'Tis Better to Receive - The Use of a Receiver in Managing Distressed Real Estate

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I. Introduction

Long ignored as a tool for addressing problems associated with distressed projects, state and federal court receiverships are becoming a more popular means of managing such properties. Creditors increasingly are seeking the appointment of receivers as an alternative to bankruptcy, both for managing financially troubled assets and, in some jurisdictions, for disposing of collateral. The passage of the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 ("BAPCPA") led to predictions of a new golden age for state court and federal receiverships.2

That renaissance did not occur prior to the economic downturn which began in 2008. At least one author has suggested that the expected upsurge did not occur largely as a result of lenders’ comfort level with the well-settled and clearly defined laws of the federal bankruptcy code3 (the “Bankruptcy Code”) and lenders’ unfamiliarity with receiverships.4 Further, receivership law depends on the development of that law within the specific jurisdiction in which the collateral or debtor is located.

However, lenders seem to be re-examining receiverships as an effective way to manage and dispose of distressed real estate projects. In many situations, as lenders in the current economic climate have learned, receiverships can provide a faster, more cost effective strategy for dealing with managing and disposing of troubled assets.

Unlike the law in the vast majority of jurisdictions governing receiverships, federal bankruptcy law contains well established procedures under Chapters 7 and 11 of the Bankruptcy Code for effective judicial supervision of the management of properties owned by a debtor. Few, if any, mechanisms exist outside of the Bankruptcy Code for providing a lender with proper assurances that the debtor’s assets are being properly managed, but a carefully crafted receivership order which specifically delineates a receiver’s authority offers a possibility. Receivership orders can be narrow or broad and offer considerable flexibility. However, the lack of use of receiverships for many years has created a serious consequence in addition to general unfamiliarity. Unlike federal bankruptcy law, few states have a well-developed body of statutory or case law defining the powers and liabilities of receivers.

Bankruptcy laws contain well-recognized enforcement/sale remedies such as the Section 363 sale (which the debtor/owner must initiate), the “assignment for the benefit of creditors” (again, an assignment the debtor must make per the governing statutory or common law scheme), and a consensual auction outlined via a forbearance agreement.

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Nevertheless, some debtors and lenders wish to avoid bankruptcy proceedings because bankruptcy proceedings often involve greater expense and less flexibility. State law receiverships offer a possible alternative, but only in some jurisdictions. The purpose of this paper is to outline the practicalities, pitfalls, and benefits of state court receiverships in order to assist counsel in analyzing whether a state court receiver is the appropriate vehicle for managing or disposing of a distressed asset.

II. General Law of Receiverships

A. Common Law

In the absence of specific statutory authority, a court’s power to appoint a receiver rests largely in the discretion of the court sitting in equity. Receivership had its origins in the English court of chancery at an early date. It was incidental to, and in aid of, the jurisdiction of equity to enable the court to accomplish, as far as practicable, complete justice among the parties before it. Its objective was to secure and preserve the property or thing in controversy for the benefit of all concerned pending the litigation, so that the property might be subjected to such order or judgment as the court might make or render.5

Not surprisingly, no uniform standards for the appointment of a receiver exist among the states.6 Legal and practical differences vary among the states regarding situations in which a receiver may be appointed, the standards for appointment, notice to be given to adverse parties, the burden of proof and party bearing the burden of proof, the showing required for appointment of a receiver and the amount of any required bond.

There are four types of receivers, but the two basic types of non-bankruptcy receivers are: (i) a general (or liquidating) receiver; and (ii) a special or limited receiver.7

A “general” receiver is analogous to a bankruptcy trustee under either Chapter 7 or 11 of the Bankruptcy Code in that the receiver controls all the assets and operates the debtor’s businesses with the intent of either selling such assets as a going concern or liquidating the assets. A general receiver takes charge of the business entity entirely, simply to wind up the business and distribute assets or to continue its operation as a going concern.8 The general receiver's purpose is to protect property which is directly involved in the underlying litigation where such property might otherwise be dissipated, wasted,

5 Chicago Title & Trust Co. v. Mack, 347 Ill. 480, 483 (1932).
6 A federal district court may have the power to appoint a receiver in the event a party meets the requirements for federal jurisdiction. Where federal jurisdiction does not exist, the appointment of a receiver is dependent upon the laws of a particular state.
7 The two other types of receivers are “pendente lite” and “statutory” receivers. “Pendente lite” receivers are appointed during the course of litigation. “Statutory” receivers are appointed by virtue of an enabling statute.
misappropriated or unlawfully diverted. Receivers appointed under such circumstances are generally conferred extensive authority over the entity's affairs.9 Not all states authorize the appointment of a general receiver.

A “special” or “limited” receiver only takes possession of designated assets or businesses of the debtor leaving the remainder of the debtor’s assets and businesses in the debtor’s possession. A receiver who takes charge of mortgaged real estate during a foreclosure is an example of a special receiver. Subject to statutory limitations and in contrast to federal bankruptcy law, the order appointing the receiver defines the special receiver’s powers. In other words, the order appointing the special receiver defines the power of that receiver subject to the limitations of the jurisdiction’s established case law. The court order is therefore critical in identifying the assets which constitute the receivership estate.

Unlike the bankruptcy proceeding or the general receivership proceeding, both of which involve all of a debtor’s assets, a limited receivership only involves those assets which are specifically included in the order appointing a receiver. A limited receiver has no authority over the components of the debtor’s assets or businesses not subject to the receivership. The Bankruptcy Code contains no analogous provision. Unless a real estate project is owned by single purpose entity, the limited receiver, as opposed to a general receiver, will be the type most commonly sought a by a lender seeking to manage or dispose of a real estate project. The nature of the collateral encumbered by the lender seeking the appointment of a receiver will often be determinative as to the contents of the receivership estate for the limited receiver and a court will be loathe to appoint a receiver for assets which are not subject to the lender’s liens.

Analysis of the lender’s collateral package is therefore critical in determining whether a state court receiver will be able to take possession of all of the assets needed to operate a debtor’s property or business. Failure of a lender to hold liens encumbering all of the critical permits for an operating business or architectural or engineering plans for a half-completed condominium project cripples the effectiveness of a bankruptcy trustee as well as a state court receiver from the outset.

B. State Statutes

A majority of states have enacted statutes authorizing the appointment of a receiver under various circumstances.10 Circumstances authorizing the appointment of a receiver include waste or material injury to property of the debtor, insolvency, fraud or misappropriation of corporate assets.11 Many states also provide for appointment of a

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9 Id. at 346; Duparquet Huot & Moneuse v. Evans, 297 U.S. 216, 221 (1936).
10 See generally Federal and State Court Receiverships as Alternatives to Bankruptcy—Pros and Cons, American Bankruptcy Institute, Best of Mid-Atlantic Bankruptcy Workshop ABI-CLE 3 (2005).
receiver on general equitable principles, whether the debtor is solvent or insolvent.\textsuperscript{12}

The relative ease or difficulty in obtaining a receiver often depends on the reason for the appointment. Circumstances in which a receiver may be appointed may include:

(1) Where the facts and circumstances render the appointment of a receiver an appropriate exercise of the court’s equitable jurisdiction;\textsuperscript{13}

(2) In connection with the foreclosure or enforcement of a mortgage in order to collect rents or profits, or manage, conserve, operate or even, where authorized, sell the mortgaged real estate;

(3) The existence of incomplete improvements or mechanics’ liens;\textsuperscript{14}

(4) The winding up of the affairs of a corporation that is insolvent or in danger of insolvency or has forfeited its corporate rights;

(5) The winding up of the affairs of a dissolved partnership;

\textsuperscript{12}See e.g., Pa. R. Civ. P. 1533 and \textit{Tate v. Philadelphia Transp. Co.}, 410 Pa. 490, 499-500, 190 A.2d 316, 321 (1963) (receiver may be appointed upon showing of right to such appointment, irreparable damage will in all probability result absent appointment, appointment will not substantially injure or interfere with rights of others, and greater damage will occur absent appointment; if gross mismanagement, fraud or similar circumstances); \textit{Grant v. Allied Developers, Inc.}, 44 Md. App. 560, 409 A.2d 1123 (Md. Ct. Spec. App. 1980) (court may appoint receiver on equitable grounds to preserve a corporation’s assets where actions of directors, officers, or other are \textit{ultra vires}, fraudulent, or otherwise illegal).


\textsuperscript{14}Mich. Comp. Laws §§ 570.1120-570.1123.
The winding up the affairs of a limited liability company;¹⁵

In actions between persons jointly interested in a fund;

In aid of enforcing a final judgment or in connection with supplementary proceedings;

In connection with fraudulent conveyances;¹⁶ and

In an action by a secured lender to determine the existence, location, nature and magnitude of any hazardous substance into, onto, beneath or from the real property security.¹⁷

C. Federal Common Law

Receiverships under federal law can also provide for the management and disposition of distressed assets in certain circumstances. Federal Rule of Civil Procedure 66 was amended effective December 1, 2007. As amended, Rule 66 provides that (i) the Federal Rules of Civil Procedure govern an action in which the appointment of a receiver is sought or a receiver sues or is sued; (ii) the practice in administering an estate by a receiver or a similar court-appointed officer must accord with the historical practice in federal courts or with a local rule; and (iii) an action in which a receiver has been appointed may be dismissed only by court order.

If the underlying action is filed in federal court, the plaintiff must satisfy the requirements of federal subject matter jurisdiction. Since creditor’s rights claims are not typically based upon a federal question, diversity of citizenship and the minimum amount in controversy under 28 U.S.C. § 1332 generally must exist in order to invoke federal court jurisdiction.¹⁸ Once federal court jurisdiction over the substantive dispute is established, the federal court has ancillary jurisdiction to appoint a receiver and ancillary subject matter jurisdiction over actions commenced by the receiver in carrying out the receiver’s duties.¹⁹ The minimum contacts analysis of Int’l Shoe Co. v. State of Washington²⁰ and its progeny does not apply to ancillary actions and proceedings brought by a federal receiver to execute his duties in districts other than the district in which the receiver was appointed.²¹ 28 U.S.C. § 1692 allows nationwide service of process in a

¹⁸ See Inland Empire Ins. Co. v. Freed, 239 F.2d 289, 290 (10th Cir. 1956).
²⁰ 326 U.S. 310 (1945)
federal receivership proceeding, and the territorial jurisdiction of the appointing court extends to any judicial district in which receivership property is found.

The ability to maintain diversity jurisdiction is often a factor considered in selecting a federal receiver over a state receiver. Joinder of unknown owners and non-record claimants may destroy diversity of citizenship.22 Ultimately the decision to join an unidentified party in connection with the appointment of a federal receiver for the sale of real estate should be one made by the lender after consulting with its title insurer.

The body of law developed for analyzing federal receiverships is perhaps even less developed than the law surrounding state law receiverships in many jurisdictions.

The appointment of a receiver by a federal court is an extraordinary remedy and is granted only in cases of clear necessity to protect a party’s interest in property.23 Federal courts only appoint a receiver cautiously and only when clearly necessary to preserve property pending its final disposition.24 In many respects, the appointment of a receiver is analogous to the granting of an injunction.25

Factors typically influencing a federal court’s exercise of discretion in appointing a receiver are:

(1) The existence of a valid claim of the moving party;

(2) Fraudulent conduct on the defendant’s part;

(3) Imminent danger that property would be lost, concealed, injured, diminished in value or squandered;

(4) Inadequacy of available legal remedies;

(5) The probability that the harm to the plaintiff by denial of the appointment will be greater than the injury to the parties opposing appointment;

(6) A movant’s probable success in the action; and

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(7) The possibility of irreparable injury to plaintiff’s interest in the property.  

Harking back to a court’s general equity jurisdiction, a federal court will not appoint a receiver in equity unless the appointment is ancillary to some form of final relief which is appropriate for equity to give. In other words, the appointment of a receiver is only a means to reach some legitimate end sought through the exercise of the power of a court of equity. It is not an end in itself.

D. Federal Receivership Statute

Federal court receiverships are particularly useful if the receivership assets are located in more than one state. A federal receiver may manage, operate or sell properties if the properties are located in multiple states. 28 U.S.C. § 754 provides that a receiver appointed in a civil action or proceeding involving property (real, personal or mixed) situated in different districts shall, upon giving bond as required by the court, be vested with complete jurisdiction and control of all such property with the right to take possession of such property. The purpose of 28 U.S.C. § 754 is to give the appointing court jurisdiction over property in actual or constructive possession and control of the debtor, wherever such property may be located. Accordingly, a federal receivership is particularly useful if the receivership assets are located in more than one jurisdiction.


Property in the possession of a receiver or receivers appointed by one or more district courts shall be sold at public sale in the district wherein any such receiver was first appointed, at the courthouse of the county, parish, or city situated therein in which the greater part of the property in such district is located, or on the premises or some parcel thereof located in such county, parish, or city, as such court directs, unless the court orders the sale of the property or one or more parcels thereof in one or more ancillary districts.

28 Id.
Like state law receiverships, federal receiverships have their own technical requirements for which compliance is required. For example, 28 U.S.C § 754 provides a federal receiver must, within ten (10) days of appointment, file copies of the complaint and the order appointing the receiver in each district in which receivership property is located. This statute further provides that failure to file such copies in any district divests the receiver of jurisdiction and control over property in that district. A panel of the Third Circuit Court of Appeals considering section 754, however, has held that failure of a receiver to file the required documents timely does not divest the court of jurisdiction once the documents are properly filed.

III. Governing Law

Usually, the court in which the receivership action is pending has jurisdiction over the property constituting the receivership estate.

Distressed real estate loans secured by multiple properties in multiple jurisdictions often present problems in determining applicable law. Although most of these loans contain specific choice of law provisions, these provisions may be unenforceable if the

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31 28 U.S.C § 754.

32 See S.E.C. v Equity Serv. Corp., 632 F.2d 1092, 1095 (3d Cir. 1980); but see S.E.C. v. Vision Commc’ns, Inc., 74 F.3d 287 (D.C. Cir. 1996) (receiver’s failure to file complaint and order of appointment before commencing action to enjoin interference with sale was fatal, and late filing would not revive court’s jurisdiction).

33 See generally Federal and State Court Receiverships as Alternatives to Bankruptcy—Pros and Cons, American Bankruptcy Institute, Best of Mid-Atlantic Bankruptcy Workshop ABI-CLE 2 (2005).
forum court determines that enforcement of loans or waivers of substantive rights will violate that jurisdiction’s public policies.34

Some foreclosing lenders seek to avoid choice of law problems by bringing enforcement litigation in federal court. Federal common law applies in determining whether to appoint a receiver in a diversity action.35 Federal courts are not bound by state law in determining whether an equitable remedy exists.36

However, where federal common law is to be applied, it should incorporate the applicable state law absent a compelling federal interest to the contrary.37 For example, an Illinois district court applied Illinois foreclosure law to the appointment of a receiver in order not to frustrate agreed upon commercial contracts premised on state law and to discourage forum shopping.38

On the other hand, another federal district court applied the more stringent federal standards rather than Minnesota state law in denying the appointment of a receiver to collect rent payments and manage Minnesota real estate during mortgage foreclosure proceedings.39

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34 See Lister v. NationsBank of Delaware, N.A., 329 S.C. 133, 494 S.E.2d 449 (S.C. App. 1997) (noting that South Carolina has not adopted the “most significant relationship” test to choice of law questions). South Carolina has also adopted the Uniform Commercial Code’s position regarding contractual choice of law provisions, which recognizes that “when a transaction bears a reasonable relation to this State and also to another state or nation the parties may agree that the law either of this State or of such other state or nation shall govern their rights and duties.” S.C. Code Ann. § 36-1-105(1). Courts interpreting South Carolina law have limited parties’ ability to select another forum’s law in situations where the application of another jurisdiction’s law “would be obnoxious” to South Carolina’s public policy. See Barnes Group, Inc. v. C & C Products, Inc., 716 F.2d 1023 (4th Cir. 1983). Nevertheless, in Barnes, the court observed that “not every situation where contractually chosen law diverges merely in degree from that of the state whose law would otherwise apply impinges upon the fundamental policy of that state.” 761 F.2d at 1031. Courts applying South Carolina choice of law would most likely (i) enforce a contract provision specifying the law that is to govern the contract so long as the provision which is being enforced does not result in a violation of the public policy of the State of South Carolina, (ii) apply the laws of South Carolina to matters of procedure in South Carolina, and (iii) apply the laws of South Carolina to any matter related to the creation, perfection or priority of liens or enforcement of remedies with respect to any of the collateral described in the loan documents located in South Carolina.


IV. **The Enforceability of Language in Loan Documents Consenting to the Appointment of a Receiver**

Some jurisdictions provide that a borrower’s consent in a loan document to the appointment of a receiver upon default automatically entitles the lender to the appointment of a receiver. Some states honor such provisions based on statute or case law.  

Other states give receivership clauses evidentiary weight but do not regard them as binding. For example, some courts have appointed a receiver where in the absence of such an agreement, the appointment would have been denied. In *Barclays Bank of California v. Superior Court*, the applicable statute provided that a receiver may be appointed in an action by a mortgagee for the foreclosure of its mortgage where it appears that the mortgaged property is in danger of being lost, removed, or materially injured, or that the condition of the mortgage has not been performed and that the property is probably insufficient to discharge the mortgage debt. There was no contention that the property was probably insufficient to discharge the mortgage debt. However, the trust deed recited that upon default, the beneficiary would be entitled to the appointment of a receiver. The court held that the provision was not binding, but it presented a *prima facie* but rebuttable evidence of the beneficiary’s entitlement to a receiver.

In *Riverside Properties v. Teachers Insurance and Annuity Association*, the statute at issue was almost an identical statute and the receivership clause was very similar to that in *Barclays Bank of California v. Superior Court*. The court stated that the court must look to unambiguous writing that the parties entered into as an expression of their intent. The court explained that though such a recital is not binding, it is one of the equities to be considered.

Other courts have refused to enforce receivership clauses in cases where they would have denied appointment in any event. In *Barclays Bank, P.L.C. v. Davidson Ave. Assoc., Ltd.*

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42 55 Am. Jur. 2d *Mortgages* § 952 (1996) (“[I]f the mortgage contains a provision for a receiver in case of default, the appointment will be made upon a less clear showing than is ordinarily required.”).


The prevailing view seems to be that jurisdictions do not find consents to be controlling. In South Carolina, for example, unless the appointment is governed by specific statutory law, the appointment of a receiver lies exclusively in equity. The appointment of a receiver rests in the trial court’s discretion, regardless of a provision calling for the appointment of a receiver as a matter of right. These courts typically hold that the very purpose of a receiver “is to take property... out of the possession of the person in whose possession it is found and place it in the hands of a third party pending litigation.” Courts which hold that appointment of a receiver is a matter of equity usually view an express agreement as one factor weighing heavily in favor of the appointment of a receiver.

Language in some cases which use equity as the exclusive basis in determining whether to appoint a receiver suggests that the appointment of a receiver is a drastic remedy, to be exercised with great circumspection. Federal law does not enforce provisions granting a lender the automatic right to the appointment of a receiver based on provisions of loan documents.

V. Standards for the Appointment of a Receiver in State Court Proceedings

A. Generally

Among the various states, the appointment of a receiver may be based on the court’s exercise of equity jurisdiction or an enabling statute that provides for receiverships when certain criteria are met. Courts commonly consider various factors in determining whether to appoint a receiver, some of which are not cited in applicable statutes. These factors include:

1. The existence of a valid claim of the moving party;
2. Fraudulent conduct on the defendant’s part;

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47 E.g., Pelzer v. Hughes, 27 S.C. 408, 3 S.E. 781, 785 (1887).
49 Truesdell v. Johnson, 144 S.C. 188, 197, 142 S.E. 343, 345 (1928).
50 See Truesdell v. Johnson, 144 S.C. 188, 142 S.E. 343, 345 (1928); Pelzer v. Hughes, 27 S.C. 408, 3 S.E. 781, 784-85 (1887).
(3) Imminent danger that property will be lost, concealed; injured diminished in value, or squandered;

(4) Inadequacy of available legal remedies;

(5) The probability that the harm to the plaintiff by denial of the appointment will be greater than the injury to the parties opposing appointment;

(6) Plaintiff’s probable success in the action; and

(7) The possibility of irreparable injury to plaintiff’s interest in the property.52

Some courts have appointed a receiver when current management or ownership is hopelessly deadlocked, has demonstrated a lack of trustworthiness or has acted in a manner not in the best interest of the business.53 Despite some language in case law noting the “drastic nature” of a receiver’s appointment,54 trial judges in jurisdictions using the equity analysis as a practical matter routinely appoint receivers where there is an assignment of leases, a provision in a mortgage authorizing the appointment of a receiver as a matter of right, and an issue relating to rents or to the condition of the property. Factors which seem to be important in evaluating the decision to appoint a receiver include actual physical deterioration of the estate’s assets, impairment of security, character of the property and inadequacy of the value of the assets in proportion to the debt.55

B. Mortgage Foreclosure Actions

The most frequent action seeking the appointment of a receiver is one for foreclosure of a mortgage. Courts in all states have the unquestioned equitable discretion to appoint a receiver.


54 See note 50, supra.

Under the law in some states, a receiver may be appointed if necessary to assist the mortgagee in the enforcement of an assignment of rents or upon a failure of the mortgagor to pay real estate taxes or insurance premiums, thereby committing waste.

In contrast to states which note the “drastic” nature of the remedy, some states permit appointment of a receiver without much more than a showing of a mortgagor’s default and a provision in the mortgage entitling the mortgagee to a receiver upon default. Other courts require a showing that the value of the mortgagee’s security is inadequate or actual or threatened waste. In Dart v. Western Savings & Loan Association, the mortgagee was not entitled to a receiver since the security was adequate and no waste was threatened. The court explained the reason for the rule that a mortgagee is not entitled to a receiver if the security is adequate and no waste is threatened is that, the mortgage being but a lien, the mortgagor is entitled to possession and all the benefits, such as income, which the possession of property ordinarily enjoys.

The Minnesota court in Frantz Klodt Son, Inc., required proof of three elements to justify the appointment of a receiver: (1) the mortgagor is insolvent; (2) the mortgagor is committing waste; and (3) the value of the security is inadequate to cover the mortgaged debt. In Atco Construction Development Corporation v. Beneficial Savings Bank, the trial court was held to have abused its discretion in appointing a receiver in the absence of a showing that the mortgaged property is being wasted or otherwise subject to serious risk of loss.

Some states do not require insolvency for receivership where the mortgage specifically assigns rents as security. This principle is best stated as follows:

[W]here the mortgage pledges the rents and profits and provides for the appointment of a receiver and the proof shows inadequacy of security, a receiver should be appointed without proof of insolvency.

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57 For example, Michigan law includes such a provision at Section 600.2927 which provides that mortgage may define waste to include nonpayment of real estate taxes or insurance premiums.
61 Id.
62 231 N.W.2d 350 (Minn. 1978).
Illinois permits appointment of a receiver for non-residential real estate without much more than a showing of the mortgagor’s default and a provision in the mortgage entitling the mortgagee to a receiver upon default.\(^65\) Section 5/15-1702 of the Illinois Mortgage Foreclosure Law ("IMFL") provides that “whenever a mortgagee entitled to possession so requests, the Court shall appoint a receiver.” The presumptive right to possession lies with the mortgagee of non-residential real estate. The mortgagee must simply show a right to possession in the mortgage and a default. The burden then shifts to the mortgagor to show good cause why a receiver should not be appointed.\(^66\) The IMFL provides that if the mortgaged real estate is other than residential real estate the court shall, upon request, place the mortgagee in possession if the mortgagee is so authorized by the terms of the mortgage or other written instrument, and the court is satisfied that there is a reasonable probability that the mortgagee will prevail on a final hearing of the cause except that if the mortgagor shall object and show good cause.\(^67\)

The Restatement of Property identifies two approaches to the appointment of a receiver in a lien theory state. First is the traditional rule that limits the possibility of obtaining the appointment of a receiver where neither the mortgage nor other agreement contains language mortgaging the rents or authorizing a receivership upon mortgagor default. Where this is the case, not only must the mortgage obligation be in default, but the real estate must be inadequate to satisfy the mortgage obligation and waste must be occurring or have occurred. However, where the real estate mortgage or other instrument contains language mortgaging the rents or authorizing the appointment of a receiver to take possession and collect rents upon default, the only requirement for a receivership is that the mortgagor be in default.\(^68\)

Jurisdictions which have adopted the Uniform Assignment of Rents Act have sought to establish coherent uniform standards for the appointment of a receiver. This act provides that an assignee is entitled to the appointment of a receiver if the assignor of rents is in default and either (a) the assignor has agreed in a signed document to the appointment of a receiver in the event of default; (b) it appears likely that the real property may not be sufficient to satisfy the security obligation; (c) the assignor has failed to turn over to the assignee proceeds that the assignee was entitled to collect; or (d) a subordinate assignee of rents obtains the appointment of a receiver under the law of this state other than this act.\(^69\)

The appointment of a receiver in a mortgage foreclosure action is generally ancillary to the pending foreclosure action. In states that authorize power of sale


\(^{67}\) 735 Ill. Comp. Stat. 5/15-1701(b)(1).

\(^{68}\) *Restatement (Third) of Property (Mortgages)* § 4.3 (1997).

\(^{69}\) Uniform Assignment of Rents Act § 7.
foreclosure, a mortgagee may foreclose privately without any judicial proceeding. In such states, the appointment of a receiver may be in an action by a secured lender for specific performance of an assignment of rents provision in a deed of trust, mortgage or separate assignment document. 70

C. Burden and Type of Proof

The burden and showing necessary for the appointment of a receiver also varies from state to state. For example, in Illinois, the presumptive right to possession and appointment of a receiver lies with the mortgagee of non-residential real estate. The mortgagee must simply show a right to possession in the mortgage and a default. The burden then shifts to the mortgagor to show good cause why a receiver should not be appointed. 71

Oklahoma requires the secured lender to present evidence that a condition of the mortgage has not been performed and that the mortgage instrument provides for the appointment of a receiver. 72

The ability of the mortgagee to show waste to the encumbered property seems to be the key to Florida cases. In one case, a Florida court reversed a trial court’s order appointing a receiver for mortgaged real estate where the lender failed to show either waste of the properties or any impairment of the security. 73 Another Florida court reversed an order appointing a receiver without testimony, sworn pleadings or an affidavit demonstrating “waste” impairing the security. 74

In South Carolina, the lender must establish an “apparent right to property which is the subject of the action and which is in the possession of an adverse party and the property, or its rents and profits, are in danger of being lost or materially injured or impaired . . . .” 75 Thus, appointment rests in the court’s discretion, regardless of the standard provision in most mortgages calling for the appointment of a receiver as a matter of right. 76

Relying on more traditional notions of equity, federal courts have held that appointment of a receiver is an extraordinary remedy and is granted only in cases of clear necessity to protect a plaintiff’s interest in property.  

D. Circumstances Other Than Mortgage Foreclosure

1. Ancillary Proceedings

State and federal standards for appointment in equity of a general receiver are similar. Although trial courts have broad discretion in appointing a receiver, the appointment of a receiver is a discretionary remedy which should be “exercised sparingly, with caution and circumspection, and only in an extreme case, under circumstances as demand or require summary relief.” The reason is that the appointment of a receiver is in derogation of the fundamental property right of the legal owner to possession and enjoyment of his property. The court in *Citicorp Savings v. Occhipinti* explained:

The general rule is that the applicant must show, first, that he has a clear right to the property itself or has some lien upon it, or that the property constitutes a special fund to which he has a right to resort for the satisfaction of his claim; and second, that the possession of the property by the defendant was obtained by fraud, or that the property itself, or the income arising from it, is in danger of loss from neglect, waste, misconduct or insolvency.

As an ancillary remedy in conjunction with a pending proceeding, appointment of a receiver is rarely a means within itself unless unusual circumstances warrant. The general rule is that “a receiver will be appointed only in aid of some recognized, presently existing legal right, and no appointment will be made in a case where a receivership is the sole remedy prayed for.” However, there may be exceptions to this rule created by statute or by the courts themselves and in cases of extreme necessity.

2. Business Entity Problems

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80 131 Ill. App. 3d 835 (2nd Dist. 1985).


The most common situation where a receiver is appointed other than in a mortgage foreclosure action is in the wind up of a corporation that is (i) insolvent; (ii) in danger of insolvency; (iii) has forfeited its corporate rights; or (iv) engaged in a shareholder’s dispute. In such circumstances, a shareholder or creditor generally can obtain the appointment of a receiver provided that the party seeking the appointment shows the threat of an injury which a receivership may avert.83

Many state corporation acts are based, at least in part, on the Model Business Corporation Act. Section 14.32 of the Model Business Corporation Act provides that a court in a judicial proceeding brought to dissolve a corporation may appoint one or more receivers to wind up and liquidate the corporation’s business and affairs. Delaware has a very comprehensive receivership law. Still, the appointment of a receiver will only be granted where urgent circumstances are present other than the mere collection of a debt and where some truly beneficial purpose will be served by the receivership proceeding.84

VI. The Importance of the Receivership Order

A. Generally

A receiver’s powers are generally derived from applicable statutes, common law and the order appointing the receiver. In some instances state statutory or common law may not clearly define the powers and obligations of the receiver, and these will need to be determined by the court on a case by case basis. Other states, such as Delaware and Washington, have comprehensive statutes which set forth the powers and obligations of a receiver.85

A receiver’s powers are strictly governed by the terms of the order appointing the receiver, particularly a limited receiver.86 The contents of the order appointing the receiver are critical in determining both the scope of the receivership estate as well as the powers of the receiver. In the case of limited receiverships, the receivership order defines the extent of the receivership estate. In this context, the receivership estate in cases involving a defaulted loan generally cannot exceed the collateral securing the loan. In other words, carefully delineating the scope of a receiver’s authority in the order is essential.

85 See also Federal and State Court Receiverships as Alternatives to Bankruptcy—Pros and Cons, American Bankruptcy Institute, Best of Mid-Atlantic Bankruptcy Workshop ABI-CLE 3 (2005).
As a matter of law, the appointment of a receiver puts all the property subject to the receivership into the court’s custody. As a general proposition, the authority of a receiver, particularly a limited receiver, is limited by the terms of the order.

Many jurisdictions require that a court make specific findings of fact in order to support the appointment of a receiver. The findings are generally not considered to be an adjudication on the merits. State law also often requires specific conclusions of law in order to support the receiver’s appointment. The order should contain these conclusions. A consensual or contested order should grant specific powers to the receiver, establish the limits of those powers, protect the parties, and make clear the receiver’s relationship with the property the receiver is charged with preserving.

B. The Receivership Estate

The foreclosing lender must carefully consider what property will constitute the receivership estate and whether giving possession of this property to a receiver makes economic sense. For example, giving possession of a hotel’s underlying real and personal property makes little sense if the hotel is being managed under the terms of a management agreement. In such circumstances, the manager, rather than the owner of the hotel units, effectively controls the hotel’s income stream.

One of the oft-overlooked items in the documentation of many loans is the need of the lender or the receiver to have access and rights to software, such as the reservation system of a hotel or the management software of a shopping center. Parking rights are also often a problem. Courts are generally extremely reluctant to extend the receivership order to items which do not constitute collateral for the underlying loan.

In most cases, the portion of the property usually in danger is the income stream generated by the property. The lender’s documentation is therefore critical. If the collateral package does not include all items necessary to generate the project’s income, the appointment of a receiver may be of little value to the petitioning lender. For example, problems often arise if a lien has not been granted on necessary computer software where consents to assignment of licenses may be required but may not have been obtained.

In the case of a hotel, the income stream is generated by the operating business. In the case of a shopping center or apartment complex, the income stream is the rents. If the plaintiff lender cannot establish an “apparent right to the property,” because the property was not included in the lender’s collateral package, the lender, or a receiver, may not be able to capture this income stream.

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87 See R. Clark, *Clark on Receivers* § 36 (1959) (receiver is an arm or administering hand of the court); *Atl. Trust Co. v. Chapman*, 208 U.S. 360, 372 (1908) (receiver is officer of court, and its property is in custodia legis are the same as if actual possession is with an officer of the court).

Prior to seeking a receiver, a lender should consider whether the order can effectively authorize a receiver to operate under the owner's licenses or permits, and to rely on the owner's insurance, or whether the receiver must obtain its own licenses, permits, and insurance or hire someone who has the appropriate permits and licenses. If the lender has done a good job in documenting the loan to obtain assignment of permits such as building permits, architectural plans or engineering plans, assignment of these rights, plans and permits to a receiver is not problematic so long as all required third party consents have been obtained.

Other permits are personal or held by individuals. The classic example is a liquor license. Most jurisdictions hold that liquor licenses are held by individuals and are not assignable. Consequently, a receivership order cannot order the assignment to a receiver of these types of personal permits or licenses.

C. Contents of the Order

A receivership order should minimally:

1. Explain why the receivership is needed;

2. Describe in broad terms the assets which comprise the receivership estate and identify specific, important assets;

3. Address whether the receiver is authorized to borrow money and under what terms;

4. Address whether the receiver may sell assets of the receivership estate;

5. Establish the receiver’s rights to custody of assets and records and require their delivery from the debtor;

6. Authorize the receiver to retain other support professionals;

7. Describe how the receiver will be compensated;

8. Describe whether the receiver has the right to sell, lease or dispose of assets and under what general terms;

9. Describe generally the receiver’s ability to contract with third parties for goods and services for the benefit of the receivership estate;

10. Describe the receiver’s ability to use the debtor’s permits (such as the liquor permit) and other licenses and apply for new licenses; and
(11) Establish the receiver’s obligations to file inventories, status reports and other reports regarding the receivership, its assets, its businesses and its operations.89

D. Pleadings and Notice Requirements

Lenders seeking the appointment of a receiver under state law must pay careful attention to state-specific notice requirements for debtors and other creditors, as well as state-specific pleading requirements. Most jurisdictions require a motion in order to seek the appointment of a receiver. Legal and pleadings standards vary by jurisdiction. Failure to pay close attention to these highly technical requirements can lead to the invalidation of the receiver’s appointment. Lenders are usually in a hurry to have a receiver appointed, but too much speed can have serious adverse consequences for the lender and actually slow the process of obtaining a receiver or, worse yet, impede the speed of the underlying collection action itself through an appeal of the appointment of a receiver.

State laws themselves often contain contradictory pleading requirements which only become evident in the speed by which the foreclosing lender seeks the appointment of a receiver. For example, South Carolina permits filing a motion for the appointment of a receiver with the service of a summons and complaint or at any later time but requires that the motion be accompanied by a supporting affidavit.90 However, South Carolina Rule of Civil Procedure 6(d) also requires that the supporting affidavits be served not later than two (2) days before the hearing, unless the Court permits them to be served at some later time. The affidavit must be signed by a representative of the lender or servicer who has knowledge of defaults, the collateral and the consequences of the failure to obtain a receiver.

The nature of the notice and the contents of that notice to the defaulting borrower can often be problematic. Not only will the required notice vary by jurisdiction, but the absence of developed case law or statutory direction can make proper notice an unnecessary problem.

Even within a particular state, the rules and case law regarding proper notice of a hearing to appoint a receiver, as well as the pleading requirements discussed above, may be contradictory. For example, S.C. Code Ann. § 15-65-40 (1976) appears to authorize ex parte orders appointing a receiver. On the other hand, other South Carolina Rules of Civil Procedure and statutes inconsistently mandate four (4) and ten (10) day notice of any hearing on a motion to appoint a receiver.


90 S.C. R. Civ. P. 6(d).
S.C. Code Ann. §15-65-20 (2005) provides that no receiver shall be appointed “without notice of the application for such appointment to the party. . .” This statute further provides that at “least four days’ notice of the application must be given, unless the court shall, upon it being made to appear that delay would work injustice, prescribe a shorter time.” Ordinarily four (4) days’ notice must be given to the owner and any party to the action in possession of the property or claiming an interest therein under any contract, lease or conveyance from the owner pursuant to S.C. Code Ann. § 15-65-20 (1976). On the other hand, South Carolina Rule of Civil Procedure 6(d) and case law require that motions must ordinarily be heard only upon giving at least ten (10) days’ notice. These inconsistencies create a powerful argument for a defaulting borrower that the lender must give at least ten (10) days’ notice prior to seeking the appointment of a receiver.

Further, there is some question under South Carolina law as to whether the motion to appoint a receiver should be treated as a motion for a temporary restraining order. If a lender couches the order as a temporary restraining order, state law often imposes a requirement that the lender post a bond in order to obtain the appointment of a receiver. The Court may also require a subsequent hearing in order to make a temporary restraining order permanent. South Carolina Rule of Civil Procedure 65(a) provides that no temporary injunction shall be issued without notice to the adverse party. Rule 65(b) provides that no temporary restraining order shall be granted without notice of motion for the order to the adverse party unless “it clearly appears from specific facts shown by the affidavit or by a verified complaint that immediate and irreparable injury, loss or damage will result to the applicant before notice can be served and a hearing had thereon.” If the owner cannot be found, notice to the party in possession is sufficient. If no one is in possession, notice is not necessary and the person claiming property may be served by publication.

The lender’s desire for speed in appointing a receiver and the inconsistencies regarding notice are often the recipe for a disaster to the foreclosing lender. The problem can manifest itself in the appealability of an order appointing a receiver. S.C. Code Ann. §§ 18-9-150 and 160 and South Carolina Appellate Court Rule 225 make the order

91 Id.
93 E.g., S.C. R. Civ. P. 65(c) (“no restraining order or temporary injunction shall issue except upon the giving of security by the applicant, in such sum as the court deems proper, for the payment of such costs and damages as may be incurred or suffered by any party who is found to have been wrongfully enjoined or restrained”).
94 Id. at 65(b).
appointing a receiver immediately appealable to the Supreme Court of South Carolina, without requiring the borrower to post a bond to stay the appointment of a receiver.96

VII. Qualifications for Serving as a Receiver

The discretion available to a court in appointing a receiver distinguishes the situation from the appointment of a trustee under federal bankruptcy law. As a general proposition, the court appointing a receiver, not the foreclosing lender, determines the identity of the person providing the receivership services. In bankruptcy proceedings, the identity of a Chapter 7 trustee is often determined by a specific list of Chapter 7 trustees. Bankruptcy courts possess more discretion in the appointment of Chapter 11 trustees.97 In contrast, the petitioning lender in a state receivership proceeding can propose as a receiver any person or entity it believes is best suited to manage the receivership assets instead of relying on a standing panel of bankruptcy trustees. Some courts will only appoint an individual as a receiver as opposed to a corporation for whom the individual works.

The receiver, whether in a state or federal case, serves as an officer of the court and not as the agent of any of the parties to the litigation.98 Accordingly, the receiver’s fiduciary duties run to the court, not to any particular creditor, the debtor, or any other party in interest.99 Selection of an independent, qualified receiver candidate is important in light of the receiver's duty to the court.

To the extent specialized knowledge of the business or assets is required or advisable, it is preferable to propose a candidate who possesses the required knowledge or experience. Such qualities, along with a history of prior appointment by courts to serve as a receiver or trustee, will make a candidate more inviting to the court and increase the likelihood that the court will appoint such person as the receiver. Courts, however, are not required to accept the petitioning lender’s recommendation. On the positive side, a state court generally possesses the ability to appoint a receiver with specialized knowledge of the receivership assets. By the same token, however, state law does not require the appointment of a receiver with specialized knowledge. The advantage of using a qualified state court receiver, as opposed to a panel bankruptcy trustee, is obvious.

99 Federal and State Court Receiverships as Alternatives to Bankruptcy—Pros and Cons, American Bankruptcy Institute, Best of Mid-Atlantic Bankruptcy Workshop ABI-CLE 5 (2005).
As a general rule, an attorney actively engaged in securing or opposing receivership should not be appointed receiver.100

VIII. General Powers and Limitations of a Receiver

A. In General

A petitioning lender must consider the benefits of displacing existing management as opposed to allowing the debtor to remain in possession of the property under Chapter 11 of the federal bankruptcy code. Receiverships can offer a faster, more cost-effective resolution than bankruptcy with the initiating creditor having the ability to customize the process.101 Receiverships typically do not require the filing of schedules or statements of financial affairs. Payment processes and professional fees incurred on behalf of the receiver are not as exacting as they are under the Bankruptcy Code.102 On the downside, however, unlike bankruptcy and with some exceptions, receiverships do not generally impose automatic stays on other proceedings, provide for the channeling of all claims in a single proceeding or provide for preference recovery.

State court receiverships offer both lenders and borrowers a tool for potentially avoiding liability. While some jurisdictions afford lenders the theoretical opportunity to seize rents without appointment of a receiver,103 lenders must be wary of allegations by the borrower that collection of rents has converted the lender into a “mortgagee in possession.” In some jurisdictions, notifying tenants of a property owner’s default and instructing the tenants to pay rents directly to the lender could result in allegations that the lender has become a mortgagee in possession. Under most applicable state laws, a mortgagee in possession owes a fiduciary duty to borrowers for the management of the property.104 By using a receiver, the lender avoids this potential liability. In those jurisdictions which provide a statutory right to obtain and exercise an assignment of rents on default, the exercise of the right to collect the rents should not, in itself, result in the mortgagee deemed to be a mortgagee in possession.


102 Id.

103 See e.g., S.C. Code Ann. 29-3-100 (2007) (authorizing a lender who has properly perfected a security interest in rents to notify tenants after a default of the existence of a default and to collect leases revenues and rents).

Many borrowers in the existing economic climate are seeking solely to protect themselves from allegations that they have somehow violated various non-recourse carveouts which often include personal liability for failure to apply rents properly. By seeking the appointment of a receiver to handle the property’s rents, the borrower can potentially avoid allegations of personal liability for misapplication of rents by having the receiver, an officer of the court, collect and apply rents.

Many jurisdictions do not define powers usually granted to a receiver. While a receiver’s powers are strictly governed by the terms of the order appointing the receiver, the scope of a receiver’s powers is particularly problematic in addressing a receiver’s ability to (i) borrow money; (ii) lease property; or (iii) sell assets.

B. Power to Borrow in State Court

Lenders seeking the appointment of a receiver often want a receiver to finish, protect or maintain distressed real estate projects. In this context, the two critical questions often are: (1) Does applicable law permit the receiver to borrow funds? and (2) What is the priority of any borrowings over the claims of junior lien creditors? When a construction loan is foreclosed and the project is not complete or revenues are insufficient to keep an operating business running, the lender’s attorney should consider whether the court’s inherent equity power will empower the court to authorize the receiver to contract to finish construction and to borrow additional funds secured by receiver's certificates or a judicial lien. A key question in such circumstances is whether the lender can make advances which would have priority over subordinate liens or mechanics’ liens. The priority of any such borrowings is discussed below.

Many jurisdictions only authorize the appointment of a receiver to preserve the status quo of the real and personal property subject to the lender’s liens and therefore to not permit a receiver to borrow funds other than to maintain the property. Preserving the status quo limits the receiver’s power with respect to borrowing. In these jurisdictions, it is critical to distinguish between funds borrowed to maintain a project and funds borrowed to complete a project. In some jurisdictions, receivers may borrow to complete construction projects in the hands of the receiver, which, without completion, are of little or no value.

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105 See 66 Am. Jur. 2d Receivers § 304, et seq. (2001). 66 Am. Jur. 2d Receivers § 304. (“receivers’ certificates are certificates or evidences of indebtedness issued under a court order by receivers in possession of property, payable out of a particular fund and are usually a first lien on the property”).

106 Kirven v. Lawrence, 244 S.C. 572, 137 S.E.2d 764 (1964); Andrick Dev. Corp. v. Maccaro, 280 S.C. 103, 311 S.E.2d 95 (Ct. App. 1984); Truesdell v. Johnson, 144 S.C. 188, 197, 142 S.E. 343, 345 (1928).

107 75 C.J.S. Receivers § 292(d)(3)(cc) (1952) (citing as authority Guimarin v. S. Life & Trust Co., 100 S.C. 12, 84 S.E. 298 (1915)).
Other jurisdictions take a more expansive view of a receiver’s ability to borrow. A receiver has no authority to borrow money, unless specifically authorized by the court. However, the power of the court generally is extensive enough to authorize the receiver to borrow money necessary for the preservation and management of the property in receivership.\textsuperscript{108}

Some jurisdictions distinguish between funds necessary to maintain daily operations and funds needed to prevent waste though, in practical terms, this may not be a valid or proper distinction. In \textit{Koester v. Citizens’ Pub. Co.},\textsuperscript{109} the South Carolina Supreme Court observed:

There is one circumstance which will justify a court in authorizing the issuance of receiver’s certificates in the case of a \textit{private} corporation and displacing prior liens thereby. In a case in which the money is required, not for the purpose of operating the business, but for the purpose of saving the property from destruction . . . .\textsuperscript{110}

The \textit{Koester} court denied the receiver the power to borrow because of lack of notice. Still, \textit{Koester} stands for the proposition that threat of destruction of the estate’s assets justifies allowing the receiver to borrow.

In \textit{Guimarin v. S. Life & Trust Co.},\textsuperscript{111} the South Carolina Supreme Court acknowledged that it was proper for a receiver to be appointed to complete the construction of two Y.M.C.A. buildings left incomplete by a failed contractor. There, the receiver was authorized to take all steps necessary, including hiring subcontractors, to complete the projects. The Supreme Court stated: “[C]onstruction companies [are] wound up by receivers, and it is frequently necessary to . . . complete contracts in order to prevent utter ruin.”\textsuperscript{112} The unifying theme of the decisions in \textit{Koester} and \textit{Guimarin} seems to be that jurisdictions such as South Carolina which view receiverships as an extension of the court’s general equitable power will permit borrowings where waste threatens the property.

C. Priority of Borrowings in State Court

In a non-bankruptcy context, the priority of borrowings is often a hotly contested issue where the real or personal property is encumbered by junior liens. “Expenses of a receiver appointed to preserve property from destruction and waste, pending the outcome

\begin{footnotes}
\item[108] See 66 Am. Jur. 2d Receivers § 149 (2001), 75 C.J.S. Receivers, § 175(a) (1952) (“a receiver is limited in his power to borrow money. . . , but the court in a proper case may confer the power on him”).
\item[109] 154 S.C. 154, 151 S.E. 452, 460 (1930)
\item[110] Id. (citation omitted) (emphasis added).
\item[111] 100 S.C. 12, 84 S.E. 298 (1915).
\item[112] 100 S.C. at 17, 84 S.E. at 299.
\end{footnotes}
of litigation . . . are a first charge against property so held.”113 “Creditors who have contributed to the completion of a construction project [which] without completion is of little or no value, have priority over preexisting liens.”114 Regarding priority disputes between the receiver’s creditors and pre-receivership creditors, the South Carolina Supreme Court implicitly recognized a super priority for the receivers borrowing where the funds were used to save the property from waste or destruction.115 In West Virginia, “[t]he principle is well established that . . . a court of equity has the power to authorize and direct issuance and sale of certificates of a receiver and prefer them to prior subsisting liens for the preservation of the property affected from waste, impairment or loss until such time as may be required to put the property in salable condition. . . .”116

In non-default situations in some jurisdictions, such as South Carolina, mechanics’ liens have priority over subsequent advances made directly to a borrower after notice of the mechanic’s claim to the lender. For example, South Carolina law grants priority to advances made under a mortgage as of the date of the original recording of the mortgage under most circumstances.117 However, these advances do not take priority over the holder of a mechanics’ lien who has furnished labor, services, or materials in connection with the construction of improvements, has filed a mechanics’ lien and has served the lender with notice of the filing in accordance with the provisions of South Carolina Rule of Civil Procedure 4.118 Consequently, a lender cannot make advances to complete the project after receipt of notice of the mechanics lien without these advances being subordinate to the claims of the mechanics. In these circumstances, some lenders see receiverships as an alternative for making advances to the property while attempting to assure that these advances have priority over previously filed mechanics’ liens.

Whether advances to a receiver to complete a construction project or even protective advances to pay insurance or tax bills can be given priority is an open question in many jurisdictions. As noted above, the South Carolina Supreme Court in Koester distinguished between borrowing to operate an ongoing business and borrowing to save assets from depreciation – favoring the latter and discouraging the former. The unanswered question under this analysis is what constitutes the “threat of destruction.” In Guimarin, the South Carolina Supreme Court recognized a similar rule but went even further to allow liens incurred during the receiver’s construction activity to prime prior mechanics’ liens incurred during the insolvent debtor’s construction efforts. “Where a receiver is appointed to operate property for the benefit of the lien holder thereon, he may

114 Id. at 292(d)(3)(cc) (emphasis added).
115 154 S.C. at 175-76, 151 S.E. at 460.
make the operating expenses a first charge, upon not only the current earnings, but the corpus of the estate.”

Some jurisdictions provide the receiver, under defined circumstances, with the ability to complete construction of a project which is the subject of the receivership. For example, by statute in Michigan, a circuit court is authorized to appoint a receiver over property against which a construction lien has been filed pursuant to the Michigan Construction Lien Act, upon request by a construction lien claimant or a mortgagee to complete construction, if the court finds that: (i) a substantial unpaid construction lien exists or (ii) that the mortgage is in default and the lien claimant and or mortgagee “are likely to sustain substantial loss if the improvement is not completed.”

The receiver under the Michigan act may petition the court to permit completion of construction of the improvements in whole or in part, to borrow money to complete the construction, and to grant security, by way of mortgage or otherwise, for the borrowings. The receiver may also petition the court for authority to borrow funds for other purposes, “including such purposes as preserving and operating the real property.” The type of security that the court may authorize includes a mortgage lien or an assignment of rents as additional security. The court is to determine the priority of any security granted by the receiver and may authorize the grant of liens which will prime an existing mortgage and other liens against the property. This will be helpful if the priority of the construction loan mortgage over the construction liens is in dispute and the construction lender is willing to advance additional funds only if the repayment is secured by a lien with priority over the construction liens. In that instance, the construction lender can (with the approval of the court) make a new loan to the receiver and be granted a super-priority lien as to proceeds advanced under the new loan.

In order to appoint a receiver under the Michigan act, the court is required to make a finding that the value added to the real property which will result from the construction is likely to exceed the cost of additional construction. In determining the cost of the additional construction, the court is to include (i) direct costs; (ii) all estimated overhead and administrative costs; and (iii) the costs of any interest expense on the funds

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121 Id.
122 Id.
123 Id.
124 Id.
125 Id.
which are borrowed to complete construction.\textsuperscript{127} In addition, a receiver appointed under the Michigan act may petition the court for authority to sell the property interest which is under foreclosure.\textsuperscript{128}

In other areas of law, certain fiduciary agents are routinely entitled to a super priority for debts incurred during the administration of an estate.\textsuperscript{129} The Court of Appeals for the Fourth Circuit recognized and applied the Bankruptcy Code’s super priority provision, Section 364(d)(l), in the case of \textit{In re Snowshoe Co., Inc.},\textsuperscript{130} in which the court held that a bankruptcy trustee’s operating capital loans were entitled to a super priority because a ski resort’s value would have declined severely if it failed to open because of capital constraints.

Ultimately, a receiver's ability to borrow may depend on his being able to insure subsequent creditors a priority over existing liens or to obtain a legal opinion stating that the receiver can do so.

D. Borrowing in Bankruptcy Court

Bankruptcy law is clear on the issues of both the ability of a Chapter 11 debtor in possession or trustee to borrow and the priority of these loans. Bankruptcy Code Section 363(c)(2) authorizes a debtor in possession (a “\textit{DIP}”) to operate its business under Section 1108 and to use cash collateral only (i) if the DIP has the consent of each entity which has an interest in the cash collateral, or (ii) if the court after notice and hearing pursuant to Bankruptcy Rule 4001(b), authorizes the use of such cash collateral. Bankruptcy court approval of the use of cash collateral under Bankruptcy Code Section 362(c)(2) requires the debtor to prove that the creditor whose rights are affected has \textit{“adequate protection.”}\textsuperscript{131} The Bankruptcy Code sets forth examples of adequate protection in Section 361, which include:

\begin{enumerate}
\item Requiring the DIP to make a cash payment or periodic cash payments to the affected entity to the extent the use of the cash collateral results in a decrease in the value of the affected entity’s interest in the cash collateral;
\item Providing the affected entity with an additional or replacement lien to the extent the use of the cash collateral results in a decrease in the value of the affected entity’s interest in the cash collateral; or
\end{enumerate}

\textsuperscript{127} Id.
\textsuperscript{128} Mich. Comp. Laws § 570.1123(3). See Part VIII(G), infra.
\textsuperscript{129} See 11 U.S.C. § 364(d)(l) (1976) (“[t]he court. . . may authorize. . . the incurring of debt secured by a \textit{senior} or equal lien on property of the estate”) (emphasis added).
\textsuperscript{130} 789 F.2d 1085 (4th Cir. 1986).
\textsuperscript{131} \textit{In re JKJ Chevrolet, Inc.}, 190 B.R. 542, 545 (Bankr. E.D. Va. 1995).
(3) Any other relief giving the affected entity the equivalent of that entity’s interest in the property other than administrative expense priority under Section 503(b)(1) of the Bankruptcy Code.

Other examples of adequate protection are: (i) limiting or conditioning the debtor’s authority to conduct its business, such as restricting salaries or limiting the debtor’s ability to purchase inventory; (ii) requiring increased or reinstated insurance coverage; (iii) requiring the debtor to inspect the collateral periodically or maintain an auditor on the debtor’s premises; (iv) requiring the debtor to furnish frequent accounting information; (v) requiring the debtor to discharge or bring current senior liens; (vi) requiring the debtor to segregate and account for cash collateral; (vii) the existence of an equity cushion in the lender's collateral132; or (viii) providing a secured guaranty.133

In determining if there is sufficient adequate protection, or even if adequate protection is necessary, the bankruptcy court may consider: (i) if the debtor’s request presents a threat to the status quo; (ii) whether the affected lender has sufficient protection against decline in the value of its collateral; and (iii) a balancing of the equities between the debtor and the affected lender.134

In addition to the examples of adequate protection set forth in Section 361, bankruptcy courts have also found that a creditor’s first priority security interest in virtually all of a debtor’s assets was sufficient and did not require additional adequate protection.

These are not the exclusive means of providing adequate protection, but the DIP may not give the affected party an administrative expense priority under Section 503(b)(1) as a form of adequate protection.

Bankruptcy Code Section 364 authorizes a DIP to operate its business under Section 1108 and obtain unsecured credit and secured debt in the ordinary course of business. The lenders of such credit or debt will have administrative expense priority under Section 503(b)(1).135 After notice and hearing, the bankruptcy court may authorize a DIP authorized to operate under Section 1108 to obtain unsecured credit and secured debt other than in the ordinary course of business and the lenders of such credit or debt will have administrative expense priority under Section 503(b)(1).136


If the DIP is unable to obtain credit giving the lender administrative expense priority or a secured claim, then after notice and hearing, the bankruptcy court may authorize the DIP to obtain credit or incur debt under increasingly favorable terms to the lender, the most favorable being to give the lender a senior or equal lien on property of the estate already subject to a lien.

A DIP may give a lender a senior or equal lien on property of the estate only if: (1) the DIP is unable to obtain credit under any other terms provided for in Section 364, and (2) there is adequate protection of the party holding an existing lien on the property. The burden of proof on the issue of adequate protection lies with the DIP or trustee.

In sum, a plaintiff lender should consider whether an involuntary Chapter 11 bankruptcy petition is a better method to preserve the assets if the appropriate state court does not authorize borrowing by a receiver.

Involuntary bankruptcy petitions under the Bankruptcy Code do not possess the same problems, but have their own set of potential pitfalls, not the least of which is the potential liability of lenders and other petitioning creditors for filing an involuntary petition which is later dismissed.

E. Leases in Bankruptcy Court

A DIP or bankruptcy trustee may, under Section 363(c)(1), enter into a lease of property of the estate in the ordinary course of business without the need for notice and hearing. The trustee or DIP may, under Section 363(b)(1), enter into a lease of property of the estate other than in the ordinary course of business only by order of the court after notice and hearing. Since it is not always entirely clear when a DIP which is in the business owning, leasing and operating an income producing property will be deemed to enter into a lease in the ordinary course of business so as to enable the DIP to enter into the lease without court approval, it is usually prudent under such circumstances, to seek a court order to avoid any possible later challenge on the ground that the DIP did not have authority to enter into the lease.

A trustee or DIP has the authority under Section 365, in the exercise of business judgment and subject to court approval, to assume or reject an executory contract or unexpired lease (except as provided in Sections 765 and 766). An executory contract or lease must be assumed or rejected in its entirety. In order to assume an executory

139 For example, if the bankruptcy court dismisses an involuntary petition, the court may grant judgment against the petitioners and in favor of the debtor for costs and reasonable attorney’s fees. 11 U.S.C. § 303(i). If the court determines that the petitioners have filed the petition in bad faith, the court may also award the debtor actual or punitive damages. Id.
contract, the DIP must provide *adequate assurance* (as set forth in Section 365(f)(2)) of future performance whether or not there has been a default in the debtor’s performance of the executory contract or lease. Any party to the contract or lease can seek relief from the court to compel the DIP or the trustee to assume or reject the contract or lease.

If there has been a default in the trustee’s or DIP’s performance of an executory contract or lease, the trustee or DIP may only assume the executory contract or unexpired lease under Section 356(b)(1) if the trustee or DIP: (a) with certain exceptions noted below, cures or provides adequate assurance of prompt cure of the default; (b) compensates the other party for any actual pecuniary loss resulting from such default; and (c) provides adequate assurance of future performance under the contract or lease. There is no requirement to cure a default or provide adequate assurance of cure with regard to:

1. Any default involving breach of a provision relating to the insolvency or financial condition of the debtor before the commencement or closing of the case or any provision relating to the appointment of a trustee or custodian,\(^{140}\) or
2. Payment of any penalty rate provided for under the lease or satisfaction of any provision relating to a default arising from any failure of the debtor to perform non-monetary obligations under the executory contract or unexpired lease, if the default is impossible for the trustee or DIP to cure upon assumption of the lease. However, if the default involves failure to operate on the leased premises in accordance with the lease, the default must be cured upon assumption and the trustee or DIP must compensate the other party to the lease for its actual pecuniary loss.\(^{141}\)

While an executory contract or unexpired lease may contain a provision preventing its assignment, the Bankruptcy Code will permit assumption and assignment of the contract or lease under Section 365(f) of the Bankruptcy Code unless the contract is one for personal services, a financial accommodation or one that is not assignable by applicable non-bankruptcy law.

Except for a lease of non-residential real property, a DIP must determine whether to assume or reject an executory contract at any time before confirmation of the plan of reorganization or upon request of a party in interest.\(^{142}\) Assumption or rejection of a lease or executory contract is generally accomplished by motion.\(^{143}\)

\(^{143}\) See F. R. Bankr. R § 6006.
If the bankruptcy trustee or DIP is a lessee of an unexpired lease of non-residential property, the trustee or DIP must assume or reject the executory contract within one hundred twenty (120) days of the filing of the order for relief. If the trustee or DIP fails to assume within the one hundred twenty (120) day time period or to obtain an extension of the time period upon a showing of cause, the lease will be deemed rejected and the trustee or DIP lessee must immediately surrender possession of the leased property to the lessor. The bankruptcy court may extend the trustee’s or DIP’s deadline to accept or reject for ninety (90) days “for cause” upon motion of the DIP or the lessor. The court may grant subsequent extensions only upon prior written consent of the lessor in each instance.

If a trustee or DIP rejects a lease under which it is the lessor, the rights of the lessee are governed by Section 365(h). The lessee may treat the lease as terminated by the rejection, or, in the alternative, may continue in possession of the leasehold through expiration of the lease term and retain rights under the lease relating to payment of rent and subletting. If the lessee continues in possession, the trustee or DIP landlord is not obligated to perform any of its obligations under the lease, such as providing services required under the lease. The lessee is obligated to pay the rent reserved in the lease but is entitled to offset against rent reserved the value of any damages caused by the debtor-lessee’s nonperformance after the date of rejection.

F. Leasing by Receivers

A court appointed receiver takes custody of the receivership property subject to existing lease and licenses for use and occupancy of the premises. The terms of the order of appointment should grant the receiver authority to enter into new leases for the premises. Even if the appointment order confers a general power to enter into leases, it may be advisable for the receiver to enter into a particular lease only upon entry of a specific court order approving the terms of the lease following notice to all interested parties and hearing. Leases entered into by the receiver and any court orders authorizing entry into the lease should expressly provide for the effect of a later foreclosure or receivership sale on the rights under the lease. In most instances, the parties will want to provide that the lease will survive any later sale of the receivership assets and that the terms of the lease executed by the receiver will be binding upon the purchaser of the property. The lender and lessee should also consider the advisability of using a subordination and non-disturbance agreement.

Most states do not give the receiver the power to reject existing leases. However, a receiver may have the ability to rescind an existing lease if the lease contravenes a provision of a prior recorded mortgage or the lease was entered into while the mortgagor was in default and the lease is not commercially reasonable. The receiver may be able to reject or rescind such a lease on a theory that the lease was a fraudulent or other avoidable transfer if the lease was entered into at a time that the lessor was insolvent and the lease does not provide for payment of fair consideration.

In contrast to states that do not grant a receiver the express authority to reject executory contracts or leases, Delaware grants a receiver the power to disavow executory contracts. Similarly, a general receiver (as compared to a limited receiver) in Washington may (subject to certain limitations) assume or reject any executory contract or unexpired lease of the person or entity over whom the receiver was appointed following notice and hearing to the other party, and the court may condition assumption or rejection “on the terms and conditions the court believes are just and proper under the particular circumstances of the case.”

G. Sale of Assets – Generally

Another area in which lenders to distressed projects have been exploring the utility of receiverships is the sale of the collateral. Foreclosure actions in jurisdictions permitting only judicial sales can often take months or years. Impatient with the process, lenders increasingly seek to have receivers sell collateral in order to expedite the process of disposing of collateral. The question, which is often jurisdiction dependent, is whether a judicially appointed receiver has the power to sell collateral. The laws varies among jurisdictions regarding whether a receiver can sell assets free and clear of liens, claims and encumbrances absent consent or satisfaction of such claims. Ultimately, the answer is jurisdiction specific and depends on three critical inquiries: (1) applicable case and statutory law; (2) whether the order appointing the receiver authorizes the receiver to

150 Wash. Rev. Code § 7.60.130(1).
151 Federal and State Court Receiverships as Alternatives to Bankruptcy— Pros and Cons, American Bankruptcy Institute, Best of Mid-Atlantic Bankruptcy Workshop ABI-CLE 9 (2005). See, e.g. Frye v. MacWilson, 39 Ohio App. 158, 177 N.E. 232 (1931). Novor v. Fourth St. Bargain Store Co., 16 Del. Ch. 259, 145 A. 119 (1929); N. J. Stat. Ann. § 14A:14-7 (receiver may sell assets free of encumbrances only if sale may be reasonable expected to benefit general creditors of the corporation without adversely affecting the interest of the holders of the encumbrances); In re Valley Road Sewerage Co., 685 A.2d 11, 18 (N. J. Super. 1996) (receiver can sell assets free and clear of liens satisfied from sale proceeds); Bogosian v. Foerderer Tract Comm., 264 Pa. Super. 84, 9b, 399 A.2d 408,414 (1979) (receiver can sell assets free and clear only if there is a “reasonable prospect” that a surplus will be left after the sale for use by the general creditors); but see Md. Code Ann. Corp. & Ass’ns, § 3-418 (absent agreement otherwise, receiver can sell (a) equity of redemption or (b) only what could be sold absent insolvency proceeding).
sell or otherwise dispose of collateral; and (3) in the final analysis, whether the purchaser can obtain title insurance.

Jurisdictions, such as South Carolina, where the purpose of a receivership is to preserve the status quo and where foreclosure is permitted only by judicial sale, do not permit a receiver to dispose of assets. As noted above,152 these courts typically hold that the very purpose of a receiver “is to take property. . . out of the possession of the person in whose possession it is found and place it in the hands of a third party pending litigation.”153 It is difficult to rationalize the sale of assets with the strictures that a receiver is only authorized to preserve the status quo.

In Illinois, the receiver is entitled to possession of the mortgaged real estate and other property subject to the mortgage during the foreclosure 735 Ill. Comp. Stat. § 5/5-1704 (b). The receiver is authorized to operate, manage and conserve the property. No reported Illinois case exists authorizing a receiver to sell property, though at least one trial court has permitted the receiver to sell units within a partially completed condominium and apply the proceeds to the mortgage indebtedness. A creative lawyer may consider relying upon the court’s equitable authority to appoint a receiver in addition to the statutory authority. The requirements for the court to appoint an equity receiver in a case which is not a mortgage foreclosure action or a foreclosure action which predates the Illinois Mortgage Foreclosure Law are a full hearing, adequate notice, a possible bond requirement, imminent danger, and a clear right to recovery.154

Some lenders seek a way around this restrictive case law by claiming that a sale is necessary in order to preserve the ultimate value of the receivership estate. The law is not well developed as to the interrelationship of equity's power to sell real estate and protections granted borrowers by the laws of individual states. For example, some states have statutory appraisal rights designed to protect a borrower from “fire sales” of real property.155

The state statutory scheme may provide only a broad statement describing a receiver’s ability to make a sale outside the ordinary course of business. For example, the statute in Indiana simply provides that a receiver may, under the control of the court

152 See note 106 supra and accompanying text.
153 Kirven v. Lawrence, 244 S.C. 572, 137 S.E.2d 764 (1964); Andrick Dev. Corp. v. Maccaro, 280 S.C. 103, 311 S.E.2d 95 (Ct. App. 1984); Truesdell v. Johnson, 144 S.C. 188, 197, 142 S.E. 343, 345 (1928).
155 See e.g. S.C. Code Ann. §§ 29-3-680 through 29-3-760 (2007) (authorizing the reduction of a deficiency judgment against the mortgagor by the “true value” of the real property sold at a foreclosure sale “taking into consideration sale value, cost and replacement value of improvements, income production and all other proper elements.”).
“sell property in the receiver’s own name, and generally do other acts respecting the property as the court or judge may authorize.”156

Some jurisdictions clearly permit receivers to sell assets.157

The state of Washington addresses a receiver’s power to make a sale outside the ordinary course in great detail and grants a receiver the power to sell receivership real property (except for a leasehold estate with a remaining term of less than two years or vendor’s interest in a real estate contract) with the court’s approval after notice and hearing.158 The Washington statute is even broader than Section 363(f) of the Bankruptcy Code159 and allows the court to authorize the receiver’s sale to be free and clear of liens and of all rights of redemption, even if the sale will not generate proceeds sufficient to satisfy fully all claims secured by the property.160 This right to sell free and clear of liens does not apply if (a) the property is used principally in the production of crops, livestock, or aquaculture, or the property is a homestead and the owner of the property has not consented to the sale following the appointment of the receiver161 or (b) the owner of the property or a creditor with an interest in the property serves and files a timely opposition to the receiver’s sale, and the court determines that the amount likely to be realized by the objecting person from the receiver’s sale is less than the person would realize within a reasonable time in the absence of the receiver’s sale.162

However, even in a state like Washington, which provides a receiver with broad powers and where statutes contain provisions analogous or similar to the provisions of the Bankruptcy Code, such as an automatic stay, there may be an issue with regard to whether the state statutory scheme is preempted by the provisions of the United States Bankruptcy Code.163

156 Ind. Code § 32-30-5-7 (5).
157 E.g., Novor v. Fourth St. Bargain Store Co., 16 Del. Ch. 259, 145 A. 119 (1929); N. J. Stat. Ann. § 14A:14-7 (receiver may sell assets free of encumbrances only if sale may be reasonable expected to benefit general creditors of the corporation without adversely affecting the interest of the holders of the encumbrances); In re Valley Road Sewerage Co., 685 A.2d 11, 18 (N. J. Super. Ct. App. Div. 1996) (receiver can sell assets free and clear of liens satisfied from sale proceeds); Bogosian v. Foerderer Tract Comm., Inc., 264 Pa. Super. 84, 399 A.2d 408,414 (1979) (receiver can sell assets free and clear only if there is a “reasonable prospect” that a surplus will be left after the sale for use by the general creditors); but see Md. Code Ann. Corp. & Ass’ns, § 3-418 (absent agreement otherwise, receiver can sell (a) equity of redemption or (b) only what could be sold absent insolvency proceeding).
158 Wash. Rev. Code § 7.60.260(1).
159 See notes 173 through 182 infra and accompanying text.
161 Id.
H. Sales of Collateral as an Alternative to Foreclosure

Foreclosure procedures often afford a borrower various redemption rights. In some states there may even be a statutory redemption rights afforded to the mortgagor to redeem the property from a mortgage foreclosure sale by paying the amount bid to purchase the property at the foreclosure sale together with interest and perhaps other costs incurred by the purchaser after the sale for real estate taxes, insurance premiums, settlement of other liens against the property and the like. A receiver’s sale is not subject to these rights; therefore a receiver’s sale could interfere with the mortgagor’s right of redemption. Courts generally are reluctant to permit actions which operate to clog or interfere with the mortgagor’s rights of redemption. Under these circumstances, a mortgagor (or subordinate lien or interest holder which may also hold redemption rights) could possibly challenge a receiver’s sale of property in lieu of foreclosure if the effect is to deprive the mortgagor of redemption rights which it might otherwise be entitled to exercise if the mortgaged property were foreclosed in accordance with statutory procedures.

In every instance where a receiver seeks to sell property, the receiver should consult the law of the particular jurisdiction appointing the receiver in order to determine the scope of a receiver’s power to sell receivership property. In those states where there is no statutory or common law providing clear authority for a receiver to sell the real estate which is the subject matter of the receivership, a receiver may only have the authority to conduct such a sale if expressly or impliedly consented to by all parties holding an interest in the real estate. It is also possible that a receiver will be deemed to have such authority if the owner and other interest holders default by failing to appear and not actively opposing such a sale.

I. Mechanics of State Court Sale

A sale of property through a receiver should be accomplished through one or more court orders. All parties having an interest in the property to be sold should be provided notice and an opportunity to be heard prior to any sale of the property. The order allowing a receiver to sell the property should memorialize any affirmative consent of the interest holders to the sale and the fact that notice and opportunity for hearing was provided to all interest holders. In many instances the willingness of a title insurer to insure a sale by a receiver will be a significant, if not determinative, consideration in determining if such a sale is a feasible method of liquidating the receivership asset and paying off liens.

The order authorizing the sale should refer to the legal basis for the sale through the receiver (such as borrower’s and other interest-holders’ consent, statutory authority or court decision). It may be helpful for the order to designate the receiver as the “attorney in fact” for the borrower/owner of the property. The order should authorize the receiver to execute a purchase agreement subject to judicial approval. The purchase agreement can be executed by the owner/borrower “by and through” the court-appointed receiver, as authorized by court orders and court approval in the form of a “confirmation order” made a condition of closing. Court approval for a sale through the receiver in the initial order
appointing the receiver, together with the confirmation order, should provide a basis for a
title insurer to issue title insurance. The order appointing the receiver and authorizing the
receiver to sell the property should both be attached as exhibits to the deed and recorded.
The motion for approval of the sale and confirmation should be served on the
borrower/owner and all others having liens on the property. Consideration should also be
given to the possible need to notify others who may have an interest in the property, such as
tenants or easement holders.

J. **Sales of Personal Property**

The sale of personal property is governed by both Article 9 of the Uniform
Commercial Code and the same rules as that for the sale of real property, unless the court
orders otherwise.\(^\text{164}\) Sales of personal property assets encumbered under Article 9 of the
Uniform Commercial Code (the “\textbf{UCC}”) by receivers in either state or federal
proceedings would presumably need to satisfy the provisions of Part 6 of Article 9. In
particular, the receiver would need to pay careful attention to the notice requirements of
Sections 9-611, \textit{et seq.} of the UCC.

K. **Sales by Federal Receiver**

by a federal court action. A federal court receiver may sell real property by either public
or private sale. A public sale must occur in the district where the receiver was appointed,
unless otherwise approved by the court. In addition, the terms and conditions of the sale
will be as directed by the court.\(^\text{165}\) The court must approve the form of notice of any
public sale, and such notice must be published at least once a week for four (4) weeks
prior to the sale.\(^\text{166}\) Real property may be sold by private sale if the federal court
determines that such private sale is in the best interest of the receivership estate. As in a
public sale, the court sets the terms and conditions of the sale. In a private sale, however,
the court must appoint three disinterested appraisers to appraise each parcel of property.
The private sale of real estate will not be confirmed by the court unless the sale price is at
least two-thirds (2/3) of the property’s appraised value, or if a competing offer for the
property is received in an amount at least ten (10\%) percent greater than the amount of
the original offer. Notice of a proposed private sale must also be approved by the court
and published in a newspaper of general circulation at least ten (10) days prior to the
hearing on the confirmation of the sale.\(^\text{167}\)

Federal courts appear to be liberal with respect to protecting the finality of
receivership sales. A judicial sale “made with notice and in the manner prescribed by law
will not be denied confirmation or be set aside for mere inadequacy in price unless the


price is so gross as to shock the conscience of the court, coupled with slight additional circumstances indicating unfairness such as chilled bidding.” At least one federal court has approved a sale which did not comply with this procedure in exigent circumstances. A panel of the United States Court of Appeals for the Third Circuit, in *Tanzer v. Huffines*, upheld the expedited sales of corporate property by a receiver which did not comply with the statutory appraisal and notice requirements due to the extraordinary circumstances of the case and the poor financial condition of the company.

One Ninth Circuit opinion has held that the right to sell estate assets is within the scope of a receiver’s complete control over receivership assets under 28 U.S.C. § 754, a conclusion firmly rooted in the common law of equity receiverships.

As noted above, the ultimate factor in determining the federal receiver’s ability to sell property will more often than not be the willingness of the title insurer to insure the sale despite technical failures to comply with the federal statutory procedure.

L. **Sales in Bankruptcy**

Section 363(b)(1) allows the bankruptcy trustee or DIP to sell or lease property of the bankruptcy estate other than in the ordinary course of business upon notice and hearing. A sale not in the ordinary course of business may be by private sale or public auction. Bankruptcy courts require a sound business purpose for the use of Section 363, and a strong showing that a sale outside the plan confirmation process is justified. A common justification for a Section 363 sale is that the value of the assets will rapidly deteriorate and that the seller urgently needs the cash from the sale to continue its remaining businesses to avoid a liquidation which will lead to a lower recovery by creditors.

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169 412 F.2d 221 (3rd Cir. 1969).

170 *S.E.C. v. Am. Capital Inv., Inc.*, 98 F.3d 1133, 1144 (9th Cir. 1996). 28 U.S.C §754 vests a receiver with “complete jurisdiction and control of all such property with the right to take possession thereof.”

171 *See In re Indus. Valley Refrigeration & Air Conditioning Supplies, Inc.*, 77 B.R. 15, 21 (Bankr. E.D. Pa. 1987) (stating that the requirements for a Section 363 Sale include accurate and reasonable notice, a showing that the price to be paid is adequate, fair and reasonable, and a showing of good faith, e.g., the absence of lucrative insider deals). *See also In re Lionel Corp.*, 722 F.2d 1063, 1071 (CA N.Y. 1983). The reluctance of bankruptcy courts to permit a sale which circumvents confirmation of a plan strongly echoes the reluctance of many state courts to allow receivership sales to circumvent statutory protections afforded by state foreclosure laws and appraisal processes. *See* notes 152 through 163 *supra* and accompanying text.

Section 363(f) permits a bankruptcy trustee or DIP to sell property free and clear of liens if one of five (5) tests can be satisfied:

1. Applicable non-bankruptcy law would permit sale of the property free and clear of the lien.\(^{173}\)

2. The holders of all liens on the property consent.\(^{174}\)

3. The sales price of the property is greater than the aggregate value of all liens on the property.\(^{175}\)

4. The lien is subject to a bona fide dispute.\(^{176}\) The property may be sold while the dispute is being litigated so that liquidation of assets will not be delayed until final resolution of the dispute. Following a sale the proceeds will be held and distributed in accordance with resolution of the dispute.\(^{177}\) At least some courts hold that the trustee or DIP may rely on a dispute between third parties as a basis to conduct a sale under Section 363(f)(4).\(^{178}\)

5. The holder of the lien could be compelled, in a legal or equitable proceeding, to accept a money satisfaction of the lien.\(^{179}\)

The bankruptcy trustee and DIP have a duty to maximize the bankruptcy estate’s value for the benefit of creditors and other interested constituencies. Any agreement by the trustee or DIP to make a sale of property not in the ordinary course of business requires court approval. In many instances the court’s approval of the sale will be conditioned upon a requirement that the sale of the property also be set for public auction to determine if there are any other bidders willing to pay a higher price. The use of an auction procedure will permit the trustee of DIP to maximize the value received on the sale.

If the sale is not in the ordinary course of business, Section 363(c) requires court approval. If the trustee or DIP enters into a purchase agreement prior to court approval, the purchase agreement must include court approval as a condition of the obligation of the trustee or DIP to perform. The terms of such a purchase agreement will often provide

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\(^{177}\) In re Clark, 266 B.R. 163, 171 (9th Cir. BAP 2001).

\(^{178}\) In re Gulf States Steel, Inc. of Alabama, 285 B.R. 497, 507 (Bankr. N.D. Ala. 2002) (citing In re Gerwer, 898 F.2d 730, 733 (9th Cir. 1990)).

for the purchaser to serve as a “stalking horse,” pursuant to which the buyer’s offer is subject to receipt of higher and better offers in a public auction.

An order of the bankruptcy court will set forth the auction’s bidding procedures. The purchase agreement may address the procedures and terms of the bidding process, but any such procedures are subject to the bankruptcy court’s approval. Items to consider including in an order setting bidding procedures are: (a) bidder qualification standards, good faith deposit requirements, and providing information regarding a bidder’s financial qualifications and ability to pay the purchase price; (b) standards for competing offers that can be accepted and requirements of minimum bid increments; (c) requirements of cash bids; (d) limitation of closing contingencies; and (e) payment of a break-up fee and/or reimbursement of expenses incurred payable to the stalking horse if not the successful purchaser.180 Section 327 and Bankruptcy Rule 6005 set forth the requirements and procedures for retention of any professionals who may be required in connection with the sale, such as an auctioneer, appraiser or broker.

In order to obtain authorization for a Section 363(f) sale of property free and clear of any interests, Bankruptcy Rule 6004(c) requires the filing of a motion for authority to sell free and clear, which is served on the parties with liens or other interests in the property. Local bankruptcy rules which may include additional relevant provisions also must be consulted. The Bankruptcy Rules establish certain notice procedures for all sales of property that are not in the ordinary course of business.181 If those procedures are modified (for example, less than twenty (20) days’ notice of the sale), appropriate court orders should be obtained to assure that the sale is no subject to a later challenge based on procedural grounds.182

M. Avoidance Powers

The Bankruptcy Code grants a bankruptcy trustee or DIP various avoidance powers.

A trustee or DIP has “strong arm powers” under Bankruptcy Code Section 544 as a hypothetical lien creditor to avoid unperfected liens and unrecorded conveyances. For example, if a real estate mortgagee or secured creditor with a lien on personal property did not properly perfect its security interest in the property, the lien may be avoided and the holder of the security interest will become an unsecured creditor.

A trustee or DIP has the authority to bring actions to recover transfers which are deemed preferences under Bankruptcy Code Section 547.

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A trustee or DIP may recover fraudulent transfers made with intent to hinder, delay, or defraud creditors under Bankruptcy Code Section 548. The trustee can recover those transfers made by the debtor for less than reasonably equivalent value at a time that the debtor was insolvent or became insolvent as a result.

As a general rule, most state court receivers do not have avoidance powers.

IX. Miscellaneous Issues

A. Vacating the Receivership Order

Some jurisdictions allow for a borrower to vacate the appointment of a receiver by posting a bond. In such jurisdictions, the Court is often required to make a finding of the value of the property which is being subjected to the receivership in order to calculate the amount of any bond.

B. Legal and Other Professional Fees

Most jurisdictions authorize receivers to hire support professionals. A receiver is entitled to retain his own counsel if authorized by the court or otherwise authorized by case law or statute. It would be a conflict of interest for the attorney for the mortgagee or other parties to be the attorney for the receiver.

C. Receiver’s Fees

One of the subjects nearest and dearest to a receiver’s heart is the method by which the receiver will be paid. Many orders appointing a receiver do not set a fee for the receiver but instead leave the fee’s determination to a subsequent hearing. For example, S.C. Code Section 15-65-100 provides that compensation of receivers shall be set by the Court appointing the receiver.

The receiver’s fee is left to the court’s sound discretion based on value of receiver’s services determined by considering the nature, extent and value of the administered property; complexity and difficulty of work; time spent; knowledge, experience, diligence, labor and skill required of, or devoted by, the receiver; thoroughness displayed; results accomplished; amount of money coming into the receiver’s hands; and fair value of services rendered measured by conservative, private business standards. It is generally accepted that the receiver’s fees have priority over all liens. Nevertheless, it is critical to remember that a receiver is an officer of the court.

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not an employee of the lender, and prior arrangements between lenders and potential receivers must recognize that the receiver should be paid by the receivership estate, though the lender can guaranty payment of these fees.

D. Discharge of Receiver

Where a receiver has been appointed, the receiver should file a petition for discharge after delivering a deed to the purchaser. The receiver should simultaneously make final accounting. Only after the final accounting has been accepted by the court should the receiver be discharged and an order discharging a receiver be filed with the court. Suits against receivers should be terminated prior to the termination of the receivership. The discharge order should cancel any bond previously posted by the receiver.

X. Effect of Bankruptcy Filing on Court Appointed Receiver

A. Turnover of Property

A recent cutting edge issue is whether Section 543 of the Bankruptcy Code requires a previously appointed receiver to turn over receivership assets immediately upon the filing of a bankruptcy petition. Generally, upon the filing of a bankruptcy petition, a receiver must cease all actions impacting property of the bankruptcy estate under Section 543(a). Furthermore, Section 543(b)(1), generally requires a receiver to turn over all property of the bankruptcy estate to the bankruptcy trustee. A receiver is deemed to be a “custodian” under Section 101(11).

187 11 U.S.C. § 543(a), provides in part:

A custodian with knowledge of the commencement of a case under this title concerning the debtor may not make any disbursement from, or take any action in the administration of, property of the debtor, proceeds, product, offspring, rents, or profits of such property, or property of the estate, in the possession, custody, or control of such custodian, except such action as is necessary to preserve such property.

188 11 U.S.C. § 543(b)(1), provides:

(b) A custodian shall—

(1) deliver to the trustee any property of the debtor held by or transferred to such custodian, or proceeds, product, offspring, rents, or profits of such property, that is in such custodian's possession, custody, or control on the date that such custodian acquires knowledge of the commencement of the case; . . .

189 In the event of filing a bankruptcy petition, a state court receiver will be deemed a custodian under Section 101(11) and the receiver will be required to transfer assets to a DIP under Section 543 and Bankruptcy Rule 6002. 11 U.S.C. 101(11) defines a “custodian” as:
One court has found that “turnover provisions of §543 are part of the statutory expression of the Congressional preference that a Chapter 11 debtor be permitted to operate and control its business during the reorganization process.”\textsuperscript{190} However, under Section 543(b)(1), a bankruptcy court may allow a receiver to remain in place if the interests of creditors would be better served by allowing the receiver to remain in possession of the debtor’s property.\textsuperscript{191}

The Bankruptcy Code is unclear as to the circumstances under which a receiver must turn over the receivership property to a DIP or bankruptcy trustee. On the one hand, Section 543 of the Bankruptcy Code allows for maintenance of the status quo. On the other hand, Section 543 requires immediate turnover of the receivership property.\textsuperscript{192} To avoid this conflict, the receiver could file an emergency motion requesting that the receiver be excused from complying with the provisions of Sections 543(a) through (c) of the Bankruptcy Code.\textsuperscript{193}

However, the most common scenario involves the lender seeking relief from the automatic stay provisions of Section 362 (d)(1) for cause or seeking to excuse the receiver from having to turn over the property under Sections 543(a) and (b)(1).

Bankruptcy courts have considered the following factors in determining whether a receiver should be excused under Section 543(d)(1).\textsuperscript{194}

(A) receiver or trustee of any property of the debtor, appointed in a case or proceeding not under this title; (B) assignee under a general assignment for the benefit of the debtor's creditors; or (C) trustee, receiver, or agent under applicable law, or under a contract, that is appointed or authorized to take charge of property of the debtor for the purpose of enforcing a lien against such property, or for the purpose of general administration of such property for the benefit of the debtor's creditors.


\textsuperscript{191} In re WPAS, Inc., 6 B.R. 40, 43 (Bankr. M.D. Fl. 1980). See also, In re Corporate & Leisure Event Prod., Inc., 351 B.R. 724, 732 (Bankr. D. Ariz. 2006) (noting that though the ordinary rule is that a receiver must turn over property to a debtor in possession, bankruptcy courts have discretion to waive that requirement if the interests of creditors would be better served by continuing the receiver in possession). 11 U.S.C. § 543(b)(1), provides:

(d) After notice and hearing, the bankruptcy court— …

(1) may excuse compliance with subsection (a), (b), or (c) of this section if the interests of creditors and, if the debtor is not insolvent, of equity security holders would be better served by permitting a custodian to continue in possession, custody, or control of such property…


\textsuperscript{194} See generally, id.
(1) Is there sufficient income to fund a successful reorganization?

(2) Will the debtor use the receivership property for the benefit of creditors?

(3) Has there been mismanagement?

(4) Have there been avoidance issues raised with respect to the receivership property retained by the receiver?

(5) What is the impact of the automatic stay on the receivership?

The cases addressing under Section 543(d) whether a receiver may remain in place after the filing of a bankruptcy petition are fact intensive, turning upon whether the assets of the particular debtor should be administered by the existing receiver or returned to the debtor.\textsuperscript{195} Courts generally articulate the standard as one of allowing the receiver to remain in possession when the receiver has been proceeding expeditiously and professionally to manage the affairs of a debtor and has experience in the debtor's industry.\textsuperscript{196}

The case of \textit{In re KCC-Fund V, Ltd.}\textsuperscript{197} illustrates the analysis. In that case, the debtor owned and operated three apartment complexes. Prior to the filing of a bankruptcy petition, one of the debtor's secured creditors sought and obtained the appointment of a receiver for these properties in a state court action.\textsuperscript{198} A few days after the receiver's appointment, the debtor filed under Chapter 11 of the Bankruptcy Code.\textsuperscript{199} The secured creditor then filed a motion to excuse the receiver’s compliance with the requirements of Section 543, on the grounds that continuing with the state court receiver was in the best interest of the debtor's creditors.\textsuperscript{200} Not surprisingly, the debtor opposed the motion.\textsuperscript{201} At the hearing on the motion, the evidence showed, among other things, that the maintenance of the three complexes had been "sadly neglected" and there were "rotted through places in the soffits and eves that can and will cause serious damage."\textsuperscript{202} In addition, concrete and brick work had been neglected until hazardous conditions existed.\textsuperscript{203} These factors contributed to the court ultimately granting the motion to


\textsuperscript{196} Id.

\textsuperscript{197} 96 B.R. 237, 238 (Bankr. W.D. Mo. 1989)

\textsuperscript{198} Id.

\textsuperscript{199} Id.

\textsuperscript{200} Id.

\textsuperscript{201} Id.

\textsuperscript{202} \textit{In re KCC-Fund V, Ltd.}, 96 B.R at 240.

\textsuperscript{203} Id.
excuse compliance with Section 543 until the debtor was able to confirm a plan of reorganization.  

In considering whether the best interests of creditors would be served, the bankruptcy court may examine a variety of factors, including the likelihood of reorganization, the probability that funds required for reorganization will be available, whether there are instances of mismanagement by the debtor, and whether turnover would be injurious to creditors. Section 543(d) “does not require or permit consideration of the interest of the debtor.”

In addition, compliance with the turnover requirements (but not the accounting requirement) will be excused after notice and hearing “if the custodian is an assignee for the benefit of the debtor’s creditors that was appointed or took possession more than 120 days before the date of the filing of the petition, unless compliance with such is necessary to prevent fraud or injustice.” A state court receiver is not generally considered an “assignee for the benefit of the debtor’s creditors” since, unlike a receiver, an assignee for the benefit of creditors is one to whom a debtor voluntarily assigns its property to be administered for the benefit of its creditors.

Where the mortgaged property is the debtor’s only asset and the value of the property is less than the amount of the indebtedness owed to the mortgagee, the bankruptcy court may decide to excuse compliance with the turnover requirements in Section 543 and allow the receivership to continue if the receivership provides the most likely vehicle of enhancing the value of the property. One court recognized that the mortgagee is more likely to advance additional funds for tenant improvements or operating expenses if the receivership continues, and that such a consideration may be a basis to excuse the receiver from the turnover requirement.

B. Surcharge of Custodian and Protection of Third Parties

After notice and hearing, a bankruptcy court will protect entities to which a custodian has become obligated with respect to such property or proceeds, product, offspring, rents, or profits of such property. Similarly, after notice and hearing, the bankruptcy court will provide for the payment of reasonable compensation for services rendered and costs and expenses incurred by the custodian. A request for a custodian’s

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204 Id.
fees must contain a “sufficient itemization of effort expended and results accomplished to enable the Court to make a reasoned determination that the amount requested is ‘reasonable compensation for services rendered.’”\textsuperscript{211}

The Bankruptcy Code authorizes a bankruptcy court after notice and hearing to” surcharge such custodian, other than an assignee for the benefit of creditors that was appointed or took possession more than 120 days before the date of the filing of the petition, for any improper or excessive disbursement, other than a disbursement that has been made in accordance with applicable law or that has been approved, after notice and a hearing, by a court of competent jurisdiction before the commencement of the case under this title.”\textsuperscript{212}

“A receiver may be liable to an estate for failure of its stewardship, and if the estate is harmed the receiver may be surcharged.’ The receiver is bound to exercise reasonable care. The receiver is not responsible for mere mistakes in carrying out the receiver’s duties. However, Section 543 ‘does not give carte blanche to the bankruptcy court to review the orders of the [state] court.”\textsuperscript{213}

XI. Assignments for the Benefit of Creditors

A. Common Law

\textsuperscript{212} 11 U.S.C. § 543(c)(3).
An assignment for the benefit of creditors sometimes offers an alternative to a receivership and bankruptcy for controlling and liquidating collateral securing a distressed loan. Assignments are rooted in English common law and predate the enactment of federal bankruptcy laws. An assignment is defined as a voluntary transfer by a debtor of its property to an assignee in trust for the purpose of applying property or proceeds thereof to the payment of its debts and returning any surplus to the debtor.\textsuperscript{214} It is a contract under which the assignor transfers all of its right, title, interest in, and custody and control of, its property to a third-party assignee in trust.\textsuperscript{215} The result is a unique trust arrangement in which the assignee holds property for the benefit of a special group of beneficiaries, the creditors. Since the creditors do not have a claim against the third party assignee, they do not have a claim against property to which the assignee now holds title.

Both solvent and insolvent debtors can use an assignment. However, it is seldom used by a debtor who is able to pay its debts in full. An assignment is a useful remedy when the value of the collateral exceeds the secured debt such that there should be a recovery for unsecured creditors or even a return on equity. An assignment for benefit of creditors can also be an effective remedy when property is held in more than one state.

Among the duties of the assignee are:

1. Collection of the assets of the assignor;
2. Reducing the assets into cash;
3. Taking legal action to recover assets such as bringing actions under applicable fraudulent transfer statutes or any state preference statutes;
4. Determining the extent, validity and priority of liens and claims against the assigned property; and
5. Distribution of assets in accordance with priorities recognized under applicable state law.

In discharging its duties, an assignee owes fiduciary duties to equity holders as well as creditors.

State laws govern an assignment for the benefit of creditors. Some states still base assignments on common law.\textsuperscript{216} Many states do not have statutes governing


\textsuperscript{215} Paul It Schwendener, 358 Ill. App. at 74.

assignments. Other states regulate assignments for the benefit of creditors by requiring the initiation of formal court proceedings. These statutes govern the procedural formalities of making an assignment, including (i) whether they must be recorded; (ii) when the assignee must give notice to creditors; (iii) whether the assignee must be bonded; (iv) the nature of the schedule of assets and liabilities the assignee must file with the court; and (v) court supervision of the proceedings. Some states require compliance with these state statutes. Compliance is discretionary in other states.218

An assignment is designed to liquidate collateral instead of reorganizing a distressed company. A receiver may liquidate or maintain, operate or conserve collateral depending on the nature and extent of the receivership. An assignee’s duties are solely to liquidate the collateral. The extent of judicial intervention and supervision also differentiates an assignment from a receivership. A receiver is appointed by the court, and is accountable to the parties and the court. An assignee in a common law assignment for the benefit of creditor is not appointed by the court.

A common law assignment is an extra-judicial remedy. However, it may be impacted by ancillary court procedures such as recovery of fraudulent transfers. Additionally, Article 9 of the UCC has enlarged an assignee’s powers by placing the assignee in the position of a lien creditor from the time of the assignment. Accordingly, if an otherwise valid security interest is not properly perfected, it is subordinate to the assignee. A statutory assignment has differing levels of intervention depending upon the particular state.

A common law assignment must satisfy all the common law requirements to be of effect. Common law requirements require that an assignment for the benefit of creditors (i) must be in writing; (ii) have express language establishing a trust over all property for the benefit of creditors; (iii) make the assignor and assignee parties to the document establishing the assignment; (iv) make the transfer of the property absolute and unqualified; and (v) require the assignee to accept the assignment.219 However, the assignee does not have extraordinary powers.

**B. Statutory Assignments**

There are three levels of statutory requirements for states that have enacted statutory assignments; minimalist, medium and expansive. Minimalist states have basic assignment provisions; typically ones permitting an assignment for the benefit of

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217 Id.


creditors and the recording of the assignment. As a result, an assignee may benefit from lien creditor status under the UCC. States with a medium amount of statutory requirements also have notification requirements and avoidance provisions. For example, among the statutory provisions under California law applicable to assignments are the right to recover preferential transfers under Cal. Code of Civil Proc §1800 and the authority of the assignee to exercise any and all rights available to any one or more creditors of the assignor in connection with a fraudulent transfer action. The states with the most expansive scope of statutory requirements also may include provisions for certain types of unsecured claims or claims adjudication procedures or both.

Florida is an example of a state with an expansive assignment statute. The assignee files a petition in circuit court, to which the assignment document along with the schedules of assets and creditors are attached. The assignment proceeds as an ongoing case. Court authorizations, approval of transactions and resolution of disputes are initiated by motion. The assignee may even reject a lease of both certain real and personal property under which the assignor is the lessee. New Jersey provides for an assignee to sell, at a public or private sale, any real estate taken under a general assignment.

C. Advantages and Disadvantages

The common law assignment is used more often than the statutory assignment. A common law assignment places more discretion in the assignee. It is also generally less expensive, speedier and more flexible because the assignee does not have to comply with the additional statutory requirements.

Advantages of an assignment for the benefit of creditors include lower costs than a bankruptcy, greater flexibility and the distribution of assets more quickly. Creditors often like the less formal assignment process.

A significant advantage of an assignment is the ability of the assignor, not the court as would be the case in a receivership, to select an assignee that understands the assignor’s business and can competently liquidate the assignor’s assets in a manner yielding the highest value. Assignees are generally workout specialist or receivers. Most states allow the assignee to operate the assignor’s business for a period of time. The ability to operate the assignor’s business for a limited time and for the limited purpose of

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221 Cal. Civil Code § 3439.07(d). However, there is a recent California case which held that a statute that gives an assignee the authority to recover preferences is pre-empted by the bankruptcy code. See In re Sherwood Partners, Inc., 394 F.3d 1198 (9th Cir. 2005).
selling the assets on a going-concern basis is beneficial in maximizing value for creditors. Furthermore, the assignor’s ability to utilize Article 9 of the UCC, fraudulent transfer laws and preference laws, where applicable, provides the assignee with leverage to deal with creditors.

The primary disadvantage with the assignment for the benefit of creditors is the absence of a discharge. An assignee may not sell real estate free and clear of liens unless to by the secured creditor. However, the purchaser may receive the real estate free and clear of unsecured debts. Therefore, the assignee must realize enough proceeds to satisfy claims of secured creditors against real estate or other assets subject to liens unless the secured creditors agree to receipt of less than the entire debt owed.

An assignee for the benefit of creditors is bound to exercise the same care in the management of the estate entrusted to him that an ordinarily prudent person would use in his own affairs under like circumstances. An assignee may be held personally liable for such losses, deficiencies or injuries as occasioned by violation of this rule and the duties it imposes. On the other hand, a receiver may be liable on his receiver’s bond or by statute depending upon the particular jurisdiction. In one case, the court found that the express language of the Illinois Code of Civil Procedure permitted an original action against a receiver for its conduct in caring for property during the course of the receivership.

The possibility of a dividend after payment of administrative costs exists. The possibility of all creditors agreeing to accept proceeds in full from the liquidation of assets in full release of their claims also exists. Additionally, an assignment does not provide for reorganization of a distressed company. Ultimately, the assignment requires the cooperation of a large number of creditors. Dissenting creditors may threaten or bring an involuntary bankruptcy proceeding. However, there is logistical pressure on creditors to accept the assignment process because of the expense of bankruptcy and the ultimate absence of an advantage from a bankruptcy.

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