

RECEIVERSHIP 101: 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 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

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

A. No

CRC 3.1179(b)(1)

A. No

CRC 3.1179(b)(2)-(4)

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

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: A Failing Business

Borrower informs Lender that it will cease operations, but is unable to provide a plan for orderly operation

Typical fact patterns includes:

- Inventory shrinkage
- Removal of business assets
- Payments to trade creditors instead of Secured Lender
- Embezzlement



Disposition of Assets: Fraudulent Transfer of Assets

- Transferring assets to newly formed (secret) entity
- Selling inventory at a loss
- Skimming accounts
- Paying phony accounts payable

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

Q. Can the Receiver sue?

A. Yes

Q. Can the Receiver sell assets outside the ordinary course of business?

A. Only with Court approval

Q. Can the Receiver abandon assets that are too costly to maintain?

A. Yes

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
- Receiver pays expenses, including his or her fees and counsel's fees from rent collected
- Balance paid to Lender at end of Receivership

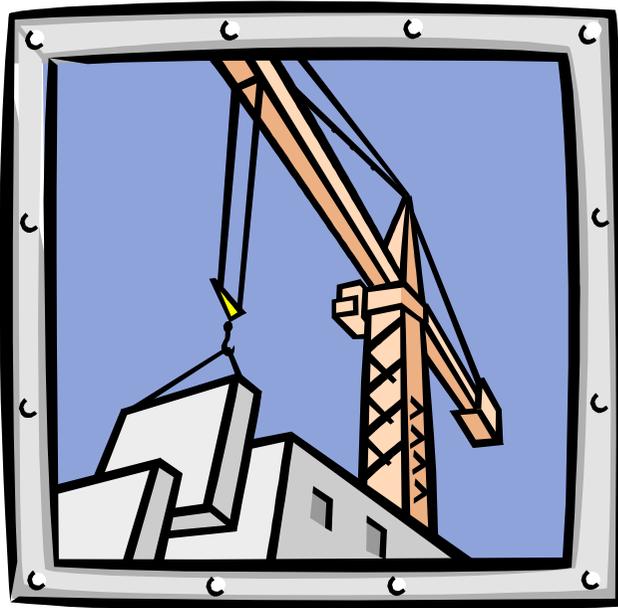


A trustee's sale
is an auction.

- To recover a substantial deficiency, Lender can choose to foreclose judicially
- Receiver acts as auctioneer
- Borrower has one year to pay debt and redeem property
- 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

Equity Receiverships

Loan in default

- To protect collateral when there are disputes among principals or owners of a business
- To protect collateral for all creditors when loan is unsecured

Collect or enforce a judgment

- To collect assets, liquidate them and pay to Lender when Borrower will not repay even after the Lender has obtained a judgment

CCP 564(b)(3)-(4)

Equity Receiverships

Preserve property

- To protect collateral where property is in danger of being lost, removed or materially injured

Business insolvency or dissolution

- To protect assets when a business is insolvent or going to be dissolved
- Corporation, LLC, partnership or sole proprietorship

Equity Receiverships

Borrower needs to borrow more

- To provide knowledgeable business management to generate funds for repayment (and any new loan made)

Deadlocked principals

- To provide knowledgeable business management when principals cannot agree how to move forward

Procedures for Requesting Receivership Appointments

- When?
 - When the lawsuit is filed
 - But can move anytime during the lawsuit
- How?
 - Ex Parte Motion
 - **Most common**
 - **Quick**
 - **Give notice before 10 AM of the previous Court day**
 - Noticed Motion
 - **16 Court days + 5 days for mailing!!**

Procedures for Requesting Receivership Appointments: Ex Parte Motions

- Why Ex Parte?
 - Defendant is:
 - In default
 - Collecting rents or accounts
 - Stealing collateral or assets
 - Dissipating collateral or assets
 - There is or will be an Irreparable Injury or an emergency
CRC 3.1175(a)(1)
- What is needed for Ex Parte relief? **CRC 3.1175-1176**
 - Plaintiff must post a bond
 - Plaintiff must show irreparable injury will occur if Receiver is not put in place immediately
 - Default under Assignment of Rents **CC 2938 (c)**
- Second Order confirming no later than 15 – 22 days

Procedures for Requesting Receivership Appointments: Ex Parte Motions

- Single assignment judges unfamiliar with Receivership
- 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** CRC 3.1175(a)(4)
 - **Stops embezzlement or theft**

Procedures for Requesting Receivership Appointments

If Ex Parte Motion is Denied

- Set hearing to appoint a Receiver
- Ask for Order Shortening Time
 - **CRC 3.1176(a) vs. CRC 3.1300(b)**
- Ask for Temporary Restraining Order (TRO) to stop Defendant from looting the Receivership estate and to keep the status quo pending the hearing on the motion to appoint the Receiver
 - Bond required for TRO **CCP 529**

Procedures for Requesting Receivership Appointments

Noticed Motion

- If no irreparable injury, must proceed on a noticed motion
- 16 Court days' notice if you're lucky

Order Appointing Receiver

- Source of power
- Judicial Counsel form

CCP 568

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 **CCP 567(b)**

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. **CCP 569**

Sale of Property

- A Receiver may sell property of estate **only** after order of the Court
CCP 568.5

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 Inventory

- Must be filed within 30 days **CRC 3.1181**

Receiver's Attorney

- Must obtain Court permission before employing counsel.

CRC 3.1180

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

CRC 3.1182

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

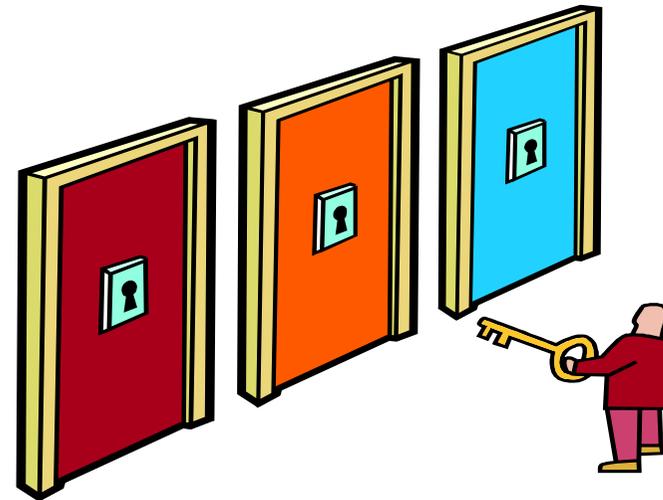
- If there is cause (usually fraud is required)

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

Questions?



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