

RECEIVERSHIPS OVER REAL PROPERTY

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1. Introduction.

Under Arizona law, as articulating general common law equitable receivership principles,

The superior court or a judge thereof may appoint a receiver to protect and preserve property or the rights of the parties therein, even if the action includes no other claim for relief.

A.R.S. § 12-1241. See also Rule 66(c)(4), Arizona Rules of Civil Procedure.

Under A.R.S. § 33-702(B), a Receiver may be appointed if the Mortgage or Deed of Trust provides for an assignment to the mortgagee/beneficiary of the leases, rents, issues, profits or income from the property. Often this assignment is contained as well in a separate Assignment of Rents and Leases executed by the borrower.

This power is exercisable whether the assignment is effective before, upon or after default under the mortgage/deed of trust and without regard to the adequacy of the security or the solvency of the borrower, and may be exercised independent of and precede the exercise of any other right. A.R.S. §§ 33-702(B) and 33-807(C). The default can be monetary (failure to make payment under the debt obligation) or non-monetary (e.g., failure to maintain the property).

It once was held that the court lacked jurisdiction to appoint a Receiver as simply an adjunct to a non-judicial trustee's sale. First Phoenix Realty Investments v. Superior Court, 173 Ariz. 265, 841 P.2d 1390 (App. 1992). However, the relevant statutes, A.R.S. §§12-1241 and 33-807, were revised in 1993 to effectively reverse that holding, and now it is clear that a judicial action whose only claim is one for receivership is nonetheless valid.

The lender invoking the receivership authority of A.R.S. § 33-702(B) should demonstrate that it received an absolute assignment of rents and not merely an assignment as security or a pledge. The controlling determinate in whether an absolute assignment or a pledge was given is the intent of the parties. See Kinnison v. Guaranty Liquidating Corp., 18 Cal.2d 256, 115 P.2d 450 (1941). Well-drafted loan documents should cover the matter.

2. Procedures for Appointing a Receiver.

The procedure for appointing a Receiver is set forth in A.R.S. § 12-1242 and Rule 66, Arizona Rules of Civil Procedure. (The analogous Rule for federal actions is Federal Rule 66.) The initial step is the filing with the superior court of an Application for Appointment of a Receiver, either included in a verified Complaint or in a separate and independent verified Application filed in conjunction with or after the Complaint, which seeks the issuance of an Order to Show Cause. Rule 66(a), Arizona Rules of Civil Procedure. As mentioned above, the Complaint and Application does not need to be brought with any other claim for relief. A.R.S. § 12-1241. Thus, for example, a lender can initiate a non-judicial trustee's sale of the property and simultaneously and independently seek the appointment of a Receiver over the property through the Complaint and Application.

Of course if a judicial foreclosure is pursued, it is most efficient to include both the foreclosure and receivership claims in the same Complaint. While a receivership action may be brought in any county, the statutory "proper" county for the action is where the property is located. A.R.S. § 12-401(12). Unless circumstances otherwise dictate, it is best to file the action in the first instance in the "proper" county to avoid the inherent time delay in changing venue should the defendant seek to have the action transferred to the "proper" venue pursuant to A.R.S. § 12-404.

Service of the Application and the issued Order to Show Cause on the adverse party must be obtained, except only that a Receiver may be appointed without notice (i)

if "substantial cause" exists or (ii) if, after ten (10) days, the applicant shows by affidavit that direct personal service cannot be obtained. Rule 66(a). Service should, of course, be made on the defaulting borrower and owner of the property (if different), but wise practice dictates that service also be obtained or notice given to all persons with recorded or other beneficial interests in the property, particularly those with interests junior to the lien instrument upon which the Application is based. If not, persons holding other lien interests on the property may be able to intervene in the receivership action. See Rule 24, Arizona Rules of Civil Procedure.

Upon appointment, the Receiver must file with the clerk of the court a bond as set by the court "conditioned that he will faithfully discharge the duties of receiver." Rule 66(b). While it is the preferred practice to have an individual appointed as Receiver, it is not uncommon to have a business entity appointed directly as Receiver. An individual Receiver sometimes contracts with his or her own company or some other company to perform custodial, managerial or supervisory functions on the property. This procedure is unobjectionable so long as the Receiver maintains ultimate control over and responsibility for the property.

The bond amount is in the court's discretion, although it is customary with rent-producing property to request that the bond be set in an amount based on some multiple of monthly gross rents.

The Receiver cannot be a party, an officer or employee of a party, an attorney for a party, or a person interested in the legal action, provided only that, after proper notice, the court may appoint an employee or officer of a party or an interested party if the property has been abandoned or if the Receiver's duties will consist chiefly of physical preservation of the property, collection of rent, or farming of growing crops. Rule 66(b)(1), Arizona Rules of Civil Procedure. While this might allow a lender to seek the appointment of one of its own officers or employees as Receiver, prudence dictates the use of a third-party, disinterested Receiver to better insulate any of the Receiver's actions being held to be those of the lender.

3. Powers and Responsibilities in a Receivership.

The Receiver is a ministerial officer of the court, and acts subject to the court's control. See, e.g., Stowell v. Arizona Savings & Loan Association, 93 Ariz. 310, 380 P.2d 606 (1963). Thus, the exact language of the court's order appointing the Receiver is key in establishing the scope and breadth of the Receiver's powers and responsibilities.

Some general powers and responsibilities associated with a receivership under general principles and Arizona law are set forth below:

(a) Powers:

- Commence and defend legal actions relating to the property (including forcible detainer and eviction actions);
- Collect and receive rents, issue, profits and income from the property to apply to the debt and account therefore;
- Collect and pay debts and obligations relating to the property;
- Protect, maintain and preserve the property;
- Borrow money, obligating the assets or the income of the property;
- Sell the property free and clear of liens.

The major actions of a Receiver, such as borrowing money or creating liens against or selling the property, as well as significant construction and improvement of the property beyond simple maintenance, should only be pursued with express court authorization. See generally Clark On Receivers (1959).

(b) Responsibilities:

As a ministerial officer of the court, the Receiver is obligated to faithfully perform the duties set forth by the court. The lender is normally insulated from liability

arising out of the Receiver's duties and actions with respect to the property. To maintain this separateness, the lender should avoid attempting to direct the Receiver's duties and actions except through the court, and the Receiver should be encouraged to retain or consult with independent counsel from the outset, and most particularly if and when significant issues arise.

4. Receiver's Authority Following Foreclosure or Upon Bankruptcy.

(a) Following foreclosure:

Once a foreclosure of the property occurs and title is transferred to a new owner, the Receiver's functions with respect to the property theoretically end, subject to the practicalities of terminating the receivership. See Norwest Bank Arizona v. Superior Court, 192 Ariz. 240, 963 P.2d 319 (App. 1998). The Receiver is typically required to make a final accounting to the court before final termination and discharge of the receivership and exoneration of the bond. See Rule 66(c)(3), Arizona Rules of Civil Procedure.

Further, with respect to a judicial foreclosure of the property, with its attendant redemption period following the Sheriff's Sale, it is a wise practice to expressly provide in the Judgment or other order of the court that the receivership may continue through the redemption period if the mortgagee is the successful purchaser at the Sheriff's Sale. The purchaser of the property at the Sheriff's Sale is entitled to receive from the borrower or other tenant-in-possession the income from the property or value for the use of the property during the redemption period.

(b) Upon bankruptcy:

Upon the filing of a bankruptcy petition under the Bankruptcy Code which affects the property, the mandatory stay of the Bankruptcy Code enjoins further exercise of control over the property by the Receiver. 11 U.S.C. § 362(a)(3). A Receiver (or "custodian" as defined in 11 U.S.C. § 101(11)) has a mandatory duty to turn over the property and account to the bankruptcy trustee. 11 U.S.C. §§ 101(11), 542 and 543.

A lender desiring to maintain either the Receiver, or even itself as a mortgage-in-possession, in control of the property should pursue with the Bankruptcy Court the avenues allowed by § 543(d) of the Bankruptcy Code, which excuses compliance with the turnover requirement in certain circumstances in the interest of the creditors of the bankruptcy estate, such as to prevent fraud or imminent harm to the property as an asset of the estate. In such a circumstance, the Bankruptcy Court could then permit the Receiver to continue in place in order to preserve and protect the property.

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