



The ABCDs of Equitable Receivership

BY JACK TANNER

This article covers the fundamentals of equitable receiverships, including tips for best practices.

A receivership can be an efficient and economical equitable remedy. This article covers the basics and explains best practices for effective equitable receiverships.

A is for Appointment

One of the most powerful remedies available to a litigant is the appointment of a receiver. There are many different types of receivers, but this article concerns itself with a receiver “pendente lite” (pending litigation), sometimes called an “equity receiver.” This receiver is appointed via the inherent power of a court sitting in equity, and not pursuant to any statute.¹ The test for appointment is simply that, considering all

the factors a court sitting in equity should consider, the appointment of a receiver is appropriate to preserve the assets of the estate.² A court’s appointment is reviewable only upon an abuse-of-discretion standard.³

Generally, the moving party must “have an interest” in the property sought to be put into receivership.⁴ While the circumstances in which a receiver might be a good idea are nearly limitless, there are recurring situations where an equity receiver is typically appointed, including:

- **Ineffective management of a business.** This occurs where management is not effective and the usual methods of replacement or accountability do not work. Examples of ineffective business man-

agement are deadlocked equity holders that cannot agree on how the company is to be run (or perhaps cannot even agree on the selection of management); bad management not accountable to equity holders via the usual types of litigation; or mistrusted management (e.g., a receiver might be used to conduct elections to find out who properly is management).⁵

- **Trusts.** A receiver is useful where there are intra-beneficiary disputes or disputes between the trustee and the beneficiaries.⁶
- **Divorce.** Where business assets are subject to a divorce action, a divorce court can appoint a receiver to operate the business assets during the divorce action.⁷

- **Pending dissolution of a business or trust.** When a business or trust is being dissolved, a receiver can operate it until the dissolution is complete.
- **After judgment.** CRCP 66(a)(2) expressly provides that a receiver may be appointed after judgment to dispose of the property subject to the judgment.

A receivership action is commenced by filing a complaint seeking the appointment of a receiver. A federal receiver can be appointed if federal jurisdiction otherwise exists, and only as a remedy incident to another claim for relief.⁸ CRCP 66(d)(1) allows the request for a receiver to be the only claim for relief in a complaint. The rules regarding notice pleading apply to a receivership complaint, but it is better to provide greater detail and specificity in setting out the grounds for a receiver. A verified motion is usually filed to support the appointment, which brings the issue of whether a receiver should be appointed to the court's attention immediately.

The movant (not necessarily the plaintiff) must propose a specific receiver to the court; there is no "panel" of receivers as there is for bankruptcy trustees. The movant should bear in mind it has no control over the receiver once the receiver is appointed. The receiver is an arm of the court with a fiduciary duty to the court and to whomever the court ultimately determines to be the proper beneficiaries (usually creditors and equity holders).⁹ The receiver does not and cannot owe the party responsible for its appointment any more duty than it owes others.¹⁰

The ability to choose the receiver is one of the most useful aspects of receiverships because it allows the selection of a receiver with particular expertise. If possible, the plaintiff should find a receiver who already knows the business, rather than worrying about finding a receiver with legal expertise. The receiver can always retain counsel to help with the legal aspects. The court does not have to appoint the proposed receiver, but can ask other parties for their suggestions, or even select a receiver *sua sponte*. As a general rule, a receiver does not have to be licensed in the business being put into receivership.¹¹

A receivership estate (the *res*) is created by the order appointing the receiver. What

constitutes the *res* depends on the property in which the movant has an interest. Usually, but not always, a company shareholder asks that the company itself be put into receivership. In these instances, the receiver takes over management of the entire concern with an eye toward recapitalization or a sale as a going concern. And usually, but not always, a secured creditor asks for its collateral only to be put into the *res*. These instances often result in liquidation

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of the collateral, because there is usually not a going concern to recapitalize or sell.¹²

Unlike a bankruptcy, which is given structure by the Bankruptcy Code, there are few statutes regarding receiverships because receiverships are within the court's inherent power. This flexibility, while one of the greatest advantages of a receivership, comes with a price: the equity receiver's effectiveness will depend on the order of appointment. Because the order appointing a receiver sets out the scope of the receiver's

authority,¹³ it requires careful thought and consideration, and the order appointing a receiver should be as detailed as possible. An order appointing a receiver should contain at least the following boilerplate items:

- a finding regarding jurisdiction and venue;
- findings of fact that support the appointment of the receiver;
- a conclusion of law that a receiver should be appointed;
- a requirement that the appointment is subject to the receiver filing an oath and posting bond;
- a detailed description of the *res*;
- a statement that the receiver is directed and empowered to take into custody all assets that will be within the estate;
- a statement that the receiver is given those powers traditionally and customarily held by receivers (an "including but not limited to" list is a good idea);
- a provision allowing the receiver to sell receiver's certificates to raise money;
- a provision fixing the receiver's compensation and setting the priority in which bills are to be paid (generally following the absolute priority rule, discussed below);
- a provision allowing the receiver to hire and pay professionals, staff, and other personnel as required to effectively manage the estate;
- a stay of actions against the companies or property in the estate, including requiring that all actions against the receiver be brought in the appointing court;
- a provision stating all actions taken by the receiver are in its capacity as such, and not individually; and
- a provision protecting the receiver's agents.

The language in the orders should be tailored to the specific matter. The plaintiff and the proposed receiver should discuss and negotiate other orders that would be helpful. These will vary from case to case, but may typically include:

- if difficulty in collecting the assets is anticipated, an order that the sheriff or U.S. marshal will assist with collections;
- if difficulty with the defendant or its principals is anticipated, an order that the

defendant (and its principals) is prohibited from holding itself out as the defendant and taking any action on its own behalf;

- how often reports should be filed (rarely more often than monthly); or
- an order naming parties who maliciously damaged the property going into the estate and making their claims contingent absent further order. This may prevent an attempted end-run around the receivership to the bankruptcy court.

A receiver, being a judicial appointee pursuant to the inherent power of the judicial branch, is an officer of the court that appoints it.¹⁴ The receiver has a fundamentally different relationship with the court than a bankruptcy trustee. A receiver is *not a party* to the receivership action.¹⁵ As such, a receiver and its appointing judge can speak *ex parte*.¹⁶

B is for Business Operations

In the broadest view, the receiver’s job is to preserve assets and avoid waste,¹⁷ so once appointed, the receiver’s first task is usually to take control of all assets, especially those that are easily subject to waste or misuse. As a matter of law, the appointment of a receiver puts all the property subject to the suit in *custodia legis*, that is, in the custody of the law.¹⁸ Thus, although taking physical possession of the property is helpful and should be effected as soon as possible, physical possession by the receiver it is not required. The receiver acts as the registry of the court,¹⁹ and any knowing interference with the receiver’s functions is punishable by contempt.²⁰

The receiver’s next task, what to do with the property, illustrates the genius of receiverships, which lies in the flexibility to pursue different courses of action. Depending on the facts of the case, the business might not be salvageable, and a liquidation would be appropriate. But with good management and some creative work by the receiver, the business could be recapitalized or reorganized and emerge from receivership as a going concern. Other times, the company might be sold as a going concern for much greater value than a liquidation of its assets. This is to be contrasted with the restrictive “pigeon holes” provided by the Bankruptcy

Code, which restrict the bankruptcy trustee’s possible courses of action.

A receiver should concentrate on preserving assets, running the business, and organizing a path forward. In this regard, litigation is an unwanted distraction. It is usually in everyone’s ultimate best interests if collateral litigation is stayed or abated while the receiver works on its more fundamental duties. If other litigation is

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pending, or even if it is not, parties often want discovery from the receiver. This interferes with the receiver’s primary duties, and the court should enter orders minimizing litigation burdens on the receiver.

The receiver should keep the court informed of what it is doing. The most effective way to do this is to file regular reports with the court and ask for court approval of those reports, or better yet, ask that the reports be incorporated into court orders. The reports serve three primary functions:

1. They tell the court and the estate what has already happened. This saves time by obviating the necessity of the receiver to communicate with estate beneficiaries and the court separately.
2. If approved, they protect the receiver’s actions from later attack. This is especially helpful because the receiver is operating a business, paying bills, paying itself, and so on. Not knowing for years after the fact that the court approved of its actions would be a terrible burden.
3. They can suggest the direction a receiver is considering. This can flush out objections from the court or the estate as early as possible, before the receiver has too much time or too many resources invested along a particular path.

As a general rule, the receiver’s reports should be ministerial and non-adversarial. If the receiver anticipates an objection to a course of action, it is probably best to file a separate motion regarding that course of action. That way, the approval of the report’s non-controversial matters is not delayed while the disputed matter is resolved.

The receiver must submit the report itself, under oath. It must be sent to every party who has entered an appearance, and should be sent to all claimants and any other interested parties. Some receivers create a webpage and post all reports and other documents to make them available to estate beneficiaries and the general public.

As stated above, the receiver’s charge is to gather and protect assets. If the assets are tangible, this may require a lot of legwork and the help of a sheriff or marshall. If the assets are intangible, protecting them becomes more esoteric. In the *Eller Industries v. Indian Motorcycle Manufacturing, Inc.* receivership, the primary assets were claims to the Indian Motorcycle trademark, so “protecting and preserving” those assets involved buying several companies, filing extensive litigation, hiring a licensing agent and entering into many licenses, and greatly expanding the business beyond its original parameters.²¹ The failure to do this would have caused the claims to the trademark and the vast majority of the value of the estate to be lost.

If the business operations do not generate sufficient cash to pay the receiver and other administrative creditors, the receiver usually sells receiver's certificates. These certificates act as liens upon the assets of the estate.²² The certificate usually bears interest and may contain some kind of additional incentive as well. In the *Indian Motorcycle* receivership, receiver's certificate purchasers also received a certain percentage of the company that would emerge from the receivership.

When a receiver enters into any contract, it should be approved before the receiver makes payment. This can be done in the original order appointing receiver for routine contracts, but for non-routine contracts the approval can be sought in receiver's reports or by separate motion. Once approved, the receiver need not get approval for each subsequent payment. Sales out of the ordinary course of business, especially of real property, should be confirmed by the court after the sale is concluded.²³

Unlike a bankruptcy, a receiver's fees (and its counsel's fees) do not have to be approved in advance of each payment. Assuming the order appointing receiver provided the rate of compensation for the receiver (which every order appointing receiver should), and once the motion to hire specific counsel is approved (which may be done by motion or in the receiver's first report), each month the receiver simply pays itself and its lawyers from the estate. The receiver then reports to the court in its next receiver's report what was paid. The court's approval of these payments (by approving the next report or otherwise) can only be reversed for an abuse of discretion.²⁴ Motions are only required if someone with standing objects to the fees.

In addition to its obvious expediency, this procedure protects confidentiality. Because there is typically no detailed bill submitted to the court, the company's competitors do not have a chance to peruse the receiver's or its counsel's bills to gather information that could help them compete with the company in receivership.

C is for Claims

Because there is no automatic stay, an order to present and file claims, complete with a

claims-bar date, is more important in equity receiverships than in a bankruptcy case, and thus should be entered promptly. Under U.S. Supreme Court precedent, a judgment obtained against a company in receivership *after* the receiver's appointment is binding on the receiver if timely filed as a claim.²⁵ This means if a suit is ongoing at the time of appointment, the receiver may have to fight that suit in a foreign jurisdiction, which is contrary to a main point of having a receivership. As part of submitting a claim to the receiver, however, the court may require parties to voluntarily dismiss pending litigation. Thus, a receiver should obtain such an order quickly, as it is an advantage to the entire estate.

This type of order does not require dismissal of the pending suit, which may be beyond the judge's authority; it simply states that if the claimant wants to participate in a distribution from the receivership estate, it must voluntarily dismiss any pending case. Unless trial is imminent, the plaintiff/potential claimant should realize that if it prosecutes the case to judgment, it will miss the bar date. In the vast majority of instances, the pending suit is dropped. In rare cases where it is not, typically the bar date is missed and the claim is disallowed. When this type of order is entered, the receiver should send it immediately to all potential claimants, especially those who already have litigation pending.

The receiver should review and make recommendations to the court on all claims. In many cases, vendor claims are not disputed. Where there are disputed issues of fact, the court should hold an evidentiary hearing. A claimant is entitled to "notice and an opportunity to be heard,"²⁶ but not the full-blown procedures of complex litigation. This is one of the advantages of receiverships—many disputes regarding the company in receivership can be resolved quickly and with less expense than in standard litigation.

In an attempt to leverage a greater payment, a claimant may try to initiate full-blown complex litigation under the Rules of Civil Procedure to establish its claim. It is well established, however, that as long as the claimant has notice and an opportunity to be heard in the receivership, which does not require an actual hearing, due

process is satisfied.²⁷ Generally, a receiver should not spend its efforts litigating with its own estate if it can be reasonably avoided.

D is for Disposition, Distribution, and Discharge

Once the assets are gathered, if there is no recapitalization, there is often a sale.²⁸ The sale can be on any terms and conditions the court sets and is only reviewable for the grossest abuse of discretion.²⁹ The sale is generally free and clear of claims, liens, and encumbrances, with claims, liens, and encumbrances attaching to the sale proceeds, but junior to administrative claims.³⁰ This can even be accomplished in the sale of real property that has a deed of trust against it, with the receivership's administrative expenses paid ahead of the mortgage.³¹

The sale process can be frustrated when buyers want warranties and representations from the receiver. Seeking such assurances is misguided because a receiver cannot warrant or represent much regarding the assets; generally, they preexisted the receiver's tenure. It is also foolish, because a warranty or representation from a receiver is useless once the assets have been distributed, even before the termination of the case. So long as it is following court orders, the receiver is not individually liable for receivership obligations.³² Instead, the receiver delivers the property along with a court order stating the property is free and clear of prior claims, liens, and encumbrances.

Once the sale is completed, the receiver distributes the assets pursuant to a formula approved by the court to whomever the court determines should receive them.³³ Usually, claims are paid pursuant to the absolute priority rule, in the following order: the receiver, its counsel, other administrative creditors, receiver's certificate holders, pre-appointment secured creditors, pre-appointment priority creditors, pre-appointment unsecured creditors, and equity holders.

The absolute priority rule is not imposed by statute, and the court can vary from it for sufficient equitable justification. For example, a claimant may have a secured claim, but if that claimant is a bad actor the court may put that claimant at the back of the line. This is

because a receivership is entirely in equity. Although equitable subordination under § 510 of the Bankruptcy Code can reach the same result, there is a difference in presumptions and burdens of proof. In a receivership, whatever the receiver proposes to the court as fair is the starting point, and an objecting creditor has the burden to overcome that presumption. In bankruptcy, the Bankruptcy Code sets the presumptive distribution and the trustee has the burden to alter that scheme.

Once the sale is complete and the approved claimants are paid, the receiver prepares a final report and is discharged. This ends the estate and the receiver has no further obligations or liabilities. Creditors not paid in full can still pursue the company for any deficiency, but generally the company has no further assets, so it is a waste of time and effort to do so.

Conclusion

Receiverships are extraordinarily powerful remedies. A receivership can immediately eliminate ineffective or bad management and put the company under the supervision of the court. The receiver can be chosen specifically for his or her knowledge of the troubled company. Although a receivership needs to be pursued with great care, the results can make the extra work worthwhile. ^{CL}



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NOTES

1. *E.g., Johnson v. El Paso Cattle Co.*, 725 P.2d 1180 (Colo.App. 1986) (appointing a receiver in equity is an inherent power of district court); *Roll v. Davis*, 85 Colo. 594 (1929) (courts have inherent power to appoint receivers to preserve property in litigation).
2. *Savageau v. J. & R. A. Savageau, Inc.*, 285 P.2d 810, 813 (Colo. 1955).
3. *Joufflas v. Wyatt*, 646 P.2d 946, 947 (Colo.App. 1982).
4. CRCP 66(a)(1). This certainly includes secured creditors and equity holders. It is more difficult for unsecured creditors to obtain a receiver; they usually must show some other extremely inequitable conduct by the defendant, such as fraud or a crime.

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5. Appointing a receiver to supervise the disputed elections of the taxi cab cooperative was the original basis of the appointment of a receiver in *In re Yellow Cab Coop. Ass'n*, City and Cty. of Denver Dist. Ct. Case No. 91 CV 2401. See generally *In re Yellow Cab Coop. Ass'n v. Mathis*, 185 B.R. 844 (Bankr.D.Colo. 1995).

6. *Melville v. Weybrew*, 103 P.2d 7 (Colo. 1940) (where court in equity had subject matter jurisdiction over matter before it, it had inherent authority to appoint receiver to displace trustees over trust).

7. *E.g.*, *Davis v. Davis*, 366 P.2d 857 (Colo. 1961). Appointing a receiver specifically during a divorce proceeding is an inherent power of the court. *E.g.*, *Grayson v. Grayson*, 352 P.2d 738, 743 (Or. 1960).

8. *Kelleam v. Maryland Cas. Co. of Baltimore, Md.*, 312 U.S. 377, 381 (1941).

9. *Nw. Mut. Life Ins. Co. v. First Interstate Bank of Denver*, 703 P.2d 1314 (Colo.App. 1985).

10. Clark, *A Treatise on the Law and Practice of Receivers* vol. 1, § 232 (3d ed. W.H. Anderson Company 1959) (plaintiff not owed any greater duties by receiver than other estate beneficiaries).

11. In *In re Marriage of Humphrey*, 2018 COA 31, the Colorado Court of Appeals held that a receiver pendente lite for a marijuana business during a divorce must have a license from the State of Colorado. This opinion appears to be the first U.S. case (state or federal) where a receiver pendente lite was required to obtain an occupational license in the underlying business. The opinion is based on Colorado's unusual marijuana statute, which requires both those who practice a trade and those in "control" of the business to be licensed. Unfortunately, *Humphrey* does not address the fundamental constitutional question of whether the legislature could set qualifications for a receiver pendente lite without violating the separation of powers doctrine. It simply cites cases stating that a court of equity is required to follow the

law and cites the statute without discussing whether it was constitutional. Moreover, the Colorado Supreme Court denied certiorari, so that fundamental question remains unanswered.

12. These are simply general observations. For example, enough collateral could be put into the res by a secured creditor that an entirely new going concern could be formed. Or a receiver over a going concern could decide liquidation is the best course of action.

13. *Zeligman v. Juergens*, 762 P.2d 783, 785 (Colo.App. 1988).

14. *McClain v. Saranac Mach. Co.*, 28 P.2d 1009 (Colo. 1934).

15. Clark, *supra* note 10 at vol. 2, § 641(j) (receiver not party to receivership action); *Medcorp, Inc. v. Pinpoint Techs, Inc.*, 2011 WL 940827 (D.Colo.) (same).

16. Though they may not want to; this is one of the many things that led to disaster in the *Yellow Cab Coop. Ass'n* receivership.

17. Clark, *supra* note 10 at vol. 1, § 87(d).

18. *Welch v. Renshaw*, 59 P. 967 (Colo.App. 1900) (conduct of a receiver when following court orders is conduct of the court itself); *Eller Indus. v. Indian Motorcycle Mfg., Inc.*, 929 F.Supp. 369 (D.Colo. 1995). See also Clark, *supra* note 10 at vol. 1, § 36 (receiver is an arm or administering hand of the court) and vol. 2, § 332 (effect of appointment of receiver is to put property in custody of court).

19. See *Atl. Trust Co. v. Chatman*, 208 U.S. 360, 372 (1908) (receiver is officer of court, and property in estate is in custodia legis); *Brunswick Corp. v. J & P Inc.*, 424 F.2d 100, 103 (10th Cir. 1970) (funds in custodia legis are the same as if actual possession is with an officer of the court).

20. *E.g.*, *Clear Creek Power & Dev. Co. v. Cutler*, 245 P. 939 (Colo. 1926).

21. *Indian Motorcycle Mfg., Inc.*, 929 F.Supp. 369.

22. *Frank v. Bonnevie*, 77 P. 363 (Colo.App. 1904).

23. *E.g.*, *Mullen v. Bromley*, 122 P. 66 (Colo.

App. 1912) (receiver's sale without proper confirmation order reversed); Clark, *supra* note 10 at vol. 1, § 517.

24. *Bemis Co. v. Fimple*, 470 P.2d 88 (Colo.App. 1970); *Welch*, 59 P. 967.

25. *Riehle v. Margolies* 279 U.S. 218 (1929).

26. *S.E.C. v. Am. Capital Invs., Inc.*, 98 F.3d 1133 (9th Cir. 1996).

27. *Id.*

28. Sometimes there is no sale and the distribution of assets is in kind. These comments apply equally to in-kind distributions.

29. *Rossi v. Colo. Pulp and Paper Co.*, 299 P. 19 (Colo. 1931); *United Sec. Co. v. Ostenberg*, 152 P. 1163 (Colo. 1915) (law allows receiver to sell property in receivership on such terms as the appointing court directs); *United States v. Branch Coal Corp.*, 390 F.2d 7, 10 (3d Cir. 1968) (court's exercise of discretion in setting terms and conditions for judicial sales will be undisturbed other than for abuse of discretion); *United States v. Stonehill*, 83 F.3d 1156, 1160 (9th Cir. 1996) (court had discretion to tailor requirements for sale to property being sold).

30. See generally Clark, *supra* note 10 at vol. 2, § 500. This has a practical effect comparable to a Bankruptcy Court sale order under 11 USC § 363.

31. *E.g.*, *Plateau Supply Co. v. Bison Meadows Corp.*, 500 P.2d 162, 165 (Colo.App. 1972) (court did not abuse its discretion in selling mortgaged property in receivership free and clear and then allocating proceeds to pay receiver ahead of secured creditor); *German Nat'l Bank v. J.D. Best & Co.*, 75 P. 398 (Colo. 1904) (no error in paying costs of receivership ahead of secured mortgage).

32. *Bayles v. Kansas Pac. Ry. Co.*, 22 P. 341 (Colo. 1889). There is an exception to this general rule for tax problems: the receiver can be individually liable for post-appointment federal taxes. 31 USC § 3713.

33. *Nw. Mut. Life Ins. Co.*, 703 P.2d 1314.



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