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Legal Alert



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California Superior Court Invalidates Receiver's Sale of Real Property Holding That the Sale of Collateral Over the Objection of the Borrower is Tantamount to Foreclosure

This alert applies to secured lenders and court-appointed real property receivers considering the disposition of receivership estate property by receiver's sale.

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Attorneys, lenders, and court-appointed receivers have often debated the limits of a receiver's power to sell real property out of a receivership. While receivers have for years cited to the same statutory authority and case law for the proposition that they are empowered to sell real property out of a receivership, one California Superior Court recently concluded that there are significant restraints on a receiver's ability to conclude such a sale. In *Wachovia Bank, NA v. Downtown Sunnyvale Residential, LLC, et al.*, the Santa Clara Superior Court likened the receiver's proposed sale to a *de facto* foreclosure, and refused to approve the sale, despite the fact a different judge in the same court had previously authorized the receiver to sell the property.

Overview of remedy

Under California law, in the event of a borrower default, a lender with a security interest in real property has various legal remedies available under the terms of its loan agreement and deed of trust. Three common remedies are nonjudicial foreclosure, judicial foreclosure, and the right to seek the appointment of a receiver to, among other things, maintain and protect the real property that serves as collateral for a loan. Unsurprisingly, each has attendant risks and benefits. For example, nonjudicial foreclosure allows for a quick and inexpensive foreclosure, but eliminates a lender's ability to recover a deficiency judgment against a defaulting borrower. Judicial foreclosure is considerably more time consuming and costly, and provides the borrower with a right of redemption, but maintains a lender's ability to seek a deficiency judgment against a borrower. The appointment of a receiver can also be expensive and time-consuming, but is often favored by lenders because it permits greater flexibility and protections, including in connection with the sale of real property out of a receivership. For example, a receiver's sale may benefit the lender by paying off the lender's loan without the lender incurring the risks and liabilities attendant to holding legal title to the property.

A receiver is a neutral third-party appointed by the court. Under California law, a receiver is, by definition, an agent of the appointing court, not any of the parties, despite the fact that a receiver is typically appointed at a lender's request. California law recognizes the right to appoint a receiver under a variety of enumerated circumstances, the most common of which is 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. A receiver may be appointed to complete construction of a stalled or troubled project, and perform necessary clean-up at contaminated property. California also recognizes the general equitable right to appoint receivers "in all other cases where necessary to preserve the property or rights of any party." An equity receiver typically has the authority to take complete control over an entity to preserve the value of the entity and its assets, which may ultimately include a decision to, among other things, wind up the entity and liquidate its assets.

Because it is the lender, as plaintiff, that usually seeks the appointment of the receiver, the lender and its counsel often influence the direction of the receivership through the preparation of a customized order appointing the receiver. For example, the order spells out the specific powers the lender would like the receiver to have. Frequently, this includes the power to sell real property free and clear of any liens.

Summary of Case

In the *Downtown Sunnyvale* case, the lender sought and obtained the appointment of a receiver in connection with a large but incomplete retail development project. The owners of the project effectively abandoned it in 2009, resulting in over \$20 million in mechanics' lien claims and unpaid property taxes. The receiver sought and obtained approval from the court to sell the property out of the receivership. In accordance with that order, the receiver sent out 500 solicitations, received thirty bids, identified the six best bids, and ultimately selected one bid as better than all others. The selected bidder made a \$10 million nonrefundable deposit, and the receiver sought approval from the court to consummate the contemplated sale. Although the receiver complied with an existing court order from a prior judge regarding sale procedures, the borrower objected to the sale when it finally came for hearing and the court ultimately denied the receiver's request for permission to sell the property.

At oral argument on the motion to approve sale, the lender emphasized the equitable role being performed by the receiver over a then-abandoned property that returned no rents or profits. The *Downtown Sunnyvale* court nonetheless characterized the receiver as merely a rents-and-profits receiver, as opposed to an equity receiver, and found it compelling that the receiver was appointed in a lawsuit for judicial foreclosure and specific performance of a rents provision. The court likened the sale of the property over the objections of the borrower to a foreclosure that lacked the statutory protections guaranteed under California law. The borrower complained that it should be able to buy the property.

Lessons

The *Downtown Sunnyvale* case suggests that the onus is on receivers to demonstrate that, either as a consequence of the language of the appointing order or the practical realities of the receivership, they are more than merely a "rents and profits" receiver, and that any contemplated sale procedure affords protections analogous to those provided by California's foreclosure laws; that is, a receiver should be able to demonstrate that a proposed sale is open to all comers, that the best and highest bids will be neutrally evaluated by the receiver in the exercise of his or her business judgment, and that the defaulting borrower's rights will be protected by either allowing them to cure their default and render the contemplated sale moot, or by securing a waiver of those rights. *Downtown Sunnyvale* also strongly suggests that a sale to which a defaulting borrower stipulates is the best way to avoid the concerns raised by the court. Following *Downtown Sunnyvale*, under appropriate circumstances, receivers may seek the stipulation of the defaulting borrower by brokering an agreement between the lender and the borrower whereby the lender offers something of value to the defaulting borrower in exchange for a waiver. Specifically, a lender could agree to waive the right to pursue a deficiency judgment or to waive or limit its rights to pursue the borrower's guarantors. In addition, as the costs of the litigation may be added to the borrower's unpaid debt, receivers may prevail upon borrower to stipulate to a receiver's sale because it will shorten the duration of the litigation and thereby reduce the costs of the litigation and consequently the unpaid debt of the borrower. All proposals for marketing a subject property should be approved by the appointing court, as should all other material steps up to and including the actual sale. The more open and involved with the court a receiver is in connection with a prospective sale, the more likely it is to be approved.

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