

Commercial Financial Services Brief: Minnesota Poised to Adopt New Statutes Governing Receiverships and Assignments for the Benefit of Creditors

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On March 28, 2012, the Minnesota Legislature gave final passage to HF 382, a comprehensive revision of Minnesota statutes governing receiverships and assignments for the benefit of creditors (ABCs) in the state. Following signature by the governor (which is expected), the new statutes will take effect on August 1, 2012. Sponsored by the Minnesota State Bar Association and its Business Law and Real Property Sections, the new statutes are the product of more than two years of work by a committee of Minnesota lawyers and receivers, including Gray Plant Mooty attorneys Steve Grinnell and Phil Kunkel.

Receiverships

The use of receiverships has been growing in Minnesota and in other states. Long a mortgage lender's remedy for preserving commercial property and rents during foreclosure, receivership has grown in popularity as a potentially speedier and lower-cost alternative to bankruptcy in a variety of other situations. These include its use as a vehicle for liquidating a fraudulent enterprise and distributing proceeds to creditors, for taking control of a corporation or other business entity where the owners are deadlocked or those in control have acted fraudulently or unfairly toward other owners, and as an individual creditor's remedy to seize and prevent dissipation of assets prior to judgment or to satisfy a judgment. However, current Minnesota statutes provide little guidance to courts and practitioners regarding the substantive law and procedures to be applied. New chapter 576 of Minnesota Statutes is intended to provide clear rules and procedures governing receiverships.

New chapter 576 establishes two primary types of receiverships: (1) the limited receivership, in which the primary purpose is to preserve and protect property while some process or proceeding is pending (for example, a receivership involving a commercial building during foreclosure), and (2) the general receivership, in which all or substantially all of the property and assets of the person or entity over which the receivership is imposed are subject to the receivership, for the purpose of liquidation and distribution to creditors. The statute provides that a receivership may change from one type to the other and may be customized to use elements of each. Although the receiver's powers and duties will vary depending on the

type of receivership, the statute makes clear that the receiver is appointed by and is an officer of the court in all cases.

The new statute addresses a number of procedural issues relating to the appointment of receivers and the administration of receivership proceedings. Although a discussion of all of these procedures is beyond the scope of this alert, some are discussed below:

- *Eligibility of Receiver.* The new statute sets out the eligibility and qualifications of receivers in some detail. A receiver may be a natural person or an entity, and need not be a resident of Minnesota. The court must make written findings that the proposed receiver is qualified and independent both with respect to the parties and the underlying dispute.
- *Receiver's Bond.* Although an existing court rule requires the receiver to post a bond, this requirement is often waived under current practice. The new statute requires a bond, in an amount to be set by the court.
- *Employment and Compensation of Professionals.* The new statute requires attorneys, accountants, appraisers, and other professionals retained by the receiver to file a notice of their retention and proposed compensation with the court, but does not require court approval of the retention unless there is an objection. The receiver is authorized to pay professionals without prior court approval, but the court may require such payments to be disclosed in the receiver's reports and specify a process for parties in interest to object.
- *Notice Regarding Receivership and Motion Practice.* The statute requires the receiver in a general receivership to give notice of the receivership to all known creditors and other parties in interest. Parties in interest may submit notices of appearance and the receiver is required to maintain and periodically file a master service list of those entitled to receive notice.
- *Reports.* The statute requires the receiver to prepare and maintain appropriate business records relating to receivership property, including all receipts and disbursements, and to file with the court and serve on parties in interest such interim and final reports of the receiver's activities and administration of the receivership as the court may order.
- *Claims and Distributions.* The new statute provides that the court will establish the form of the claims process to be followed in a general receivership (and, if the court orders, in a limited receivership), including whether and where proofs of claim are to be submitted, the deadline for such submissions, and other issues. The statute also specifies procedures relating to the objection and allowance of claims, priorities, interest on unsecured claims, and procedures relating to distributions to be made by the receiver.

In addition to these and other procedural issues, new chapter 576 also addresses various substantive matters relating to the powers of receivers and the administration of receiverships. A number of these concepts have been borrowed from federal bankruptcy law. Some of these substantive provisions include:

- *Actions By or Against the Receiver.* The receiver in a general receivership may bring actions based on causes of action belonging to the "respondent"—the term used in the statute to identify the person over

whose property the receiver is appointed—and pursue claims and remedies for fraudulent transfers involving receivership property.

- *Mortgage Foreclosure Receiverships.* The new statute gives the receiver for property in foreclosure discretion to apply income from the property to pay tenant security deposits, real estate taxes, insurance, and other expenses of the property in any order the receiver determines is appropriate to preserve the property's value, rather than specifying a strict order of priority, as is the case under current law.
- *Turnover of Receivership Property.* Parties in possession or control of receivership property are required to surrender that property to the receiver upon demand unless the court orders otherwise. The receiver may also seek to compel turnover by motion in the receivership. In the absence of a bona fide dispute, the failure to surrender possession and control of receivership property to the receiver may be punishable as a contempt of court.
- *Stays.* The new statute provides for an automatic stay in all receivership proceedings of certain actions to obtain possession of receivership property, or to interfere with or exercise control over receivership property, or to create or perfect any lien against receivership property. In addition, in a general receivership, the order appointing the receiver operates as a stay of actions against the respondent or the receiver, or to enforce a senior lien in receivership property. Unless modified by the court, however, this stay expires 30 days after the date of the receiver's appointment.
- *Executory Contracts.* New chapter 576 provides that the receiver succeeds to all of the rights and duties of the respondent under any executory contract, unless the court orders otherwise. With court approval, the receiver may assign such contracts to third parties to the extent permitted by the contracts. The statute also permits the receiver to perform under the terms of executory contracts, subject to the obligation to pay for the value of goods and services received during the receivership. The receiver may also terminate an executory contract with court approval, and the statute addresses the treatment of any resulting claim for damages.
- *Sales Free and Clear of Lien.* The new statute permits the court in certain circumstances to order that a receiver's sale of property in a general receivership is free and clear of all liens, including redemption rights of the respondent. This is a significant enhancement of the receiver's powers that has the potential to facilitate and maximize value in receivership sales. The receiver must demonstrate that the amount likely to be realized by any person objecting to the receiver's sale is equal to or more than the objecting person would realize within a reasonable time absent the sale.

Assignments for the Benefit of Creditors

An ABC is a procedure in which a debtor voluntarily transfers all or substantially all of its property to a third party—the "assignee"—who is responsible for liquidating the property and distributing the proceeds to the debtor's creditors in full or partial satisfaction of their claims. Although ABCs are commonly used in other states to efficiently liquidate business assets and distribute proceeds to creditors, various limitations in Minnesota's current statute render them virtually unworkable here, and statutory ABCs are almost never used in the state.



New chapter 577 supersedes current statutes governing ABCs in Minnesota. The new statute treats ABCs under the same statutory framework that governs a general receivership under new chapter 576.

Under new chapter 577, an ABC is commenced by filing the assignment with the district court for the county in which the assignor resides or in which its principal place of business is located. The statute specifies the form of assignment and provides that the assignee must be a Minnesota resident who is otherwise eligible to be a receiver under new chapter 576. The assignee is required to give notice of the assignment to all known creditors and other parties in interest. Thereafter, the statute provides that the assignee is treated as a general receiver and all of the proceedings in the ABC are governed by new chapter 576.

Conclusion

New chapters 576 and 577 make substantial procedural and substantive changes to the laws governing receiverships and ABCs in Minnesota. Receiverships have been on the rise even before these changes, and new chapter 576 may accelerate this trend. ABCs have nowhere to go but up. Whatever the impact, however, on the number of these proceedings in the future, the rules are about to change, and creditors and potential debtors will be well-advised to become familiar with them.

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