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Applications to Appoint Temporary Receivers

Todd E. Soloway, a partner at Pryor Cashman, and Luisa K. Hagemeier, of counsel to the firm, write: The distrust occasioned by a mortgagor's default understandably moves a foreclosing secured lender to seek the appointment of a temporary receiver. However, many lenders mistakenly believe that an application for the appointment of a receiver in a foreclosure context is a fait accompli. In reality, the mere fact that a default exists will not alone be sufficient to obtain the appointment of a temporary receiver.

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The distrust occasioned by a mortgagor's default understandably moves a foreclosing secured lender to seek the appointment of a temporary receiver and thereby to remove the financial and managerial reins from the borrower. However, many lenders mistakenly believe that an application for the appointment of a receiver in a foreclosure context is a fait accompli. In reality, the mere fact that a default exists will not alone be sufficient to obtain the appointment of a temporary receiver—a remedy the courts regard as "drastic," "intrusive" and "extraordinary." Thus, a court will not grant an application for appointment unless it is satisfied that the value of the property securing the mortgage and the parties' interests in it are at risk if a temporary receiver is not appointed.[1]

In this article we will lay out the procedural mechanisms for applying for the appointment of a temporary receiver and the potential pitfalls that may present themselves.

There are two statutory avenues for seeking appointment of a temporary receiver pending the resolution of a mortgage foreclosure action in New York: CPLR §6401(a) (the "necessity" statute) and New York Real Property Law (RPL) §254(10) (the "receiver clause" statute).

Applications Under §6401(a)

In the absence of a "receiver clause" in the mortgage documents (explained below), an application for the appointment of a temporary receiver pending resolution of a mortgage foreclosure action is governed by CPLR §6401.[2] The hurdles to be surmounted on an application pursuant to CPLR 6401(a) are notoriously high: a party with an interest in the property must move on notice and prove by "clear and convincing" evidence that the property is in danger of being "materially injured or destroyed" and that the appointment of a temporary receiver is "necessary" to protect the parties' interests in the property. The statute provides that:

Upon motion of a person having an apparent interest in property which is the subject of an action in the supreme or county court, a temporary receiver of the property may be appointed...where there is danger that the property will be removed from the state, or lost, materially injured or destroyed.

The application may be made by any party with an "apparent" interest in the property and on notice to the mortgagor.[3] The applicant then bears the burden of proving by "clear and convincing" evidence both that (1) there is a risk of irreparable loss or waste to the subject property, and (2) the appointment of a receiver is "necessary" to protect the parties' interests. The mere fact that a mortgagor has defaulted or has consented to the appointment of a receiver is an insufficient basis for granting the appointment, as neither demonstrates waste or mismanagement of the property.[4]

Considerations Under §6401

The key stumbling blocks in applying for the appointment of a temporary receiver under CPLR §6401 are proving the "necessity" of the appointment and the imminence of irreparable loss to the value of the property.[5] The appointment will not be found necessary absent proof that the asset's value will be impaired, to the actual detriment of a party with an interest in that property, unless a temporary receiver is appointed. The importance of the necessity element, and of carefully proving it with evidentiary facts (rather than mere assertions of conclusions or assumptions), is nicely illustrated by comparing the decisions in *U.S. Bank Nat'l Ass'n v.*

Culver[6] and *Wells Fargo Bank, N.A. v. Ambrosov*.[7] The application for appointment of a temporary receiver in both of these mortgage foreclosure actions was made by the board of managers of the condominium in which the unit being foreclosed was located, a lienor junior to the mortgagee. The board in each case claimed that the foreclosure proceeds would be insufficient to pay common charges that would accumulate on the units during the pendency of the foreclosure action, and thus that a temporary receiver should be appointed to lease the units and use the rent to pay the common charges on a current basis.

The *Culver* court granted the application, based on a finding, among other things, that it "appear[ed] unlikely that the foreclosure sale will produce any excess monies or generate enough to cover the outstanding first mortgage held by the plaintiff."[8]

Despite seemingly identical facts, the *Ambrosov* court denied the board's application. The important distinction was this: in *Ambrosov*, the board failed to present evidence that there would be insufficient funds left in the foreclosure to pay the board's claim for common charges. The court expressly noted that, "if the available equity were sufficient to cover the value of [the board's] financial interest they would have no basis for the appointment of a temporary receiver."

The second hitch applicants face is demonstrating that the value of the property is in imminent danger. In this regard, an application will most likely be denied if the property is adequate security for the debt,[9] or if the movant fails to prove by clear and convincing evidence that there is an actual risk that the subject property will be irreparably injured imminently, and not merely that the borrower or manager has engaged in some malfeasance not directly related to the property itself.[10]

Applications Under §254(10)

RPL §254(10) appears to provide a mortgagee with a less onerous route to the appointment of a temporary receiver in mortgage foreclosure actions if the mortgage documents contain a so-called "receiver clause"—language providing, in substance, that "the holder of this mortgage, in an action to foreclose it, shall be entitled to the appointment of a receiver."[11] RPL §254(10) provides that such a covenant:

must be construed as meaning that the mortgagee, his heirs, successors or assigns, in any action to foreclose the mortgage, shall be entitled, without notice and without regard to the adequacy of any security of the debt, to the appointment of a receiver of the rents and profits of the premises covered by the mortgage.

The statute affords obvious advantages over CPLR §6401(a), despite the fact that appointment of a receiver is not automatic, as is erroneously suggested by the language of the statute, and particularly that of its title—"Mortgagee entitled to appointment of receiver." The prevailing rule in New York is that a receiver clause in the mortgage documents authorizes but does not require the court to appoint a temporary receiver, and courts may exercise their equitable discretion to determine whether to grant the application.[12]

Unlike an application under CPLR 6401(a), which must be made on notice to the mortgagor, an application for the appointment of temporary receiver pursuant to RPL §254(10) may be made on an ex parte basis.[13] Furthermore, it is unnecessary for the mortgagee to prove either that the security for the defaulted loan is inadequate or that the appointment of a receiver is "necessary."[14]

Finally, in stark contrast to the heavy burden borne by the party moving for appointment under CPLR §6401(a) to prove by clear and convincing evidence that the property is in danger of irreparable injury or loss and that a receiver is necessary to protect the parties' interests, in considering applications under RPL §254(10), courts appear to impose the burden on the mortgagor to prove that granting the application would be "inequitable."[15]

But as noted above, an application to appoint a temporary receiver pursuant to RPL §254(10) will not automatically be granted upon a loan default by the mortgagor even if the mortgage documents contain a receiver clause.

Considerations With §254(10)

What does the "receiver clause" approach mean in practical terms? Other than a receiver clause and the mortgagor's default, just what is required to prevail on an application under RPL §254(10)?

The most significant body of case law involving RPL §254(10), shows that courts adopt a middle ground between automatic appointment and imposition of the stringent requirements of CPLR §6401(a). Thus, courts have denied applications for appointment under RPL §254(10) where they find that the parties' interests in the subject property can be protected by more benign means, such as a reorganization plan.[16] On the other hand, courts have granted applications under RPL §254(10) where a receiver may not be technically "necessary," but "would help to clarify and monitor the use of the subject premises during the pendency of this action," where there was evidence that unknown individuals were occupying the property.[17]

Accordingly, it is advisable in applying for the appointment of a temporary receiver pursuant to RPL §254(10) to include affidavits and other evidence showing that the value of the property is at risk (or, perhaps, inadequate security of the debt, even though this is not a technical requirement) and that either the property or its rents and other income are being mismanaged by the borrower. Such a showing will certainly give the reviewing court comfort that appointment is not inequitable.

Conclusion

RPL §254(10) may not be the magic wand suggested by its language, but it affords mortgage lenders distinct advantages over CPLR §6401(a). It is thus an important tool of which lenders should avail themselves by including receiver clauses in their mortgage documents and, if it becomes necessary to apply for the appointment of a temporary receiver, by supplying the court with evidence that, even if not necessary, the appointment of a temporary receiver would not be inequitable to the mortgagor.

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Endnotes:

1. See First Nat'l Bank v. Caputo, 124 A.D.2d 417, 418 (3d Dept. 1986); Groh v. Halloran, 86 A.D.2d 30, 32 (1st Dept. 1982); S.Z.B. Corp. v. Ruth, 14 A.D.2d 678, 678 (1st Dept. 1961); *Ullah v. Luthfur Rahman, Vidya Haridas, P.C.*, N.Y. Slip Op., Index No. 20752/10 (Sup. Ct. Queens Co. 2011).

2. See, e.g., *Caputo*, 124 A.D.2d at 417.

3. Although CPLR §6401(a) does not by its terms require that the motion be made on notice, the necessity of notice of such motions is universally acknowledged. See, e.g., Siegel, New York Practice 4th §333; McLaughlin, Practice Commentaries, C6401:2; Haig, Commercial Litigation in New York State Courts, §17: 52, at 154-55 & nn. 2-6.

4. Ficus Investments Inc. v. Private Cap. Mgt., LLC, 61 A.D.3d 1, 872 N.Y.S.2d 93 (1st Dept. 2009); *Caputo*, 124 A.D.2d at 418; *Groh*, 86 A.D.2d at 33-34 (without evidence that property or owners were insolvent, institution of foreclosure action against property was "improvident" basis for granting application for receiver, and the lower court gave undue weight to borrower's failure to oppose motion).

5. See Kristensen v. Charleston Square Inc., 273 A.D.2d 312, 312 (2d Dept. 2000).

6. 27 Misc.3d 1233(A), 911 N.Y.S.2d 697 (Sup. Ct. Orange Co. 2010).

7. 26 Misc.3d 1207(A), 906 N.Y.S.2d 784 (Sup. Ct. N.Y. Co. 2010).

8. *Culver,* 27 Misc.3d 1233(A), 911 N.Y.S.2d 697.

9. See *Ullah v. Luthfur Rahman, Vidya Harida, P.C.*, N.Y. Slip Op., Index No. 20752/10 (Sup. Ct. Queens Co. Jan. 21, 2011) (application for appointment of receiver denied where value of property provides security for movant's interest and property is generating rental income to pay money owed); Societe Generale v. Charles & Co. Acquisition Inc., 157 Misc.2d 643, 597 N.Y.S.2d 1004 (Sup. Ct. N.Y. Co. 1993) (application for appointment of receiver denied where property was appraised for $2.6 million, mortgage was only $1 million and condominium board's lien was only $25,000 and increasing by only $2,000 per month, absent evidence that property was in danger of deterioration).

10. See Tita v. Lampeas Family Ltd. Partnership No. 4, 26 Misc.3d 1241 (Sup. Ct. Queens Co. 2010) (application for appointment denied in absence of evidence of waste or mismanagement of property); Natoli v. Milazzo, 65 A.D.3d 1309, 886 N.Y.S.2d 205 (2d Dept. 2009) (motion for appointment of temporary receiver denied because allegations that defendant committed acts that damaged assets of another property, but not subject property, did not constitute clear and convincing evidence that subject property was at risk of irreparable loss or damage); S.Z.B. Corp. v. Ruth, 14 A.D.2d 678 (1st Dept. 1961) (absent likelihood of premises falling into disrepair or deteriorating in near future, abuse of discretion to appoint receiver).

11. A receiver clause entitling a mortgagee to avail itself of RPL §254(10) need not mimic the statute verbatim.

12. See, e.g., Ridgewood Sav. Bank v. New Line Realty VI Corp., 24 Misc.3d 1227(A), 897 N.Y.S.2d 672 (Sup. Ct. N.Y. Co. 2009); *Washington Mut. Bank v. 293 Grand Ave. Partners LLC*, No. 42557/07, N.Y. Sup. Ct. Kings. Co. (Dec. 5, 2007) (denying application based only on allegation of default and existence of receiver agreement); *DiMaria v. Belgiorno*, No. 016872/03, N.Y. Sup. Ct. Nassau Co. (July 12, 2004) (same); Naar v. I.J. Litwak & Co. Inc., 260 A.D.2d 613, 614 (2d Dept. 1999); *Blair v. Donlon*, 51 N.Y.S.2d 921, 922 (1944); FDIC v. Vernon Real Estate Investments, Ltd., 798 F.Supp. 1009, 1012 (S.D.N.Y. 1992) (RPL §254(10) does not automatically entitle mortgagee to appointment of temporary receiver).

13. See *Vernon Real Estate Investments*, 798 F.Supp. at 1012 (insufficient notice not grounds for removing receiver). See also N.Y. R.P.A.P.L. §1325 ("Where the action is for the foreclosure of a mortgage providing that a receiver may be appointed without notice, notice of a motion for such appointment shall not be required").

14. Id. at 1013.

15. See *Ridgewood Savings Bank v. New Line Realty VI Corp.*, 24 Misc.3d 1227(A), 897 N.Y.S.2d 672 (Sup. Ct. Bronx Co. 2009); *Vernon Real Estate Invs.*, 798 F.Supp. at 1012.

16. See *Chatam-Phenix*, 146 Misc.2d at 208.

17. See *Rockman v. Valentine*, No. 23051/03, Sup. Ct. Suffolk Co. (Jan. 12, 2004) (grant of application limited based on fact that subject property was vacant and mortgagee already had access); *County Nat'l Bank v. Ebb Tide Bay, Ltd*, No. 24735/00, N.Y. Sup. Ct. Suffolk Co. (Nov. 12, 2002).