LENDER'S EDGE

IDEAS AND INSIGHTS FOR DEALING WITH DISTRESSED ASSETS

June 2011

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LENDER'S EDGE:

The Use of Receivers in Protecting Your Collateral

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Effective loan enforcement requires a wide range of tools to collect debts and protect collateral. An increasingly popular tool that may be available to lenders is to seek a court appointed receiver. Receivers are individuals or entities that are appointed by the court to manage, control, protect and preserve collateral for the benefit of all parties during the pendency of a court action. Receivers may be appointed, either by request of a party or on the court's own motion, at the outset or any time during pending litigation as it becomes necessary. In most cases, the need for a receiver typically arises after an instance of default, and a request for appointment of a receiver is made with the filing of a lawsuit against a borrower for breach of the underlying loan documents.

The use of receivers has increased as the number of defaulting loans has increased. With respect to defaulted loans, lenders are concerned about mismanagement, the potential for fraud by borrowers, and the diminution of cash and assets

that secure their loans. A receiver's main job is to secure assets and to place them beyond a borrower's reach before those assets disappear or diminish in value. A receiver can help a lender in quickly taking control of collateral in a wide variety of circumstances and in maintaining this control while a lender pursues foreclosure on real property, exercises UCC remedies (for disposition of other collateral), or prosecutes a lawsuit.

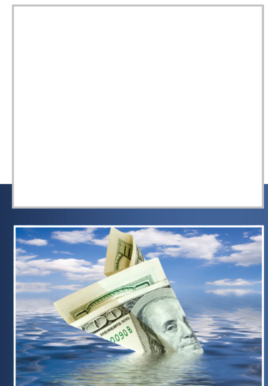
For instance, a receiver is appropriate where:

- A borrower is diverting or depleting inventory, receivables or cash flow;
- A borrower is failing to deliver possession of collateral and/or information about the collateral;
- A borrower is failing to maintain collateral (or pay taxes and other expenses related thereto);
- There is infighting among multiple borrower partners;
- The collateral consists of seasonal or perishable inventory;
- Tenants or account debtors of the borrower may not recognize the authority of the lender to collect rents and receivables without a court order (or where a lender must obtain possession of real property to collect rents and may do so through the appointment of a receiver).

A receiver can also help a lender obtain control over collateral without assuming the cost and risk of a replevin. For instance, the statutory bond required for a replevin in most states is generally double the value of the collateral, whereas a receiver's bond is generally set in the discretion of the judge and can be much lower. (In some cases, if the loan documents so provide, a receiver's bond may not be required at all, although this too is at the discretion of the judge). The appointment of a receiver also serves as a "liability shield" by allowing the lender to avoid becoming a mortgagee in possession.

Statutory Power to Appoint Receiver:

The power to appoint a receiver is generally found in state statutes and court rules, and these vary from state to state, as do the powers that a court will grant to a receiver. For instance, some states such as Missouri broadly grant courts the power to appoint receivers where "such appointment shall be deemed necessary" and vests the receiver with the duty to "keep and preserve all property and protect any business or business interest entrusted to him."[1] Missouri Supreme Court Rule 62.08(a) adds that the receiver in fulfilling its duties will act to "the extent and in the manner that the court may direct." Missouri courts have held more specifically that receivers are appointed in circumstances where "it appears that, through fraud, mismanagement, misconduct or



[1] Missouri Revised Statutes §515.240.

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otherwise, there is likelihood that the property will be squandered, wasted, misappropriated or unlawfully diverted without the court's intervention."[2]

Other states consider the appointment of a receiver to be a more drastic remedy and therefore place greater restrictions on the availability of a receiver. For instance, in Texas a creditor may obtain a receiver "to subject any property or fund to his claim," but the creditor must have a "probable interest in or right to the property or fund, and the property or fund must be in danger of being lost, removed, or materially injured."[3] Similarly, a mortgagee in Texas may obtain a receiver in an action for the foreclosure of the mortgage and sale of the mortgaged property, but the mortgagee must show that "the mortgaged property is in danger of being lost, removed, or materially injured" or that "the condition of the mortgage has not been performed and the property is probably insufficient to discharge the mortgage debt."[4]

States such as Illinois more routinely recognize the right of a mortgagee to obtain the appointment of a receiver in an action for the foreclosure of the mortgage.[5] For instance, Illinois foreclosure statutes direct courts to appoint a receiver upon a "request of any party and a showing of good cause," and they provide that the receiver will have "full power and authority to operate, manage and conserve" the property.[6] Illinois foreclosure statutes also provide specific powers of a receiver that include securing tenants, executing leases, collecting rents, insuring property and paying taxes.[7]

A receiver's powers are limited by the court's order appointing him. As a result, the powers granted by a court in Missouri may be greater than those granted in Texas or other states with more restrictive laws governing receiverships.

A receiver does not acquire title to the property involved, but rather serves as a custodian of such property under the jurisdiction of the court. Therefore, some courts are hesitant to grant a receiver outright authority to sell assets. Still, common law in a number of states holds that receivers are creatures of equity and are granted equitable powers, and there is a surprising amount of case law whereby judges have granted receivers the authority to sell assets when it is equitable to do

[2] *Lynch v. Lynch*, 277 S.W. 2d 692, 694 (Mo. App. 1955); *Jewish Center for Aged v. BSPM Trustees, Inc.*, 295 S.W.3d 513 (Mo. App. E.D. 2009), rehearing and/or transfer denied (Sep. 14, 2009), transfer denied (Nov. 17, 2009); *Sangamon Associates, Ltd. V. Carpenter 1985 Family Partnership, Ltd.*, 165 S.W.3d 141 (Mo. 2005), as modified on denial of rehearing (Jul. 12, 2005).

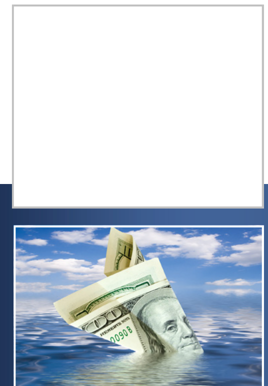
[3] TX Civ. Prac. & Rem. Code §§ 64.001(a)(2), (b).

[4] TX Civ. Prac. & Rem. Code §§ 64.001(a)(4), (c)(1) and (2).

[5] *Id.*; 735 ILCS 5/15-1704 (which is not to be confused with the right of a mortgagee to be placed in possession of real estate under 735 ILCS 5/15-1701(b)(2) and (c)(1) pending foreclosure).

[6] 735 ILCS 5/15-1704(a) and (b).

[7] 735 ILCS 5/15-1704(b).



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so. Receiver sales have become increasingly popular in recent years, with various lenders employing them for different reasons. Sometimes receiver sales are attractive if the particular property is not a suitable candidate to be held in the lender's REO portfolio, such as when the property suffers from an environmental condition. Other times, lenders may not want to own properties that are heavily regulated, like nursing homes. Still other lenders, when their REO inventory is already at capacity, may not wish to foreclose and own any other property whatsoever, and may seek to have a receiver market the property for sale to a third-party buyer, essentially skipping the process of taking ownership of and redisposing the property. And receiver sales have become popular in the CMBS industry, where lenders cannot offer new financing to induce potential third-party buyers to buy their REO, but where lenders can offer third-party buyers the opportunity to assume their existing indebtedness prior to an actual foreclosure.

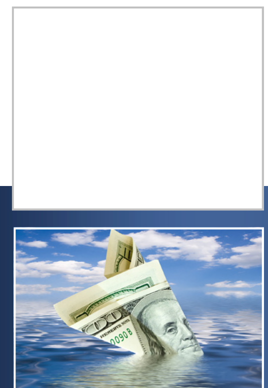
In most states, a request for appointment of a receiver must be made in conjunction with the filing of a lawsuit against a borrower for breach of the underlying loan documents or for some other cause of action. These states consider the appointment of receiver to be "ancillary" to the assertion of some independent cause of action. In other states, the request for appointment of a receiver may be filed without any other claim against the borrower.

Receivership Provisions in Loan Documents:

One of the best ways a lender can ensure the appointment of a receiver is to include this specific remedy in the loan documents or forbearance and workout agreements. A clear provision for the appointment of a receiver in the loan documents will give a lender a strong argument for the appointment of a receiver, as the borrower has agreed to such a remedy by signing the loan documents. These provisions should not only include the right to appoint a receiver upon any default, but broad powers of the receiver to take control of properties and collateral, to manage properties, to collect rents, profits and receivables, to enter, cancel or modify leases, and to pay taxes, insurance and other expenses. Wherever possible, these provisions should allow the receiver to act without posting a bond (although a bond may be mandatory in some states, or in the discretion of some judges).

Whom to Select as Receiver:

In most cases, a lender and its counsel will choose the receiver to be appointed (but this is not universal, and in certain counties in New York and Ohio, for example, the court and not the lender, will choose the receiver), and this selection is generally made before any petition or motion is filed (although the court has the power to make a final determination). The choice of a receiver depends on, among other things, the property or collateral to be secured, the size or scope of the property or collateral, the type of business of the borrower, the experience of potential receivers,



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and even the fees and costs charged by potential receivers. For example, a lender seeking a receiver for a multi-unit apartment building will want to choose a property manager experienced in managing large apartment buildings, whereas a lender seeking a receiver for a few small single-family residences may be more concerned about the fees that a receiver will charge. Similarly, a lender seeking a receiver for the liquidation of equipment or inventory will want an experienced liquidator who has knowledge of that business (or a wide range of businesses), or at least an individual who has many years of experience buying and selling such equipment and inventory.

Conclusion:

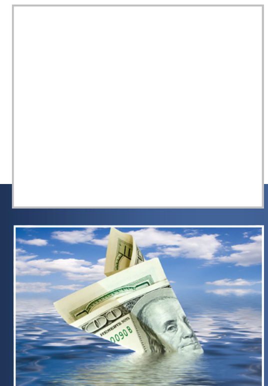
Lenders should consider the appointment of a receiver as a valuable tool in collecting debts and protecting collateral, particularly where foreclosure, replevin or other actions will not provide immediate protection. ■

The Missouri Uniform Fraudulent Transfer Act

One of the most effective but underutilized tools available to creditors in recovering assets that have been transferred by a debtor is the Uniform Fraudulent Transfer Act (UFTA). The UFTA was initially approved by the National Conference of Commissioners on Uniform Laws more than 25 years ago, and has since been adopted in 45 states. Since its enactment in Missouri in 1992, the UFTA has provided an increased opportunity for statutory relief to creditors in the event of a debtor's fraudulent transfer of property. The UFTA offers a statutory roadmap to creditors as to what types of transfers are considered fraudulent, when a claim can be brought and the range of remedies available.[1]

What Types of Transfers are Considered Fraudulent

The UFTA offers an opportunity for both creditors whose claims arose before the transfer at issue, and creditors whose claims arose after the transfer, to recover under the theories of actual intent and constructive fraud. To do so, the creditor must show either (1) actual intent (that the debtor had actual intent to defraud a creditor) or 2) constructive fraud (that the creditor made a transfer without receiving reasonably equivalent value



[1] The UFTA as enacted in Missouri may be found in RSMo. § 428.005 to § 428.059. Unless otherwise indicated, all statutory citations in this article refer to the Missouri Revised Statutes.

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in return and the debtor's assets were unreasonably small for the intended transaction or the debtor knew or should have known that he would be unable to pay his debts as they became due).[2]

In order to bring a claim under the actual intent prong, the creditor must prove that the debtor had an actual intent to hinder, delay or defraud any of his creditors.[3] The UFTA lists eleven nonexclusive factors, or "badges of fraud" to be considered by the court in determining the debtor's intent, including whether the transfer was to an insider, was of substantially all of the debtor's assets, was concealed and whether it was in exchange for inadequate value.[4] The creditor has the burden of establishing the debtor's fraud by clear and convincing evidence. Although, the existence of one or more of these factors does not lead to an irrefutable presumption of actual intent to defraud, the factors are used as relevant evidence of a debtor's intent.

If a debtor's actual intent cannot be established, the UFTA may still apply if constructive fraud exists. Constructive fraud refers to transactions in which the debtor received less than equivalent value for the property transferred and the debtor is on the brink of insolvency, as evidenced by the fact that the debtor was engaged in or was about to engage in a transaction for which his assets were unreasonably small or the debtor believed, or reasonably should have believed, that he would incur debts beyond his ability to pay as they became due.[5] Under a broad definition, the UFTA provides that value exists when, in exchange for the transfer or obligation, a property is transferred or an antecedent debt is secured or satisfied.[6] While reasonably equivalent value is not defined in the UFTA, generally, a transfer in exchange for a security interest is considered to be reasonably equivalent, regardless of a discrepancy between the value of the asset and the amount of the debt secured because the amount of the debt is the limit of the security interest conferred. But, a secured creditor's mere agreement to forbear from enforcing its rights and remedies under a standstill agreement may not be considered sufficient value to justify the grant of a security interest in previously unencumbered property. A debtor having unreasonably small assets for an existing or planned transaction is not insolvent, but is viewed as falling just shy of insolvency, and a debtor who believes he is to incur debts beyond his ability to pay is approaching the

2 RSMo. §428.024
3 RSMo. §428.024.1
4 RSMo. §428.024.2
5 RSMo. §428.024.2
6 RSMo. §428.019.1

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statutory presumption of insolvency found in the UFTA.[7] Thus, this constructive fraud provision is applicable to present and future creditors whose debtor has not yet reached full insolvency as defined under the UFTA.[8]

An additional provision of the UFTA applies only to present creditors whose claims arose prior to the allegedly fraudulent transfer and whose debtors are insolvent. There are two types of transfers by debtors that are actionable under this provision. The first is that in which the transfer was made without receiving a reasonably equivalent value in exchange and the debtor was insolvent at the time of the transfer or became insolvent as a result of the transfer.[9] Insolvency is defined under the UFTA as occurring when the sum of the debtor's debts is greater than all of the debtor's assets at a fair valuation[10] and a presumption of insolvency arises when a debtor is generally not paying his debts as they come due.[11] Assets under this definition do not include property that has been transferred, concealed, or removed with intent to hinder, delay or defraud creditors or that has been transferred in a manner that would make the transfer voidable under the UFTA[12] and debts under this definition exclude obligations that are secured by a valid lien on property of the debtor that is not included as an asset.[13]

The second situation in which a transfer is fraudulent as applied to present creditors is when the transfer was made to an insider for an antecedent debt, the debtor was insolvent and the insider had reasonable cause to believe that the debtor was insolvent.[14] The term insider includes all those in close relation to the debtor such as a relative or general partner of an individual or a director or officer of a corporation.[15]

Secured creditors concerned that implementing their rights of foreclosure would implicate the provisions of the UFTA relating to reasonably equivalent value may be assured by the UFTA's safe harbor provision that presumes that reasonably equivalent value is given if the person acquires the debtor's interest in the asset pursuant to a regularly-conducted, non-collusive foreclosure sale or

7 A presumption of insolvency arises when a debtor is generally not paying his debts as they come due (RSMo. § 428.014.2).

8 The UFTA defines a debtor as insolvent when the sum of the debtor's debts is greater than all of the debtor's assets at a fair valuation (RSMo. § 428.014.1).

9 RSMo. §428.029.1

10 RSMo. §428.014.1

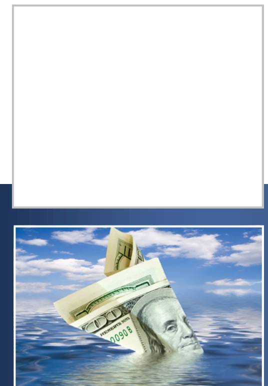
11 RSMo. §428.014.2

12 RSMo. §428.014.4

13 RSMo. §428.014.5

14 RSMo. §428.029.2

15 RSMo. §428.009.7



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execution of power of sale for the acquisition or disposition of the interest of the debtor following a default under a mortgage, deed of trust or security agreement.[16] However, strict adherence must be paid to the statutory foreclosure proceedings so that the foreclosure may be deemed "regularly conducted".

When a Claim Can be Brought

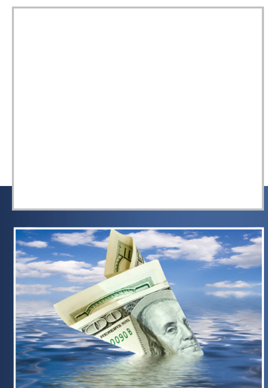
Various provisions of the UFTA apply depending on whether the creditor's claim arose before or after the transfer at issue. However, claims under the UFTA are also subject to varying statutes of limitations based on the type of claim alleged. Claims asserting actual fraud must be brought within four years after the transfer was made or within one year after the transfer was or could reasonably have been discovered by the creditor.[17] Claims alleging a form of constructive fraud must be brought within four years after the transfer was made[18] and claims contending a transfer to an insider must be brought within one year after the transfer was made.[19]

Notably, §548 of the Bankruptcy Code contains a similar provision to the UFTA that allows a trustee to avoid transfers or obligations incurred by the debtor based on actual or constructive fraud if the transfer occurred within two years before a bankruptcy filing.[20] In addition, §544 of the Bankruptcy Code also allows the trustee to rely on state fraudulent transfer law, and to utilize the longer four-year look-back period under the UFTA, to avoid a fraudulent transfer to the same extent that an unsecured creditor would be able to attack the transfer under state law.[21]

Remedies

The UFTA offers a wide range of remedies available to creditors in the event of a fraudulent transfer of property. The creditor may obtain avoidance of the transfer to the extent necessary to satisfy the creditor's claim, an attachment against the transferred asset, an injunction against further disposition of assets by the debtor and/or a transferee, appointment of a receiver to control the transferred asset and if the creditor has obtained a judgment on a claim against the debtor, the creditor may levy execution on the asset transferred or its proceeds.[22] One of the benefits of the UFTA is that creditors may obtain avoidance of transfers and may levy execution

16 RSMo. §428.019.2
17 RSMo. §428.049.1
18 RSMo. §428.049.2
19 RSMo. §428.049.3
20 11 U.S.C. § 548
21 11 U.S.C. § 544(b)
22 RSMo. §428.039



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on assets transferred, even though the transferee appears to be innocent of any fraud.

The UFTA also affords the creditor "any other relief that the circumstances may require and expressly incorporates any pre-existing legal and equitable principles of law,"[23] thus leaving open the possibility of recovering punitive damages and attorney's fees.[24] This broad provision also permits prejudgment attachment so long as one of the statutory requisites is met (i.e., debtor conceals himself, debtor absconded, debtor has or is about to fraudulently convey property).[25] However, care should be taken to fully meet the statutory requirements as failure to do so could result in tort liability for the creditor.

Offering a wide variety of remedies and a chance to recover fraudulent transfers without the burden of proving actual intent, the UFTA should be a key weapon in a creditor's arsenal. However, the UFTA also contains potential liabilities for a creditor, and thus requires knowledge and experience with its intricacies to avoid problems. ■

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[23] RSMo. §428.054
[24] *See Volk Construction v. Wilmenscherr Drush Rg*, 58 S.W.3d 897 (Mo.App.E.D. 2001)
[25] RSMo. §521.010

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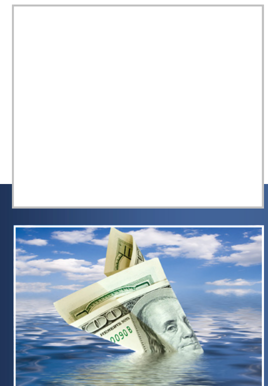

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