

## MEMORANDUM

TO: Appointment and Powers of Real Estate Receivers Drafting Committee, Advisors and Observers

CC: Harriett Lansing, Richard Cassidy, Anita Ramasastry, Lane Shetterly, John Sebert, and Ben Orzeske

FROM: Thomas S. Hemmendinger and R. Wilson Freyermuth

DATE: October 3, 2013

RE: Summary of September 27 – 28, 2013 Meeting of the APRER Drafting Committee

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The Drafting Committee on a Model Act on the Appointment and Powers of Real Estate Receivers met on September 27 and 28, 2013 in Minneapolis. Those attending were Commissioners Thomas Hemmendinger (Chairperson), John Burton, Ellen Dyke, Patricia Fry, Donald Mielke, Fred Miller, Rosemary Sackett, Mark Sandlin, and Gay Taylor-Jones; Reporter R. Wilson Freyermuth; ABA Section Advisors Kay Kress, James Schwartz, and Justin Williams; and Observers Kenneth Jannen (ALTA), Beverly McFarland (California Receivers Forum), Benjamin Reeves, and Jeffrey Smith.

ULC President Harriett Lansing, Executive Committee Chair Richard Cassidy, and Executive Director John Sebert attended portions of the meeting.

Commissioners Steve Cawood and Thomas Edmonds, ABA Advisor John Trott, and Staff Liaison Ben Orzeske could not attend.

We considered the Reporter's August 21, 2013 draft of the Model Act. We also discussed the issues raised in the Reporter's Notes and many other issues raised by the participants. The discussion was extremely productive, with everyone contributing helpful and practical substantive comments and suggestions.

The positions stated in this memo are not final decisions based on formal votes. Instead they reflect the consensus on what the Committee wants the Reporter to include in the discussion draft for consideration at the Spring 2014 meeting.

After introductions and housekeeping matters, the meeting went as follows:

- 1) General Drafting Approach. The Reporter advised us that the draft takes the middle approach between the extensive and detailed statutes of Minnesota and Washington and the more sparse statutes in some other states.

2) Scope (draft section 3).

- a) Property in General. The Committee would like to leave the term “real property” undefined and leave its meaning to other state law. The Act should not be restricted to real property located solely within the state, as this creates an unintended inconsistency with the intended breadth of the provisions governing ancillary receiverships (see also below under Ancillary Receiverships).
- b) Residential Real Property. The Act should apply to residential property, but subject to the following:
  - i) Consistent with the Committee’s charge from the Executive Committee, the Act should exclude property that is exclusively the owner’s primary residence. This will require changes to the definition of “residential real property.”
  - ii) We addressed mixed-use property, such as a farm, ranch, or vineyard on which the owner lives. The consensus was that the Act should apply to this type of property, and another part of the Act should address the relative rights and duties of the receiver and the owner with respect to the part of the property in which the owner lives. Therefore, subsection (c) of the August draft is no longer necessary.
  - iii) The Chair and the Reporter will give further thought to a suggestion from several Commissioners that scope be defined by some type of positive reference to commercial property, rather than to an exclusion of certain residential property.
- c) State Agency Regulation. The draft excludes cases where a state agency is the receiver or where a state agency appoints, controls, or regulates the receiver. The intent of this provision is to exclude non-judicial receiverships and certain types of debtors, such as state-chartered banks, insurance companies, and hospitals. The Committee approved the substance of this provision, but would like the language to be refined.
- d) Receiverships under Other Law. Subsection (e) provides that the court may appoint a receiver under law other than the Act. The Committee was comfortable with this approach. Further, we are of the view that the Act should not specifically authorize courts to apply provisions of the Act selectively to proceedings that are outside the scope of the Act.
- e) Supplemental Principles. The Committee was also comfortable with subsection (f), which preserves other law, including equity, unless displaced by specific provisions of the Act.

3) Cases Where a Receiver is Authorized or Required (draft section 5).

- a) The Committee decided that subsection (a) on standing ought to be a free-standing section. It is possible to delete clause (1), because the respondent fits within clause (3) (person

holding an ownership interest in the property). The Committee suggested that the Act should not use the procedural term “respondent” to refer to the party over whose property the receiver is appointed, but should instead use a more descriptive term (such as “owner,” broadly defined to include any possessory interest in receivership property, including a leasehold estate).

- b) The Committee would like to collapse subsection (c) (standards for appointment) into subsection (b) (cases in which a receiver may be appointed). There was strong sentiment that the use of “may” in subsection (b) sufficiently articulates the fact that appointment of a receiver lies within the court’s discretion.
  - c) Some of the grounds in subsection (d), particularly (3) – (5), could possibly be incorporated into subsection (b) on discretionary appointment. The Receiver will consider these points for the next draft.
  - d) The Committee decided that the provisions on mandatory appointment in the case of a receivership clause in the mortgage ought to be bracketed in the next draft. The provision reflects the law in some states, but in other states a receivership clause does not trump the court’s discretion whether to appoint a receiver. This subsection will also be rephrased along the lines of the Uniform Assignment of Rents Act (“UARA”) to say that the petitioner “is entitled to” appointment of a receiver, rather than as a direct command to the court.
- 4) Ex Parte Appointment (draft section 6).
- a) The Committee decided that this section ought to address notice and hearing. It should contain a subsection (a) stating the general rule that the court will appoint after notice and hearing (a defined term that allows for short notice if circumstances warrant), and a subsection (b) dealing with truly ex parte appointment.
  - b) The Committee decided to delete the current subsection (c), allowing ex parte appointment based on a receivership clause in the mortgage.
- 5) Persons Ineligible (draft section 7).
- a) Our consensus was that this should be redrafted as a disclosure requirement, rather than as a disqualification rule. This change will require language to make clear that the court has the right to say no to a proposed receiver.
  - b) The Committee does not want to include a competence standard.
  - c) The definition of “family member” in (b)(1) should specify blood or affinity out to the third degree.

6) Survey Subcommittee.

- a) The survey project yielded much practical information. For example, the survey confirmed that the Committee is essentially on the right track on all major issues.
- b) The response rate was high. Further, of the 38 persons who answered, most wanted to be added as Observers and will be added.
- c) We expressed thanks to the subcommittee members, Pat Fry (chair), Fred Miller, Cheryl Kelly, Mark Sandlin, and John Trott for their work on this useful project.

7) Automatic Stay (section 14).

- a) Several Commissioners, Advisors, and Observers thought that prohibiting any act to “interfere with” with the receiver was too broad. For the next draft, the Reporter will consider whether another term will work, or whether it should simply be deleted.
- b) The consensus was that the automatic stay should be limited to things such as the ones in subsection (a), plus certain essential parts of (b) that preserve the receiver’s ability to manage the property and, if authorized, sell it with good title.
- c) The court will have specific authority to expand the stay.
- d) The next draft will include suggested language for the Committee to consider on the consequences of a stay violation.

8) Receiver as Lien Creditor (draft section 9).

- a) Several participants expressed concern over including this section. Fred Miller will investigate and report back on why Minnesota included this provision, and what its experience has been. The Reporter will also do the same for Washington. Once we have that information, a conference call on the issue may be necessary.
- b) Whichever way the Committee finally decides this issue, the Act should require the recording of a lis pendens or a copy of the appointment order in the real estate records.

9) Security Interest in After-Acquired Property (draft section 10).

- a) The next draft should include a cross-reference to this section in the automatic stay section.

10) Turnover (draft section 11).

- a) As reflected in the draft, a demand should be required before third parties have a duty to turn over assets.

- b) This section should also be coordinated with the automatic stay section.

11) Power to Sell (draft section 16).

- a) After discussion, the consensus was for the Reporter to draft the following set of Alternatives, each requiring court approval after notice and hearing:
  - i) *Alternative A (new)*: The receiver can cause the sale of the property in the same manner as the party who obtained the appointment of the receiver (petitioner) would have outside of receivership. For example, if the petitioner is the first mortgagee, the receiver can exercise the statutory power of sale or conduct a judicial foreclosure according to other state law. This would preserve any post-foreclosure right of redemption applicable under other law. Or, if the petitioner is a judgment creditor, the receiver can sell by sheriff's sale or whatever other procedure the state's law permits for judgment creditors.
  - ii) *Alternative B (new)*: The receiver can sell free and clear of the interests of the party who obtained the appointment of the receiver and all subordinate interests, including any right of redemption, but subject to senior interests unless they consent.
  - iii) *Alternative C (similar to the existing draft's Alternative D)*: If the receiver is appointed in a case that is ancillary to a foreclosure, and if the mortgagor agreed to a receiver's sale, then the receiver can sell free and clear of all liens (other than liens for unpaid property taxes, which generally have priority over mortgages) and redemption rights, unless the agreement for sale provides otherwise.
  - iv) *Alternative D (similar to the existing draft's Alternative C)*: The receiver can sell free and clear of all liens (other than liens for unpaid property taxes) and rights of redemption.
  - v) *Alternative E (similar to the existing draft's Alternative A)*: The receiver's power to sell is left to other law. Based on some concerns raised with the language of this Alternative, it will need to be revised for the next draft.
- b) The Committee will consider these alternatives at the next meeting. Several of the Commissioners and Observers advocated that to the extent the Act authorizes receiver sales, it should encourage the use of sale methods other than the traditional judicial auction sale.
- c) Subsection (b) on the attachment of liens to proceeds should make clear that the rule applies even if the proceeds are not sufficient to satisfy all liens. This may be done in the text or in a comment. Further, liens on the proceeds should rank according to the "validity, perfection, and priority" they had on the receivership property that gets sold.
- d) Fred Miller and the Reporter will check on whether a sale in Minnesota or Washington can

be free and clear of the right of redemption if that is receivership property. Jack Burton noted that the Minnesota statute appears to envision the possibility that the statutory right of redemption might or might not be included within the receivership estate, and inquired as to the basis for that position. The Reporter will check with the drafters of the Minnesota statute.

- e) The Committee was comfortable with the substance of subsection (c) on manner of sale and credit bidding.
- f) The Committee wants the brackets removed from subsection (d) on the protection of good faith purchasers.

12) Receiver's Powers (draft section 12).

- a) The Committee discussed the need for the receiver to have access to digital assets. The Reporter will confer with the reporter of the drafting committee on fiduciary access to digital assets and report back.
- b) The Act should distinguish between the power to incur unsecured debt and the power to incur secured debt. The Reporter will provide a memorandum on the constitutional issues involved in priming liens for debt incurred by the receiver.
- c) The power in (a)(4) as drafted (“the power to assert rights, claims, causes of action, or defenses that relate to receivership property or the conduct of the receivership”) may be broader than intended. The Committee wants to ensure that the power is not a strong-arm power, and that the power applies only to rights and defenses of the owner that relate to the receivership property. The Reporter will consider an alternative formulation of the intended power for the next draft.
- d) An “ordinary course” standard should be considered for some powers, such as (a)(3) on payment of expenses incidental to the exercise of the receiver’s powers and duties.
- e) A concern was raised that the identity of the proceeds of the collateral of different creditors not be lost through the manner in which the receiver administers the funds. The next draft will address this by clarifying the receiver’s duty of accounting for receivership property.
- f) The receiver’s power with respect to claims should be to recommend allowance or disallowance of claims, rather than to actually disallow claims.

13) Executory Contracts (draft section 17).

- a) The Act should clarify the following:

- i) The power is limited to contracts related to receivership property.
  - ii) The receiver's power to reject unexpired leases (subsection (f)) is subject to the requirement of court approval after notice and hearing.
- b) The business judgment rule should be the standard, either in the text or through a comment.
- c) The Committee is of the view that residential leases should receive some protection. One suggestion is that, if the tenant entered into the lease in good faith, the receiver cannot reject it. Another suggestion is to limit this protection to leases with a term of no more than one year.
- d) Questions were raised on whether, and if so how, the Act should address land sale contracts and those types of time shares that are licenses, rather than fee interests. The Committee did not have a consensus view; the Reporter will take these issues under advisement in preparing the next draft.
- e) Another issue to consider is how to address leases with affiliates.
- f) The Reporter will study these issues further.
- 14) Model (or Form) Receivership Order. There was a general (but not unanimous) agreement that a model receivership order in the Act or the comments is not necessary, but we may revisit the issue later in the drafting process.
- 15) Immunity (draft section 19).
- a) The consensus was that this provision should be as simple as possible.
  - b) The Reporter will provide an issues memorandum on immunity and the scope of immunity at common law.
  - c) One suggestion was to add a shortened statute of limitations with respect to actions against the receiver, and the Reporter will consider that and report back. Another was that the court may address the issue in its final order.
- 16) Ancillary Receiverships (draft section 24).
- a) Subsection (a) allowing the receiver to seek appointment of an ancillary receiver should be moved to the section on the receiver's duties.
  - b) The Reporter's Notes for the next draft should include an example of how the ancillary receivership provisions will work.

17) Definitions (draft section 2).

- a) As noted above, the definition of “residential real property” will be narrowed.
- b) Also as noted above, the Committee would also like to change the term “respondent” to “owner” or some other term that is not tied to litigation nomenclature. Further, the definition may need to be refined.
- c) Time did not permit us to address other definitional issues raised in the Reporter’s Notes.

18) Other Issues.

- a) The Act should not contain priority rules for claims.
- b) The Act should contain only bare minimum procedural rules, because courts already have comprehensive civil rules that either apply or can be adapted to receivership practice. The Reporter will streamline the procedural provisions in the next draft.
- c) The Act should make clear that the doctrine of *in custodia legis* applies to receivership property.
- d) The consensus was that section 18 on utilities should be deleted, but Fred Miller will look into Minnesota’s rationale and experience on this issue, then report back.
- e) The amount of the receiver’s bond (draft section 8) should be subject to the discretion of the court.
- f) The Act should provide that an action for the appointment of a receiver is not to be considered an “action” within the meaning of a state’s “one-action” rule.

19) Enactability; Additional Observers.

- a) Everyone was mindful that the Act should be readily enactable, and the group did a great job testing ideas and suggestions against enactability concerns.
- b) As noted above, most of the survey respondents signed up to be Observers. The Executive Director will also reach out to the American Bankers Association.

20) Wrap-up and Next Steps.

- a) By the end of the meeting, the consensus was that the Reporter has sufficient guidance from the Committee to prepare the discussion draft.
- b) As noted above, Fred Miller will report back on various aspects of the Minnesota law, and

the Reporter will do the same on Washington law.

- c) The Reporter will also prepare memoranda on the issues noted above.
- d) Our next meeting will be in the Spring of 2014, at which time we will consider a revised discussion draft of the Act. If all goes well, the Committee will present a further revision for a first reading at the 2014 ULC annual meeting.