FEATURE ARTICLE

JOHN M. (JACK) TANNER, Esq.
Fairfield and Woods, P.C.

PART I

Equitable Receivership as an Alternative to Bankruptcy

When a receivership may be a good idea for a creditor, and how to get a receiver appointed over a debtor.

"Unlike a bankruptcy, which is given substance and structure by the Bankruptcy Code, statutes regarding receiverships are scant. This flexibility, which is one of the greatest advantages of a receivership, comes with a price."

"If the only tool you have is a hammer, you treat every problem like a nail." — Abraham Maslow

When a company gets into financial trouble, many creditors' reaction is to seek to put the debtor into bankruptcy. An equitable receivership may be the better course of action for creditors, however. For purposes of this article, an "equitable receivership" is a receivership that is neither a simple care-taking pending foreclosure nor initiated by a governmental regulator.

There are two primary advantages of a receivership. First, it immediately replaces management with the receiver, whereas a bankruptcy entrenches management. If money is really the problem, bankruptcy may a good course of action; but if money is just a symptom and the actual problem is management, then a receivership may be better for creditors.

Second, a receivership has greater flexibility than a bankruptcy. The individual or company best suited to serve as receiver may be appointed. A receivership judge can set out virtually any procedures that are appropriate.

Bases for Appointment of a Receiver

While most commercial Deeds of Trust provide for appointment of a receiver upon default, few asset-based loan documents do. As such, a creditor is left to seek appointment under Colo-

Visit our web site at

www.coloradobankers.org

rado law, which provides a receiver may be appointed whenever in fairness one should be appointed. Appointment is, however, considered an “extraordinary remedy” and done only when there is no other adequate remedy available. A receiver can be appointed for the company itself, for some or all its assets, or both. The appointment of a receiver creates an estate, similar to a bankruptcy estate.

The circumstances in which a receiver might be a good idea are limitless. There are, however, some recurring situations where an equity receiver is appointed:

Impotent Management of a Business

When management is not being effective and the usual methods of replacement do not work. For example:

- **Deadlocked shareholders or partners.** In many privately owned companies, the equity is owned equally by a small number of people, and if this number is even a deadlock may occur. A deadlock that is causing the company injury cries out for a receivership.
- **Bad management.** At times a controlling shareholder may not be doing what is best for the company, but is not susceptible to a shareholder derivative suit. He or she may be judgment proof, may have abandoned his or her role, or such a suit may just take too long to be effective.
- **Mistrusted management/limited receivership.** A receiver may be appointed for a limited function when there is concern about who really is management. In the Yellow Cab receivership, there was concern about voter fraud in the election of management, so a receiver was appointed to supervise the election.

Trusts

A trust may also give rise the appointment of a receiver. For example:

- **Intra-beneficiary dispute.** Where there is a dispute among actual or potential beneficiaries of a trust, appointment of a receiver may allow the trustee to satisfy the duty to distribute or otherwise maintain the status quo until the dispute is resolved.
- **Beneficiary/trustee dispute.** Where there is a dispute between the beneficiaries and the trustee, the appointment of a receiver may be in the interest of the beneficiaries so that the trustee cannot use the trust corpus to fund the litigation against the beneficiaries.

Domestic

During a divorce, issues may arise regarding ownership or management of a family business. A receiver may be advisable in such a situation.

After Judgment

A receiver may be appointed after judgment to dispose of the property of the judgment debtor by way of a more orderly (and more profitable) procedure than a mere Sheriff’s sale, such as a sale as a going concern.

Mechanics of Appointment of Equity Receiver

A receivership action is commenced by the filing of a complaint seeking the appointment of a receiver. A verified motion is usually filed at the same time—this immediately brings the issue to the court’s attention.

Proposing a Receiver

The plaintiff must propose a specific receiver—there is no panel as there is for bankruptcy trustees. The receiver must be neutral and, once the receiver is appointed, the plaintiff has no legal control over the receiver’s actions. The receiver is an officer of the court and has fiduciary-like duties to the court and whoever the court ultimately determines are the proper beneficiaries (usually creditors and equity). The receiver does not and cannot owe the plaintiff any more duties than it owes others.

Even if the case is a proper one for a receiver, the plaintiff’s proposed receiver may be rejected by the court. The defendant may propose its own receiver, who also may be rejected by the court. The court can even select its own receiver.

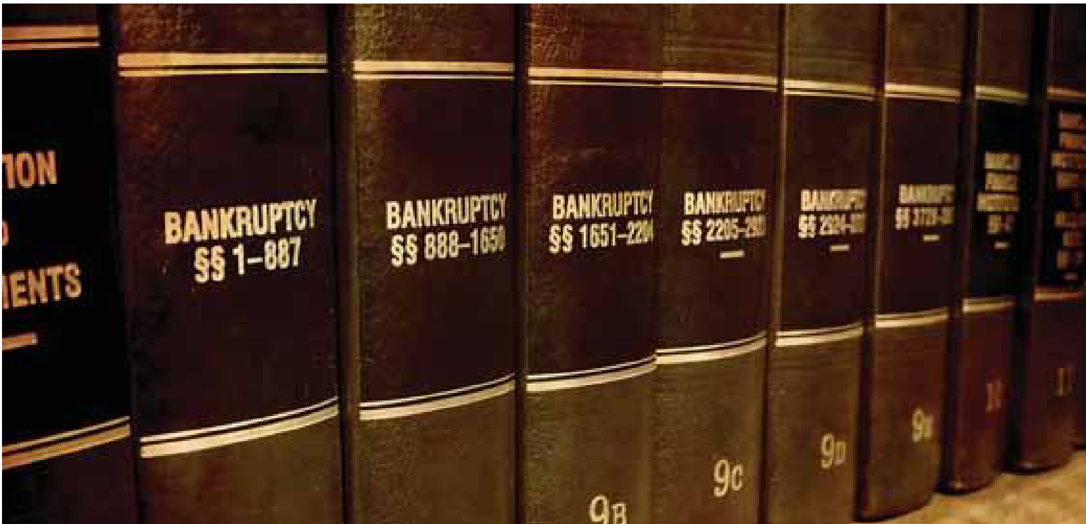
One way the plaintiff may exert influence over a receiver is in funding. Often a receivership estate lacks sufficient cashflow, so the receiver sells receiver’s certificates (liens against the estate—discussed in Part II in the next issue of Colorado Banker) to fund operations. As a practical matter, the plaintiff is the most likely the buyer of such certificates, and may decide to buy them only under certain conditions.

The Appointing Order

Unlike a bankruptcy, which is given substance and structure by the Bankruptcy Code, statutes regarding receiverships are scant. This flexibility, which is one of the greatest advantages of a receivership, comes with a price: the powers of a receiver are limited to those set out in the court orders. As such, the Order Appointing Receiver needs careful thought and consideration, and should be as broad and detailed as possible. ■

END PART I. In the next issue of Colorado Banker, the author discusses how a receivership proceeds, how assets are distributed to creditors and other claimants, and how the receivership is concluded.

About the author: Jack Tanner is a commercial litigator with Fairfield and Woods, P.C., with considerable experience in the area of receiverships and other litigation relating to troubled companies. He can be reached at 303.894.4495 and jtanner@fwlaw.com.



FEATURE ARTICLE

JOHN M. (JACK) TANNER, Esq.
Fairfield and Woods, P.C.

PART II

Equitable Receivership as an Alternative to Bankruptcy

How a receivership operates, how claims are paid, and how the receivership is resolved.

This is the second in a two-part series. In the first part, the author discussed situations where a creditor might find it advantageous to get a receiver appointed over a debtor and how to obtain the appointment of a receiver.

Immediate Effect of Appointment

When a company is put into receivership, the receiver immediately supplants company management. For this reason alone, creditors may prefer a receivership over bankruptcy when a debtor company has a sound business plan and its money problems are just a symptom of bad management. A bankruptcy, on the other hand, tends to entrench that bad management.

The appointment of a receiver puts all property subject to the suit into the custody of the court, which acts through its receiver. Although the receiver taking physical possession of property is helpful, it is not required. Any interference with the receiver's functions is punishable by contempt of court.

Early Actions

- **Nationwide notice (federal receiverships).** A federal receiver has jurisdiction only over property in judicial districts where it was appointed or where it files certain paperwork. Filing the papers is often a federal receiver's first task.
- **Equitable stay.** The appointing court should enter an order prohibiting any other court from entering orders that purport to order the receiver to do (or not do) anything. This includes execution on a money judgment or orders compelling discovery.
- **Order to present and file claims/bar date.** An Order to Present and File Claims

Receivership | continued on page 16

"Receiverships offer greater flexibility for creditors than do bankruptcies. A receivership immediately eliminates bad management and puts the company under the supervision of the court."

with a quick bar date that requires a claimant to dismiss any other claims (such as pending litigation) before filing a claim is helpful in consolidating all actions into the receivership. Such an order should be sent to all potential claimants.

- **Order protecting agents.** Receivers have about the same judicial immunity as a judge. The receiver should obtain an order stating that all its agents have that same immunity.
- **Discovery.** The court should enter an order that allows discovery against the receiver but interferes as little as possible with the receiver's primary duties.

General Operation

Receiver's Reports

The receiver should file regular reports. The reports inform the court and the estate what has happened, may protect the actions of the receiver from later attack, and can suggest the direction a receiver is considering (this can flush out objections early in the proceedings and thereby save time and money).

As a general rule, receiver's reports should be ministerial and non-adversarial. They must be signed under oath by the receiver and be sent to all parties, and should be sent to all claimants. A receiver may distribute via posting on the Internet.

Gathering and Protecting Assets

The receiver's charge is to gather and protect assets. If the assets are tangible, it may require leg work and the help of law enforcement. If the assets are intangible, protecting them becomes more complicated. In the *Indian Motorcycle* receivership, protecting the primary asset—the Indian Motorcycle trademark—involved buying companies, filing litigation, hiring a licensing agent, entering into licenses, and otherwise expanding the business beyond its original parameters.

Raising Money

If cash flow does not allow the receiver to pay itself, its counsel, and other post-appointment creditors, the receiver may sell receiver's certificates to raise funds. These certificates are secured by a lien on the assets of the estate.

Paying Expenses

A contract should be approved before the receiver acts pursuant to it. This can be done in the appointing order, monthly receiver's reports, or by separate motion. Once approved, the receiver need not get approval for each subsequent act further to the contract. Unlike a bankruptcy trustee, receivers seldom have to put the full detailed bills of themselves and their counsel on the public record, which can be another advantage.

Winding Up a Receivership

- **Determination of claims.** Receivers should set up the most expedited process reasonable to determine claims. Due process is satisfied as long as the claimant has notice and an opportunity to be heard. Generally, a receiver should not spend efforts litigating with the estate if it can be reasonably avoided.
- **Payment of claims.** Once the sale is completed, the receiver distributes the assets pursuant to a formula, which is usually proposed by the receiver and approved by the court after considering any objections. Typically, the receiver and its counsel are paid first (to the extent they have not already been paid), receivership certificate holders second, the receiver's other administrative creditors third, and pre-appointment creditors after that. As in bankruptcy, pre-appointment creditors tend to fall into classes, but the classes are neither rigid nor statutorily imposed. Typically, distribution is based on the "absolute priority" rule: secured, unsecured (priority), unsecured (general), and then equity.

Reorganization

In some instances, receiver will be able to successfully reorganize the company. As a receivership cannot discharge debt, which means all bills are either paid in full or new arrangements are reached with enough creditors that the company can succeed. At that time, the receiver is discharged.

Sale

If the company cannot be reorganized, its must be liquidated or distributed in kind. The sale can be on any terms and conditions the court sets, and is reviewable only for the grossest abuse of discretion. A receiver generally does not give representations and warranties, but provides a court order saying that the sale is free and clear from all claims, liens, and encumbrances of parties with notice of the receivership.

Discharge of the Receiver

Once the company is reorganized or the claimants are paid, the receiver is discharged. This ends the estate and creditors with actual or constructive knowledge of the receivership generally cannot pursue the receiver, the estate, or the buyer for debts that existed before the closure of the estate.

Conclusion

Receiverships offer greater flexibility for creditors than do bankruptcies. A receivership immediately eliminates bad management and puts the company under the supervision of the court. The receiver can be chosen for his or her knowledge of the industry of the troubled company. In the proper case, a receivership can be an effective process for creditors or investors of a troubled company. ■

Jack Tanner is a commercial litigator with Fairfield and Woods, P.C., with considerable experience in the area of receiverships and other litigation relating to troubled companies. He can be reached at 303.894.4495 and jtanner@fwlaw.com.