

AMERICAN BANKRUPTCY INSTITUTE JOURNAL

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Feature

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UCRERA: Coming to Your State?

On March 25, 2017, Utah became the first state to enact the Uniform Commercial Real Estate Receivership Act (UCRERA), which was drafted by the National Conference of Commissioners (hereinafter, "National Conference") on Uniform State Laws and adopted at its annual meeting in July 2015. At least four other state legislatures (Nevada, Oklahoma, Michigan and Maryland) are currently considering adopting UCRERA. Other state legislatures are likely to follow.¹ This article provides bankruptcy professionals with a brief introduction to this uniform law.



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Background

A few years ago, the National Conference appointed a distinguished committee, chaired by **Thomas S. Hemmendinger** (Brennan, Recupero, *et al.*; Providence, R.I.), to study and draft a uniform state law governing the administration of commercial real estate receiverships. The National Conference saw a need for such a law because very few states have any comprehensive statutory guidance regarding the appointment and powers of commercial real estate receivers. Presently, receivership law essentially is made by judges on a case-by-case basis. Without a uniform statute, every receivership case is unique, and in every such case, there are lingering questions about whether a broad appointment order from a court of equity can override other state laws governing liens, debt-collection remedies and foreclosure procedures.

Summary of Key Statutory Provisions in the Utah Act

What follows is a *brief summary* of UCRERA's key provisions. Practitioners are urged to read the statute carefully for a more comprehensive under-

standing of the proposed legislation. Moreover, the National Conference report on UCRERA contains comments and examples that are helpful in applying the specific provisions of the statute.

Definitions

In general, the definitions in UCRERA are *similar* to definitions for similar terms found in the Bankruptcy Code and Uniform Commercial Code. However, some defined terms have no corresponding definitions in the Bankruptcy Code, whereas other important terms in the law are intentionally undefined to allow for situational flexibility.

Notice and Opportunity for Hearing

Many of the concepts in UCRERA will be familiar to bankruptcy professionals. For example, under UCRERA, the court may enter orders only after such notice and opportunity for a hearing as is appropriate under the circumstances, and it might issue an order without an actual hearing if no interested party timely requests a hearing or if the particular circumstances require an order before a hearing can be held.

Scope and Exclusions

UCRERA applies to all receiverships for *real property*, as well as *related* personal property, *except* where the real property is improved by one to four "dwelling units," *unless* the dwelling units are used as part of a commercial enterprise. The legislation does *not* apply to a receivership authorized by the laws of state where the receiver is a governmental unit or an individual acting in an official capacity on behalf of the governmental unit. The statute also can be supplemented by general principles of law and equity.

Power of the Court

The trial courts of the applicable state have *exclusive* jurisdiction of receivership proceedings

¹ To review UCRERA and track its legislative progress, visit uniformlaws.org/Act.aspx?title=Commercial%20Real%20Estate%20Receivership%20Act.

brought under the statute. With regard to venue, however, other provisions of state law will govern.

Appointment

UCRERA establishes standards under which a court may appoint a receiver in the exercise of its equitable discretion. These standards, which are specified in the statute, include circumstances both before and after the judgment. In addition, the statute contains broad authority to appoint a receiver “on equitable grounds.” It also allows for an appointment “during the time allowed for redemption to preserve a property sold in an execution or foreclosure sale” and to secure the rents during such time. UCRERA further establishes standards under which a petitioning mortgage lienholder is *entitled* to the appointment of a receiver. Where the court appoints a receiver on an *ex parte* basis, the court may also require the party seeking an appointment to post security for any damages, attorneys’ fees and costs incurred by a person injured if the appointment is later determined to have been unjustified.

Identity and Independence of Receiver

The statute requires that the receiver be independent and disinterested. However, certain types of specified relationships do not disqualify a receiver. Furthermore, while a party seeking an appointment of a receiver may nominate someone, the court is not bound by any such nomination.

Receiver’s Bond

Every receiver *must* post a bond that is conditioned on the faithful discharge of the receiver’s duties in an amount specified by the court, and that is effective upon appointment. Where required by the circumstances, the court may authorize the receiver to act before the bond is posted. The statute does not authorize the court to waive the bond requirement, although the court may approve alternative forms of security, such as letters of credit or a deposit of funds. Receivership property, however, may not be used as security.

Effect of Appointment; Receiver as Lien Creditor

On appointment, and with respect to personal property, a receiver has the status and priority of a lien creditor under chapter 9 of the Uniform Commercial Code. With respect to real property, a receiver has a similar status under the state’s applicable recording statute.

Effect on After-Acquired Property

The appointment of a receiver does not affect the validity of a pre-receivership security interest in receivership property. Any property acquired by the receiver after the appointment is subject to any pre-receivership security agreement to the same extent as if no receiver had been appointed.

Collection and Turnover of Receivership Property

On appointment, persons having possession, custody or control of receivership property must turn over the property to the receiver, and persons owing debts that constitute receivership property must pay those debts to the receiver. A person with notice of the receivership and that owes a debt that is receivership property may not satisfy the debt by paying the owner. The court also may

sanction a person’s failure to turn over property when required, unless there is a *bona fide* dispute or setoff regarding the property.

Powers and Duties of the Receiver

UCRERA grants very broad presumptive powers to the receiver. In addition, a receiver may exercise certain powers *only with court approval*, such as transferring property outside the ordinary course of business. Furthermore, the statute sets forth the receiver’s performance and reporting duties.

Duties of Owner

The statute places the duties of assistance, cooperation and turnover on owners of a receivership property. If the owner is not an “individual,” then these duties apply to *each* officer, director, manager, member, partner, trustee or other person exercising or having the power to exercise control over the affairs of the owner. A knowing failure *of a person* to perform these duties can subject the person to the payment of actual damages, including reasonable attorneys’ fees, costs and civil contempt sanctions.

Automatic Stay; Injunctions

Entry of the order of appointment imposes a stay, applicable to all persons, of any action to obtain possession of, exercise control over or enforce a judgment against receivership property. In the appropriate situations, the court can expand the scope of the stay and also grant relief from the stay. For policy reasons, certain actions are excluded from this stay, including actions to foreclose or enforce a mortgage by the person seeking the appointment of the receiver and police power actions by governmental units. The court may void an action that violates this stay. The statute also addresses the consequences of a violation of the stay and allows a court to award actual damages caused by the violation, including reasonable attorneys’ fees, costs and civil contempt sanctions.

Engagement and Compensation of Professionals

UCRERA authorizes the receiver to engage and pay professionals. A professional is not disqualified from being hired solely because of the person’s engagement by, representation of or other relationship with the receiver, a creditor or a party. In addition, the statute does not prevent the receiver from serving as an attorney, accountant, auctioneer or broker “when authorized by law.” Both receivers and their retained professionals must file itemized statements of their work and can only be paid upon court approval.

Use, Sale, Lease, License or Other Transfer of Receivership Property Other than in the Ordinary Course

With court approval, the legislation permits the receiver to use, sell, lease, license, exchange or transfer receivership property other than in the ordinary course of business. Unless the agreement of transfer provides otherwise, the transfer is free and clear of a lien of the person that obtained appointment of the receiver, any subordinate lien and any rights of redemption, but such a sale is subject to liens that are senior to the lien of the person who obtained the receiver’s appointment. Liens extinguished by the receiver’s sale attach to proceeds with the same validity, perfection and priority as they

had with respect to the property sold, even if the proceeds are not sufficient to satisfy all obligations secured by the liens. The sale could be conducted as either a public auction or a private sale.

Creditors with valid secured claims may credit bid, but only if the creditor tenders funds sufficient to satisfy (in full) the reasonable expenses of transfer and the obligations secured by any senior liens extinguished by the transfer. For example, Senior Mortgage Creditor A holds a secured claim with an unpaid balance of \$3 million, Junior Mortgage Creditor B holds a secured claim with an unpaid balance of \$1 million, and there is a superior tax lien for unpaid real property taxes of \$100,000. Creditor B obtains the appointment of a receiver and the court authorizes the receiver to conduct an auction sale of the property. Creditor A does not consent to the sale and under applicable law may refuse prepayment of the senior debt. Any sale by the receiver will be subject to Creditor A's lien and the tax lien. However, Creditor B may credit bid at the sale up to the full amount of its \$1 million in debt, and, if it is the highest bidder, may acquire the title to the real estate, free of all junior and subordinate liens, so long as Creditor B also tenders sufficient funds equal to the costs of the sale. The statute also provides a safe harbor for good-faith purchasers in case a party objects but fails to obtain a stay.

Executory Contracts and Unexpired Leases

With court approval, a receiver may adopt or reject an executory contract of the owner that relates to the receivership property. If, under applicable state law, the owner could assign the contract, then the receiver may also assign the contract with court approval. Performance of a contract by a receiver prior to its adoption is not an implied adoption of the contract, nor does it preclude a subsequent rejection. UCRERA specifies the mechanics for adoption, assignment or rejection of executory contracts, and the resulting consequences.

A provision in a contract that requires or permits a forfeiture, modification or termination of the contract because of either a receiver's appointment or the owner's financial condition does not affect a receiver's power to adopt the executory contract. The legislation also contains protections for purchasers in possession of real property or real property timeshare interests that are analogous to those contained in the Bankruptcy Code. Finally, the statute limits the receiver's ability to reject the unexpired lease of a tenant, permitting rejection of the lease only in very limited situations.

Immunity of the Receiver

Consistent with the receiver's status as an officer of the court, the statute expressly provides the receiver with immunity for acts or omissions within the scope of the receiver's appointment. As such, UCRERA incorporates the *Barton* doctrine.²

Claims

UCRERA requires the receiver to notify "creditors of the owner" of a receiver's appointment, unless the court

orders otherwise. The statute prescribes the notice's content and the manner in which it must be given, as well as specifies the manner in which claims must be filed. The statute states what information must be included with a claim and permits the receiver to recommend disallowance of claims. The court may forgo the filing of unsecured claims where the receivership property is likely to be insufficient to satisfy secured claims.

Receiver's Reports and Discharge

The receiver may file and, if ordered by the court, must file interim reports that contain certain specified information. Upon completion of the receiver's duties, the receiver also must file a final report that contains certain prescribed information. Once the court approves the receiver's final report and the receiver has distributed all of the receivership property, the receiver has been discharged.

Receiver's Fees and Expenses

The court may award a reasonable fee to the receiver from receivership property. In addition, the court may order the person who requested the appointment to pay such fees if the receivership does not produce sufficient funds to pay them. The court may also order payment of the receiver's fees and expenses from a person whose conduct justified or would have justified the receiver's appointment.

Removal or Replacement of Receiver; Termination

The court may remove a receiver "for cause" and replace a receiver who dies, resigns or is removed. The statute does not define "cause," but leaves the determination to the courts on a case-by-case basis. The court may also discharge a receiver and terminate administration of receivership property if it finds that the appointment was "improvident" or that the circumstances no longer warrant the receivership's continuation. Moreover, if the court finds that the appointment was sought "wrongfully or in bad faith," the court may assess fees, expenses and actual damages, including reasonable attorneys' fees and costs, against the person who sought the appointment.

Ancillary Receivership

Where a receiver has been appointed by another state, the statute authorizes the court to appoint that person or its designee as an ancillary receiver for the purposes of obtaining possession, custody and control of receivership property located within the state. Once an ancillary receiver has been appointed, that receiver has all of the rights, powers and duties of an original receiver appointed under the statute, unless the court orders otherwise.

Receivership in the Context of Mortgage Enforcement; Anti-Deficiency Rules

UCRERA makes it clear that a receiver's appointment on request of a mortgagee or assignee of rents does not make the mortgagee or assignee a "mortgagee in possession," and does not (1) constitute an election of remedies, (2) make the secured obligation unenforceable and (3) constitute an "action" within the meaning of any applicable "one-action" rule. Where a receiver conducts a sale of receivership property free and clear of a lien, the state's anti-deficiency rules

² See *Barton v. Barbour*, 104 U.S. 126, 129, 26 L. Ed. 672 (1881).

will apply to any extinguished lien to the same extent that those rules would have applied following a foreclosure sale not governed by the statute.

Conclusion

UCRERA vastly improves the administration of commercial real estate receiverships. It provides judges, practitioners and participants with a more procedural structure and predictability than what currently exists in most states. While the statute is not a replacement for liquidations or reorganizations of commercial real estate properties under the Bankruptcy Code and cannot modify 11 U.S.C. § 543, it does provide secured creditors with another option for managing and liquidating their distressed commercial real property collateral. **abi**

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