

# Receiverships Under State Law: Situational Supervision

**C**ircumstances sometimes call for supervision of an asset or business. The objective may be to protect and preserve assets from the actions of distressed business owners, sell a business on a going concern basis, resolve deadlock, liquidate assets, or pay a judgment. Many states have laws providing for receiverships in these situations.

Various types of state statutory receiverships provide relief and protection to troubled businesses, their creditors, and owners. A statutory receiver is an officer of the court and therefore is answerable to the court and the judicial process for his or her actions.

Receiverships may be general or specific in scope. General receiverships include assignments for the benefit of creditors (ABCs) and receiverships to resolve deadlock in or dissolve a corporation. In a general receivership, the receiver controls the entire business and makes decisions over a broad range of assets and issues. The general receiver is also likely to work for the benefit of the enterprise as a whole and for one or more groups of constituents—for all creditors or all shareholders.

By contrast, in specific receiverships, the receiver has a more limited engagement or deals with a more limited set of assets. For example, a receiver may be appointed in a foreclosure or other proceeding solely to safeguard a particular property or, after a judgment is entered by a court, to locate and liquidate assets and apply the proceeds to one



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creditor's judgment. In the more specific receivership, a receiver often works for the benefit of only one constituent, such as a single mortgage holder or judgment creditor.

## ABCs

Increasingly commonly used are ABCs, which in many states are governed or authorized by statute. At present, 33 states and the District of Columbia have statutory provisions for the procedure in place. In some cases, ABCs are creatures of common law—that is, there are no specific statutes that govern how the ABC works, and the ABC may not be subject to court supervision.

Most ABC statutes allow a debtor to voluntarily assign its assets to a receiver for the benefit of its creditors when the debtor is insolvent. See, e.g., Wash. Rev. Code §

7.08.010; Fla. Stat. § 727.104. Some states also permit a creditor to commence an involuntary ABC against a debtor who is insolvent or when an execution against the debtor or the debtor's property is returned unsatisfied. See, e.g., Wis. Stat. § 128.001.

Receivers must be bonded and can be removed by the court for failing or refusing to perform his or her duties or for mismanagement. Some laws specifically suggest that the receiver be "independent." In many cases, however, the debtor and significant creditors agree on who will be appointed to the position. In involuntary ABCs, a secured lender who instigates the proceeding often chooses the

receiver, who then focuses on selling the lender's collateral.

An ABC receiver has broad powers and authority. The receiver operates the business, incurs and pays expenses, and arranges financing for that purpose. The receiver may also hire appraisers and brokers, and market some or all of the business for sale. The receiver notifies creditors of the pendency of the case, reviews and resolves issues relating to creditor claims, and makes distributions to creditors. Payment priorities differ somewhat from state to state and from the U.S. Bankruptcy Code.

There is generally no automatic stay imposed upon commencement of an ABC as there is when a bankruptcy is filed. However, state courts exercising jurisdiction over the assets of a company in an ABC proceeding

frequently issue orders early in the receivership that operate much like the automatic stay in a bankruptcy case, at least as to unsecured creditors. State receiverships typically cannot stay actions by a consensual lien holder to enforce its rights in its collateral. See, e.g., Fla. Stat. § 727.105.

Receivers in these proceedings have authority to sue and defend litigation relating to the ABC and the assets. That litigation can include a state version of bankruptcy preference actions to avoid and recover from recipients payments made within a defined period prior to the receivership. See, e.g., Wis. Stat. § 128.07.

Often standards for recovery and defenses differ from bankruptcy preference provisions. For example, a state version may require a receiver to prove a preference recipient had reasonable cause to believe that it was receiving a preferential transfer. The issue of preference recovery in connection with an ABC proceeding has generated court decisions, some of which block enforcement of state preference laws and some of which support the preference recovery provisions of state ABCs. See, respectively, *Sherwood Partners, Inc. v. Lycos, Inc.*, 394 F.3d 1198 (9th Cir. 2005) and *Ready Fixtures Co. v. Stevens Cabinets*, 488 F. Supp. 2d 787 (W.D. Wis. 2007).

In many instances, given that the debtor is insolvent and may not even have sufficient assets for a distribution to unsecured creditors, the ABC is effectively a substitute for a foreclosure action or for a sale under Article 9 of the Uniform Commercial Code (UCC). Particularly in states in which foreclosures must be done by judicial action, an ABC provides a mechanism to avoid a sheriff's sale, a foreclosure redemption period, and the depressed values typical of the foreclosure process. In addition, receivership allows a mortgage holder to avoid becoming involved in the chain of title.

The mortgage holder is often the highest—if not the only—bidder at a sheriff's foreclosure sale. The bidding mortgage holder may be concerned about the costs and risks of property ownership, such as environmental issues, building maintenance, property management, insurance, and holding costs.

In a statutory ABC, the receiver may engage a broker and, upon notice to the creditors and debtor, sell the property in a less distressed process than that afforded by a sheriff's sale. There will be an offer to purchase, which may be subject to competitive bidding, and a closing after court approval.

But the process permits financing arrangements in a more "normal" setting than that offered at a sheriff's sale on the courthouse steps, where buyers may be required to appear with a cashier's check for the purchase price in hand, an unlikely way to maximize the value obtained for any significant property.

There is no redemption period in an ABC as there is in a foreclosure, so the waiting time and uncertainty accompanying that mechanism is eliminated in the calculation of the purchase price and completion of the sale process.

Some states permit a "free and clear" sale process by an ABC receiver, akin to the Section 363 sale process in a bankruptcy proceeding. Others do not, and the inability to use a receivership to cleanse a property of liens and encumbrances can make the ABC less attractive than a bankruptcy sale process for going concern and other sales.

State statutory ABC proceedings can be an effective, efficient way to employ a receiver to safeguard, investigate, and sell assets, and to handle myriad creditor issues in a single proceeding. However, because laws regarding a receiver's powers and authority; the treatment of contracts, liens, and claims; preference provisions; and the sale process differ from state to state, businesses, owners, or creditors who

might be contemplating an ABC must analyze whether applying the laws of their states to their particular situations will yield the outcome they desire.

### Corporate Dissolution, Deadlock

All states have a procedure by which a receiver can be appointed as part of a court process to dissolve a corporation. Similar laws exist for other forms of legal entities, such as limited liability companies and limited partnerships. See, e.g., Del. Code Ann. tit. 6, §§ 18-802 and 18-805 (receiverships for limited liability companies in connection with dissolution); §§ 17-802 and 17-805 (receiverships for limited partnerships in connection with dissolution). However, many of these statutes lack the specificity of those dealing with corporations, so the availability and powers of statutory receivers may differ depending on the type of debtor legal entity.

At least 30 states have statutes adopting or similar to the Model Business Corporations Act promulgated by the Committee on Corporate Laws of the American Bar Association's Section of Business Law. The act (§ 14.30) provides for appointment of a

*continued on page 14*



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continued from page 13

receiver in judicial proceedings to dissolve a corporation. Dissolution proceedings may be commenced under a number of circumstances, and various corporate constituents may commence the proceedings. See also, Del. Code Ann. tit. 6 § 279 (receiverships for judicial dissolution) and § 291 (receiverships for insolvent corporations); Cal. Corp. Code § 1803 (appointment of a receiver in an involuntary corporate dissolution); Fla. Stat. § 607.1430 (grounds for judicial dissolution).

A shareholder may commence a judicial dissolution if there is a deadlock among directors and shareholders that threatens irreparable injury to the corporation; the business and affairs of the corporation cannot be conducted; those in control of the corporation are acting in a manner that is illegal, oppressive, or fraudulent; or corporate assets are being misapplied or wasted.

A creditor may commence judicial dissolution if the creditor's claim has been reduced to judgment, the execution on the judgment is returned unsatisfied and the corporation is insolvent, or the corporation has admitted in writing that the creditor's claim is due and owing and the corporation is insolvent. The corporation may also commence its own voluntary judicial dissolution.

State laws allow the court to appoint one or more receivers to wind up and liquidate, or one or more custodians to manage, the business and affairs of the corporation. The court appointing the receiver or custodian has jurisdiction over the corporation and all of its property, wherever that property is located. Model Act § 14.32.

The receiver's duties include the sale of part or all of the company's assets with the court's approval, suing and defending lawsuits for the corporation, and generally exercising the powers of the corporation to the extent necessary to manage its affairs in the best interests of the shareholders and creditors. The court may limit the supervisory powers of the receiver so that he or she acts more as a custodian. The receiver must post a bond and is compensated from the assets of the corporation or proceeds from the sale of the company's assets. See, e.g., Fla. Stat. § 607.1432.

Judicial dissolution statutes, like ABC statutes, often set out a process for creditors and others to be notified and to file claims, and for

the receiver to review, object to, resolve, and pay those claims. See, e.g., Del. Code Ann. tit. 8 §§ 280-81, 295-96.

In addition to the general dissolution statutes, most states have statutory schemes providing for receivers over certain regulated industries, such as banks and other regulated financial institutions, public utilities, and insurance companies.

As with a receivership in connection with an ABC, a receivership for dissolution of an insolvent corporation or other entity may provide a more effective and efficient vehicle than a bankruptcy or other proceeding to maximize the sale value of a business or its assets, and to make distributions to creditors.

The appointment of a receiver does not necessarily preclude a business from exercising its right to file a voluntary bankruptcy or its creditors from filing an involuntary bankruptcy against the business. However, a bankruptcy court may refrain from exercising its jurisdiction over a bankruptcy case if the "interests of creditors and the debtor would be better served by such dismissal . . .". 11 U.S.C. § 305. Sometimes when a state statutory receivership is pending, the bankruptcy court will not exercise jurisdiction over the bankruptcy case, but instead will allow the receivership to run its course in the state court.

### Appointments for Other Limited Purposes

Sometimes a creditor is not interested in pursuing a general receivership, particularly one that benefits not only the creditor initially interested in the receivership, but the debtor's other creditors as well. Frequently the creditor in such a case is a judgment creditor, a secured creditor, or one of a group of creditors interested in attacking a specific transaction or protecting specific assets.

State statutes provide for receiver appointments in various circumstances as an aid to enforcing a party's rights. See, e.g., Cal. Civ. Proc. Code §§ 564-570; Wash. Rev. Code § 7.60 (each listing instances in which the court may appoint a receiver, qualifications and requirements of such receiverships, notices, payment, and completion of receivership proceedings). In addition to the general receiverships described in more detail earlier, statutory receivers may also be appointed in the following situations:

- **Fraudulent Transfers.** The Uniform Fraudulent Transfer Act, adopted by the majority of states, provides a number of remedies for creditors who are victims of fraudulent transfers. Among them is

appointment of a receiver to take charge of the asset fraudulently transferred, or of other property of the transferee. Uniform Fraudulent Transfer Act § 7.

- **Enforcement/Execution of a Judgment.**

Most states also provide for the appointment of receivers to enforce a judgment or to assist a judgment creditor in collecting on its judgment, including identifying, assembling, and liquidating assets of the judgment debtor for payment to the judgment creditor to satisfy amounts due under the judgment. Frequently, just the threat of appointment for these purposes can persuade an uncooperative judgment debtor to find the resources to pay some or all of a judgment.

- **Foreclosures and Property Protection.**

Receivers may be appointed to preserve property or in cases in which property is in danger of being lost, removed, or damaged. Receivers may also be appointed to enforce assignments of leases and rents recorded against real estate.

### Effective, Efficient, Flexible

State statutory receiverships are uniquely suitable for handling certain situations effectively and efficiently. Receivership laws in many states provide a court-supervised mechanism for preserving and liquidating assets and businesses, and handling associated claims. The variety of receiverships available offer considerable flexibility for businesses and their constituents to ensure transparency and an orderly process to protect and administer specific assets and assert particular interests, as well as for more general oversight and wind-up of a business entity. 

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