



Continuing Legal Education

Bankruptcy Nuts 'n' Bolts

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Receiverships: An Alternative Method to Navigate the Seas of Financial Distress

J. Todd Tracy & Steven J. Reilly, The Tracy Law Group PLLC

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**RECEIVERSHIPS: AN ALTERNATIVE METHOD TO
NAVIGATE THE SEAS OF FINANCIAL DISTRESS**

*King County Bar Association Continuing Legal Education:
Bankruptcy Nuts & Bolts*

June 11, 2015

J. Todd Tracy & Steven J. Reilly

The Tracy Law Group PLLC
720 Olive Way, Suite 1000
Seattle, WA 98101
(206) 624-9894

I. Introduction

State court receiverships are becoming an increasingly popular alternative to bankruptcy in Washington State. Receiverships generally cost less and are largely administered by the parties, their attorneys, and an experienced receiver; rather than by the Bankruptcy Court and a Bankruptcy Trustee. This gives the parties greater control over the case and often times costs less.

II. What is a Receiver

A ‘receiver’ is a disinterested person or organization, appointed by a court, or by a corporation or other person, for the protection or collection of property that is the subject of diverse claims. *See Black’s Law Dictionary at 1296 (8th Edition 2004).*

III. Types of Receiverships

There are three main types of receivership appointments:

- (1) A receiver appointed by a government regulator pursuant to a specific statute;
- (2) A privately-appointed receiver; and
- (3) A court-appointed receiver.

Court-appointed receivers may be appointed in state or federal courts, and each jurisdiction may have its own rules relating to a receiver’s appointment. While court-appointed receivers generally derive their power from the common law, there are both federal and state statutes that may address the powers and duties of a receiver in a given scenario.

A discussion of federal receiverships and receiverships brought under other states’ laws is outside of the scope of these materials. Here, we will focus solely on receiverships brought under the Washington State Receivership Act (the “WSRA”), Revised Code of Washington (“RCW”) 7.60 *et al.*

Note: A receiver may be appointed over an entity or an individual, however, there are no discharge provisions in the WSRA so there may be limited benefit to appointing a receiver over an individual.

IV. A Brief History of the Washington State Receivership Act

In 2004, the Washington State legislature overhauled the prior receivership statute, RCW 7.60, and the prior ‘assignment for the benefit of creditors’ (“ABC”) statute,

RCW 7.08.¹ The present receivership statute and provisions relating to ABCs aim to provide a more comprehensive statutory framework that has many of the same protections and benefits as the bankruptcy code, such as an automatic stay of many types of actions and the sale of assets free and clear of liens.

V. Types of Receivers Under the WSRA (RCW 7.60.015)

A receiver may either be a *custodial* receiver or a *general* receiver. Custodial receivers typically have more limited powers and are normally only appointed over particular, specifically-identified collateral. Receivership appointments made solely to collect rents during the pendency of a judicial or non-judicial real property foreclosure are expressly designated as custodial receiverships.

General receivers have broader powers and normally have the power to control and manage the property or entity over which they were appointed with the same rights and powers as the owner(s) of the property over which the receiver was appointed.

Some of the provisions of the WSRA only apply in general receiverships, therefore, the Order Appointing Receiver must specify if the receiver is a custodial receiver or a general receiver. However, after notice and a hearing, a court may convert one type of receivership to the other for good cause shown.

There is a large amount of flexibility in establishing the powers and rights of a receiver. The powers and obligations of both custodial and general receivers can be expanded or limited by the provisions of the Order Appointing Receiver. Finding an attorney who knows how to tailor the Order Appointing Receiver to the specific needs of a case is a must.

While the Order Appointing Receiver can expand or limit a receiver's powers and duties, it is important to note that this flexibility is not unfettered. For example, both custodial and general receivers are subject to the business judgment rule and have a fiduciary duty to act in the best interest of the receivership estate. Additionally, attempting to modify some of the notice provisions within the WSRA may raise due process concerns.

Practice Pointer: Select a receiver who has experience in the same industry as the company that has been placed into receivership.

¹ The WSRA was further amended in 2011 to clarify a few ambiguities that existed after the 2004 amendments.
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VI. Appointment of a Receiver (RCW 7.60.025)

The WSRA provides a multitude of reasons why a receiver should be appointed. Some common examples include: (1) The property or its revenue producing potential is in danger of being materially lost or materially injured (RCW 7.60.025(b)(1)); (2) appointment of a receiver is provided for by agreement or is reasonably necessary to enforce an assignment of rents or other revenue from a particular property (RCW 7.60.025(b)(2)); (3) to the extent property is not exempt from execution, either before or after the issuance of any execution, to preserve and protect the property (RCW 7.60.025(e)); (4) in an action against any person who is not an individual if the object of that action is the dissolution of the at person, or if that person has been dissolved, or if that person is insolvent or not generally paying the person's debts as those debts become due unless they are the subject of a *bona fide* dispute, or if that person is in imminent danger of insolvency (RCW 7.60.025(i)); and (5) in accordance with RCW 7.080.030 (4) and (6), in cases in which a general ABC has been made (RCW 7.60.025(j)).

It should be noted that except where a receiver's appointment is expressly mandated by statute or is made in connection with a foreclosure to enforce an assignments of rents provision, the court must make a finding that: (1) the appointment of a receiver is 'reasonably necessary' and; (2) other remedies are inadequate.

Practice Pointer: A person may still file for bankruptcy protection if they are forced into a receivership.

VII. Eligibility to Serve as a Receiver (7.60.035)

Insiders, felons, parties to the receivership, sheriffs, and anyone having a material conflict of interest are generally not eligible to serve as a receiver.

VIII. Receiver's Bond (78.60.045)

Normally, a receiver must execute a bond with one or more sureties, in an amount specified by the court, before commencing the duties of receiver. The amount of the bond will depend on the size of the receivership and the particular risks in a particular case.

IX. Powers of the Court (7.60.055)

Generally, the court in which the receivership was filed has exclusive jurisdiction over the receivership and any controversies arising thereunder.

Practice Pointer: RCW 7.60.055(2) states that “for good cause shown, the court has the power to shorten or expand the time frames specified in this chapter.” This can be an important provision to remember when operating under time pressure.

X. Powers of a Receiver Generally (RCW 7.60.060)

RCW 7.60.060 enumerates the general powers of a receiver, in addition to those conferred elsewhere in the WSR, or otherwise by statute, court rule or court order. These powers include the ability to do all things that the owner of a business or property may do in the ordinary court of business, the ability to incur and pay expenses necessary to preserve the receivership estate, the power to obtain appraisals, the power to compel a person to submit to an examination under oath, and the power to bring or defend legal actions.

Practice Pointer: RCW 7.60.060(g) states that the receiver can seek and obtain advice or instruction from the court with respect to any course of action with respect to which the receiver is uncertain in the exercise of the receiver’s powers or the discharge of the receiver’s duties. As the WSR is relatively new, there is a paucity of case law addressing its provisions. Many turnaround practitioners attempt to analogize certain similar provisions in the Bankruptcy Code, however, a state court judge may not always agree with such comparison and bankruptcy case law is not necessarily binding on the state court. Therefore, if uncertain, it is best to get the court’s approval before approaching a situation that is not clearly contemplated by the WSR.

XI. Duties of a Receiver Generally (RCW 7.60.060)

The most important duties enumerated in this section are: (1) RCW 7.60.060(2)(a) – the duty to notify all federal and state taxing authorities and applicable regulatory agencies of the receiver’s appointment; and (2) RCW 7.60.060(2)(c) - if the receiver is appointed with respect to any real property, the duty to file with the auditor of the county in which the real property is located (or the register of lands), a certified copy of the Order Appointing Receiver.

XII. Turnover of Property (RCW 7.60.070)

A receiver can compel turnover of estate property by motion, or if there is a bona fide dispute as to the property, the receiver can initiate a lawsuit pursuant to RCW

7.60.160. Failure to turnover estate property that is not in bona fide dispute can result in a finding of contempt and result in sanctions against the non-compliant party.

XIII. Duties of Person Over Whose Property the Receiver is Appointed (RCW 7.60.080)

The person over whose property the receiver is appointed has a duty to cooperate with the receiver, to comply with orders of the court, to supply the receiver with information necessary for the receiver to complete any schedules, to deliver all pertinent documents to the receiver, and is subject to examination under oath by the receiver. This duty extends to officers, directors, managers, members, and partners, or other individuals exercising control of an entity.

XIV. Schedules of Property and Liabilities (RCW 7.60.090)

The receiver must file schedules of the assets and liabilities of the estate. In the case of a general ABC, this must accompany the assignment prior to the appointment of the receiver. In all other cases, schedules must be filed within thirty-five days of the date of appointment of the receiver. The desired form of the schedules is laid out in RCW 7.60.090. If ordered by the court, the receiver may also have to obtain an appraisal or file a complete inventory of property of the estate.

XV. Receiver's Reports (RCW 7.60.100)

A general receiver must file a monthly report of the receiver's operations and financial affairs unless otherwise ordered by the court. A custodial receiver only has to file reports as the court may require.

XVI. Automatic Stay (RCW 7.60.110)

RCW 7.60.110 provides a limited automatic stay of certain proceedings. The stay automatically expires as to most litigation matters sixty days after the entry of the Order Appointing Receiver. The stay may be extended or otherwise modified for good cause pursuant to RCW 7.60.110(2).

The stay does not prevent prosecution of criminal proceedings, proceedings regarding support obligations, regulatory actions, or issuance of a notice of tax deficiency.

Note: The WSR is silent as to who, other than parties to the receivership action, must receive notice of motions to modify the stay.

XVII. Utility Services (RCW 7.60.120)

This section requires a utility provider to give at least fifteen days notice before refusing, altering, or discontinuing service. The receiver can move the court to prohibit any alteration or discontinuance of utility services by providing adequate assurance of payment, as approved by the court after notice and a hearing.

XIII. Executory Contracts and Unexpired Leases (RCW 7.60.130)

This section only applies to general receivers. It allows a general receiver to assume or reject a contract after notice and a hearing. Like in bankruptcy, the receiver must cure any defaults to assume the contract but does not have to cure *ipso facto* clause violations to assume. Assignable contracts under applicable state law can still be assigned by the receiver after they have been assumed. Contracts that are not assignable under applicable state law generally cannot be assigned. If the receiver rejects an executory contract or unexpired lease, it shall be treated as a breach of the contract or lease occurring immediately prior to the receiver's appointment, and the receiver's right to possess or use property pursuant to any executory contract or lease shall terminate upon rejection of the contract or lease.

In the case of a general receiver, any contract with the state shall be deemed rejected if not assumed within sixty days of the appointment of the receiver unless otherwise agreed or ordered by the court.

XIV. Receivership Financing (RCW 7.60.140)

If a receiver is operating a business or managing a person's property, the receiver may obtain unsecured credit in the ordinary course of business, and after notice and a hearing, the receiver may obtain secured credit, and/or unsecured credit outside of the ordinary course.

Note: This provision does not permit priming.

XX. Abandonment of Property (RCW 7.60.150)

After notice and a hearing, estate property that is burdensome or of inconsequential value to the receiver, may be abandoned. However, a receiver may not abandon

hazardous material or property prohibited to be abandoned by other state statute or rule.

XX. Actions by and Against the Receiver or Affecting Property Held by the Receiver (RCW 7.60.160)

The receiver can sue and be sued in the receiver's capacity as such. Litigation by or against the receiver is adjunct to the receivership case and shall be presided over by the judge assigned to the main receivership case. If the state is not a party to the litigation and suit is brought in a venue different than that of the main receivership case, the receiver may seek to change the venue of the adjunct proceedings, assuming the courts of this state have jurisdiction over the case.

Note: RCW 7.60.160(7) provides the following, "A judgment against a general receiver is not a lien on the property or funds of the receivership, nor shall any execution issue thereon, but upon entry of the judgment in the court in which a general receivership is pending, or upon filing in a general receivership of a certified copy of the judgment from another jurisdiction, the judgment shall be treated as an allowed claim in the receivership. A judgment against a custodial receiver shall be treated and has the same effect as a judgment against the person over whose property the receiver is appointed, except that the judgment is not enforceable against estate property unless otherwise ordered by the court upon notice and a hearing."

XXI. Personal Liability of the Receiver (7.60.170)

A receiver will only be personally liable if loss or damage is caused by a failure of the receiver to follow a court order or by an act or omission which would expose a member of a board of directors to personal liability (assuming such director's liability is limited to the maximum extent permitted by RCW 23B.08.320 - limitation on liability of directors). Generally, a receiver is personally liable for failure to remit sales tax collected after appointment generated from property under the receiver's control. The receiver is also personally liable for any loss or damage caused by fraud on the part of the receiver, intentional torts committed by the receiver, or by acts or omissions for which an officer of a business corporation organized and existing under Washington State law would be liable under the same circumstances. RCW 7.60.170(4) provides that only a successor receiver appointed by the court may have a cause of action against the malfeasant receiver under this section.

Practice Pointer: Always pay post-appointment sales tax!

XXII. Employment and Compensation of Professionals (7.60.180)

Subject to court approval, a receiver may employ professionals to assist the receiver so long as such professionals do not have an actual conflict of interest or the inappropriate appearance of a conflict. A receiver is not necessarily precluded from also acting as an attorney or accountant for the estate if it is in the best interests of such estate.

Practice Pointer: In order for the receiver and the receiver's professionals to get paid, they must file and properly serve all parties to the action (and all parties requesting notice of the action), with an itemized billing statement detailing the work completed, time spent, and costs incurred. This must be done on thirty days' notice. If any party objects, the receiver or professional seeking appointment may request a hearing on at least five days notice to the person(s) having filed an objection. In a custodial receivership in aid of foreclosure, the fees and costs incurred can be allowed by stipulation of the secured creditor affected by the appointment.

XXIII. Participation of Creditors and Parties in Interest in Receivership Proceedings: Effect of Court Orders on Non-Parties (RCW 7.60.190)

Creditors and other parties in interest who receive notice of the pendency of the receivership in accordance with 7.60.210 are bound by the acts of the receiver in regard to the receiver's management and disposition of estate property, whether or not they are formally joined as parties.

This section also provides certain notice deadlines. For instance, persons on the master mailing list are entitled to not less than thirty days' written notice of the hearing on any motion or other proceeding involving any proposed; allowance or disallowance of any claim or claims, abandonment, disposition, or distribution of estate property, other than an emergency disposition of property subject to eroding value (think perishable goods) or a disposition of property in the ordinary course of business, settlement of a controversy that may affect distribution to creditors from the estate, compensation of the receiver or a professional employed by the receiver, and/or application for termination of the receivership

Any objection to the proposed action described above must be filed and served on the receiver and the receiver's attorney (if any) at least three days prior to the date of the proposed action.

Practice Pointer: Recall that any time period enunciated in this chapter may be shortened or otherwise modified by the court upon a showing of good cause.

XXIV. Notice to Creditors and Other Parties in Interest (RCW 7.60.200)

A general receiver must provide notice of the receivership by publication in the county or counties in which estate property is known to be located once a week for at least three consecutive weeks. The first notice has to be published within thirty days of the receiver's appointment. Notice must also be mailed to all known creditors and other parties in interest within this same time period. The proscribed form of notice is provided in RCW 7.60.200.

XXV. Submission of Claims in General Receiverships (RCW 7.60.210)

All claims, **except for claims of creditors with security interests (i.e. fully secured creditors)**, arising prior to the receiver's appointment, must be served upon the receiver and receiver's counsel as described in the WSRA. Any claim not so filed will not receive any distribution from the estate. Just as in bankruptcy, a claim, executed and served in accordance with this section constitutes prima facie evidence of the validity and amount of claim. This section is not applicable to custodial receiverships.

Practice Pointer: If you are representing a creditor in a receivership, timely file a claim. It is surprising how often creditors miss out on a distribution because they fail to timely file a claim. Also, if you are representing a receiver, make sure and do a thorough investigation of possible secured claimholders as they do not necessarily have to file a claim.

XXVI. Objection to and Allowance of Claims (7.60.220)

Any time prior to the entry of an order approving the general receiver's final report, the general receiver or any party in interest can object to a claim. Claims that are not disallowed (a.k.a. allowed claims), are entitled to distribution pursuant to the statutory schema spelled out in RCW 7.60.230. Objections to claims are subject to mediation prior to litigation by request. In certain cases, claims may be estimated.

XXVII. Priorities (RCW 7.60.230)

The priority schema in the WSRA is not as detailed as the bankruptcy code but it has a similar structure. See RCW 7.60.230 for the priority and distribution structure.

XXIII. Secured Claims Against After-Acquired Property (RCW 7.60.240)

This section makes clear that pre-receivership security interests which include an after-acquired property clause will attach to after-acquired property of the receivership estate.

XXIX. Interest on Claims (RCW 7.60.250)

The ability to pay post-appointment interest on claims happens so rarely that it will not be addressed in these materials.

XXX. Receiver's Disposition of Property – Sales Free and Clear (RCW 7.60.260)

This section codified a receiver's common law right to sell assets of the receivership estate free and clear of liens. The court may authorize a general receiver to sell free and clear whether or not sale proceeds would be sufficient to satisfy all secured claims, except agricultural and homestead property may not be sold by a receiver absent consent from the owner of the property or if the owner of the property or a property in interest timely objects to the sale and the court finds that the proposed sale is not in the best interest of the estate. Recall that sales outside of the ordinary course require thirty days' notice to all interested parties.

Just as in bankruptcy, all security interest and other liens encumbering the property conveyed transfer to the proceeds of the sale, net reasonable expenses of the sale, in the same order and priority as the liens had immediately prior to the conveyance. Also, as in bankruptcy, secured creditors holding claims against the property may credit bid the amount of their secured claim at a public sale. If there is a co-owner of the property being conveyed, the receiver may partition in accordance with applicable Washington state law.

Reversal of the sale or modification of the sale does not affect the validity of the sale to a good faith purchaser.

XXXI. Resignation or Removal of Receiver (RCW 7.60.270)

The Court, *sua sponte* or on motion by any party in interest, may remove and/or replace the receiver if the receiver fails to execute and file the bond as required by RCW 7.60.045, if the receiver resigns, or if the receiver fails to serve for any other reason. The receiver being replaced must file a final report and accounting with the court prior to the court entering an order discharging the receiver from all further duties and responsibilities after notice and a hearing.

XXXII. Reasons to Move for Appointment of a Receiver

Filing for bankruptcy and moving for the appointment of a receiver each has its own benefits and drawbacks. It is important to consult with counsel that is well-versed in both receivership and bankruptcy law to decide which path would best serve your client. Below is a list of some of the benefits that receiverships offer:

Benefits to Debtors:

For debtors, the primary benefits of filing a receivership are cost and control. While a receiver is a third-party neutral who owes a fiduciary duty to the receivership estate, when a debtor files for appointment of a receiver (oft times through a general assignment for the benefit of creditors) they will have more control selecting a receiver than they would a bankruptcy trustee. This control allows a debtor to find a receiver with specialized knowledge in a particular industry who understands the goals and needs of the debtor. An experienced receiver with specialized knowledge can obtain better results for the debtor, and by extension, for the receivership estate. This can be true in both liquidation and reorganization scenarios.

Receivers play a valuable role in deadlocked businesses by maintaining the operations of the business while disputes are worked out amongst management/owners.

For debtors, receiverships are preferable to bankruptcy where there were potential preference payments made to insiders of the debtor within a year. These 'preferential' payments can be pulled back by a bankruptcy trustee under Section 550 of the bankruptcy code whereas they cannot be pulled back in a receivership.

Finally, moving for appointment of a receiver can give a debtor more time; creditors may allow borrowers additional time to raise capital or sell assets as long as the business is under the control of a receiver. This is particularly true in cases in which the creditor believes that a debtor is in financial distress due to mismanagement.

Benefits to Creditors:

For creditors, the primary benefits of a receivership are also cost and control.

In terms of control, a single creditor may move for the appointment of a receiver. In bankruptcy, however, if a debtor has more than twelve creditors, it is necessary to

have three or more unsecured creditors with non-contingent, non-disputed, liquidated claims to file an involuntary bankruptcy. The WSRA gives an individual creditor the ability to unilaterally move for the appointment of a receiver. However, it should be noted that the filing of an involuntary bankruptcy petition in bad faith, or moving for the appointment of a receiver in bad faith, can subject the moving party(ies) to payment of debtor's costs and fees, as well as punitive sanctions as the court sees fit. *See 11 U.S.C. §303(i) and RCW 7.60.290(5).*

The ability to select a receiver specialized in the same industry as the debtor (rather than having a non-specialized bankruptcy trustee appointed) gives a creditor more control as well. If the creditor is the one who moves for the appointment of the receiver, they will also usually be the one who proposes the appointment of a particular receiver.

A receivership is preferable to bankruptcy for creditors where there were potential preference payments made to the moving creditor within the last ninety days. These 'preferential' payments can be pulled back by a bankruptcy trustee under Section 550 of the bankruptcy code whereas they cannot be pulled back in a receivership.

Finally, a receivership can reduce a creditor's risk of liability. In our experience, receiverships filed by creditors are most common in real property foreclosures. Receiverships allow secured creditors to effectively take control of and sell the debtor's collateral without having to come into title. This reduces the secured creditor's risk of liability while they are waiting for the collateral to be sold or otherwise disposed of.

Conclusion:

Receiverships can be preferable to bankruptcy for both debtors and creditors. Due to the amount of court oversight and extensive administration in chapter 11 cases following BAPCPA, in many cases, receiverships are a more cost-effective alternative to bankruptcy. Additionally, appointment of a receiver experienced in the same industry as the debtor serves to enhance the return to creditors of the estate and can increase the chance of reorganization for the debtor. It is important to keep receiverships in mind as an alternative to bankruptcy when deciding what course of action is best for your client.