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Use of a Limited Scope Receiver: When Does It Make Sense?

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Most attorneys who seek the appointment of a receiver know that judges are trained to believe that the appointment of a receiver is considered an extreme remedy – one only to be used when all other remedies have failed.¹ Judges typically perceive at least two significant liabilities associated with the appointment of a receiver: (a) the added cost; and (b) the potential disruption to the business. Does the recommendation to appoint a limited scope receiver (“LSR”) tend to “solve” or mitigate these and potentially other concerns? The LSR may improve the odds of defeating the “extreme remedy” roadblock while still accomplishing the plaintiff’s goals.

The LSR falls somewhere between a traditional rents and profits receiver and a full-fledged receiver. The LSR is more commonly used for an operating company or case that goes beyond the traditional rents and profits receivership. Rents and profits receiverships are generally limited to collecting rents, paying bills related to the property, ensuring no health and safety issues at the property while preserving and protecting the property until the time of foreclosure by the secured lender. The appointment of rents and profits receivers today is frequently outlined in the bank’s lending documents. The LSR is likely to be more applicable to an equity receivership that involves an operating company, taking charge of bank accounts or ensuring timely payment of a required obligation – all activities that go beyond the more standard rents and profits activity.

The following paragraphs will outline some of the conditions, benefits, limitations and types of cases or circumstances where the LSR may serve your purposes and more easily facilitate the appointment. By way of background, one of the key benefits of the appointment of a receiver is the opportunity to craft the order of appointment to fit the circumstances – tailor-made for each case. The LSR is nothing more or less than asking the court to appoint a receiver with narrowly defined duties. The words “limited scope” may help plaintiff’s counsel to sell the court on the less-disruptive nature of the appointment in addition to the benefit of the perception of reduced fees.

Following are a few hypotheticals to help understand the different uses of the LSR.

Example 1

A successful restaurant with \$5 million in annual revenues is owned 50% by a restaurateur whose personality and operating experience is important to the success of the business and 50% by a financial investor who fronted the money to establish the now successful restaurant. As with many creative types, the restaurateur is more creative than detail-oriented, and more than a little loose on financial details. The limited partner (“LP”) learns that the restaurant is behind in its payment of sales taxes and payroll taxes; these delinquencies have inflated profits and the reward formula for the operator. What to do? By definition, the LP should not be involved in the operation, and yet this investor has a keen interest in the successful financial operation of the business. The appointment of a receiver would likely be disruptive and demoralizing to the restaurateur – something that, if it happened, might not be in the best interests of the investor. The investor opts to seek the appointment of a limited scope receiver whose only task is to go to the restaurant once every two weeks to ensure that the tax payments are made timely.

The LSR takes a proactive role in resolving the dispute and helps the restaurateur buy out the financial investor with financing. From the investor’s perspective, this is a success. From the restaurateur’s perspective, he has achieved freedom from the oversight (and meddling) of the investor while hopefully learning a lesson on the importance of making timely tax payments. Success: The court was willing to make the limited scope appointment, the defendant was not overburdened with the presence of a receiver (yet the key issues that caused the default were supervised by the LSR), and the limited role kept the costs down.

Example 2

Here is another example: In a family law matter, a successful business man and respondent fails to make court-ordered spousal and child support payments in the amount of \$50,000 per month. The petitioner asks the court to appoint a LSR for the purpose of making sure the monthly support payments are made timely. Again, due to the limited nature of the request, the court grants this minimally obtrusive appointment. Somewhat predictably, the respondent thumbs his nose at the LSR – no support payment is made. The LSR returns to court with a report and petition for instruction – the options are to either (a) seize the bank accounts or (b) take operational and financial control of the flourishing business. Before the petition can be heard, the respondent considers his options and the payments are miraculously made from that point forward.

Let’s consider the family law example from the perspective of the petitioner. Setting aside the revenge motive that can be present in a family law matter, the petitioner’s perspective is likely that the respondent’s company is the goose that lays golden eggs – that are of key benefit to the petitioner – particularly when it comes time divide the assets and buy out the petitioner’s community law interests. Therefore, the LSR brings a method of enforcement without materially interfering with or denigrating the value of the business.

However, let's suppose that the respondent didn't do the noble thing and continued to refuse payment. Now a neutral officer of the court (the LSR) is seeking instruction for expanded powers of the receiver rather than the petitioner or "moving party." Under this non-payment scenario, the petitioner's counsel has effectively taken a two-step, indirect approach to taking financial and operational control of the business. Would the Court be inclined to grant the receiver's petition for instruction? The respondent's refusal to follow the court's order may provide the impetus for the court to take the more extreme and expensive measure of allowing the receiver to take full operational and financial control.

Another aspect of the above example is getting good numbers when it comes time to value the company for the purpose of division of assets. It will be harder (but not impossible) for the respondent to "cook the books" and report an artificially low profit and therefore lower the company's value if a LSR is involved. If the respondent does attempt to push through a low value and the petitioner objects, is the Court likely to expand the receiver's duties to take an independent look at the income statement/balance sheet and resulting value? The likely answer is yes.

Example 3

The half owner and operator of a company that imports and finishes doors for high-end homes decides unilaterally that his 50% owner/partner/and original investor (the one who put up the money to start the business) is no longer necessary. Over the years, the investor has received his original investment back at least two dozen times over – this investor has been well-compensated. The investor payments stop and all accounting stops – the investor is essentially locked out. The counsel for the investor moves for the appointment of a LSR for the purpose of preparing an accounting to determine the best option for resolving the dispute – a buy out or, if necessary, filing for dissolution. Under this fact pattern, would the Court be inclined to grant the ex-parte petition to appoint a LSR rather than a full-scope receiver (to take financial and operational control)? The likely answer is yes.

In life, sometimes baby steps are preferable to giant steps – more productive, less risk and a better result. Each attorney seeking the appointment of an equity receiver should weigh the merits of a limited scope receiver first in terms of circumnavigating the Court's predispositions against the appointment of a receiver and second in terms of getting a better result with less expense. There are likely some cases where this "toe in the water" approach is not preferable to the more direct full frontal attack. Hopefully this article has made an argument for at least considering the LSR option.

¹ Some loan documents call for the appointment of a receiver in the event of a default. Under these circumstances, the appointment is still considered extreme, but more likely will be granted.

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