COUNSELOR'S CORNER

State Receiverships:

A Banker's Tool for Faster, Cost-Efficient Recovery on Troubled Loans

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Receiverships have become increasingly popular tools for developing and implementing cost-effective and expeditious workout strategies for troubled loans. Washington's Receivership Act, one of the best in the country, can be an effective tool for lenders.

A state court receiver is an independent officer appointed by the court to manage or liquidate the assets of a borrower for the benefit of its creditors. In most cases, a secured lender selects the receiver before the appointment. Banks frequently decide to use a receiver to take over the borrower's assets if workout negotiations are unsuccessful or if the property might be subject to neglect, ineffective management, vandalism or unusual liability concerns. Washington has one of the most advanced receivership statutes in the U.S. and lenders can benefit from knowing how to use it effectively.

1. General vs. Custodial Receiverships

In a general receivership, the receiver takes custody and control of all of the borrower's assets and may operate the borrower's business while administering and liquidating the assets of the borrower for the benefit of the creditors. General receiverships are frequently used when the creditors stand the best chance to recover through a liquidation of the borrower's business as an operational enterprise.

In a custodial receivership, the receiver takes control over selected assets of the borrower, such as a condominium complex. Custodial receiverships are typically initiated by secured lenders in aid of the lender's foreclosure of the liens on real property. The July 2011 revisions to Washington's Receivership Act now permit lenders to obtain a receiver in aid of foreclosure immediately after service of a Notice of Default.

2. Key Receivership Provisions

Once a receivership order is entered, a lender typically monitors but does not get involved in liquidating or managing the borrower's assets. The stay of actions by most creditors protects the assets while the receiver administers the estate. There are provisions permitting a receiver to borrow funds to finance the receiver's administration, and the lender works with the receiver and his counsel to come up with an agreed-upon budget.

The receiver employs the necessary professionals to administer the estate, maintains and preserves the assets, makes sale preparations, and communicates with the court and the creditors as necessary through notices and orders. Under Washington's Receivership Act, costs of the receivership are entitled to administrative priority; these costs include the receiver's fees, receiver's professionals' fees, management fees and related expenses. Such costs are typically added to the borrower's secured indebtedness and satisfied from proceeds of the receiver's disposition of the assets. Like a bankruptcy trustee, the receiver has the ability to reject, assume or assign contracts, sell property free and clear of liens, and to abandon property as appropriate. The receiver may make interim distributions to secured lenders throughout the duration of the receivership.

It is not surprising that more secured lenders are choosing receiverships and that many more are likely to do so in the months to come.

If, at the conclusion of the receivership, the borrower's debt exceeds the value of the assets realized by the receiver, many lenders seek a deficiency from the borrower. While this avenue may not be available in receiverships that culminate with a foreclosure, it is certainly common in receiverships involving the sale of an operating business.

3. Advantages of a Receivership

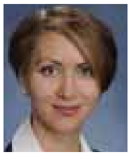
Some of the most attractive features of receiverships include their cost-effectiveness (including the ability to select the receiver and negotiate the receiver's fees), speedy recovery with interim distributions, avoidance of liability, and retention of foreclosure rights.

Lower Cost. The receiver's fees are typically less than the bankruptcy trustee's and are negotiated between the lender and the receiver before the appointment (a choice of hourly compensation, monthly fixed fee, contingency or a combination thereof). Because the borrower's property is under control of the receiver, not the bank, the lender's costs and risks associated with managing the property (including liability for hazardous material clean-up, condominium warranties, maintenance expenses, and so on) are eliminated or mitigated by the receivership.

Faster Recovery/Interim Payouts. Receiverships have a much shorter lifespan than bankruptcies. Notice periods are shorter and more limited under Washington's Receivership Act than the Bankruptcy Code. Moreover, as the receiver sells assets of the estate, secured lenders may receive interim distributions.

Ability to Foreclose. Receiverships allow the petitioning lender to retain the ability to foreclose without court order while the receivership is pending.

In sum, the Washington's Receivership Act enables secured lenders to: 1) quickly gain access to the borrower's assets, 2) have an independent third party, usually of the lender's choosing, proceed with an orderly liquidation of such assets, and 3) protect the interests of creditors pending such liquidation, without incurring the significant costs of a bankruptcy or taking on the risk of the property management through other lender-managed solutions. Consequently, it is not surprising that more secured lenders are choosing receiverships and that many more are likely to do so in the months to come.



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