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The ABCDs of Equity Receiverships

Presented by:
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ABCDs of Equity Receiverships

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ABCDs of Equity Receiverships

- A is for Ancient History and Appointment
- B is for Business Operations
- C is for Claims
- D is for Distribution, Discharge, and Dismissal



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ABCDs of Equity Receiverships

- “Receiver” has unfortunately become ambiguous. The most common receivership is “foreclosure” receiver.
- This is court officer who controls property being foreclosed upon until the foreclosure is resolved.
- These often do not even require lawyers, and are not the subject of this talk.



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ABCDs of Equity Receiverships

- Statutory or regulatory receivers are receivers put enabled by statute or regulation, not inherent power of judicial branch.
- The Resolution Trust Corporation that Congress put in place during FSLIC/FDIC failures was this type of receiver.
- These are highly particularized, and are also not the subject of this talk.



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ABCDs of Equity Receiverships

- We are talking about receivers *pendente lite* also called “equity receiver.”
- Equity Receiver is court officer that supervises and runs an entire business, trust, estate, or certain assets.
- Recent Uniform Act confuses terminology and receiver is now called “custodian” and a liquidator is called a “receiver.”



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A is for Ancient History

- From the 1600s into the 1900s, Britain ruled the waves.
- This was not just the Royal Navy.
- England had world’s largest commercial fleet.



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A is for Ancient History

- Problems arose when a tradesman would work on a ship but not get paid.
- The law gave the tradesman a lien against a ship.
- The tradesman could prevent the ship from leaving port.



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A is for Ancient History

- If the ship did not leave port, it could not generate the money to pay the lien-holder.
- If the ship did not leave port, it could not engage in commerce and the government could not collect taxes.
- This was correctly viewed as unnecessarily wasteful.



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A is for Ancient History

- English chancery courts hit upon idea of a court officer that went on ship as it left port and “received” monies paid to the ship as it unloaded cargo.
- The receiver paid those working on the ship, and took remainder of the money back to chancery court to pay the lien holder (or as the court directed).



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A is for Ancient History

- The English chancery expanded this process to other cases where a receiver was appointed pending litigation (*“pendente lite”*).
- The idea was to put a company, trust, estate, or other asset under court supervision pending litigation to avoid waste.



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A is for Ancient History

- American courts that sit in equity began appointing receivers pending litigation to avoid waste even before the American Revolution.
- Appointing a receiver is an inherent power of an equity court, along with injunctions, contempt, and masters.



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A is for Appointment

- Modern receiverships work the same way, except instead of a ship they involve a company, trust, estate, or asset.
- The principal of receiverships is still to avoid waste to a valuable asset.
- Common law applies, and varies state-to-state and federally.



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A is for Appointment

- An equity receiver is one of the most powerful and flexible remedies known to Anglo-American jurisprudence.
- The circumstances where a court with equitable powers might appoint a receiver are almost limitless.
- Some scenarios occur repeatedly, however.



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A is for Appointment

- Ineffective management of a business that leads to waste.
 - Deadlock of equity (or similar problem);
 - Incompetent management, and usual methods of removal don't work;
 - Bad management (same); and
 - Mistrusted management (same).



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A is for Appointment

- The same sorts of issues regarding trusts.
 - Ineffective trustee;
 - Incompetent trustee, and usual methods of removal don't work;
 - trustee management (same); and
 - Mistrusted trustee (same).



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A is for Appointment

- A secured creditor might get a receiver appointed just over the property that is the security.
- A receiver can be appointed in a divorce over the marital estate or a part thereof.
- A receiver can be appointed pending dissolution of a company or a trust.



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A is for Appointment

- Can be for limited purpose:
 - Supervising litigation where stakeholders are conflicted.
 - Supervising elections or other procedure to determine who really is proper management.
 - Controlling assets while management is temporarily incapacitated.



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A is for Appointment

- Post-judgment to assist in judgment collection.
 - Judgment debtor is still operating.
 - Judgment creditor's judgment never seems to make it to top of "pay" stack.
 - Usual collection methods have been tried and failed.



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A is for Appointment

- “If the only tool you have is a hammer, every problem looks like a nail.”

– Psychologist Abraham Maslow



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A is for Appointment

- If the problem is really cash, bankruptcy may be indicated.
- If cash is just a symptom, and the real problem is the management, then receivership may be indicated.



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A is for Appointment

- Court appoints receiver to supervise certain assets under court's control.
- This can be entire company, or only certain assets of company.
- This creates new estate that a receiver supervises.
- The appointing court enjoins entire world from interfering with the assets under its control.



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A is for Appointment

- Equity receivership is extraordinary remedy.
- Think preliminary injunction on steroids.
- Court will not appoint receiver lightly.



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A is for Appointment

- Generally to have standing, plaintiff must have interest in property put into receivership.
- Equity owner of company.
- Secured creditor.
- Unsecured creditor only if also fraud or other serious malfeasance by company.
- Beneficiary of trust or estate.



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A is for Appointment

- Unlike bankruptcy, there is no panel of receivers.
- Party desiring a receiver selects and proposes receiver to court.
- Defendant may propose own receiver.
- Court is not bound by either proposed receiver, and can select its own.



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A is for Appointment

- This is great advantage over bankruptcy.
- Court appointing receiver can select a receiver familiar with business or industry (any maybe not a lawyer!).
- Once appointed, however, receiver is beholden to court, not plaintiff.
- Plaintiffs, and some receivers, tend to forget this.



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A is for Appointment

- Plaintiff files complaint and asks for hearing.
- Court may or may not have hearing.
- While *ex parte* appointments are often allowed by contract in mortgages/deeds of trust, for equity receivership court will typically have a hearing.
- Federal court – appointment of receiver cannot be only claim for relief.



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A is for Appointment

- Fundamental reason to appoint a receiver is to avoid waste (recall the ship stuck in port due to pending legal dispute).
- Where a company is not functioning and usual legal remedies will not work, it may be proper to get a receiver appointed.



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A is for Appointment

- Bankruptcy trustee has nice separation of powers:
 - Operates pursuant to Bankruptcy Code adopted by Congress (Article I to U.S. Constitution).
 - Is an Article II Appointee – taken from a panel of trustees selected by U.S. Trustee who is appointed by U.S. Attorney who is appointed by the President.
 - Appears in front of Article III appointee with appeal to Article III courts.



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A is for Appointment

- Receiver is Art. III top to bottom:
 - Appointed by court.
 - Reports to court.
 - Can only be disciplined by court.



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A is for Appointment

- Unlike bankruptcy, no code or rules for receiverships (appointment is inherent power of judicial branch).
- A receiver is given its powers and duties by the Order Appointing Receiver.
- A good Order Appointing Receiver will run 16 to 20 pages.



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A is for Appointment

- Plaintiff may want to interview several prospective receivers.
- Because the receiver has to work under with the Order Appointing Receiver, it is typical for the receiver to be involved in its drafting.
- The receiver typically is not substantially involved in drafting the complaint or motion to appoint, however — this could create a conflict of interest.



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A is for Appointment

- Plaintiff files complaint and motion to appoint receiver.
- Under federal law, receivership is only a remedy and there must be some other claim for relief justifying appointment.
- Some states allow appointment of receiver to be sole claim for relief.



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A is for Appointment

- Once motion is made, defendant may also want to interview prospective receiver.
- If defendant proffers a different receiver candidate, plaintiff may want to interview that candidate as well.
- Defendant can also tender own proposed form of Order Appointing Receiver.



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A is for Appointment

- Court can reject all candidates and select its own.
- Court can enter modify proposed order.



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A is for Appointment

- A good order appointing receiver should include:
 - Findings of jurisdiction and venue;
 - Findings that support appointment;
 - Conclusion supporting appointment;
 - Order that it takes effective immediately upon posting of oath and bond;
 - Order that the receiver is directed and empowered to take control of the estate;



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A is for Appointment

- A good order appointing receiver should include (con't):
 - Findings of jurisdiction and venue;
 - Findings that support appointment;
 - Conclusion supporting appointment;
 - Order that it takes effective immediately upon posting of oath and bond;
 - Order that the receiver is directed and empowered to take control of the estate;



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A is for Appointment

- A good order appointing receiver should include (con't):
 - Order that the receiver has “usual powers”;
 - Power to sell Receiver’s Certificates;
 - Power for receiver to hire professionals;
 - Power for receiver to pay himself and its professionals;
 - Fixing receiver’s compensation; and
 - Fixing priority of payment.



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A is for Appointment

- Payment priority in Order generally follows “absolute priority” rule (originally in receiverships – later coopted by Congress for bankruptcy code):
 - Receiver;
 - Receiver’s counsel
 - Other administrative creditors;
 - Receiver’s Certificate Holders (receivership equivalent of bankruptcy super-priority lien);



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A is for Appointment

- Payment priority in Order generally follows “absolute priority” rule:
 - Secured pre-appointment creditors (only as to secured property);
 - Priority pre-appointment creditors (usually taxes or employee wages;
 - Unsecured pre-appointment creditors; and
 - Equity.



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A is for Appointment

- A good order appointing receiver may include:
 - Ability to get help from sheriff or marshal;
 - Order that defendants not hold themselves out as company;
 - How often make reports (rarely more often than monthly).



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A is for Appointment

- Typically, bond is required to protect against malfeasance.
- Amount is set by court.
- An oath is also usually required.
- Some case law says if no oath or bond posted, all actions thereafter are void.
- At common law, if estate becomes administratively insolvent, party that obtained appointment has to pay receiver's administrative expenses.



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B is for Business Operations

- Once receiver is appointed, all assets in the estate are *in custodia legis* ("in the custody of the law").
- You can think of a receivership as "the company" as sitting in the courtroom.
- Receiver operates company but under the control and direction of the court.
- Court enjoins entire world from interfering.



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B is for Business Operations

- Receiver is officer (sometimes “arm”) of Court.
- Takes direction from Court.
- Treats all parties and claimants equally (must be neutral and unbiased).



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B is for Business Operations

- Once receiver is appointed, it should promptly take control of all assets especially cash and bank accounts.
- The receiver typically tries to operate the company as it was before as much as possible at least until it understands the situation.



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B is for Business Operations

- Receivership does not have automatic stay like bankruptcy does.
- Typically court enjoins equitable actions against the company (actions designed to make the company do or not do something).
- Legal actions (claims to recover a debt) are more problematic—receivership court generally cannot stay pre-existing legal actions.



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B is for Business Operations

- State court: if receivership estate property is also in another state, then the receiver may have to get “ancillary” receivership created in that other state so it can exercise powers over property there.



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B is for Business Operations

- Federal court: receiver must send notice pursuant to 28 U.S.C. § 754 to any other district that has estate property “within 10 days after . . . appointment.”
- Split of authority whether this is absolute, or notice can be sent within 10 days of learning of property in such district.



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B is for Business Operations

- The receiver must keep an eye on why it was appointed:
 - If for sale, it should immediately start working toward a sale of the company as a going concern.
 - If that is not possible, it should work on orderly liquidation.
 - If its job is merely to care take the company until some issue is resolved, then it should operate until the issue is resolved.



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B is for Business Operations

- Receiver should always only act pursuant to court orders.
- In many states, receivers have quasi-judicial immunity and cannot be sued except for deliberately wrongful conduct.
- Other states hold receivers to fiduciary standard to estate.



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B is for Business Operations

- Receiver can hire as its agents whoever it needs to operate the property properly.
- This may be a businessperson as receiver hiring a lawyer, or it may be a lawyer as receiver hiring a businessperson.



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B is for Business Operations

- Receiver should promptly get order immunizing its agents from suit to the same extent he is immune.
- Receiver may want to get order regarding discovery sought from estate—spending time on litigation rather than running company not good for estate.



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B is for Business Operations

- Generally, administrative costs are paid out of operations.
- If operation does not generate cash to pay receiver's agents, receiver can sell "receiver certificates" that act as first lien on property.
- This is the equivalent of a bankruptcy Section 363 super-priority lien.



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B is for Business Operations

- Key advantage over bankruptcy: the receiver can pay himself and his lawyers and other agents first, without an additional court order beyond the order appointing receiver.
- The receiver then reports the payments to the court after the fact.



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B is for Business Operations

- Receiver should regularly report to court all actions it is taking.
- Receiver should regularly ask for court approval for all actions it is taking.
- This carries cost (especially in litigation) but is best course of action.



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B is for Business Operations

- Receiver can operate business as usual without special orders of court.
- A sale out of the ordinary course of business requires court approval in advance and confirmation after the fact.
- Sale of real property out of the ordinary course without a post-sale confirmation order may be void.



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B is for Business Operations

- Sometimes inexperienced buyers ask receivers for warranties and representations at time of sale – this is foolish.
- Receivers generally cannot give them.
- Even if they could, they are useless once receiver is discharged.
- Instead, buyer gets court order that runs with property saying buyer's ownership is free and clear.



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B is for Business Operations

- Buyer's confirmation order should expressly state that buyer is getting property free and clear of claims, liens, and encumbrances.
- Claims, liens, and encumbrances attach to proceeds of sale in same order (but junior to receivership's administrative expenses).
- This can prime pre-existing mortgage.



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C is for Claims

- Biggest difference between a receivership and a bankruptcy: receiverships generally cannot discharge debt.
- Liens against assets of company usually attach to proceeds of sales conducted by receivers.
- Creditors must file claims with the estate to be paid out of proceeds.
- This is akin to a bankruptcy "substitution of collateral."



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C is for Claims

- Receiver can use carrot rather than stick to stop legal actions against assets in his custody.
- Receiver should promptly obtain order to present and file claims with short bar date.
- Note that this is different than bankruptcy, which typically does not call for claims until it knows it has property to distribute.
- Point of this order is really getting jurisdiction over all claimants.



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C is for Claims

- Order to Present and File Claims should require a party to file a claim if it wants to participate in distribution from estate.
- Order should require claimants to drop all pending litigation in other courts and bring claims in receivership court.
- This now has same effect as automatic stay: If creditors want to participate in receivership distribution, they must bring all litigation in the receivership case.



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C is for Claims

- Pre-appointment creditors file claims (usually to be paid at wind-down of estate).
- Receiver makes recommendations to Court.
- Any party or claimant can object.
- Court makes decision on allowance or disallowance.



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C is for Claims

- Resolution of disputed claims requires “notice and opportunity to be heard.”
- Full blown Rules of Civil Procedure are not required or claim resolution – Court can adopt abbreviated procedures.
- Court may allow discovery, no discovery, or limited discovery.



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C is for Claims

- Interest on claims can be disallowed, and usually is if estate is not paid in full.
- Same for attorneys' fees.



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C is for Claims

- While technically receiverships cannot discharge debt, some receivership courts enter “cram down” orders where:
 - A third party puts some money in, but will only do so if it ends all litigation;
 - Amount put in is not enough to pay all claims; and
 - Court approves deal and issues injunction against future claims.



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D is for Distribution

- Usually, receivership ends with some kind of sale.
- Other times, distribution can be in-kind.
- Receiver's only distributes assets (or cash) as ordered by the court.



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D is for Distribution

- Receiver can only “approve” a claim, but it takes court order to “allow” a claim so that the receiver actually pays it.
- Receivers usually do not get involved in inter-claimant disputes, such as priority disputes.



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D is for Distribution

- Receivership usually pays out in this order:
 - Receiver;
 - Receiver's professionals;
 - Receiver's certificate holders;
 - Secured pre-appointment claims;
 - Priority pre-appointment claims;
 - General unsecured pre-appointment claims;
 - Equity.



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D is for Discharge

- Sometimes receiverships terminate with successful recapitalization of company, and thus no sale.
- Also no final sale generally where receiver was appointed for limited purpose.
- In these (and some other) cases, the receiver asks to be discharged because its work is finished.



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D is for Discharge

- If successful reorganization or limited purpose, receivership may carry less stigma than bankruptcy.
- Caption just shows up as regular civil lawsuit (*Smith v. ABC Co.*), not like a bankruptcy filing.



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D is for Discharge

- At conclusion of case, receiver should get:
 - Findings from court that all actions it has take are correct;
 - Order from discharging receiver and receiver's bond;
 - Order that any future dispute be brought in receivership court.



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D is for Dismissal

- Usually contemporaneously with receiver's dismissal, case is dismissed.
- Court often retains jurisdiction to hear any disputes that arose out of receiver's conduct.



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E is for the End

- A receivership can be a powerful tool for creditors or investors of troubled companies.
- Receiverships can provide greater flexibility and precision than bankruptcies.
- Receiverships require careful advance planning.



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Questions?

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