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Secured Lenders: Keeping Your Receiver in the Driver's Seat During Bankruptcy

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You put in the work to get a receiver appointed. Do not let a bankruptcy filing get in the way of your efforts. A receivership is a remedy used by secured lenders primarily to preserve their collateral when a borrower fails to pay its debt and the property may be at risk of losing value. The receivership is often used during a judicial proceeding to foreclose a lender's mortgage on real estate. In a court-authorized receivership, an independent party will be appointed as receiver and will exercise control over the mortgagor's property to preserve and manage the property. That sometimes involves managing business operations, collecting rents or even preparing the property for a sale.

It is not uncommon that on the eve of a foreclosure sale, as a defense, a mortgagor will file a voluntary petition for bankruptcy to stop the sale of the property. The Bankruptcy Code not only stops the sale by virtue of the automatic stay, but it also imposes obligations on the receiver to turn over property to the debtor-in-possession and provide an accounting in the bankruptcy case pursuant to Section 543(b) of the Bankruptcy Code.

Section 543(b) states that a custodian shall:

(1) deliver to the trustee any property of the debtor held by or transferred to such custodian, or proceeds, product, offspring, rents or profits of such property, which is in such custodian's possession, custody or control on the date that such custodian acquires knowledge of the commencement of the case; and

(2) file an accounting of any property of the debtor, or proceeds, product, offspring, rents or profits of such property, that, at any time, came into the possession, custody or control of such custodian.

Section 543(a) generally bars a receiver from taking further action to administer property of the estate, or in other words, to perform the duties and obligations the receiver is required and authorized to carry out in the non-bankruptcy proceeding.

What secured lenders should know is that the court-appointed receiver's turnover requirements may be excused pursuant to Section 543(d). Under Section 543(d), the bankruptcy court may excuse the receiver's compliance with Sections 543(a) and (b) if the interest of creditors would be better served by permitting the receiver to continue in possession, custody or control of the property.

Factors that bankruptcy courts have often looked at to determine whether compliance should be excused are:

(1) The likelihood of reorganization and whether funds held by the receiver are required for reorganization;

(2) Whether there were instances of mismanagement by the debtor;

(3) Whether turnover would be injurious to creditors; and

(4) Whether the debtor will actually use the property for benefit of its creditors.

In re Franklin, 476 B.R. 545, 551 (Bankr. N.D. Ill. 2012) (citing *In re Falconridge, LLC*, No. 07-BK-19200, 2007 WL 3332769, at *7 (Bankr. N.D. Ill. Nov. 8, 2007)). Generally, when the majority of a debtor's debt is owed to a secured lender, the secured lender's interest is given great weight. *See In re Foundry of Barrington Partnership*, 129 B.R. 550, 558 (Bankr. N.D. Ill. 1991).

These factors are not exhaustive and the bankruptcy court's inquiry will be fact specific.

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