in order to get a Receiver appointed?

A. Yes

The Essentials: FAQ's

- Q. What is the interplay between a bankruptcy and a receivership?
- Receiverships normally primarily benefit the secured creditor and not the borrower
 - Receivers are normally not accountable to unsecured pre-receivership creditors of the borrower, nor face any interference from a Committee of Unsecured Creditors
 - A bankruptcy by the borrower is usually more expensive for the secured creditor because of the necessity of dealing with multiple constituencies that do not exist in a receivership
 - Bankruptcies involve more judicial oversight than receiverships
 - Borrower has the ability to restructure the secured creditors' obligations in a bankruptcy, which is not available to a borrower in a receivership

Junior Secured Creditor's Appointment of Receivers

- Can a junior secured creditor obtain the appointment of a receiver, even though there is a senior secured creditor that has first lien on rents?
- What actions can the senior secured creditor take if a junior secured creditor has a receiver appointed?
- Are there some advantages to a senior secured creditor if the junior secured creditor takes the laboring oar to appoint a receiver?

Q. Does there have to be a lawsuit filed in order to get a Receiver appointed?

A. Yes

FAQ's continued

Q. Can a defendant ask that a Receiver be appointed?

A. Yes, but it is uncommon

Usual circumstances include:

- Borrower sues a Lender and Lender files a cross-complaint to collect the loan and appoint a Receiver
- One partner sues another partner and second partner files a cross-complaint and asks to appoint a Receiver

Q. Who can be a Receiver?

A. There are no statutory requirements.

Q. Who cannot be a Receiver?

A. A party, attorney of a party, interested person or relative of the judge

Q. Can I make a deal with the proposed Receiver...

- To manage the property after I foreclose?

A. No

- As to compensation and how he or she will manage the property?

A. No

FAQ's continued

Q. How does the Court choose who to appoint as Receiver?

A. It is up to the judge, but the parties usually nominate

Q. What types of Receivers are there?

A. 1. Rents and profits receivers; 2. Equity receivers

Q. Is the Receiver liable for debts incurred by the Borrower prior to the appointment of the Receiver?

A. No

Q. Can a receiver sue?

A. Yes

Q. Can a receiver abandon assets that are too costly to maintain?

A. Yes

When Would a Lender Consider Moving to Appoint a Receiver?

- Real estate loans are in default
- To collect rents
- A responsible neutral person is needed to care for distressed assets
- To collect assets and liquidate collateral



Disposition of Assets: What Can the Receiver Do?

- Secures control over premises
- Inventories: tangible and intangible assets
- Recovers property
- Begins to collect accounts and rents

Disposition of Assets: What Can the Receiver Do?

What issues arise in connection with a receiver's sales of real property?

- A trial court in San Jose recently held that the protections afforded borrowers by the California foreclosure laws prohibit sales of real property by rents, issues and profits receiver.
- Was this a correct decision?
- Issues you need to be concerned with in connection with receivership sales of real property – working closely with a title insurance company to insure the sale and to determine what conditions the title insurance company will impose on insuring the sale
- Can a receivership sale realistically close over the objection of the borrower?
- How does a receiver deal with paying mechanics' liens and other subordinate liens which have been recorded against real property in connection with a receivership sale?
- Does California law provide that junior liens on real property can be extinguished in a receiver sale?

Disposition of Assets: What Can the Receiver Do?

Receiver's approach to dealing with pre-receivership contracts of the borrower defendant.

- The receiver's ability to assume or reject pre-receivership contracts of the borrower.
- Can a receiver appointed over a hotel reject a burdensome franchise agreement? Is this a wise move?
- How does a receiver deal with pre-receivership union contracts of the borrower?
- What steps can a receiver take to lease out vacant property in an asset over which he or she is appointed?
- What practical issues arise in connection with a receiver's entering into lease negotiations, including obtaining court approval of the proposed lease and convincing the secured creditor to enter into a SNDA so the lease survives the secured creditor's foreclosure
- Should a receiver enter into leases if the secured creditor's ultimate goal is to have the receiver sell the property over which he or she has been appointed?

Real Estate Foreclosures

Most common Receivership is where there is a monetary default and an income-producing property

- Lender commences judicial foreclosure and asks the Court to appoint the Receiver to collect rents, **and** records a Notice of Default under the Deed of Trust to begin nonjudicial foreclosure
- Lender must choose between foreclosing nonjudicially at a trustee's sale or obtaining a decree of foreclosure in Court
- Election of remedies not final until auction completed or Court enters judgment

Real Estate Loans: Nonjudicial Foreclosure (Trustee's Sale)

- Receiver collects rent for 3 months and 20 days – the notice period before a sale can take place in California
- Receiver pays expenses, including his or her fees and counsel's fees from rent collected
- Balance paid to Lender at end of Receivership



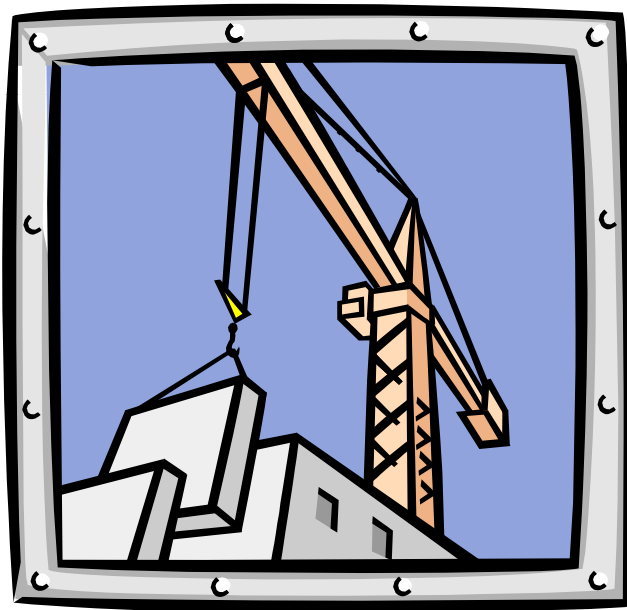
A trustee's sale is an auction.

Real Estate Loans: Judicial Foreclosure

- To recover a substantial deficiency, Lender can choose to foreclose judicially
- Borrower has one year to pay debt and redeem property in California
- Receiver remains in possession during this year

Real Estate Loans

A Receiver may be appointed if the Borrower:



- Fails to complete construction
- Fails to make repairs
- Denies Lender the right to inspect for environmental hazards

Procedures for Requesting Receivership Appointments

- When?
 - When the lawsuit is filed
 - But can move anytime during the lawsuit
- How?
 - Ex Parte Motion
 - Noticed Motion

Procedures for Requesting Receivership Appointments: Ex Parte Motions

Counter-arguments to Receiver is a drastic remedy

- Irreparable injury not needed if default under Assignment of Rents
- Deed of Trust or Security Agreement may include agreement to appointment of a Receiver
- A Receiver Costs Too Much
 - **Paid out of estate**
 - **Lost rents and profits**
 - **Plaintiff ultimately responsible for expense of Receivership**
 - **Provides management services Defendant should be providing but is not, such as property management and competent business operations**
 - **Stops embezzlement or theft**

Procedures for Requesting Receivership Appointments

Noticed Motion

- If no irreparable injury, must proceed on a noticed motion

Order Appointing Receiver

- Source of power

How to Supplement Receiver's Powers

- Petition Court for instructions and seek orders authorizing specific actions

Receiver's Bond

- The Receiver will faithfully discharge duties and comply with the Court
- In addition to ex parte bond

Receiver's Powers

- Receiver must keep funds in insured accounts, maintained by licensed securities dealers and **not** in the Bank that is a party to the action.

Sale of Property

- A Receiver may sell property of estate **only** after order of the Court

After Reinstatement

- No statutory provisions address turnover of possession after reinstatement
- Provide for turnover after reinstatement in Order Appointing Receiver
- Order Approving Final Accounting should include explicit instructions as to disposition of assets in possession of Receiver

Administrative Insolvency

- Receiver should consider solvency of estate at outset and throughout the assignment
- Seek consensual solution
- Ask Plaintiff to lend money to Receivership estate and issue Receiver's certificates
- Petition for Instructions or Move for Discharge

Receiver's Certificates

- Receiver borrows money to sustain operations of illiquid enterprise/property by selling “Receiver's Certificates” (almost always to secured creditor).
- Certificates bear interest and have priority over all debts except administration of the Receivership estate.

Receiver's Monthly Reports

- Report to parties and (if requested) non-parties
- Lenders entitled to reports if Borrower's principals caused appointment of Receiver
- Not filed with Court
- Narrative of events, financials, reports, fees

Receiver's Fees

- Receiver and counsel must seek Court approval of fees on interim and final basis
- Paid out of assets of Receivership
- Appointing party can be held liable for payment if estate is insolvent

Receiver's Final Account

- Final account and report must be approved by the Court

Borrowers in Chapter 11

- Seeking to keep control of property, Borrowers often file Chapter 11 when a Receiver is appointed.
- Borrowers often fail to comprehend the serious fiduciary responsibilities that Debtors-in-Possession owe to Creditors

Receiver's Response

- Makes no further disbursements
- Delivers property to Debtor-in-Possession
- Files accounting in bankruptcy court
- After noticed hearing, Court will allow fees and costs to Receiver

Procedures: Effect of Bankruptcy on Lender

Choice #1: Deal With Bankruptcy Court

- Lender can allow Borrower to become Debtor-in-Possession

Choice #2: Move To Appoint A Chapter 11 Trustee

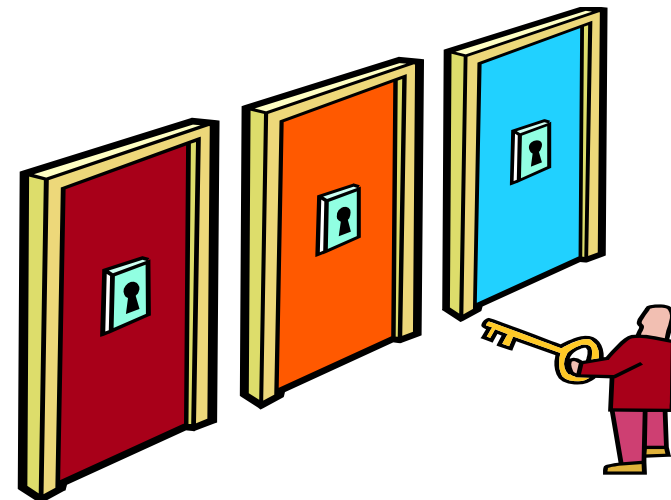
- If there is cause (usually fraud is required)

Procedures: Effect of Bankruptcy on Lender

Choice # 3: Move To Excuse Compliance In The Best Interest Of Creditors

- Under section 543 (a) and (b) of the Bankruptcy Code
- Bankruptcy courts rarely grant this motion

Which course of action is best depends on the circumstances of each case



Considerations

Lender

Borrower

Lender lacks confidence in the management skills of the Borrower	Borrower does not wish to give up control of the asset
Lender does not have the expertise to work with the Borrower to try to turn around its operations	Borrower believes that the appointment of a Receiver will destroy the Borrower's ability to voluntarily sell the asset for a profit
Lender believes the Borrower has committed financial defalcations and needs a thorough independent review of the Borrower's operations and financial record keeping	Borrower is concerned that the Receiver will discover the "skeleton in the closet" that Borrower has successfully hidden from Lender for years

Considerations

Lender

Borrower

Receiver can maximize cash because he/she is not liable for pre-appointment trade obligations and may not be making regular mortgage payments to Lender	Borrower is afraid that the Receiver will damage his delicately balanced relationships with suppliers
Lender will not advance needed funds to the Borrower, but will advance them to the Receiver through "Receiver's certificates"	"Hope springs eternal in the [Borrower's] breast . . . "
Receiver brings new "neutral" professionalism to often tense situation	Borrower assumes that the Receiver is the Lender's hired gun who is out to get the Borrower

Considerations

Lender

Borrower

Receiver takes interim control of an environmentally challenged asset	Borrower is afraid that the EPA will come after him
Receiver must deal with franchisors and other contractual relationships	Borrower fears that his or her franchise will be terminated because the Receiver was appointed
Receiver can provide accurate financial and other information about the business	Borrower fears that the Receiver will discover the true financial condition of the business and shut it down

Considerations

Lender

Borrower

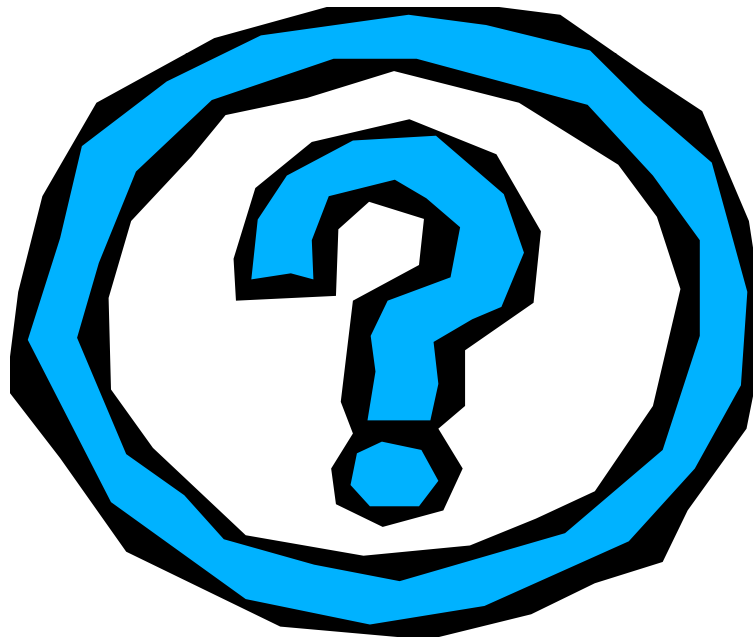
Lender is concerned about the cost of the Receivership

Borrower is concerned about the cost of the Receivership

Lender wants the Receiver to sell the business or its assets to pay off the loan

Borrower may file Chapter 11 to oust the Receiver

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