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Key Considerations For Appointing A Real Estate Receiver

By **Dave Wald and Mark Silverman** (February 17, 2023, 7:10 PM EST)

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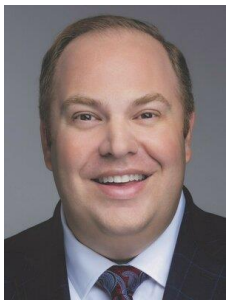

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With commercial real estate loan distress expected to grow dramatically in the coming months, courts may be faced with an explosion of lenders asking courts to appoint receivers to take control of real estate collateral — something many judges have rarely or potentially never had to deal with in recent years.

One of the many tools in a creditor's toolkit is seeking the appointment of a receiver over a defaulted piece of real estate. A receiver gives the lender some insulation from liability on property-level issues and also keeps better control of any cash coming into the property.

Once the decision has been made to seek the appointment of a receiver, typically you want to act as quickly as possible. Therefore, in the interest of time, your goal is usually to have the court grant your request for a receiver at the initial hearing, or, if the grounds exist, do so on an ex parte or emergency basis.

The decisions you make about the need for a receiver, the underlying litigation, venue, type of receivership and form of the proposed order can all make a significant difference in how successful you are in having the court grant your request for appointment of receiver at the initial hearing.

Here are some of the issues that will arise and that you should be prepared to address.

Why You Need a Receiver

In most jurisdictions, the court will want to know why you want a receiver, and why now.

Courts generally consider the appointment of a receiver to be a severe remedy — at least for the borrower. Receiverships also require a lot of the court's time and attention to supervise.

If you have been negotiating with the borrower for a very long time, what has changed? Did the borrower just stop making loan payments and is now keeping the rental income? Did the borrower recently abandon the property and leave it unmanaged or unsupervised? This is particularly an issue for ongoing construction?

Or did you discover fraud or theft by the borrower? Are there leases that need to be renewed, but the borrower is unresponsive or has insufficient funds to commit to a lease? Are there deferred maintenance items that need resolution? Are there issues with the franchisor in a hospitality asset? Are there urgent life safety issues at the property? If so, any of these issues may give rise to seeking emergency relief.

Simply telling the court that the lender is now tired of working with the borrower won't usually get a sympathetic response from the court. Similarly, advising the court of the financial harm without more, can in some states be problematic.

State or Federal Court

If the property and the borrower are in the same state, typically state court will be the best venue. State courts are also typically more accustomed to real estate receivership and commercial foreclosure issues. Every state has its own receivership laws and the standard for appointing a receiver varies state to state. A lender should evaluate the specific state law elements for appointment of a receiver before proceeding.

If the property and the borrowers are in different or multiple states, federal court may be the better choice. However, you will need to show why the receiver will be the remedy for the relief you're seeking. In order to have access to a federal court, you will need to show an independent basis for federal jurisdiction, i.e., diversity jurisdiction.

And federal court may be the better choice if you're seeking a receiver to take control of the borrowing entity — property federal equity receivership — and asking the court to give the receiver the authority to control the borrowing entity's ability to file for bankruptcy.

Venue

Often the choice of venue is determined by either the loan documents or the location of the property and the borrower. If you have the option to file in more than one venue, then take the time to try and determine which venue is more likely to promptly grant your request for a receiver.

Most times, venue is set by the location where the property sits. Even if the documents provide that venue can be in an alternative location, best practice is to typically file where the property is located.

While the loan documents may entitle you to request the appointment of a receiver, the loan documents alone do not necessarily mean that the court will automatically do so. Judges have very broad latitude in the appointment of receivers and the authority they grant to a receiver.

Given this broad latitude and the reality that judges often have widely differing familiarity, understanding and views on receivers and the urgency with which they need to be appointed, different courts can reach very different conclusions on the need for a receiver.

And just because you have the option of filing in a court that has a designated writs and receivers department, does not mean these courts will be more receptive to your request. Often, they are not.

The time you spend trying to determine the most appropriate venue can make the difference between a prompt, successful ex parte appointment, and spending many months in multiple, costly and time-

consuming hearings and court-imposed incremental remedies prior to obtaining the appointment of a receiver.

The Underlying Litigation

In many states, to have a receiver appointed, the lender will need to file a judicial foreclosure action or otherwise file suit against the borrower.

In states with so-called one-action laws — where a lender can either foreclose or sue the borrower for any losses — a judicial foreclosure and appointment of a receiver is also necessary if the lender wants to both foreclose and recover any additional monetary damages or deficiencies.

In any event, prior to filing the underlying litigation, give thought as to what outcome you are seeking, so it ties to your rationale for requesting a receiver.

The Type of Receivership

Generally, there are two different types of receiverships: rents, issues and profits receiverships, and equity receiverships. A rents, issues and profits receivership controls property, while an equity receivership controls a legal entity, typically the borrower.

Among other things, an important potential benefit of an equity receivership is that the court can give the receiver the sole authority to file bankruptcy of the entity. The disadvantage of an equity receivership is that the receiver is typically responsible for the operation and maintenance of the legal entity, including the filing of tax returns and other public agency filings.

The Form of the Order

Often the form of the receivership order can make a difference in the likelihood that the court will appoint a receiver.

There are multiple types of receivership orders.

Some states and courts have a standard preprinted form rents, issues and profits receivership order. This order typically just grants the receiver basic authority to control the property and its income and expenses as well as enjoining the borrower or anyone else from operating the property or interfering with the receiver. If there is a standard form order, often the standard order can be customized with an addendum that modifies the standard order.

You can also fully customize an order that is specific to the circumstances of the property and the lender's intentions for the receiver's scope of authority and activities. In those orders, some lenders will seek the ability for the receiver to market and sell the property — subject to court approval. In some states, and in some circumstances, this relief will be granted.

The benefit of the standard, unmodified form order is that courts are usually familiar with the order and the authority granted to the receiver — and often are more comfortable issuing a standard form receivership order on an ex parte basis. However, unless the lender's intention is just to protect, preserve and operate the property until it is foreclosed, the form order will likely have to be expanded for the receiver to accomplish the intended scope of work.

For example, in certain large office building receiverships, the parties will need to come up with a court-ordered strategy to handle smaller leases without court intervention. Without thinking through those property-specific processes, the receivership will be less efficient.

Since each court hearing is costly, you'll need to balance the expediency of using a standard, unmodified form order with the necessity to return to court one or more times to obtain additional authority for the receiver.

In circumstances where the court may already be familiar with or may be more receptive to a standard form order with an addendum that includes additional orders, that can be the better approach.

If at the hearing the court is reluctant to issue an order with an addendum, the court has the option to remove or strike the addendum and still appoint the receiver with the standard form order, allowing additional orders to be considered by the court at another hearing.

If the borrower will stipulate to the receivership order, then you should work together with the proposed receiver to submit to the court a proposed order that contains all the authority and instructions that the receiver is likely to need to perform their anticipated duties.

The Scope of the Order

As noted above, the appointment of a receiver is an equitable remedy. Courts have broad authority over the issuance of receivership orders, and appellate courts are reluctant to second-guess the lower courts in these matters. Receivers are agents of the court, answering to the court, not the parties, and as such courts are generally protective of receivers.

While different attorneys may have different views on what authority a receiver may be granted by the court — if the court issues the order, the receiver may use that order to execute their duties and responsibilities.

As a result — particularly if the borrower will stipulate to the proposed order — ask the court for the language setting forth the specific duties and responsibilities you want. Subject to the issue of expediency noted above, the worst that will happen is the court won't grant some of the line items in your proposed order.

Obtaining the Order by Stipulation, Ex Parte or Noticed Motion

As a rule, it's always best to have all the parties stipulate to a receivership and the order appointing receiver. The court is far more likely to promptly issue a receivership order that has been stipulated to by all the parties. Sometimes this is not possible, or the cost is too high in the lender's negotiations with borrower.

While you can file a stipulated order with the court for its approval without a hearing, it may take a long time for the court to actually issue the order. So it's nearly always best to request the receivership order at an ex parte hearing — even if all the parties have stipulated to the order. You will then know if the court will grant the order, and if granted, typically the court will sign the order right there at the hearing.

On the other hand, if the court has questions or wants to take the matter under advisement, at least

you'll have had the opportunity to explain why you want the order and answer the judge's questions.

Often if the court is unsure about the need for a receiver or wants to give the borrower more time to submit opposition, you'll be able to schedule the date for the order to show cause at the ex parte hearing. It's prudent to have an in-the-alternative request for an order shortening time, so you'll have the opportunity to argue for an expedited order to show cause hearing date.

Be Prepared

Always be prepared to explain to the judge what a receiver is and the legal basis for your request that the court appoint a receiver.

Even if you're familiar with the judge you will be appearing before, it's always possible that the assigned judge will call in sick or otherwise have the hearings assigned to another court that day.

Since the appointment of receivers is an equitable remedy primarily based on case law that may date back to the late 1800s, you should be prepared to explain to the judge why they have the legal authority and latitude to appoint a receiver. It comes up more often than you might expect.

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