

ALTERNATIVES TO BANKRUPTCY

Kimberley H. Tyson, Esq.
Ireland Stapleton Pryor & Pascoe, PC
1675 Broadway, Suite 2600
Denver, CO 80202
Telephone: (303) 623-2700
Direct: (303) 628-3698
Email: ktyson@irelandstapleton.com

A. FORECLOSURES

Foreclosures are creatures of state law. A foreclosure of real property is governed by state statute or rule; foreclosure of personal property is governed by Article 9 of the Uniform Commercial Code.

1. Advantages.

Foreclosure sales may be preferred because they can occur relatively quickly and can terminate other interests in the property.

2. Disadvantages.

If the lender's collateral is located in multiple jurisdictions, the processes may vary significantly from jurisdiction to jurisdiction. Further, foreclosure sales of real property are on different timelines from foreclosure sales of personal property. This can make coordinating the asset sales challenging.

Depending upon the type of property (commercial vs. residential) and the number of junior lienholders, redemption periods may greatly lengthen the time before a foreclosure can be completed. If there are governmental liens, often such creditors have significant time periods within which to exercise their redemption rights.

Finally, foreclosure sales frequently give rise to liability claims challenging everything from the valuation of the property to the sale process to the validity of the underlying obligation.

B. RECEIVERSHIPS.

1. Authority for Appointment of a Receiver.

Authority for the appointment of a receiver arises either by contract or by statute. When a receiver is sought pursuant to the terms of a contract, the party seeking the appointment

of a receiver typically need only show the debtor is in default as that term is defined in the contract.

When a receiver is appointed by statute (this will, of course, vary by jurisdiction), typically the party seeking the appointment of a receiver must show it has an interest in the property at issue. In addition, the party may need to demonstrate some or all of the following: (a) there has been fraud or gross mismanagement by debtor's management; (b) the debtor is failing to conduct business in an authorized manner; (c) the debtor is insolvent; and/or (d) the property is in danger of being dissipated or wasted.

In many jurisdictions, including Colorado, a receiver may be appointed in conjunction with a foreclosure proceeding. For example, C.R.S. § 38-38-601 permits the court to appoint a receiver for the affected property if it appears the security is clearly inadequate or the premises are in danger of being materially injured or reduced in value as security by removal, destruction, deterioration, accumulation of prior liens, or otherwise so as to render the security inadequate. A foreclosing creditor may even take possession of the property if such facts exist and if the premises are abandoned by the owner. Under these circumstances, the foreclosing creditor is subject to the same duties and liabilities for the care of the premises and for the application of the rents and profits as a receiver.

2. Why Appoint a Receiver?

There are a number of reasons for appointing a receiver. At the outset, the receiver is an officer of the court and, before being appointed, must take an oath. The receiver is neutral and acts as a fiduciary for all claimants or other interested parties. Because of the neutrality of the receiver, he or she cannot take sides. For a creditor unfamiliar with the receivership process, it can come as an unpleasant surprise to discover it cannot control the receiver it had appointed and, in fact, that receiver may scrutinize and challenge the creditor's position.

The appointment of a receiver provides the requesting creditor with a means of removing the debtor or its principals without creating liability on behalf of the creditor. Because the requesting creditor never has direct control of the assets, it is insulated from liability.

Often the creditor seeking the appointment of a receiver will provide the court with the names of several potential receivers who would be qualified to administer the particular assets at issue. This will ensure the assets are administered in a competent manner during the pendency of the receivership.

A receivership will prevent further dissipation of the assets, particularly cash, and may be used to remedy actual fraud and reverse fraudulent transfers.

3. Types of Receiverships.

There are several types of receiverships. Some receiverships are quite limited in scope and are established to accomplish a specific task. For example, a receivership put in place during the pendency of a foreclosure or the liquidation of an entity. There, the receiver has control over only the property subject to the foreclosure or liquidation action and merely holds the property during the pendency of the foreclosure or liquidation proceeding.

At the other end of the spectrum are receiverships tasked with the full management of an asset or business. These may arise when a business is failing and there is going concern value to be preserved. A receiver may be also tasked with the full management of an asset in the context of a real estate project. Receiverships in these circumstances permit the real estate project to proceed while giving the construction lender assurance that advances are being spent properly.

4. The Receivership Order.

Unlike a bankruptcy where all of the debtor's assets become property of the estate and the trustee or debtor's duties are established by statute, the property of a receivership and the rights and duties of a receiver are established in the order appointing the receiver. For this reason, it is important for the requesting party to take time to carefully prepare the application and proposed order to ensure the receivership accomplishes the desired goals.

A receivership order should contain a specific description of the property to be subject to the control of the receiver. In addition, the order must compel the party in possession of those assets to turn the property over to the receiver. The order must specifically delineate the receiver's duties and powers. The receivership order should provide direction to the receiver regarding the use of cash and provide procedurally guidance to the parties. Finally, the receivership order should set forth any required bond and the oath the receiver must take. A copy of a receivership order is attached to the materials.

5. Turnover of Property by a Custodian – 11 U.S.C. § 543.

11 U.S.C. § 543(b) requires a custodian, including a receiver, to turn over any property of the debtor in its possession when he or she learns of the commencement of the case. The bankruptcy court may excuse compliance with subsection (b), "if the interests of creditors and, if the debtor is not insolvent, of equity security holders would be better served by permitting a custodian to continue in possession, custody, or control of such property." 11 U.S.C. § 543(d)(1).

In determining whether to excuse turnover, a bankruptcy court considers several factors including: (a) whether there is sufficient income to fund a successful reorganization; (b) whether the debtor will use the turnover property for the benefit of the creditors; (c) whether there has been mismanagement by the debtor; (d) whether or not there are avoidance issues raised with respect to property retained by a receiver, because a receiver does not possess avoiding

powers for the benefit of the estate; and (e) the fact that the bankruptcy automatic stay has deactivated the state court receivership action. The debtor's interests are irrelevant in this context.

Pending the determination of this motion, the receiver is excused from complying with the turnover provisions of 11 U.S.C. § 543(b). If the receiver or custodian nevertheless turns over the property to the debtor, most courts hold the pending motion to excuse turnover moot.

Under 11 U.S.C. 543(d)(2), the court may excuse turnover if the custodian is an assignee for the benefit of creditors that was appointed or took possession more than 120 days prior to the bankruptcy filing.

6. Advantages/Disadvantages to a Bankruptcy Case.

Receiverships may be less expensive than a Chapter 11 case because there are not nearly as many procedural requirements. It is important to remember, however, that the creditor seeking the appointment of a receiver typically pays the cost of the receiver.

Receiverships can be tailored to a particular situation, something not possible with a bankruptcy case. Receiverships cases tend to move more quickly and there is greater flexibility. Finally, it may be possible for a receivership to be managed without the knowledge of vendors or customers thereby maintaining the maximum going concern value.

There are disadvantages to a receivership. Receivers are creations of state law and their powers are limited to assets within the appointing court's jurisdiction. If a debtor has assets in a number of states, the use of a receiver is likely not appropriate or cost effective. Receiverships are not particularly effective for entities with substantial operations.

Unlike bankruptcy, there is no automatic stay. This means other disgruntled creditors may be able to pursue their rights against the debtor in other proceedings. State law does not recognize the preference action so there is no means of equalizing the distribution to creditors. Onerous contracts cannot be rejected and there is no cramdown available in a receivership context. Finally, a debtor does not receive a discharge as would be possible in a Chapter 11 plan.

C. SALES BY DEBTOR – DEEDS IN LIEU.

Debtors may transfer its assets to its secured lender by executing a deed in lieu of foreclosure agreement. Alternatively, a debtor may sell its assets to a third party with the consent of its secured lender.

1. Advantages.

The most obvious advantage to a deed in lieu agreement is that it is a quick and inexpensive means of liquidating the assets. It also eliminates the possibility of a debtor gaining additional time by filing bankruptcy on the eve of a foreclosure sale or after a receiver has been appointed.

2. Disadvantages.

There are several disadvantages. If there are other lienholders, their consent is required. There is a possibility the transfer could be later challenged by unsecured creditors as fraudulent transfer.

If the property has existing leases, those leases are not terminated. By contrast, a foreclosure generally terminates any leases. (The current exception to this rule is within the context of residential leases. The Protecting Tenants at Foreclosure Act of 2009, Public Law 111-22, Title 7, provides that during the term of the lease, the tenant has a right to remain in the unit and cannot be evicted, except for actions that constitute good cause. The provisions of this act are scheduled to expire on December 31, 2012.)

