

ABA
SECTION OF BUSINESS LAW
SPRING MEETING
MARCH 31-APRIL 3, 2005
BANKRUPTCY ALTERNATIVE:
FEDERAL RECEIVERSHIP AND STATE
LAW REMEDIES

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Introduction

Secured creditors may, upon the default by a borrower, exercise a variety of remedies to enforce their security interests. An underutilized remedy, however, is that of a federal receivership. A federal receivership is usually the quickest most cost effective method of gaining control over the collateral.

Foreclosure actions are generally brought in the county in which the property is located, while state receivership action are brought in the state in which the property is located. This will cause logistical issues when the collateral is located in multiple counties or status. A federal receivership consolidates the various actions into one proceeding, resulting in less cost and uniform results.

A receivership also allows the business to continue to operate, thereby maintaining the value of the collateral. The receiver will preserve and protect the collateral, as well as the financial integrity of the business. Although federal receivership is derived from federal common law, there are several federal statutes governing this. These materials will briefly discuss these statutes and the existing case law.

I. APPOINTMENT OF A RECEIVER

A. Federal Jurisdiction

In order to initiate an action in the federal court, the federal court must, of course, have jurisdiction. Because a secured party's enforcement of its rights is not usually based upon a

federal question,¹ diversity and the minimum amount in controversy, under 28 U.S.C. § 1332, must exist in order to invoke the jurisdiction of a federal district court. See Inland Empire Insurance Company v. Freed, 239 F. 2d 289, 290 (10th Cir. 1956); Guy v. Citizens Fidelity Bank and Trust Company, 429 F.2d 828, 831 (6th Cir. 1970). Once jurisdiction is established, the federal district court then has ancillary jurisdiction to appoint a receiver, and ancillary subject matter jurisdiction over every suit the receiver subsequently brings in the appointing court to execute his duties. Haile v. Henderson Nat. Bank, 657 F.2d 816, 822 (6th Cir. 1981).

Procedurally, to have a receiver appointed, the secured creditor will first file suit against the borrower for breach of contract, and in some jurisdictions will include a count for foreclosure. Then, it will file a motion to appoint a receiver, supported by an affidavit alleging the basis for the relief requested.

The decision of whether a receiver should be appointed is made by federal standards and resolved by federal law. Midwest Sav. Ass'n v. Riversbend Associates, 724 F. Supp 661, 662 (D. Minn. 1989); Waag v. Hamm, 10 F. Supp 2d 1191, 1193 (D. Colo. 1998). The act of appointing a receiver is analogous to the entry of an injunction; it is an extraordinary remedy that lies in the discretion of the court and should be employed “with the utmost caution and granted only in cases of clear necessity to protect a plaintiff’s interest in property.” Midwest Sav. Ass’n, 724 F. Supp at 662; Commodities Futures Trading, 481 F. Supp at 441.

The following factors are usually weighed by the court to determine whether a receiver should be appointed:

¹ Federal District Courts may, however, appoint receivers in cases arising out of the violation of federal laws. See e.g. Bryan v. Bartlett, 435 F.2d 28, 32 (8th Cir. 1971) (“federal jurisdiction in this case is based. . . on a federal equity receivership arising from violation of the federal securities regulation statutes”); Commodity Futures Trading v. Comvest Trading Corp., 481 F. Supp 438, 440 (D. Mass. 1979) (a federal district court sitting in equity, has broad discretion to appoint receivers to enforce the requirements of remedial statutes such as the Commodity Exchange Act.)

- the existence by a valid claim by the moving party;
- fraudulent conduct on the part of the defendant;
- imminent danger that property would be lost, concealed, injured, diminished in value, or squandered;
- an inadequacy of the available legal remedies;
- the probability that harm to plaintiff by denial of the appointment would be greater than the injury to the parties opposing appointment;
- plaintiff's probable success in the action; and
- possibility of irreparable injury to plaintiff's interest in the property.

See, Waag, 10 F. Supp 2d at 1193; Midwest Sav. Ass'n, 724 F. Supp at 662; Commodities Futures Trading, 481 F. Supp at 441.

B. Role of the Receiver

Once the receiver is appointed by the federal court, he becomes an officer of the court who manages and operates the property according to the laws of the state where the property is located. 28 U.S.C. §959(b).² Waag, 10 F. Supp. 2d at 1193; Midwest Sav. Ass'n, 724 F. Supp. at 662; Borock v City of New York, 268 F.2d 412 (2nd Cir. 1959) (the City of New York could properly impose real estate taxes on property in possession of the receiver even though the receiver was acting on behalf of the United States). But see In re San Vicente Medical Partners Ltd., 962 F.2d 1402, 1409 (9th Cir. 1992) (... section 959(b) does not burden the receiver for limited partnership property with all of the constraints imposed on a general partner).

² 28 U.S.C. §959(b) provides:

(b) Except as provided in section 1166 of Title 11, a trustee, receiver or manager appointed in any case pending in any court of the United States, including a debtor in possession, shall manage and operate the property in his possession as a trustee, receiver or manager according to the requirements of the valid laws of the state in which property is situated, in the same manner that the owner and possessor thereof would be bound to do if in possession thereof.

In addition, the receiver may be sued with respect to any of the acts taken or transactions engaged in while carrying on the business as a receiver. 28 U.S.C. §959(a).³ An action for possession of property held by the receiver, however, is outside the scope of § 959(a). Securities & Exchange Com'n v. Lincoln Thrift Ass'n, 557 F.2d 1274, 1277 (9th Cir. 1977). Generally, the decision of whether to allow a third party action, outside the scope of §959(a), to be brought in a separate action is within the discretion of the court appointing the receiver. Id. But see Sec. & Exchange Com'n v. United Fin. Group, Inc., 576 F. 2d 217, 221 (9th Cir. 1978) (the issue of whether an attorney, who sought to collect fees for services rendered to a company in receivership with respect to fraud litigation was required to secure leave to sue the federal receiver, was litigated in the state court, and state court's determination was *res judicata* and entitled to full faith and credit by the receivership court).

C. Effect of Appointment of a Receiver

1. Control Over Receivership property.

a. Jurisdiction by the court appointing the receiver.

Once appointed, the receiver is required to post a bond, and once the bond is posted, is vested with complete jurisdiction and of all property, personal and real, wherever situated, with the right to take possession of such property. 28 U.S.C. §754.⁴ In re San Vicente

³ 28 U.S.C. §959(a) provides:

(a) Trustees, receivers or managers of any property including debtors in possession, may be sued, without leave of the court appointing them, with respect to any of their acts or transactions in carrying on business connected with such property. Such actions shall be subject to the general equity power of such court so far as the same may be necessary to the ends of justice, but this shall not deprive a litigant of his right to trial by jury.

⁴ 28 U.S.C. §754 states:

A receiver appointed in any civil action or proceeding involving property, real, personal or mixed, situated in difference districts shall, upon giving bond as required by the court, be vested with complete jurisdiction and control of all such property with the right to take possession thereof.

Medical Partners Ltd., 962 F.2d at 1408 (the district court has the power to include property of a non-party limited partnership in the receivership as long as the non-party meets the minimum contacts of International Shoe and receives actual notice and an opportunity for hearing). See Continental Bank and Trust Company v. R. F. Apodaca, 239 F.2d 295, 298 (10th Cir. 1956); Inland Empire Insurance Company v. Freed, 239 F.2d at 292; Guy v. Citizens Fidelity Bank and Trust Company, 429 F.2d at 833 (“although formerly a District Court could not appoint a receiver for property located outside the judicial district in which it was located, 28 U.S.C. §754 clearly authorizes such an appointment”).

The jurisdiction of the court appointing the receiver, however, appears to have some limitations. The Court of Appeals for the First Circuit, in American Freedom Train Found v. Spurney, 747 F. 2d 1069 (1st Cir. 1984), limited the jurisdiction to districts in which real and personal property are located and to districts in which those asserting rights in such property are located. In American Freedom Train, the receiver initiated a cause of action in the appointing court against former officers and directors of the entity for which it was appointed receiver. These former officers and directors had no minimum contacts with the appointing jurisdiction, and did not commit the alleged acts giving rise to the cause of action in the appointing jurisdiction. The Court held that because no real or personal property was involved in the litigation, it had no jurisdiction over the litigation; 28 U.S.C. §754 was not broad enough to bestow jurisdiction without any minimum contacts, and the receiver could, therefore, not invoke the State’s long arm statute to obtain jurisdiction. Id.

He shall have capacity to sue in any district without ancillary appointment, and may be sued with respect thereto as provided in section 959 of this title.

Such receiver shall, within ten days after the entry of his order of appointment, file copies of the complaint and such order of appointment in the district court for each district in which property is located. The failure to file such copies in any district shall divest the receiver of jurisdiction and control over all such property in that district.

b. Jurisdiction by courts not appointing the receiver.

The minimum contacts analysis of International Shoe v. State of Washington, 326 U.S. 310, 66 S. Ct. 154, 90 L. Ed. 95 (1945), and its progeny is inapplicable to ancillary actions and proceedings brought by a federal receiver to execute his duties in districts other than the district in which he was appointed. 28 U.S.C. 1692. Section 1692⁵ allows nationwide service in a federal receivership, and the territorial jurisdiction of the appointing court extends to any judicial district in which receivership property is found. Haile v. Henderson Nat. Bank, 657 F.2d at 826. See also, Select Creations, Inc. v. Paliapito America, Inc., 852 F. Supp. 740, 780 (E.D. Wis. 1994) (federal receivers are empowered to collect assets anywhere in the United States and have broad jurisdiction over those who claim an interest in such property). Contra United States v. Franklin National Bank, 512 F. 2d 245, 251 (2nd Cir. 1975) (to maintain a suit in a district where he had not been appointed, a federal receiver has to allege independent jurisdictional grounds against a bank who received improper and unlawful payment).

At least one court has held that 28 U.S.C. § 754 is broad enough to include actions initiated by a receiver appointed outside the United States. See Mentink v. World Time Corp. of America, 131 F.R.D. 210 (S.D. Fla. 1990)(a receiver duly appointed by the High Court of Rotterdam, Holland, had standing to bring a breach of contract action in the United States Federal District Court pursuant to 28 U.S.C. § 754 and Rule 17 of the Fed. R.Civ.P.).

2. Filing Requirements for Extra Territorial Jurisdiction.

28 U.S.C. §754 clearly provides that a receiver must, within ten days after entry of the order appointing him, file a copy of the complaint and the order appointing the receiver in

⁵ 28 U.S.C. § 1692 provides that:

In proceedings in a district court where a receiver is appointed for property, real, personal, or mixed, situated in different districts, process may issue and be executed in any such district as if the property lay wholly within one district, but orders affecting the property shall be entered of record in each of such districts.

the district for each district in which property is located. The statute further provides that failure to file such copies in any district divests the receiver of jurisdiction and control over all of the property in that district. The Court of Appeals for the Ninth Circuit, in S.E.C. v American Capital Investments, Inc., 98 F.3d 1133, 1143 (9th Cir. 1996) has held that a separate ten day period for filing the complaint and order appointing the receiver runs from each date on which (a) an interim receiver is appointed, and (b) a permanent receiver is appointed.

The majority of courts considering §754, however, have held that failure of a receiver to **timely** file the required documents is not fatal and does not divest the court of jurisdiction once the documents are properly filed. See S.E.C. v. Equity Service Corp., 632 F.2d 1092, 1095 (3rd Cir. 1980) (“viewing the purpose of section 754. . . , it seems most consistent with the purpose. . . to permit a receiver who has failed to file within the ten-day period to reassume jurisdiction by a later filing, as long as the rights of others have not been prejudiced during the intervening period); S.E.C. v. Infinity Group Co., 27 F, Supp. 559, 564 (E.D. Penn. 1998)(failure to timely comply with section 754 is not fatal, if the rights of others have not been prejudiced during the intervening period). The Court of Appeals, in United States v. Arizona Fuels Corp., 739 F.2d 455, 461 (9th Cir. 1984) even went as far as to hold that a failure of the receiver to file copies of the complaint and the order of appointment in the district court where seller claimed it held funds, did not bar the district court from proceeding summarily to determine whether the seller’s claimed setoffs were legal and to order the refund of the setoff amounts. But see S.E.C. v. Vision Communications, Inc., 74 F.3d 287 (D.C. Cir. 1996) wherein the Court of Appeals for the District of Columbia held that the receiver’s failure to file the complaint and order of appointment until **after** it filed an action to enjoin interference of its sale of receivership property was fatal, and the late filing could not be used to invoke the jurisdiction of the court. The court

distinguished the above cited cases finding that in those cases the receiver did not seek assistance from a court outside of the appointing court until after it had complied with § 754, albeit untimely. The court then remanded the case back to the district court with the comment that “on remand, the court may reappoint the receiver and start the ten-day clock of § 754 ticking once again.” *Id.* at 291.

II. SALES OF ASSETS BY A RECEIVER

The sales of assets by a receiver are governed by 28 U.S.C. §§ 2001, 2002, 2004. At least one court has determined that, in addition, “the power of sale is within the scope of a receiver’s ‘complete control’ over receivership assets under §754, a conclusion firmly rooted in the common law of equity receiverships.” *S.E.C. v. American Capital Investments, Inc.*, 98 F.3d at 1144 (9th Cir. 1996). The statutory provisions governing the sale of assets are very specific with respect to certain requirements (e.g. notice provisions, appraisals), but vague with respect to the procedures to be employed in the sales, thereby allowing for flexibility and creativity. In addition, under federal law, there is no right of redemption from judicial sales under 28 U.S.C. § 2001(b). *U.S. v. Heasley et al.*, 283 F.2d 422 (8th Cir. 1960).

A. Sale of Real Property

The sale of real property by a receiver may be through a public sale or a private sale. A public sale must occur in the district where the receiver was appointed, or in some other district, if the court so orders. In addition, the terms and conditions of the sale will be as directed by the court. 28 U.S.C. § 2001. Notice of a public sale must be approved by the court, and published at least once a week for four weeks prior to the sale, in at least one newspaper in general circulation in the county, state or judicial district where the property is located. 28 U.S.C. § 2002.

A private sale may occur if the court determines that it is in the best interest of the estate. As with a public sale, the terms and conditions of the sale will be as directed by the court. In a private sale, however, the court must appoint three disinterested appraisers to appraise each parcel of property. The originally proposed offer will not be confirmed by the court unless the sales price is two-thirds of the appraised value, or if another offer of at least 10% over the original offer is received. Notice of the private sale must also be approved by the court and published in a newspaper of general circulation at least ten days prior to the hearing on the confirmation of the sale. 28 U.S.C. § 2001.

B. Sale of Personal Property

The sale of personal property is governed by the same rules as that for the sale of real property, unless the court orders otherwise. 28 U.S.C. § 2004. U.S. v. Stonehill, 83 F.3d 1156, 1160 (9th Cir. 1996)(section 2004 gives the district court discretion as to whether appraisals are required to sell personal property).

C. Application of the Statutes by the Courts

Courts are generally liberal with respect to receivership sales. A judicial sale “made with notice and in the manner prescribed by law will not be denied confirmation or be set aside for mere inadequacy in price unless the price is so gross as to shock the conscience of the court, coupled with slight additional circumstances indicating unfairness such as chilled bidding (citations omitted).” Breeding Motor Freight Lines, Inc. v. Reconstruction Finance Corp. et. al., 172 F.2d 416, 424 (10th Cir. 1949). In addition, the Court of Appeals for the Third Circuit, in Tanzer v. Huffins, 412 F.2d 221 (3rd. Cir. 1969) upheld the expedited sale of corporate property by a receiver which did not comply with the statutory procedures, with respect to obtaining appraisals and complying with certain notice provisions, because of the extraordinary circumstances of the case and the dire financial condition of the corporation.

III. APPEALS

28 U.S.C. § 1292(a)(2)⁶ governs the types of orders entered in a receivership proceeding which are appealable. Courts considering the issue of the appealability of orders have strictly interpreted this statutory provision. The Order appointing a receiver is appealable. In re Memorial Estates, Inc., 797 F.2d 516 (7th Cir. 1986). Likewise an order directing a sale of receivership assets, and an order confirming such sale are appealable. United States v. "A" Mfg. Co., Inc., 541 F.2d 504, 506 (5th Cir. 1976). The majority of the courts, however, have limited the statute to orders refusing to direct action. See S.E.C. v. American Principals Holding, Inc., 817 F.2d 1349, 1351 (9th Cir. 1987) (district court's order affirming a compensation payment to the receiver and a spinoff of holding company's partnerships not appealable); Warren v. Bergeron, 831 F.2d 101, 103 (5th Cir. 1987)(28 U.S.C. § 1292 (a)(2) does not grant the circuit court of appeals jurisdiction over an order vacating the appointment of a receiver); S.E.C. v. American Bd. of Trade, Inc., 829 F.2d 341, 344 (2nd Cir. 1987) (the district court's orders, which nullified an auction and refused to sell property to an unsuccessful bidder dealt with administrative matters within the discretion of the district court and are not within the class of interlocutory orders from which an appeal may be taken); People v. State of Ill. Ex Re. Hartigan v. Petus, 861 F.2d 164, 165 (7th Cir. 1988) ("a motion to vacate the appointment is, in effect, a motion for reconsideration - and an order denying such a motion is not among the orders made appealable under section 1292(a)(2)"); F.T.C. v. Overseas Unlimited Agency, Inc., 873 F.2d 1233, 1235 (9th Cir. 1989)(a turnover order does not fall within §1292(a)(2) since it is not an order

⁶ 28 U.S.C. §1292(a)(2) provides that:

(a) The courts of appeals shall have jurisdiction of appeals from:

(2) Interlocutory orders appointing receivers, or refusing orders to wind up receiverships to take steps to accomplish the purposes thereof, such as directing sales or other disposals of property.

appointing a receiver, an order refusing to wind up a receivership, or an order refusing to accomplish the purposes of a receivership); State Street Bank and Trust Co., v. Brockrim, Inc., 87 F.3rd 1487, 1491 (1st Cir. 1996)(contingent order approving the sale of receivership assets in no way represents a refusal to windup the receivership or to take steps to accomplish the purposes thereof, therefore, §1292(a)(2) does not apply); S.E.C. v. Black, 163 F.3d 188, 195 (3rd Cir. 1998) (Section 1292(a)(2) does not provide the jurisdiction for appeal from a fee order because it is “interpreted narrowly to permit appeals only from three discrete categories of receivership orders specified in the statute, namely orders appointing a receiver, orders refusing to wind up a receivership, and orders refusing to take steps to accomplish the purposes of winding up a receivership”).

IV. INTERPLAY BETWEEN BANKRUPTCY AND RECEIVERSHIPS

The Court of Appeals for the Fourth Circuit, in Gilchrist v. General Electric Capital Corp., 262 F.3rd 295 (4th Cir. 2001), considered the interplay between a federal receivership case and bankruptcy. In Gilchrist, the federal district court appointed a receiver and issued an injunction directing that “all persons” take no action to affect the debtor’s assets. A week later over fifty creditors of the debtor filed an involuntary bankruptcy petition against it. The district court held the petitioning creditors in contempt for violation of injunction, and a feud then ensued between the district court and the bankruptcy court as to who had jurisdiction over the case, and whether continuation of the receivership action violated the automatic stay provision of 11 U.S.C. §362.

The Court of Appeals for the Fourth Circuit held that at the commencement of a bankruptcy case, the bankruptcy court, pursuant to 28 U.S.C. § 1334(e) had exclusive jurisdiction

over the property of the estate as of the commencement of the case. Id.⁷ Therefore, the automatic stay provisions of 11 U.S.C. § 362 prevented the continuance of the receivership proceeding and action by the district court judge.

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⁷ Contra, Securities & Exchange Com'n v. Lincoln Thrift Ass'n, 577 F.2d 600, 604, fnote. 4 (9th Cir. 1978)(“because a stay was in effect, leave of the court would have been required to file a bankruptcy petition”).

UNITED STATES DISTRICT COURT
EASTERN DISTRICT OF MICHIGAN
SOUTHERN DIVISION

Norwest Bank Wisconsin, National
Association, a Wisconsin Banking
Corporation, as Trustee,

Plaintiff,

vs.

The Malachi Corporation, Inc.,

Defendant.

Case No. 4:99-CV-40146

Hon. Paul V. Gadola

**RECEIVER'S MOTION FOR EQUITABLE STAY OF ACTIONS
AGAINST THE RECEIVER AND THE RECEIVERSHIP ESTATE**

NOW COMES HealthLink Services, LLC, in its capacity as Receiver appointed by this Court in the above-captioned matter (the "Receiver"), by and through undersigned counsel, and requests this Court to issue a stay of all proceedings against the Receiver and the receivership estate, and in support does hereby state:

1. This case was commenced by the filing of the Plaintiff's Complaint on March 23, 1999. Concurrently with the Complaint, the Plaintiff filed a Motion for Appointment of a Receiver, stating various grounds for the appointment of a Receiver for the property of Defendant, consisting of seven (7) nursing home facilities in Michigan and Wisconsin and related assets (collectively, the "Facilities").¹

¹The Facilities are more specifically described in the Order Appointing Receiver dated March 31, 1999.

2. On March 26, 1999, Plaintiff filed its Emergency Motion For Immediate Entry of Order Granting Motion of Norwest Bank Wisconsin, National Association, for Appointment of a Receiver, on an emergency basis to stem potential deterioration of the Defendant's nursing home Facilities.

3. On March 31, 1999, the Court entered an Order appointing HealthLink Services, LLC, as Receiver for the Defendant's Facilities.²

4. As reflected in the Order of this Court, the appointment of the Receiver was to assist in the maintenance of state licensing for the nursing home facilities in this receivership estate, the prevention of further dissipation of the collateral and the protection of the interests of the Plaintiff as Indenture Trustee for the Bondholders, as well as the interests of other creditors.

4. The Receiver has learned of several lawsuits having been filed against the Facilities, Malachi Corporation, Inc. ("Malachi"), and HealthBank Network Development, Inc. ("HealthBank") for debts incurred prior to March 31, 1999.

5. These lawsuits have not been defended by the Facilities, Malachi or HealthBank and the Receiver is aware of at least two defaults that have already been entered.

²On July 1, 1999, the Receiver filed a Motion for Entry of a First Amended Order Appointing Receiver. This motion is currently pending before this Honorable Court.

6. The Receiver believes it is likely that more lawsuits will be instituted and that this will result in great harm to the estate.

7. The undersigned believes that actions brought against the Receiver or the receivership estates created by this Court in any other jurisdictions conflict with this Court's exclusive jurisdiction over the Receiver and the receivership estate assets.

8. The Receiver shortly will file a motion for approval of a claims procedure in this case. Under the proposed claims procedure, all creditors of the nursing home facilities and parties holding other claims arising from the operation of the facilities, which claims accrued prior to commencement of this receivership on March 31, 1999, will be submitted to this Court for determination.

9. The Receiver has consulted with counsel for the Plaintiff and the Plaintiff has stipulated to the entry of an equitable stay.

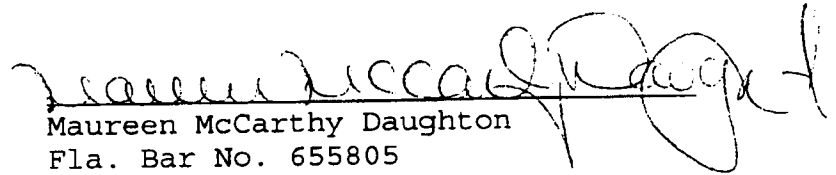
10. Counsel for the Receiver has been unable to reach the Malachi Corporation or its representatives in order to seek their concurrence.

11. This motion is supported by the attached brief.

WHEREFORE, the Receiver respectfully requests this Honorable Court enter an Order issuing a "blanket stay" effective against all persons, including non-parties, of all proceedings against the Receiver and receivership estate in order to prevent interference with the administration of the receivership.

Respectfully submitted,

HealthLink Services, LLC,
As Receiver,
By its counsel



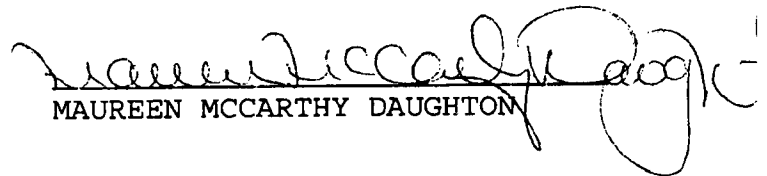
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CERTIFICATE OF SERVICE

I HEREBY CERTIFY that a true and correct copy of the foregoing has been furnished by U.S. Mail to Kay Standridge Kress, Esquire, Pepper Hamilton, LLP, 100 Renaissance Center, 36th Floor, Detroit, Michigan 48243-1157; Patrick J. McLaughlin, Esquire, Dorsey & Whitney LLP, Pillsbury Center South, 220 South Sixth Street, Minneapolis, Minnesota 55402; Malachi Corporation, c/o Emmett J. Marshall, III, Esquire, 166 West Washington, Suite 300, Chicago, Illinois 60602; Malachi Corporation, c/o Registered Agent, CSC-Lawyers, Incorporating Service (Company), 601 Abbott Road, East Lansing, Michigan 48823; and Lynn M. Brimer, Esquire, Raymond and Prokop, P.C., 2000 Town Center, Suite 2400, Southfield, Michigan 48075, this 26 day of August, 1999.


MAUREEN MCCARTHY DAUGHTON

UNITED STATES DISTRICT COURT
EASTERN DISTRICT OF MICHIGAN
SOUTHERN DIVISION

Norwest Bank Wisconsin, National Association,
a Wisconsin Banking Corporation, as Trustee

Plaintiff,

v.

The Malachi Corporation, Inc.

Defendant.

Case No.

Hon.

99-71415

PAUL D. BORMAN

MAGISTRATE JUDGE MORGAN

MOTION FOR APPOINTMENT OF A RECEIVER

NOW COMES NORWEST BANK WISCONSIN, NATIONAL ASSOCIATION

a Wisconsin Banking Corporation (the "Trustee" or "Norwest"), by and through its attorneys,

PEPPER HAMILTON LLP and DORSEY & WHITNEY L.L.P., and in support of its Motion for Appointment of a Receiver states as follows:

1. Norwest Bank Wisconsin, National Association ("Norwest" or the "Trustee") is the Indenture Trustee of six different revenue bond issues (of two series each)(the "Bonds") which were to be used to finance the acquisition or construction of three long term care facilities located in Michigan and four long term care facilities located in Wisconsin. The issuance of the Bonds and the locations of the Facilities are more fully described in Norwest's Complaint, a true and correct copy of which (less exhibits) is attached hereto as Exhibit A and incorporated herein by reference.

2. The total principal amount of the Bonds issued was \$34,210,000.00

3. The Trustee holds, either directly or by assignment from the appropriate

Bond Issuer, a mortgage against each Facility, a security interest in all of the chattels,

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receivables, general intangibles, inventory, equipment, and records relating each Facility, and an assignment of the rents against each Facility, (collectively, the "Collateral") as security for the repayment of the Bonds. The Trustee's security interests are more fully described in Exhibit A.

4. Pursuant to the Mortgages, the Trustee has the express right to seek the appointment of a receiver in the event of default.

5. The Malachi Corporation, Inc. ("Malachi") was the purchaser of the Facilities and is now the owner of the Facilities and the obligor on the Bonds.

6. Immediately after its purchase of the Facilities, Malachi delegated all management of the Facilities to HealthBank Development, Inc., or its affiliates, (the "Manager") pursuant to management agreements (the "Management Agreements") which are collectively attached hereto as Exhibit B.

7. Under the Management Agreements, the Manager was obligated to operate and maintain the Facilities in accordance with applicable state law. See Exhibit B.

8. The Manager's specific obligations included, but were not limited to, (i) arranging for timely payments on the debt service on behalf of Malachi, (ii) subordinating any management fees payable to the timely payment of the debt service, (iii) producing and disseminating certain financial reports, (iv) granting reasonable access to the Facilities' books and records, (v) arranging for timely payments of all real estate and personal property taxes on behalf of Malachi, and (vi) arranging for necessary repairs and maintenance of the Facilities. See Exhibit B.

9. Malachi is default of its obligations on the Bonds. See ¶9 of the Affidavit of Nicholas Tally, attached hereto as Exhibit C.

10. Nothing has been paid to the Trustee with respect to the Michigan Facilities since September 1998, and nothing has been paid to the Trustee with respect to the Wisconsin Facilities since October 1998. See Exhibit C, ¶13.

11. The Trustee has made at least two written requests for financial statements for the Facilities, and numerous oral requests for the same in telephone conversations with Malachi since November 1998. See January 1999 Letters from Norwest to Malachi, true and correct copies of which are collectively attached hereto as Exhibit D; Exhibit C, ¶12.

12. Despite those repeated requests for financial statements, Malachi and the Manager have failed to provide responsive information. See February 1, 1999 Letter from Malachi to Norwest, a true and correct copy of which is attached hereto as Exhibit E; Exhibit C, ¶13.

13. The real estate taxes related to the Facilities have not been paid and are now delinquent. See Title Searches, collectively attached hereto as Exhibit F.

14. The personal property taxes related to the Facilities have not been paid and are now delinquent.

15. As of March 8, 1999, the Manager had failed to make payments of payroll taxes due in connection with the Facilities in the total amount of \$795,341.00. See the Termination Agreement between the Manager and Malachi (the "Termination Agreement") attached hereto as Exhibit G.

16. Malachi and the Manager have failed to properly maintain and repair the Redford Facility which is in violation of the Redford Building Code. See Notices of Violation, collectively attached hereto as Exhibit H.

17. Malachi and the Manager have failed to pay for repairs they have caused to occur, and, consequently, a construction lien has been placed on the Riverview Facility. See Notice of Furnishing and related documents, collectively attached hereto as Exhibit I.

18. On January 26, 1999, the Trustee accelerated all of the principal and interests due on the Bonds with respect to the Gillett and Manitowoc Facilities, and on February 1, 1999, the Trustee accelerated all of the principal and interest due on the Bonds with respect to the other Facilities. See Acceleration Letters, true and correct copies of which are collectively attached hereto as Exhibit J.

19. The amount of principal and interest currently outstanding on the Bonds is in excess of \$35,227,056.25. See Exhibit C, ¶11.

20. On February 26, 1999, Malachi elected to terminate the Management Agreements pursuant to the terms of those agreements, and sent 20 days written notice of its election to terminate to the Manager. See February 26, 1999 letter from Malachi to the Manager (the "Termination Letter"), a true and correct copy of which is attached hereto as Exhibit K, and Registered Mail Return Receipt, a true and correct copy of which is attached hereto as Exhibit L.

21. Pursuant to the Termination Letter, the Management Agreements were terminated on March 18, 1999. See Exhibit K.

22. The Manager is still in possession of the Facilities.

23. The Trustee is legitimately fearful that the Collateral has been, is, and will continue to be destroyed or dissipated.

24. The appointment of a receiver is necessary and appropriate because:

a. Norwest has a valid claim against Malachi for breach of contract.

b. The appointment of a receiver is a remedy for default expressly contemplated by the contract between Norwest and Malachi.

c. Without a full and complete accounting and control over the Facilities, there exists great opportunity for fraud, concealment, and manipulation of books and records.

d. Legal remedies are inadequate to prevent the loss of state licensing of the Facilities and the resulting eviction of patients.

e. There are no other equitable remedies to provide the relief sought.

f. Appointment of an appropriate receiver will prevent the loss of state licensing and expulsion of patients, will prevent the further dissipation of the collateral, and will protect the interests of the Trustee for the Bondholders, as well as the interests of other creditors.

25. The Trustee proposes that Healthlink Services, L.L.C. ("Healthlink") be appointed to act as receiver, and that Healthlink be authorized to hire HP/Management Group, Inc. as the manager of the Facilities. Healthlink has successfully acted as receiver in similar matters across the country, and has worked closely with HP/Management Group, Inc. ("HealthPrime"), an affiliated Georgia corporation with extensive experience in the operation and management of long term care facilities, including four facilities in Michigan. Healthlink stands ready and willing to assume the role of receiver, and HealthPrime stands ready and willing to assume operation and management of the Facilities for the duration of the receivership.

WHEREFORE, the Trustee moves this Court to immediately enter an order which:

a. appoints Healthlink Services, L.L.C. as the receiver of the Facilities for the purpose of preserving and protecting the value of the collateral which secures repayment of the Bonds during the pendency of this action;

b. authorizes Healthlink to take immediate possession of the Facilities and related assets, including, but not limited to, bank accounts maintained by the Manager related to the Facilities, and accounts receivable generated by the Facilities;

c. authorizes Healthlink to hire and employ HP/Management Group, Inc. as the manager of the Facilities during the pendency of the receivership;

d. authorizes Healthlink to take all actions reasonably necessary to maintain, operate, and preserve the Facilities during the pendency of the receivership;

e. authorizes Healthlink to incur a limited amount of additional debt as is reasonably necessary to maintain, operate, and preserve the Facilities;

f. directs Healthlink to provide an accounting of the receivership estate;

g. provides for the reasonable compensation of Healthlink and HP/Management Group, Inc.;

h. directs any and all individuals and entities with actual or constructive notice of the receivership to cooperate with Healthlink's efforts to take possession of the Facilities and related assets;

i. enjoins any and all individuals and entities with actual or constructive notice of the receivership from directly or indirectly interfering with Healthlink's efforts to discharge its duties as Receiver.

j. enjoins any and all individuals and entities with actual or constructive notice of the receivership from concealing, dissipating, or destroying the assets of the receivership estate or any books and records related thereto.

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Minneapolis, Minnesota 55402
(612) 340-2600

Attorneys for Plaintiff

DATED: _____

DT: #106453 v1 (2@5101!.WPD) 114212-2

UNITED STATES DISTRICT COURT
EASTERN DISTRICT OF MICHIGAN
SOUTHERN DIVISION

Norwest Bank Wisconsin,
a Wisconsin Banking Corporation,
as Trustee

File No. _____

Plaintiff,

v.

Malachi Corporation, Inc.

Defendant.

EXHIBIT LIST TO MOTION FOR APPOINTMENT OF A RECEIVER

- A. NORWEST COMPLAINT
- B. MANAGEMENT AGREEMENTS
- C. AFFIDAVIT OF NICHOLAS TALLY
- D. JANUARY 1999 LETTERS FROM NORWEST TO MALACHI
- E. FEBRUARY 1999 LETTER FROM MALACHI TO NORWEST
- F. REAL ESTATE TAX DOCUMENTS
- G. TERMINATION AGREEMENT
- H. NOTICES OF VIOLATION
- I. NOTICE OF FURNISHINGS
- J. ACCELERATION LETTERS
- K. FEBRUARY 26, 1999 TERMINATION LETTER
- L. REGISTERED MAIL RETURN RECEIPT

UNITED STATES DISTRICT COURT
EASTERN DISTRICT OF MICHIGAN
SOUTHERN DIVISION

NORWEST BANK WISCONSIN, NATIONAL
ASSOCIATION, a Wisconsin Banking
Corporation as Trustee,

Plaintiff,

v.

CIVIL ACTION NO. 99-40146

HONORABLE PAUL V. GADOLA
U.S. DISTRICT JUDGE

THE MALACHI CORPORATION, INC.,

Defendant.

**BRIEF IN SUPPORT OF RECEIVER'S MOTION FOR
APPROVAL OF CLAIMS PROCEDURE**

I. BACKGROUND

This case was filed on March 23, 1999, by Plaintiff, Norwest Bank Wisconsin, National Association, the Indenture Trustee for six revenue bond issues the proceeds of which were used to finance the acquisition of seven long term care nursing home facilities (collectively the "**Facilities**" and individually a "**Facility**") located in Michigan and Wisconsin owned by the Defendant. On April 9, 1999 the case was transferred to this Court.

On March 31, 1999, this Court entered an Order appointing HealthLink Services, LLC, ("**Receiver**") the Receiver for the Defendant's Facilities. An Amended Order Appointing Receiver was

entered by the Court on August 10, 1999. The Court appointed the Receiver, among other reasons, to assist in the maintenance of state licensing and the retention of residents, to prevent the further dissipation of the collateral and to protect the interests of the Trustee for the Bondholders, as well as the interests of the other creditors. The Receiver is currently operating all of the Facilities. In connection with its duties and obligations, the Receiver is administering the payment of operating expenses incurred by the Facilities after the March 31st date that it was appointed Receiver.

The Receiver has learned of numerous claims and lawsuits that have been asserted against the Facilities and/or the Defendant, The Malachi Corporation, Inc., related to the facilities for debts incurred by or relating to the facilities prior to March 31, 1999. The Receiver reasonably anticipates that more claims and lawsuits will be filed against the Facilities for debts incurred prior to March 31, 1999.

On August 27, 1999 the Receiver filed a Motion for Equitable Stay to stay all proceedings involving the Facilities in order to prevent interference with the administration of the receivership. On October 29, 1999 the Court entered an Order granting the Motion and issued a blanket stay prohibiting all persons or entities from commencing, prosecuting, continuing or enforcing any suit or proceeding against the Receiver or the entities in the receivership

estate. (Exhibit 1). The Stay is in effect for 90 days, although the Receiver may seek to extend the stay by submitting a showing of good cause why the stay should be extended.

In conjunction with the Stay, the Receiver has developed a formal procedure for the filing of claims by creditors of the Facilities. The Claims Procedure is designed to provide a formal and comprehensive system to catalog claims against the estate as of March 31, 1999. In short the proposed Claims Procedure will permit (i) creditors to assert their claims; (ii) a tolling of the Statute of Limitations hereby preserving all claimants' rights by the timely filing of their claims; and (iii) an evaluation and/or adjudication, if necessary, of the claims of pre-March 31, 1999 creditors.

II. THE PROPOSED CLAIMS PROCEDURE

One of the fundamental purposes of every receivership is to place the property, such as the Facilities, under the control of the Court so that it may be preserved and held ready for disposal in accordance with the final adjudication of the rights of the interested parties. To effect this purpose, the Court appointing the Receiver must in some mode receive and, if necessary, adjudicate claims and interests asserted against the receivership property. Considerations of convenience and administration of justice require that the Court establish a procedure in which all

claims will be presented as of a certain date and if necessary, adjudicated.

The Receiver's proposed Claims Procedure is set out in the proposed Order attached as Exhibit 2. The proposed Claims Procedure is a straightforward, method for accomplishing all of the above stated purposes, and is further designed to utilize the resources of the Receiver and the Court in an efficient manner.

The significant provisions of the proposed Claims Procedure are as follows:

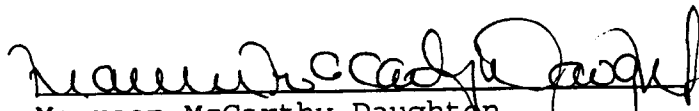
1. The Claims Procedure is applicable to all creditors of the Defendant or the Facilities for debts incurred by or relating to the Facilities, prior to March 31, 1999.
2. Within 30 days of the Order approving the Claims Procedure, the Receiver shall give notice to all known and unknown potential claimants by (i) first class mail to known potential claimants; and (ii) by publication in a newspaper of general circulation in the county in which each Facility is located.
3. A person with a claim must file a proof of claim within 90 days from the date of the entry of the Order. If a claimant fails to attach to the Proof of Claim Form all of the documentation necessary to establish the priority and amount of their claim, their claim shall be disallowed.
4. The Court may in its sole discretion, permit an unknown Claimant or a Claimant not receiving timely notice to file a late proof of claim, for good cause shown and to the extent that such filing will not prejudice the orderly administration of the Receivership.
5. The Proof of Claims will be filed with the Receiver and recorded in a Control Log for each Facility. Within 120 days of the entry of the Order, the Receiver shall prepare and serve an initial report to the Court summarizing the Proofs of Claims filed by Claimants. The

Court shall set a Status Conference to review the initial report.

6. The Court shall have exclusive jurisdiction to order and determine the validity, priority and amount of all claims filed.
7. The Equitable Stay will remain in effect until the status conference date.
8. The Statute of Limitations is tolled hereby preserving all claimants' rights by the timely filing of their claims under the procedures provided herein.

The proposed Claims Procedure is fair to claimants and permits the Court to receive and adjudicate, if necessary, the claims. The Court should grant the Motion to approve Claims Procedure and enter the proposed Order.

Respectfully submitted,



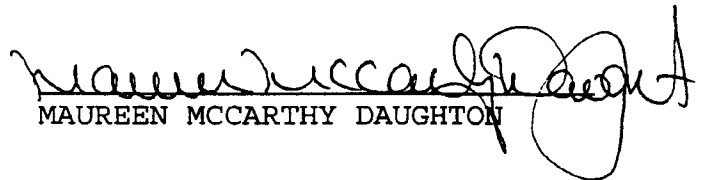
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CERTIFICATE OF SERVICE

I HEREBY CERTIFY that a true and correct copy of the foregoing has been furnished by U.S. Mail to Kay Standridge Kress, Esquire, Pepper Hamilton, LLP, 100 Renaissance Center, 36th Floor, Detroit, Michigan 48243-1157; Patrick J. McLaughlin, Esquire, Dorsey & Whitney LLP, Pillsbury Center South, 220 South Sixth Street, Minneapolis, Minnesota 55402; Malachi Corporation, c/o Emmett J. Marshall, III, Esquire, 166 West Washington, Suite 300, Chicago, Illinois 60602; Malachi Corporation, c/o Registered Agent, CSC-Lawyers, Incorporating Service (Company), 601 Abbott Road, East Lansing, Michigan 48823; Lynn M. Brimer, Esquire, Raymond and Prokop, P.C., 2000 Town Center, Suite 2400, Southfield, Michigan 48075, and Judith Greenstone Miller, Esq., 255 S. Old Woodward Ave., Third Floor, Birmingham, Mi 48009, this 7 day of January 2000.


MAUREEN MCCARTHY DAUGHTON

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UNITED STATES DISTRICT COURT
EASTERN DISTRICT OF MICHIGAN
SOUTHERN DIVISION

NORWEST BANK WISCONSIN, NATIONAL
ASSOCIATION, a Wisconsin Banking
Corporation as Trustee,

Plaintiff,

v.

CIVIL ACTION NO. 99-40146

HONORABLE PAUL V. GADOLA
U.S. DISTRICT JUDGE

THE MALACHI CORPORATION, INC.,

Defendant.

RECEIVER'S MOTION FOR APPROVAL OF CLAIMS PROCEDURE

Now Comes HealthLink Services, LLC, ("HealthLink") in its capacity as Receiver appointed by this Court ("Receiver") by and through its counsel, and requests that this Court grant Receiver's Motion for Approval of Claims Procedure with respect to the assets of the Receivership Estate. In support of this Motion, the Receiver states as follows:

1. This case was filed by the Plaintiff on March 23, 1999. On April 9, 1999, this case was transferred to this Honorable Court.
2. On March 31, 1999, this Court entered an Order appointing HealthLink as Receiver for certain property of the Defendant, consisting of seven long term care nursing home facilities in

Michigan and Wisconsin and related assets (collectively the "Facilities" and individually a "Facility").

3. An Amended Order Appointing Receiver was entered by the Court on August 10, 1999.

4. The Court appointed the Receiver, among other reasons, to assist in the maintenance of state licensing and the retention of residents, to prevent the further dissipation of the collateral, and to protect the interests of the Trustee for the Bondholders, as well as the interests of other creditors.

5. The Receiver is currently operating all of the Facilities. In connection with its duties and obligations as Receiver it is administering to the payment of operating expenses incurred by the Facilities after March 31, 1999, the date the Receiver was appointed.

6. The Receiver has learned of numerous claims that have been asserted by creditors against the Facilities and/or the Defendant, The Malachi Corporation, Inc., related to the facilities for debts incurred prior to March 31, 1999. In addition, the Receiver is aware of several lawsuits that have been filed against the Facilities for debts incurred by or relating to the Facilities prior to March 31, 1999.

7. The Receiver believes that it is likely that more claims and lawsuits will be asserted against the Facilities arising from alleged debts and obligations incurred prior to March 31, 1999.

8. On October 29, 1999, this Court entered an Order Granting Equitable Stay, pending the filing of the proposed claims procedure to prevent interference with the administration of the receivership and to maintain the status quo.

9. A formal procedure for the filing of claims and determination of claims is necessary for the orderly administration and operation of the Facilities and to preserve the assets of the Facilities for the benefit of the Defendant and all of the creditors.

10. Such a claims procedure would prevent waste of receivership assets through numerous lawsuits and collection actions, and provide a centralized forum for the filing of claims.

11. Considerations of convenience, administration and justice require that the Court establish a procedure in which all claims are presented as of a certain date and if necessary, adjudicated.

12. The Court has exclusive jurisdiction over all of the assets of the Receivership estate and has the power to establish a claims procedure.

13. The Receiver respectfully requests that this Court enter the proposed Order Granting Claims Procedure attached as Exhibit to 2 to the Brief in Support of this Motion.

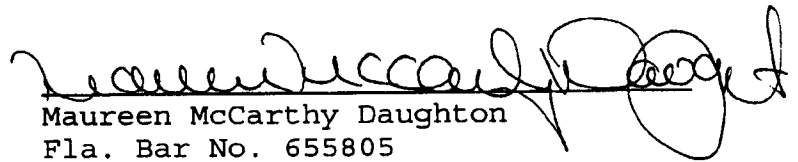
14. The Receiver believes that the Claims Procedure set forth in the proposed Order provides a straightforward and efficient method for the filing of claims incurred on behalf of the Facilities prior to March 31, 1999.

15. The Motion is supported by the Attached Brief.

WHEREFORE, the Receiver requests that this Court grant its Motion for Approval of Claims Procedure and enter the Order in the form attached to the Brief in Support and to provide such other and further relief as is just.

Respectfully submitted,

HealthLink Services, LLC,
As Receiver,
By its counsel



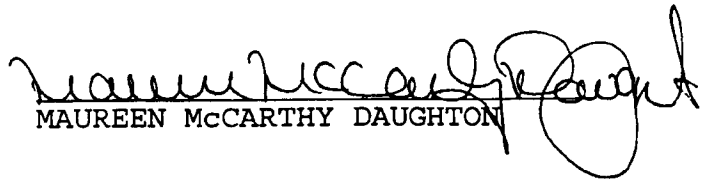
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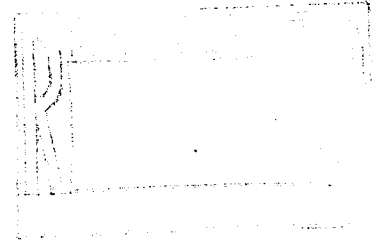
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MAUREEN MCCARTHY DAUGHTON

UNITED STATES DISTRICT COURT
EASTERN DISTRICT OF MICHIGAN
SOUTHERN DIVISION



Norwest Bank Wisconsin, National
Association, a Wisconsin Banking
Corporation, as Trustee,

Case No. 4:99-CV-40146

Hon. Paul V. Gadola

Plaintiff,

vs.

The Malachi Corporation, Inc.,

Defendant.

**MEMORANDUM IN SUPPORT OF RECEIVER'S
MOTION FOR EQUITABLE STAY OF ACTIONS AGAINST THE RECEIVER
AND THE RECEIVERSHIP ESTATE**

This action involves seven (7) nursing home facilities in Michigan and Wisconsin that, pursuant to this Court's Order Appointing Receiver entered March 31, 1999, are all property of the Receivership Court.

It has long been recognized that federal courts have the power to impose a receivership free from interference in other proceedings. See S.E.C. v. Wencke, 622 F. 2d 1363, 1372 (9th Cir. 1980). In the exercise of its jurisdiction, this Court has power to issue injunctions and all other writs necessary to protect the receivership estate from interference and to insure an orderly administration thereof.

In Eller Industries, Inc. v. Indian Motorcycle Manufacturing, Inc., 929 F. Supp. 369 (D. Colo. 1995), a joint motion was filed for stay of all equitable actions against the estate of a

corporation which had been placed in receivership. The District Court held that a blanket stay against all other foreign actions was warranted to preserve the receivership court's exclusive jurisdiction and control over the receivership. In so doing, the Court stated:

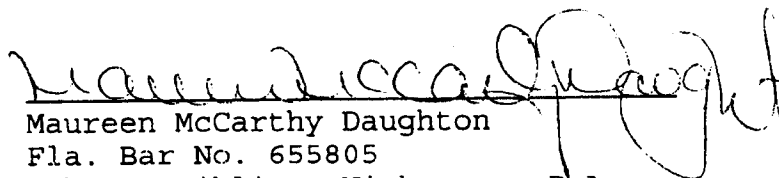
This Court has the power to enjoin particular actions or to issue a "blanket stay" order effective against all persons, including non-parties, of all proceedings against the receivership entity in order to prevent interference with administration of the receivership. The power of a federal court to enter such stays does not depend on specific congressional authorization. Rather, this authority is based upon the inherent and broad equitable powers of federal courts to protect its jurisdiction over the property for which it has taken possession.

Id. at 373 (citations omitted).

In the instant case, the purposes of this receivership, to protect assets for the benefit of all creditors, can only be achieved by an equitable stay of foreign actions. The stay of all pending and future actions against the Receiver and the receivership estates is necessary to achieve the purposes of the receivership and to prevent interference with the administration of the receivership estate and hardship to other creditors.

Respectfully submitted,

HealthLink Services, LLC,
As Receiver,
By its counsel



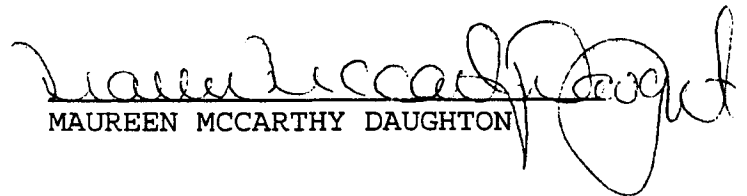
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MAUREEN MCCARTHY DAUGHTON

*“Orderly” Takeovers of Special Properties:
A Court Order Checklist
William J. Hoffman*

“Orderly” Takeovers of Special Properties:

A Court Order Checklist

by:

William J. Hoffman, President

Trigild Services, Inc.

Attorneys and others involved in the turnaround of troubled properties should be aware that there is a vast difference between traditional real estate entities like office buildings and "special assets," which run the gamut from amusement parks to restaurants.

When drafting court orders for these special properties, it is critically important to view them first as businesses and only secondarily as real estate assets.

Unlike traditional or "passive" income properties -- such as office buildings, shopping centers and multi-family housing -- special assets feature a retail component, which typically represents a significant portion of the value. Examples include hotels, restaurants, convenience

stores, gas stations, truck stops, senior care facilities and recreational or theme parks.

These assets typically involve a host of complex business issues, and require specific knowledge of the business itself, not merely general real estate management skills.

Having served as a receiver, trustee, custodian and/or manager for hundreds of retail properties, our task is always greatly impacted by the court orders which empower us. Court orders are critical to any takeover -- careful drafting not only saves time and helps curtail potential problems, but can significantly affect the cost to the receivership or bankruptcy estate, and ultimately the amount recovered on the loan.

Not surprisingly, the impact on speed, cost and effectiveness is magnified when the asset is not a simple income property, but involves the operation of a business as well. Indeed, special assets such as hotels, gas stations and theme parks, can add myriad levels of complication for any receiver or trustee, as well as the operator.

Problems and needs encountered by attorneys when dealing with these properties range from taking stock of inventories to examining franchise agreements.

Following are just a small sampling of the problems that can be encountered when working with these properties, and how they can be dealt with in the court orders. These scenarios can apply to a receiver in a pending foreclosure action, to bankruptcy trustees or to third-party operators placed through stipulations among parties.

By covering all of these anticipated hurdles in advance, a return visit to court for additional orders can be avoided, and assets can be protected more effectively.

- **Bank Accounts.** A complex property such as a hotel may have multiple bank accounts – one for ordinary operating expenses, one for processing credit card transactions, another for reservation deposits, and yet another for capital reserves.

In addition, there will be many different cash banks for personnel such as desk clerks and bartenders or accounts used by the owner under a different name. With this in mind, the court order should specifically

allow the receiver to seize all related accounts, and specify other entity names, if known. The receiver should be allowed to keep the accounts open in order to receive additional deposits or transfers, but be able to freeze all funds so no further checks can clear.

- **Inventories.** The inventory of major high-rise office building is quite simple when compared to a hotel or even a modest size restaurant.

For that reason, the court order for a special asset should allow ample time for the filing of an inventory. An “inventory” may also include accounts receivable, which can be very substantial and complex for an entity such as a truck stop or convention hotel. In addition, reporting these accounts may create false hopes about collectability.

Most receivership statutes -- when they even exist -- refer to “receipts and disbursements,” not profits and losses, thus implying that accounting should be done on a cash basis rather than accrual basis. That being the case, it is usually advisable not to include accounts payable as inventories or assets, but instead to simply note the apparent amount and then reflect any payments as income when actually received. Dollar values should not be assigned to most inventories, since such

valuations are highly subjective and can open the door to arguments later on.

- **Books and Records.** While rent roles and security deposit information are fairly uncomplicated in traditional real estate, much more detailed and critical business records are involved when dealing with special assets.

For example, lengthy lists of major corporate accounts, travel agents, previous guests, daily reports and reservations are vital for hotels, while fuel supply data and store sales records are critical bits of information for gas stations and convenience stores. For a property such as a theme park, it might be necessary to contact all previous season pass holders before re-opening for the season.

The bottom line? Past business records are critical in retail assets.

- **Franchise Agreements.** A hotel, restaurant or gas station is often branded through a franchise agreement. Most often, when an owner defaults on debt service, there are already other defaults with vendors, taxes and franchises. In addition, most franchise agreements include receivership or bankruptcy as a default. The particular franchise (or

“flag”) can be a very substantial benefit to such an asset. Yet if badly chosen, the "flag" can also be a detriment. Receivers, trustees and turnaround managers experienced with such projects can not only quickly assess the flag’s value, and successfully maintain the desirable identity, but can often improve on the terms of such agreements. The court order should always allow the receiver to negotiate such agreements.

- **Liquor and Gaming Licenses; Lottery Tickets.** This category may seem insignificant, but is actually an extremely important source of income for many special assets.

The survival of a gas station may be dependent on the sale of lottery tickets or liquor sales to attract customers to its gas pumps. A convention hotel which cannot operate its cocktail lounge or serve wine to a banquet could lose all its future bookings. For these reasons, the receiver needs authority to continue using existing licenses and/or to transfer or acquire licenses. A new license rarely allows for continued operation, and often takes months of processing, whereas assignment,

transfer or merely “use” of the existing license allows for continued operation.

The administrative agencies who control these privileges are not governed by court orders involving other parties, but an order which specifically mentions these licenses may still be of great help. The order may simply direct the debtor not to surrender or terminate the licenses, or to cooperate in transferring the license to the receiver. While the legal merits of such an order are unclear, if the agency bureaucrat believes the order to be valid and complies, the asset (and arguably all parties) will benefit. The debtor is certainly free to object, but in hundreds of cases, this has only happened to our firm once, and we still managed to obtain the license.

- **Unusual Vendor Relationships.** A special asset's relationship with vendors is often less than straightforward. For example, when a customer pays at the pump at a local gas station, often the credit card proceeds do not go to the owner or operator of the station, but are deposited directly into the account of a fuel supplier or “jobber.”

These receipts can represent the majority of sales, so cash flow at the property may be limited. Jobbers also typically require substantial deposits before delivering fuel. If the tanks need filling every day to meet demand, the receiver may need to borrow cash immediately to stay open, and additional debt requires prior court approval, which leads to the following discussion about receiver's certificates.

- **Receiver's Certificates.** Special assets often depend on going-concern value as much, if not more, than real estate or improvements value. A closed hotel is worth only a fraction of an operating one, even one which loses money. Some hotels take years to become established and stabilize, so closure can be fatal. The lender may be prepared -- particularly if forewarned -- to fund operating losses of the business in order to maintain or enhance the ultimate sale value of the asset. If this can be anticipated, the order appointing receiver should also grant permission for the receiver to borrow money. The loans can be added to the underlying indebtedness as additional advances, or receiver's certificates can be issued as a separate debt. Most judges are reluctant to agree in advance to such borrowing, so it will be important to be

prepared to explain a critical need. Some receivers and trustees are also experienced as expert witnesses in their field, and should be able to assist your legal counsel in drafting such requests. This is merely one example of why it is important to have a receiver who is knowledgeable about both receivership law and the specific business or industry.

- **Accounts Payable.** Generally, a receiver has no obligation (or even right) to pay pre-receivership debts. The court may allow exceptions when the receiver feels it is necessary to protect or benefit the estate. When such expenditures can be anticipated -- i.e. for unpaid wages -- the initial order should allow either for the specific payment, or for discretion of the receiver.

- **Management Companies.** Because of the cost savings and easy transition upon foreclosure, many lenders and servicers prefer to use a receiver who is connected to a management company (although this is harder to find with retail properties).

The court's order should not only grant authority to hire a management company, but include a company in which the receiver is a

principal, employee, etc. Naturally, the relationship should be disclosed and management fees should be competitive.

- **Intercepting Mail.** When dealing with retail businesses rather than traditional commercial income properties, it is typical for owner/operators to have many unique or personal methods of conducting their business. It is not uncommon for payments from major accounts, for example, to be directed to a location other than the subject property. For that reason, the receiver should have authority to intercept mail and to have the postmaster redirect business mail to the receiver's offices.

- **Environmental Audits.** It is frequently vital to the lender (plaintiff) to request an assessment of any environmental issues. Since it is also of importance to the receiver, along with health and safety issues, the order should specifically provide for access to conduct such inspections and audits.

- **Retaining Legal Counsel.** Aside from routine evictions or collection matters, most judges do not like receivers to automatically retain legal counsel. If the need for separate legal counsel for the receiver is expected, the purpose should be carefully detailed to facilitate

the court's approval. An experienced receiver should not need to consult with legal counsel for most matters.

- **Personal property.** With special assets such as restaurants, hotels, convenience stores and other businesses, very often the personal property may be leased. The receiver will need to determine who the actual owner is, and whether or not to continue honoring such leases. It may be beneficial to have the court "order" other parties not to remove leased equipment. However, in the case of a foreclosure action, third party lessors are not necessarily subject to that court's jurisdiction.

- **Restraining Orders.** Orders appointing receivers commonly also include Temporary Restraining Orders, which prevent the debtor from canceling insurance policies, removing property, or interfering with the receiver's responsibilities and duties.

- **Bonds.** Every court seems to have its own method for determining what size bond the receiver should post. Some judges, in dealing with traditional commercial real estate, feel that one month's rent receipts is an appropriate amount. This is based on the theory that once a month, when rents are collected, the receiver will have that much

money on hand. The receiver on a hotel or restaurant, however, will rarely if ever have such an amount at one time, and a bond in that amount could be over a million dollars. Counsel should be prepared to suggest a reasonable amount to the court, with supporting reasons, since the cost of the bond is also an expense to the receivership estate.

- **Ex Parte or Noticed Motion?** The typical hearing on a motion for appointment of a receiver is scheduled after appropriate notice to all parties, and may be set for a date days or weeks in the future. In some cases, counsel may seek an ex parte motion on an expedited basis. The motion can be held as quickly as the following day, with the notice to the other party sometimes being a simple phone call. Courts are naturally reluctant to grant a motion which removes an owner from his/her property on such short notice, so it is important to have a compelling reason. A gas station which is being forced to close because it can't pay for fuel delivery or a hotel which is about to lose its franchise would be good arguments for an ex parte motion.

Conclusion

Careful drafting is naturally important in all legal documents. However, the order appointing a receiver, or directing a trustee, becomes even more critical when an operating business comprises a substantial part of a real estate asset's value.

Because of the unique nature of these properties, the lender and its legal counsel should be extremely prudent when drafting the court order and take careful note of all the issues addressed.

While there are dozens of other "standard" items that should be included in every Court Order -- as well as many more special issues to be addressed for different types of assets -- this article should provide a thorough checklist for such special properties.

If possible, input from the proposed receiver and/or management company should be solicited at the earliest opportunity. A return visit to the courtroom for supplemental instructions and orders is expensive and time-consuming, and a delay of even a day or two can sometimes be fatal to the financial health of a business.

An attorney, licensed real estate broker, Certified Hotel Administrator and court-appointed receiver, William J. Hoffman is President of Trigild, a property management firm which has handled hundreds of special assets -- from hotels to amusement parks.

State Court Receivership
Shelly Crocker, Esq.

STATE COURT RECEIVERSHIP

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I. Nature of Receivership Actions.

A. Types of Receivership

Most states provide several mechanisms to obtain a receiver.

Historically, a receiver could be appointed by a chancery court exercising its inherent authority in equity to control the property within its jurisdiction.

Although still available under the common law of most states, many states have also adopted statutes to further delineate and define the proper uses of receivers. Additionally, most states' corporations acts permit appointment of a receiver in various circumstances, as discussed below. Such a receiver may be appointed as a custodian of specific property, or may rather be appointed over the entire corporation. Many states also provide for a receiver in aid of foreclosure under various real property foreclosure statutes.

Terminology differs widely, but states often distinguish between "general" and "special" receivers, depending on the extent of the receiver's power over the assets in a case. A receiver "pendente lite" is appointed on a temporary basis to carry out specific actions over particular property. A "custodian" may refer to a receiver with operational authority. Finally, receivers may be appointed in special circumstances under various state regulatory schemes for insurance companies, nursing homes, financial institutions, and other specific circumstances.

B. Relationship to Bankruptcy.

Prior to the widespread acceptance of bankruptcy as a reorganization tool under the Bankruptcy Act and the Bankruptcy Code, receiverships were commonly employed in both Federal and State court to obtain control over a failing corporation's assets. Indeed, a large portion of the controlling law in the area dates back to the late-19th and early-20th centuries. As bankruptcies have flourished, receiverships have become less common. Nevertheless, appointment of a receiver, either by a failing corporation or its creditors, remains a powerful tool to maximize the debtor's assets for the benefit of its creditors.

Appointment of a receiver does not prevent a corporation or individual from commencing a voluntary bankruptcy proceeding under title 11 of the Bankruptcy Code. See, e.g., *Cash Currency Exchange, Inc. v. Shine*, 762 F.2d 542, 552-53 (7th Cir. 1985). Moreover, appointment of a receiver may itself provide sufficient grounds for an involuntary bankruptcy. 11 U.S.C. § 303(h)(2). Thus, even after a receiver has been appointed, there is a risk that the case will be undermined by a voluntary or involuntary bankruptcy filing. A competent receiver will anticipate this problem, and work quickly to gain the confidence of the debtor and any creditors who are not parties to the action.

C. Receivership is a Remedy.

Except under special circumstances, the appointment of an equity receiver to preserve and protect the assets of a corporation or an individual is a remedy, not an action in and of itself. *Kelleam v. Maryland Cas. Co.*, 312 U.S. 377, 61 S. Ct. 595, 85 L.Ed. 899 (1941). A receivership is one remedy among many, such as foreclosure, injunction, or award of money damages. It is not available independently from an underlying action, but instead receivership is only appropriate in aid of some other ultimate action. See, e.g., *Norwest Bank Nebraska, N.A. v. Bellevue Bridge Com'n*, 7 Neb. App. 750, 585 N.W. 2d 505 (1998); *Hamburger Apparel Co. v. Werner*, 17 Wn.2d 310, 320, 135 P.2d 311 (1943); *United States v. Sloan Shipyards Corp.*, 270 Fed. 613 (W.D. Wash. 1921).

D. Receiver's Role.

A receiver is an officer of the court, and does not represent any one party in a receivership proceeding. Instead, the receiver acts on behalf of the court, exercising the court's jurisdiction over the assets which are the subject of the receivership. In stark contrast to a bankruptcy trustee appointed under Chapter 7 or Chapter 11 of the Bankruptcy Code, who acts as a fiduciary for the creditors, the receiver's duties and obligations are to the court first, to act on behalf of the court appointing the receiver.

Often, the receivership is instituted as part of an action to foreclose on real or personal property by a secured creditor in a case, or by a debtor corporation mired in conflict or deadlocked. In such a case, the plaintiff (whether creditor or debtor) will be the party moving for appointment of a receiver, and will be the first to contact a particular person to act as the receiver in the case. Once the receiver has been appointed by the court, the receiver does not answer to the plaintiff, but instead must exercise independent judgment on behalf of the court, and thereby on behalf of all the constituents to the receivership process. Practically speaking, of course, the plaintiff has the ability to ask the court to discharge a receiver or to dismiss the case in certain circumstances. The receiver does not become a party to the action, and so may not have standing to prevent such maneuvers by the plaintiff. Again, the best strategy for a receiver is to work quickly to gain the confidence of the parties.

II. Commencing Receivership Action.

A. Authority for Appointment.

1. General receivership statute.

A majority of states have enacted statutes authorizing appointment of a receiver under various conditions. Those conditions may include waste or material injury to property of the debtor; insolvency of the entity; or, fraud or mismanagement of the entity's assets. See, e.g., Alaska § 9.40.240; Cal. Civ.

Pro. §564; Del. Code. Ann. Title 8 §291; Iowa Code §491.66; N.J. Rev. Stat. §14A:14-2; Ohio Rev. Code §§2735.01-2735.06; RCW 7.60.020.

Generally, courts have held that the power to appoint a receiver must be exercised with great caution, and the trial court shall only appoint a receiver when no other remedy is adequate. Appointment of a receiver is said to be an extraordinary remedy, and will only be permitted where there is no other adequate remedy available.

Frequently, a prominent factor in appointment of a receiver is the insolvency of the defendant entity. Cases where mismanagement or fraud is alleged in addition to insolvency often support the appointment of a receiver. Courts have held that appointment of a receiver is proper upon a creditor's request for a corporation in an insolvent condition or in imminent danger of insolvency where the persons controlling the policy of the corporation has transferred property with the intent to defraud creditors. Similarly, where a corporation is being mismanaged and shareholders and creditors risk losing assets due to the collusion and fraud of the corporation's officers and directors, the court has inherent authority to appoint a receiver.

In preparing a motion requesting appointment of a receiver, the particular case law of the local jurisdiction should be consulted. Generally, there will be substantial case law supporting appointment where there is evidence of insolvency coupled with any aggravating circumstances.

2. Business Corporation Act.

Every state has some provision permitting appointment of a receiver in connection with judicial proceedings to dissolve a corporation. Many states have adopted the Revised Model Business Corporations Act, which provides that a corporation undergoing dissolution may be subject to receivership pursuant to Section 14.32(a):

A court in a judicial proceeding brought to dissolve a corporation may appoint one or more receivers to wind up and liquidate, or one or more custodians to manage, the business and affairs of the corporation. The court shall hold a hearing, after notifying all parties to the proceeding and any interested persons designated by the court, before appointing a receiver or custodian. The court appointing a receiver or custodian has exclusive jurisdiction over the corporation and all of its property wherever located.

The statute goes on to describe the powers and duties of the receiver, and the requirement to post bond. Receivers appointed under the Act are usually referred to as “general receivers,” while receivers with more limited powers are referred to under the Act as “custodians.” The court is authorized to redesignate receivers and custodians as need be.

B. Practical Considerations.

The commencement of a receivership in state court can be a powerful and effective tool for collecting debt, liquidating a corporation, or winding down an entity. Commonly, a secured creditor will institute a receivership in connection with a collection action encompassing various remedies.

However, a corporation wishing to avoid the expense and time constraints of the Chapter 11 bankruptcy process may also commence a receivership to dissolve its corporation. (**WARNING:** Corporate dissolution may have implications related to liability and tax consequences for the directors, officers, and shareholders, and should not be undertaken without consideration of those implications.) Sometimes, a corporate debtor that would like to utilize the receivership proceeding may enlist the cooperation of a secured creditor to institute legal action, and a stipulated receivership can be commenced. This strategy is often used when a buyer has been found for the company's assets, and the receivership process can be employed cooperatively to pay the secured debt and to pay tax debt or unsecured debt as required or permitted by the process. In other situations, shareholders are deadlocked and receivership can be utilized to move forward, even in the absence of insolvency. In these and other circumstances, receivership in a state court proceeding can be a valuable alternative to bankruptcy or out-of-court wind up.

Some factors that should be considered in advance of filing a receivership action:

1. Selection of a receiver.

Most state's statutes explicitly require that a receiver must not be interested in the debtor or the action. Generally, it is advantageous to appoint a receiver that has experience with the receivership process, and also has

some familiarity with the business of the debtor. Two sets of skills are required on the receiver's part: the ability to operate an ongoing business, and the ability to market the company's assets successfully. Often, these skill sets are mutually exclusive, and so care should be given to determining whether a particular candidate has previous experience of both types.

If real property is at issue, a plaintiff may seek a receiver with property management experience and who is licensed to sell real property. Many established property management firms employ qualified, experienced receivers. If the primary assets are intellectual property, conversely, someone with investment banking experience may be a good choice, as they often are most familiar with finding appropriate buyers for such companies. The wise plaintiff will be cautious in retaining a consultant who has never served as a receiver, unless they have particular knowledge of the debtor's affairs.

2. Springing liens.

Under state law, several state tax liabilities can "spring" into a senior priority over secured or unsecured debt upon institution of a receivership. For example, in Washington state, the Department of Labor and Industries and the Employment Security Department automatically obtain priority for any unpaid tax obligations as of the commencement of a receivership, or upon the insolvency of a debtor corporation. See, RCW 50.24.060, 51.16.160. Similarly, labor liens authorized under RCW 60.32.010 are deemed to spring

into existence and take superpriority over secured debt upon institution of a receivership. RCW 60.32.050. Excise and sales taxes owed the Department of Revenue spring into existence upon commencement of a receivership, but they do not jump over prior secured obligations. Rather, the lien takes priority based on the date the receivership is instituted. RCW 82.32.240.

If a corporation admits insolvency as part of a stipulated receivership order, the State may continue to assert the priority of its newly-found tax lien, even if the receivership is dismissed or otherwise resolved. Secured creditors should exercise caution in requesting a receiver if the status of the debtor's state taxes cannot be ascertained.

3. Pending litigation.

Unlike the Bankruptcy Code, commencement of a receivership proceeding usually does not result in an automatic stay of any other pending litigation. Nevertheless, the court's possession of the debtor's assets in a receivership proceeding confers upon that court the authority to determine all matters related to that property. Any attempt to disturb that court's authority over the property, including a parallel action to foreclose or replevy property of the receivership estate, will constitute contempt of court. The best course for a competing creditor is to intervene in the existing receivership proceeding.

4. Costs of receivership.

Typically, a debtor in a receivership proceeding will have insufficient assets to pay all creditors, and may not even generate enough assets to pay secured and priority debt. However, unlike in a bankruptcy case, in a receivership proceeding, the receiver's fees and expenses are generally paid before any other claims, including secured debt. Payment of the receiver's expenses includes payments of professionals and the expenses of maintaining the receivership, along with any expenses incurred in operating the debtor corporation during the pendency of the case. The appointment order should set forth the basis for the receiver's compensation, and perhaps authorize the employment of professionals. Plaintiff should take care to investigate and attempt to estimate the receiver's likely fees and expenses prior to instituting an action.

C. Procedure for Initiating Action.

The party seeking a receiver will need to commence a civil action. In addition to any other causes of action, the complaint should contain a cause of action seeking appointment of a receiver, and should also include a clause in the prayer for relief requesting appointment of a receiver.

Contemporaneously with the filing of the complaint, a motion to appoint a receiver, accompanied by declarations or affidavits containing the

appropriate evidentiary support and a proposed order, should be filed.

Essentially, the procedures used to obtain an injunction should be followed.

Frequently, the parties will stipulate to appointment of a receiver. In the absence of a stipulation, however, notice of the motion will be required. Clearly, defendants in a receivership proceeding are entitled to notice prior to entry of an order appointing a receiver and divesting them of possession of their property. Additionally, anyone with an interest in the property of the receivership estate should, if possible, receive notice of the proceedings. A conservative practice would be to conduct a title search or a UCC search and serve anyone who has a recorded interest in the property with notice of the proceeding, perhaps even naming them as defendants, similar to a judicial foreclosure action. Unfortunately, neither the cases nor the Civil Rules offer much guidance in this area, so common sense is required in fashioning notice.

Upon entry of an order appointing the receiver, most courts require the receiver to post a bond and to file an oath with the Court. In appropriate circumstances, the parties may request that only a nominal bond (say, \$10) be required. Where fraud or malfeasance is alleged, it is prudent to request a more substantial bond to protect the receiver from any lingering claims. Finally, several statutes require that the receiver provide notice of his or her appointment to several state and federal agencies. All taxing authorities should be provided notice accordingly.

D. Appointment Order.

Perhaps the single most important task in instituting a receivership is drafting the appointment order. Because the statutes and cases are so vague in delineating the obligations and powers of the receiver, the appointment order determines the outcome of the remainder of the case and the relationships between the receiver and the parties. A sample order for the appointment of a general receiver is attached as Appendix A.

Counsel should consider including provisions to address the following issues:

- Cooperation by the debtor or any other defendants.
- Turnover of receivership property.
- A definition of the assets of the receivership estate, including a broad definition of intellectual property.
- A limitation of the receiver's liability to the assets of the receivership estate, and no additional liability for operating the business.
- Authorize the employment of company employees and receivership professionals.
- Authorize continued operation of the business.
- Right to enter into contracts on receiver's behalf or on behalf of the business.
- Authorize assumption or rejection of executory contracts.

- No authority to pay pre-receivership debts without court approval, other than any enumerated in the order.
- Set forth a notice procedure.
- Authorize sale of assets, delineate which assets can be sold in the ordinary course of business and what requirements for court approval.
- Authorize compromise of claims within limits according to nature of case.
- Authorize anything necessary to maintain, insure or protect receivership property.
- Authorize receiver to apply to court at any time for further instruction.
- Establish expiration date for receivership in lieu of order extending time.

III. Duties and Obligations of Receiver.

A. Notice to Taxing Authorities and Public Records.

Various statutes require the receiver to notify them of the appointment of a receiver within 30 days. See, e.g., 26 U.S.C. § 6036. Additionally, the Order Appointing Receiver usually should be recorded with the county auditor or registrar of lands if real property is an asset of the receivership estate.

B. Notice to Creditors.

Generally, local civil rules will require the receiver to give notice to creditors by publication in a newspaper of general circulation of the need to file duly verified claims with the receiver and the court. In addition, the receiver may be required to give such notice to all known creditors by mail.

Civil rules will often provide that any person may give the receiver a request for special notice, and then the receiver must provide notice of certain enumerated events. Any order entered in a receivership should recite a finding that notice was provided.

As a practical matter, a general receiver should assemble a list of all known creditors and provide written notice in the form of a pleading that a receiver has been appointed over the assets of the company. The notice should then be filed with the court with an affidavit of mailing. Such a notice provides creditors with an explanation of the lack of payment of pre-receivership expenses, and also can head off any competing lawsuits or bankruptcy proceedings.

C. Inventory and Appraisal.

Federal rules require that a receiver shall file an inventory with the court of all receivership assets within 20 days' of possession of the property. Additionally, state common law often requires filing an inventory and obtaining an appraisal. Typically, the Order Appointing Receiver will include a provision either authorizing the receiver to inventory or appraise the property, or will include a provision expressly waiving the requirement.

D. Reporting Requirements.

The Order Appointing Receiver will commonly include a schedule of reporting to be filed with the court and served on the parties. It is good practice to file regular reports (depending on the case) and require the

receiver to file a final report of activities, including a formal or informal accounting of the inflows and expenses of the receivership.

E. Claims Objections.

The appointment order should specify whether the receiver will employ some sort of claims procedure, if state law does not set forth specific requirements. In some cases, the receiver may file a motion requesting that a particular procedure be employed. Under state law, the receiver usually has a duty to object to a claim in a general receivership if the claim is invalid.

F. Tax Payments.

Generally, a receiver incurs obligations to pay sales taxes collected during the receivership. Similarly, the receiver must pay federal payroll taxes, and should also attempt to pay any other payroll or business taxes as an operational expense of the receivership.

G. Powers of Receiver.

1. Employment of professionals and employees.

A receiver may employ professionals, and may also employ company employees to assist in operating the business. The authority to employ should be expressly set forth in the Order Appointing Receiver.

2. Operation of the business.

Although the power to operate an ongoing business is implied or even set out in statute, the Order Appointing Receiver should recite the power to continue operations. Conversely, the Order should also permit the receiver to

shut down a failing business in his or her discretion, unless the circumstances of the case warrant a court order that the business must continue.

3. Entry into contracts.

A receiver has the authority to enter into contracts to preserve the receivership estate for the benefit of creditors. Such contracts would include insurance, security, or maintenance provisions. Again, although the power is implied, it should be expressed in the Order Appointing Receiver.

4. Post-receivership borrowing.

Although it varies widely by jurisdiction, in some states a receiver may borrow funds from secured creditors or outside lenders, subject to court approval. See, e.g., *In re Liquidation of Cashmere State Bank*, 169 Wash. 258, 261, 13 P.2d 892 (1932). Great care should be exercised in determining whether such borrowing, particularly if granted on a secured basis, will provide a benefit to the receivership estate and its creditors. If the business has significant work in process that can be profitably completed, borrowing may be appropriate.

5. Other Powers.

In some states, receivers can institute preference claims under state law, pursue fraudulent transfer actions, assume or reject contracts, and pursue litigation on behalf of the debtor. Over time, courts of some jurisdictions have expanded receivers' powers to encompass many of the

powers of a Trustee in bankruptcy. Practitioners should consult the case law of their jurisdiction to determine the breadth of a receiver's power.

IV. Sale of Assets in Receivership Proceeding.

Sale procedures and requirements vary widely from state to state, and it is important to examine the particular law in the relevant jurisdiction to ensure a valid sale. In general, it may be helpful to remember that the sale of assets by a receiver is a judicial sale, and is tantamount to the court selling the assets in question.

Specific procedures for the sale of assets are generally found in case law. For example, under Washington law, assets of a receivership estate may be sold free and clear of liens and without the threat of successor liability under appropriate circumstances. The sale of assets requires a two-step process. First, the court must authorize the receiver to sell the assets. This authorization can be included in the Order Appointing Receiver. Once a purchase and sale agreement is signed, the receiver must ask the court to confirm the sale upon notice to creditors.

As a practical matter in most jurisdictions, the receiver should set out the proposed sale procedure, including disclosing the methodology to be used in collecting bids or offers for the assets (such as auction, listing for sale, soliciting bids from targeted prospects, or other such methods) and perhaps disclose the asking price if appropriate. The receiver should file a motion, giving notice to the parties and perhaps to all known creditors, and

should seek the court's approval for the stated procedure. The notice should recite that entry into a purchase and sale will be subject to confirmation of the sale, and should also establish whether the sale may or may not result in proceeds for distribution to unsecured creditors.

V. Discharge of Receiver and Closing Case.

A. Discharge of Receiver.

A determination that the receiver should be discharged is within the discretion of the court. The receiver, recall, is an officer of the court and serves at the court's pleasure. It is prudent to include a self-executing discharge provision in an Order Appointing Receiver so that the receiver is released even if a case goes on for want of prosecution.

The receiver should seek to be discharged as soon as all his or her duties have been complete. If necessary, the receiver can deposit any unadministered proceeds into the court registry. The receiver should prepare a final report, and the motion to discharge receiver should provide an overview of the receiver's activities in the case and how any issues have been resolved. The Order Discharging Receiver should exonerate the receiver's bond and release him or her from any further liability or obligation.

B. Closing the Case.

Because the appointment of a receiver is simply a remedy in an underlying case, discharge of a receiver does not close the case. One possible way to come to a conclusion is for the plaintiff to move for dismissal.

The dismissal of an action where a receiver has been appointed generally requires court approval.

Another possibility is to move for summary judgment on any appropriate grounds. For instance, in an action seeking foreclosure of a security interest in personal property, summary judgment be entered awarding the property or its proceeds to the plaintiff. Entry of a judgment would thereby conclude the case and resolve conclusively a secured creditor's right to payment.

APPENDIX A

IN THE SUPERIOR COURT OF THE STATE OF WASHINGTON
IN AND FOR THE COUNTY OF KING

_____, a California State
chartered bank,

Plaintiff,

v.

_____, a Washington
corporation,

Defendant.

NO. _____

STIPULATION AND ORDER
APPOINTING RECEIVER

STIPULATION

COMES NOW the Plaintiff, _____, by and through its counsel
Shelly Crocker and Crocker Kuno Ostrovsky LLC, and the Defendant, _____
_____, by and through its counsel _____ and stipulate and agree to
the following:

1. Plaintiff and Defendant executed the Loan and Security Agreement on
April 2, 1998 (the "Loan Agreement"), which was amended on July 29, 1998. As
security for the Loan Agreement, Defendant granted Plaintiff a security interest in all
tangible and intangible property, including all intellectual property, which security
interest is properly perfected.

2. Defendant is in default of its obligations under the Loan Agreement.

3. Defendant has agreed to the appointment of a receiver is necessary pursuant to RCW 7.60.020.

4. The Loan Agreement provides, in part, that any requirement for a bond shall be waived.

NOW, THEREFORE, Plaintiff and Defendant hereby stipulate and agree to entry of the following order.

Dated this _____ day of _____, _____.

CROCKER KUNO LLC _____

By _____

Shelly Crocker, WSBA # _____

Attorneys for Plaintiff

By _____
_____, WSBA # _____

Attorneys for Defendant

ORDER

1. **Hearing.** This matter came on for hearing upon Plaintiff's Motion for Appointment of Receiver (the "Motion") and the stipulation of the parties on January 19, 1999, before the undersigned Judge of the above-entitled Court.

2. **Findings.** The Court, being fully informed, made the following findings:

2.1 The appointment of a receiver for _____ (" _____") is appropriate pursuant to RCW 7.60.020(3).

2.2 _____ is not interested in the above-captioned action and is competent and qualified to act as the receiver of the assets, operations and business of Defendant.

2.3 Defendant has stipulated to entry of this order.

3. **Order.** Based upon the foregoing, it is hereby ORDERED as follows:

3.1 **Appointment.** _____ is hereby appointed as receiver or custodian of the assets, operations and business of Defendant, to take charge of and assume control of all real and personal property, tangible or intangible assets, intellectual property, operations and business affairs of Defendant, and all products and proceeds thereof (collectively, the "Assets"). _ (the "Receiver") shall act principally through its employee _____, and any change in the management of _____ shall be immediately reported to the Court and all parties in interest. The Receiver may at any time file a motion requesting that it be exonerated, discharged, and released from its appointment as receiver. The Receiver's motion may be heard five business days following the Receiver's motion. Regardless of the posture of the Receiver's motion, the Receiver shall have no continuing obligation to perform its duties as receiver hereunder 15 days after the date the motion is filed ("Suspension Date"); provided, however, that the Receiver shall provide such accountings or additional services as the Court may direct relating to the Receiver's duties or performance prior to the Suspension Date.

3.1.1 **Interim Order.** This order shall be an interim order until January 31, 1999, at which time it shall become final without further order of the court unless Defendant files and serves an objection to entry of a final order on or before January 22, 1999, at 4:30 p.m., Seattle time. Plaintiff or the Receiver may file a response to any such objection by 4:30 p.m., Seattle time, on January 27, 1999, and a hearing will be held in the Ex Parte department on February 1, 1999 at 2:00 p.m. Any actions taken by The Receiver pursuant to this order prior to January 31, 1999 shall be final actions and shall be binding upon Plaintiff and Defendant, their successors and assigns, and any other party to the transaction. The Receiver shall be entitled to compensation as provided in this order for any activities taken prior to January 31, 1999.

3.2 **Bond and Oath.** The appointment of the Receiver is subject to the Receiver furnishing as soon as practicable a bond in the sum of \$10 approved by the above-entitled Court, conditioned upon its faithful discharge of its duties as receiver. The cost of the bond shall be reimbursable to the Receiver. Entry of this order, countersigned by an authorized representative of the Receiver, evidences the Receiver's acceptance of its rights and duties hereunder and constitutes administration of any required oath of office; upon furnishing the bond the Receiver need take no further action to be approved and appointed as the receiver in this matter.

3.3 **Powers and Duties.** The Receiver shall have exclusive possession and control over all Assets with the power and authority to preserve,

protect, and liquidate them for the benefit of whomever the Court may determine to be entitled to the Assets or their proceeds. Except as otherwise limited by this order, the Receiver may do all things that can be done by Defendant. The Receiver is vested with all of the powers, rights and duties of receivers appointed under Washington law including, without limitation, the following rights, powers and duties:

3.3.1 Operation of Business; Collections. The Receiver shall have full power and authority to manage and operate the Assets and may continue or discontinue the operations of Defendant in such manner as, in the Receiver's reasonable business judgment, will maximize the proceeds realized by the receivership estate, and to seek the advice and instruction from this Court in connection therewith. The Receiver is further authorized to collect any and all rent, issues, profits, income, revenues, and accounts now due and hereafter becoming due for, or on account of such operations. The Receiver, in conducting the business of Defendant, may do so in Defendant's or the Receiver's own name.

3.3.2 Possession of Assets. The Receiver shall have the right to take and keep possession of all Assets, including without limitation all of the real and personal property of Defendant, during the pendency of the above-captioned action.

3.3.3 Collection of Accounts. The Receiver shall immediately begin collection of Defendant's accounts receivable and any other amounts payable to Defendant. If it deems it appropriate, the Receiver may

commence legal action to pursue collection of any account or other amounts receivable without prior court approval.

3.3.4 Completion of Contracts. The Receiver may assume and complete any contract for the sale or installation of software or any other transaction in the operation of Defendant that it deems prudent in its business judgment to undertake, and may contract for the labor, materials, equipment and service necessary to perform such contracts. The Receiver may apply to this Court to reject and terminate any incomplete contract or unexpired lease of Defendant, as the Receiver deems prudent in its reasonable business judgment.

3.3.5 Asset Sales. The Receiver may sell, liquidate or otherwise dispose of the Assets owned by Defendant for the fair value thereof, subject to the approval of the above-entitled Court. The Receiver shall promptly provide to those individuals entitled to notice under Section 3.4.7 of this order written summaries of all communications by or to the Receiver regarding potential sales of Assets for more than \$10,000 outside the ordinary course of business. Each summary shall include a description of the subject assets, the price offered and the proposed time of closing. The Receiver shall not sell any assets of a value in excess of \$10,000 outside of the ordinary course of business without obtaining approval of the Court following notice to parties as provided herein. Neither the Receiver nor the Plaintiff shall apply to the Court for approval to sell or liquidate the Assets before February 24, 1999 without the consent of Defendant. Any order approving such sale shall provide that the proceeds of such sale shall be impressed with any liens encumbering

such assets to the same extent, validity, and priority as such liens attached to the assets sold. Without further order of the Court or consent of the secured parties, all such proceeds shall be segregated in a federally insured bank account and not used without the consent of such secured parties or further order of the Court. The Receiver may sell Assets in the ordinary course of business without prior court approval. Except as provided in this order, and subject to further order of the Court, the Receiver's rights, powers, and authority, including its rights of custody, control, and sale of assets, shall not impair, diminish, or otherwise prejudice valid and enforceable security interests or claims in Defendant's Assets.

3.3.6 Obtaining Secured Credit. Following six business days' notice (or such other notice as the Court may approve) and the opportunity for parties in interest to request a hearing, the Receiver may borrow money upon such terms and conditions as are commercially reasonable in the banking industry for the type of loan and amount of money borrowed by the Receiver, including the right to grant security interests in the Assets of Defendant.

3.3.7 Application of Revenues and Proceeds of Receivership. The Receiver shall, after the payment of all expenses, including professional fees, incurred in the operation, liquidation and winding up of Defendant's assets and business, including loans obtained for such purposes, pay all net income, revenues, profits and proceeds derived from the Assets and operations of Defendant to the valid and enforceable secured obligations, liens, and claims, encumbering the Assets in order of the priority and amount of such security interests, liens and claims

and then to the unsecured obligations of Defendant on a pro rata basis. The Receiver may not pay any pre-receivership debts in excess of \$1,000 in the aggregate to any creditor, without obtaining an order of this Court. Any such payment will be made only if the Receiver, in its reasonable business judgment, determines that such payment is necessary to preserve or benefit the receivership estate. The Receiver may apply to the Court for further orders relating to claims procedures, distribution of receivership assets, and related issues.

3.3.8 Contracts and Employees. In order to perform its responsibilities, the Receiver may contract or otherwise provide for goods, materials, services, and supplies as determined by the Receiver in its reasonable business judgment to be necessary and appropriate, and to pay such sums as it determines to be reasonable for such goods, materials, services and supplies. The Receiver may employ such persons as the Receiver deems appropriate (including continuing the current employees of Defendant), in the management, operation and/or liquidation of the Assets, under such terms of employment as the Receiver may deem appropriate. The Receiver shall be free at all times to discharge any such person from the Receiver's employ, with or without cause. The Receiver may continue to hire or discharge existing employees in Defendant's or its own name except to the extent that Defendant is expressly precluded from doing so under the terms of any written employment agreement that the Receiver assumes on behalf of the receivership estate by court order or for other legal reasons. The Receiver is further authorized (i) to pay all workers' compensation, industrial insurance or other contributions on behalf of

Defendant for its employees; (ii) in the Receiver's discretion, to pay such benefits and make such employee benefit plan contributions as Defendant may have been obligated to make; and (iii) to pay all taxes and tax withholdings with respect to such employees for which Defendant is obligated or that the Receiver becomes obligated to pay from its management and operation of the Assets.

3.3.9 No Obligation to Complete Tax Returns.

Notwithstanding any other provision hereof, the Receiver shall be under no obligation to complete or file tax returns on behalf of Defendant for income or other taxes arising before _____ the date of this order. While acting as receiver, the Receiver shall comply with all applicable laws and regulations relating to tax reporting requirements. The Receiver shall furnish officers of Defendant with such access to books and records within the Receiver's custody or control as reasonably may be necessary in order for Defendant to complete and file tax returns on its own behalf.

3.3.10 Court Actions. The Receiver may bring and prosecute actions for the recovery of any Assets which may be in the possession of any third party, and, with the approval of the Court, it may employ attorneys and other professionals as determined by the Receiver to be necessary to assist it in fulfilling its duties. Employment of any such professionals shall only be after notice and approval of the above-entitled court.

3.3.11 Ancillary Proceedings. The Receiver is authorized, if it determines that it is necessary to do so in order to secure possession and control of

Assets located outside of this Court's jurisdiction, to commence ancillary receivership proceedings in such other jurisdictions.

3.3.12 **Settlement Authority.** The Receiver may compromise and settle claims where the disputed amount does not exceed \$1,000 without approval of the Court and without notice to parties.

3.3.13 **No Appraisal Required.** Unless the Receiver determines in its reasonable business judgment it is necessary or desirable to do so, it is excused from seeking an independent professional appraisal of the Assets. The Receiver may rely on appraisals provided by Defendant or any other party, or other means of valuation where the Receiver determines in its reasonable judgment that the appraisal or other means of valuation contains adequate indicia of reliability to be used.

3.3.14 **Care of Property; Repairs by Receiver; Insurance.** The Receiver shall maintain real and tangible personal property owned by Defendant in the condition similar to that at the time received, ordinary wear and tear accepted during the pendency of this action. The Receiver may make such repairs and alterations to any Assets as the Receiver determines to be prudent or legally required. The Receiver is authorized to insure, maintain, and protect the Assets and may incur expenses to do so. The Receiver may review all existing insurance coverage with respect to the Assets. The Receiver may maintain in place existing insurance policies, or procure such replacement or additional insurance policies, as it determines to be most economical and convenient, and to pay all premiums in

connection therewith whether presently due or becoming due after the date of this order.

3.3.15 No Personal Obligation of Receiver. No obligation incurred by the Receiver in the good faith performance of its duties in accordance with the orders of this Court whether pursuant to any contract, by reason of any tort, or otherwise, shall be the Receiver's obligation or the personal obligation of its principals. Rather, the recourse of any person or entity to whom the Receiver becomes obligated in connection with the performance of its duties and responsibilities shall be solely against the assets of the receivership estate.

3.3.16 Standard of Care. The Receiver shall at all times exercise ordinary care in employing its business judgment to administer the Assets.

3.3.17 Licenses and Permits. The Receiver may acquire or renew all governmental licenses, permits, or other authorizations, either in the Receiver's name or in the name of Defendant, pertaining to the Assets or any business associated therewith and to do all other things necessary or appropriate to operate the business of Defendant or to operate or sell the Assets.

3.3.18 Cooperation With Receiver. The parties to this proceeding, their attorneys, and all of the officers, directors, managers, agents, and employees of Defendant shall cooperate with the Receiver in connection with its management, operation, and liquidation of the Assets. Each of them shall relinquish and deliver possession of the Assets to the Receiver upon its demand, and shall turn over to the Receiver all records, books, contracts, lease documents, plans, and

specifications, accounting records, deposits and documents relating to the financing, management, control, operation and preservation of the Assets as the Receiver may demand, upon demand, and each of them is enjoined from interfering with the possession, control and operation and maintenance of the Assets by the Receiver. Upon a reasonable request of Defendant's Board of Directors, the Receiver shall provide copies of Defendant's records or files reasonably required by the Board in connection with the administration of the receivership, or any investigation or litigation involving the Board.

3.3.19 Communication with Shareholders and Former Employees.

The Receiver shall assist the Board of Directors in distributing up to two letters to the shareholders and former employees of Defendant. The Receiver shall ensure that the shareholder and employee records are updated and maintained accurately. The Receiver shall further make copies and arrange for mailing of the letters provided by the Board at the expense of the receivership estate. The Receiver may include its own communications in the mailing to shareholders and former employees where appropriate.

3.4 Administration. The Receiver is authorized to employ the following procedures and case administration:

3.4.1 Bank Accounts. The Receiver may establish bank accounts with any federally insured financial institution for the purpose of receiving and disbursing funds used for the operation, winding-up, and liquidation of the Assets and business of Defendant or may continue to use the Company's existing accounts.

3.4.2 **Professional Services.** The Receiver may contract for professional services including, but not limited to, such legal and accounting services as are reasonably required for the Receiver to discharge its duties in relation to Defendant. Employment of professionals shall require approval of this Court.

3.4.3 **Financial Reports.** The Receiver shall establish a suitable accounting system for recording and reporting the results of operations, winding-up, and liquidation of Defendant's assets and business affairs. The Receiver shall prepare operating budgets and variance reports with respect to its management and operation of the Assets. The reports shall detail the income of the receivership estate, the Receiver's fees and reimbursable expenses, and the other necessary costs and expenses of managing the Assets, including payment of professionals. The Receiver shall file on or before February 15, 1999, its first report for the period from the date of this order through January 31, 1999. Thereafter, the Receiver shall file and serve on the parties a monthly report for one month's activity on or before the fifteenth of the following month. Notwithstanding SPR 98.10W, no hearing shall be required, unless a party or creditor requests a hearing on notice or objects to any accounting or Budget.

3.4.4 **Fee.** The Receiver shall be compensated based upon an hourly rate of \$160 for the services of John Davidson, reasonable costs and expenses, plus any commission earned as set forth below. Other staff will be charged at lower rates as necessary. The Receiver shall charge for no more than 40 hours per week of any individual's time, unless notice is provided in advance. The Receiver shall

receive a \$5,000 retainer upon entry of this order from Defendant's assets. The Receiver shall not be entitled to compensation for any travel time. Travel and other related expenses, subject to the approval of the court, shall be reimbursable to the Receiver.

3.4.5 **Commission.** Upon sale or liquidation of Defendant outside the ordinary course of business, to a buyer obtained by the Receiver, in addition to its fee, the Receiver shall be entitled to apply to the Court for a success fee of one percent of the total consideration up to \$1.5 million. For any consideration received over \$1.5 million, the Receiver shall be entitled to apply to the Court for a success fee of five percent of the total consideration in excess of \$1.5 million. Total consideration shall include cash at closing, new capital invested, the value of expected royalty payments under licensing or other trademark use agreements, or other value as defined in the order approving the Receiver's fees. Such a success fee is to be paid only upon the completion of a transaction involving the sale of Defendant's principal business assets and upon the Receiver applying to the Court for approval of such fee. Notwithstanding the foregoing, no success fee will be paid for a sale to a buyer obtained by the Board of Directors or Officers of Defendant unless the Receiver can show that the amount received in the transaction exceeded the original offer made by such a buyer as a result of the Receiver's efforts, in which case the success fee shall be paid (at the same rate as above) only for the difference between the opening offer and the total consideration received. If Defendant is required to pay a commission or brokerage fee to any other entity in connection with a sale of the

Assets, any success fee sought by the Receiver shall be reduced by the commissions or brokerage fees so required. In considering payment of a success fee, the Court will consider the source of the transaction, the role of the Receiver in the transaction, the impact of payment on secured and unsecured creditors, the impact of payment on equity, the likelihood that the transaction could have been completed without the assistance of the Receiver, the Receiver's overall fees in the case, and any other relevant factors. The parties intend the success fee to compensate the Receiver for services that would normally be performed by a broker; i.e., for actions it takes in connection with packaging and marketing the Assets. If for any reason the acts of parties other than the Receiver (including without limitation a court's entry of an order for relief by or against Defendant under the United States Bankruptcy Code), the Receiver is unable to consummate a sale or liquidation of Defendant or its Assets, the appropriate court shall, in addition to the fee provided herein, determine a reasonable proration of the commission earned by the receiver as compensation for its services provided herein.

3.4.6 Payment of Fees of Receiver and Professionals. The Receiver is authorized to make payment for its hourly fees and costs (but not for its commission), and those of its professionals as follows:

(1) The Receiver or its professionals shall file a notice of intent to compensate professionals and serve such notice, together with a reasonably detailed description of the time periods, services, and amount requested on parties in interest as provided in Section 3.4.7.

(2) If no party in interest objects to such accounting within ten calendar days of its filing, the fees and costs shall be deemed approved as being fully and finally earned without further order or leave of the Court.

(3) Until such fees and costs are approved either through the process described above or by order of the Court, the Receiver and its professionals may only segregate sums for such fees.

(4) The Receiver and its professionals may provide notice of compensation every other week. The commission, if any, earned by the Receiver in conjunction with administration of Assets of the receivership estate shall be payable from the Assets only after review and approval by this or any other Court then having jurisdiction.

3.4.7 Court Approval; Procedure. Any motion by the Receiver for court approval of any act of the Receiver requiring court approval shall be served on each party hereto and each other person who has filed and served on the Receiver a request for special notice. The Receiver may file requests for special notice on behalf of any party; however, such requests filed by the Receiver shall not be deemed consents to the jurisdiction of this Court. In addition to service by mail or personal service, service may be made by telefacsimile. Requests for special notice shall comply with CR 66. Notwithstanding any provision of this order requiring court approval of any act of the Receiver, the Receiver may nonetheless undertake an action without prior court approval if it obtains the written consent of each party hereto and each other person who has filed and served on the Receiver a request for

special notice. Such acts shall, as soon as practicable thereafter, be identified to the Court.

3.4.8 **Notice.** The Receiver shall provide notice to creditors of the receivership as and when required in CR 66(c). The Receiver will further provide notice of any of the matters listed in CR 66(d) unless such notice is not required under this order. Such notice may be made by mail or personal service or confirmed by telefacsimile five days in advance of any hearing in accordance with CR 66(e) or as otherwise may be approved by the Court. The Receiver shall be deemed to have provided adequate notice if it complies with this section.

3.4.9 **Further Instructions.** The Receiver may at any time apply to this Court for further or other instructions, or for a modification of this order, or for further powers necessary to enable the Receiver properly to perform its duties, or for termination of the Receiver's appointment.

DONE IN OPEN COURT this _____ day of _____, _____.

JUDGE/COURT COMMISSIONER

Presented by:

CROCKER KUNO OSTROVSKY LLC

By _____
Shelly Crocker, WSBA # _____
Attorneys for Plaintiff

Approved as to form; notice of presentation
waived:

By _____
_____, WSBA # _____
Attorneys for Defendant

By _____
_____, its _____