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SPECIAL ISSUES WITH TROUBLED LOANS

RECEIVERSHIPS AND SUBCHAPTER V BANKRUPTCY

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Receiverships Under Minnesota Law

- Receiverships are primarily governed by Minn. Stat. Chapter 576
  - Sets out various rules, definitions, and procedures applying to receivership
- Agreements between the parties may influence receiverships
  - When appointed
  - Duties

What is a Receiver?

- “A person appointed by the Court as the court's agent, and subject to the court's direction, to take possession of, manage, and, if authorized by this chapter or order of the court, dispose of receivership property”
- Manages and cares for property often while dispute is pending

When to Use a Receiver?

- Invoked in several circumstances, including:
  - In conjunction with a mortgage lien securing a bank loan
  - Enforcing an assignment of rents provision
  - Dissolution of corporate or other business assets
  - Litigation involving dispute over ownership of property or other entity assets
  - Anytime after any default if provided for in loan documents
  - Anytime after commencement of any type of foreclosure procedure

Receivership Invoked After Default Without Foreclosure

- Covenant violation
- Escrow violation
- Failure to pay taxes
- Failure to pay insurance
- Statutory violation of landlord covenants

How Brought

- Can be separate action when foreclosure by advertisement or independent default
- Can be pursuant to motion in conjunction with lawsuit for money judgment or foreclosure by action

When Appointed

- If requested, court must appoint receiver under statute if foreclosure commenced either by action or advertisement and prior to the end of the redemption period when mortgage:
  - Secures a principal amount of $100,000 or more, or secures lien upon residential real estate containing four or mor units; and
  - Is <u>not</u> a lien on property that is homestead or agricultural property
- In a judgment or after judgment to carry the judgment into effect or preserve property pending appeal

When Appointed

cont.

- Assignment of Rents
  - Entitled to appointment of a receiver to enforce an assignment of rents provision in a mortgage
  - Limitations:
    - Original Principal more than $100,000
    - Not a lien on homesteaded residential real estate
    - Not a lien on property “entirely homesteaded as agricultural property”
  - Slightly different standard that receivers appointed in foreclosures generally

When Appointed

cont.

- May be particularly useful for complex commercial loans
- Office building mortgage
  - Where ongoing property management is necessary
  - Leases, repairs, taxes, etc.
- Development property
- Industrial operation

Duration of Receivership is Until:

- Default cured;
- Redemption periods runs; or
- Redemption occurs

When Appointed – Waste and Loss

- Waste and Loss
- Court may appoint limited receiver
  - Before judgment
  - Protect party showing an apparent right to the property that is the subject of the action
  - The property or rents and profits are at a danger of loss
- Corporate Dissolutions
  - Receiver may be appointed when corporate or other entity is dissolved, insolvent, or at danger of insolvency

Timing for Motion

- Motion or petition can be made at any time once an event has occurred entitling the bank to appointment of a receiver, and creditor does not have to wait until trial or foreclosure sale
- Can be used to preserve property pending a judgment

Court Authority Over Receiver

- Since receiver is court-appointed, the receiver serves at the discretion of the Court and must be discharged at the conclusion of receivership by the Court

Receiver Qualifications

- Must be an experienced property manager
- Must be uninterested
- Typically, an affidavit providing the property manager’s qualifications and proposed fees is sufficient

Duties of Receiver

- Collect rent and other income from property
- Pay its own fees
- Maintain property:
  - Pay taxes
  - Common area and maintenance charges
  - Insurance
  - Prevent waste, i.e., make repairs as needed

Authority of Receiver

- Depends upon whether Receiver is a limited or general receiver

Both Limited and General Receiver Powers

- Incur and pay expenses;
- Control, manage, and conserve property;
- Assert rights, claims, and defenses relating to property;
- Sue and be sued, though receiver is immune to claims
- Powers provided specifically by the Court

General Receiver Powers

- Sell property free and clear of liens after prior approval of the court
- Sell free from statutory redemption rights
- Other parties with a lien in the property can object to a sale
  - If amount to be realized is less than the objecting party would realize without a sale, court can deny sale

Receivership Stay

- Upon appointment, immediate stay puts a halt to anyone from interfering with, taking possession of, or exercising control over the receivership property
- Similar to Automatic Stay in Bankruptcy
- Lasts for 30 days from appointment unless ordered otherwise

Bond

- A bond is optional
  - May be ordered by the Court to protect the property owner
- Bonds typically not required in a foreclosure situation and will routinely be waived by the Court

Discharge of Receiver

- Since a receiver is appointed by the Court, receiver must be discharged by the Court
- Receiver will last until discharge
- The typical order appointing a receiver will provide for regular accounting to the Court on either a monthly or quarterly basis
- The order will typically require a final account to be provided with an application for discharge

Discharge of Receiver

cont.

- Receivership may end upon:
  - Receivership's goals achieved
  - Discharge by court order
  - Resignation
  - Commencement of Bankruptcy proceedings
    - Take precedence over receivership

Questions on Receivership

Subchapter V Bankruptcy

- Brief overview of new Subchapter V Bankruptcy
- Small Business Reorganization Act of 2019
- Effective February 2020
  - Not intended to address pandemic, but fortuitous timing

Background

- Traditionally business reorganizations proceed under Chapter 11 of the Bankruptcy Code
- Allows debtor opportunity to run business while in bankruptcy
- Propose plan to reorganize and restructure debts
- Chapter 11 is a very expensive process
- Subchapter V meant to provide alternative

Advantages of Subchapter V

- Cheaper, simpler, and faster than traditional Chapter 11
- No quarterly US Trustee Fees
- Debtor has the powers of a "DIP" – retains control of the assets and operations

Advantages of Subchapter V

cont.

- Elimination of the absolute priority rule imposed in Chapter 11
  - Previously owners of business not entitled to retain equity if creditors not paid in full
  - Court may confirm plan over the objection of unsecured creditors if all projected disposable income of the debtor will be applied to the Plan

Eligibility

- Entity or individual—must be engaged in commercial activity
- Total debt limits:
  - Originally $2,725,625
  - CARES Act- increased eligibility debt ceiling to $7.5 million, recently extended to March 31, 2022

Eligibility

cont.

- Half of debt limit must come from business activity
- Debtor's principal activity cannot be a single asset real estate operation

Filing Requirements

- Upon filing a petition, the debtor must file a balance sheet, statement of operations, and cash flow statements

Filing Plan

- Only the Debtor can file the Plan
- Generally, the Plan must be filed within 90 days
  - Exception "if the need for an extension is attributable to circumstances for which the debtor should not justly be held accountable"
- No disclosure statement
  - Certain things that would be in disclosure statement are required to be set out in the Plan
  - Includes history of business operations, liquidation analysis, and projects on ability to make plan payments

Filing Plan

- “Cramdown” may be included
  - Allows debtor to “cramdown” amount paid on a secured loan to the total value of the collateral, rather than outstanding debt balance
- May modify the rights of the holder of a claim secured only by a security interest in real property that is the principal residence of the debtor if the new value received in connection with the granting of the security interest was
  - not used primarily to acquire the real property
  - used primarily in connection with the small business of the debtor

Trustee

- Court appoints trustee
- Subchapter V trustee does not take possession of debtor's assets and does not have power to sell assets
- Trustee ensures debtor makes timely payments
- Help facilitate consensual plan of reorganization

Plan Modification After Confirmation

- Only the debtor may modify after confirmation
  - If debtor's business improves during course of plan, creditor cannot request modification to increase payments
  - If business declines, debtor can request modification

Modification of Vehicle Loans

- Limitation in Chapter 13, debtor may not typically use bankruptcy to cramdown a secured personal vehicle loan if incurred 910 days prior to filing
- Above limitation does not apply to Subchapter V

Use of Cash Collateral

- Under Subchapter V, Debtor still has to obtain an agreement on the use of creditor's cash collateral or be able to provide adequate protection of creditor's interest in cash collateral

Projection Disposable Income

- Similar to Chapter 13, Debtor may apply towards the Plan all disposable income to be received in a three-year plan period; or
- Alternatively, similar to Chapter 11, Debtor may distribute under the Plan that is not less than the Debtor's projective disposable income over three-year plan

Creditor's Consent to Plan

- There are no incentives to consent to Plan
- Consensual Plan does allow termination of the trustee when the Plan is substantially consummated. If nonconsensual, Trustee responsible for making distributions to creditors until the Plan is complete.

Administrative Expenses

- Debtor may pay administrative expenses over the life of the Plan
  - Not available if the Plan is consensual

Questions