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LEGAL & ACCOUNTING RESOURCE GUIDE

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Creative Use of Receiverships to Reposition and Resolve Problem Projects and Businesses

Picture a quintessential broken late-2011 North Bay real estate project: A condominium complex where construction started in 2007, but has been long halted in mid-development. The real estate recession has cut expected unit sales prices. The developer is essentially out of business, and the individual completion guarantor is insolvent. The participating banks long ago halted construction loan draws. Contractors have filed mechanics liens for unpaid work. Entitlements are about to expire. The soil is contaminated with a diesel fuel spill, discovered during construction, which needs to be remediated.

With the glimmer of a real estate recovery on the horizon, everyone agrees the project is worth much more finished than not, but it seems impossible: The participating lenders won't all agree to advance new money, and none of them will advance any money with the developer still in charge. The guarantor won't consent to a loan modification without a release, and the contractors will only go forward with certainty of payment. With various litigation threatened, no one will do anything that might get them dragged into a lawsuit.

The situation is like the ancient Gordian knot: It cannot be untied, but the right tool — the appointment of a receiver — can cut through it. A court-appointed receiver can take over and finish construction, borrowing funds from the lead lender under receivers' certificates, backed by a first-priority lien on the property. Since each step (new borrowing, new contractor agreements, resumed construction, environmental remediation, project completion, unit marketing and sales) will be approved by the court that appointed the receiver, the receiver will have qualified judicial immunity for following the court's orders in taking each step. Under Bankruptcy Code Section 543, a receiver in possession may even be able to stay in control of the project if the borrower later files bankruptcy.

Usually, lenders have receivers appointed to collect rents and preserve property during the roughly four-month California non-judicial real estate foreclosure process. Appointment of a receiver, however, can be a flexible and creative tool to solve specific business and legal problems in troubled project and business situations:

Closely-held Businesses. Where one of several co-owners is managing a business but using the assets for his or her personal gain, a receiver can step in to stop abuses during a sale or dissolution process.

High Maintenance Operations. Grape growing and winemaking are classic examples of businesses where the assets must be taken care of to preserve them. A receiver can step in and, under the terms of the court order, hire and supervise a farming company or winemaker to prevent disaster and protect the value.

Environmental Remediation. Secured lenders are often reluctant to foreclose on properties with environmental problems. There are practical headaches like signing manifests to dispose of chemicals and concerns about environmental liability as an owner or operator. But if a receiver conducts the remediation, the lender can avoid these problems. California Civil Procedure Code Section 564(c) authorizes receivers to inspect property to assess hazardous substance releases, and the receivership order (typically prepared by the lender and approved by the receiver) can authorize the receiver to remediate contamination. Because the receiver has quasi-judicial immunity, under California Rule of

Court 3.1179, he or she is not liable for acts taken which are specifically directed by the court. (Typically, under a later order submitted by the receiver.)

Completing a Broken Construction Project. Particularly recently, developer-borrowers often lack the resources to finish a construction project, and contractors won't keep working without assurance of payment. A receivership can help, because of protections afforded by California law. The court order that establishes the receiver's powers often includes language authorizing the receiver to take steps to complete a project, including employing and paying contractors and vendors as the receiver deems appropriate. The debts for those goods and services are generally entitled to payment priority over all pre-receivership obligations, although subject to debts secured by receivership property. We are currently representing the receiver of the Ritz Carlton Hotel at Northstar near Lake Tahoe, California, where we have used these techniques to resolve construction issues, including reaching agreement with contractors to complete work that had been suspended based upon assurance of payment from the receivership estate.

Selling Distressed Property. In any distressed sale with multiple levels of debt and equity, it is often difficult to get cooperation, consensus or even clear title without a risk of later litigation. A receivership can be used to facilitate the sale of property and to avoid those problems. A receiver's sale under a court order can result in delivering clean title to a buyer, and any objections can be resolved prior to the sale (rather than years later in litigation). The hearing date and deadline to object also drives the sale process to conclusion. A receiver's sale even relieves a lender from having to provide (or even negotiate over) representations and warranties to a purchaser (including implied representations of title in a grant deed) which might be necessary in a sale after a lender foreclosure.

Susan Uecker of Uecker & Associates, a prominent Bay Area receiver based in San Francisco, explains that a receiver can help solve the host of practical problems in an uncompleted project. "In one residential development, we had to complete the entitlements — with an amendment to the subdivision improvement agreement — and then finish construction. We also got a fast-track sales process approved, where offers could be accepted if none of the parties objected within five days. Because sales were done by consent, the title company didn't have to wait for the end of a long appeal period before each closing, which was critical."

That's typical of our experience – even in many situations where legal gridlock would otherwise prevent a project from being completed and sold, the creative tool of a receiver's appointment, and the opportunity for orders from the court can lead to an outcome that maximizes everyone's economic return, or at least minimizes their loss. ■

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