

Caveat Receiver

Practical Tips for Appointing or Serving as a Receiver

By Michelle C. Harrell



During litigation, counsel is often faced with the selection and appointment of a receiver. The need for a receiver arises in many contexts. Partnership agreements and operating agreements often provide for a receivership upon dissolution. A party embroiled in litigation may seek the appointment of a receiver for an entity facing operational hardship or being managed by someone the party distrusts. Parties may jointly seek the appointment of a receiver to quell the tide and expense of pending litigation, resolve discovery matters, liquidate property, investigate allegations, or continue ongoing business operations. Depending on whether counsel properly considers all aspects relating to the receiver and the receivership at the outset, receivership can be a godsend or a nightmare. A person asked to serve as a receiver should consider similar issues. Whether you are counsel facing the appointment of a receiver in your case or you are asked to serve as a receiver, this article presents practice points for you to consider during the formation, continuation, and termination of the receivership.

The Right Person

Courts have broad discretion in the appointment of receivers, as set forth in MCL 600.2926:

Circuit court judges in the exercise of their equitable powers, may appoint receivers in all cases pending where appointment is allowed by law. This authority may be exercised in vacation, in chambers, and during sessions of the court. In all cases in which a receiver is appointed the court shall provide for bond and shall define the receiver's power and duties where they are not otherwise spelled out by law. Subject to limitations in the law or imposed by the court, the receiver shall be charged with all of the estate, real and personal debts of the debtor as trustee for the benefit of the debtor, creditors and others interested.

The general terms of this statute allow the appointing court substantial latitude in the selection of the receiver and the course of the receivership. Key factors relating to the receiver that the court and parties should consider include background, rate of compensation, neutrality, temperament, availability, and geographic location.

The statute does not require that a receiver have any particular credentials, and the selection of the receiver should be tailored to fit the specific purpose of the receivership. If the receivership is being formed to liquidate property, then a certified public accountant or a broker may be a wise selection. A receiver qualified to investigate the parties' allegations or the finances of an entity in receivership should have auditing or investigative expertise.

Counsel should try to locate the receiver who has the most relevant skills and expertise. Counsel must avoid falling into the trap of selecting a person to serve as the receiver largely because that person is perceived to be well-known or preferred by the court when other criteria, such as expertise, resources, availability, and temperament, are much more important to achieve a successful outcome for the receivership. A receiver whom the parties consider neutral and competent to handle the matter will likely meet less resistance by and fewer objections from the parties as the receivership continues and critical decisions are made.

Fast Facts:

Never underestimate the critical importance of a clear, complete order appointing a receiver. The order should be reviewed and updated as the litigation progresses.

A receiver should be selected on the basis of background, expertise, neutrality, availability, compensation rate, and temperament, and not because of perceived alliances or relationships.

Parties with an interest in the receivership should treat the receiver as an arm of the court and should not seek ex-parte communications with or special treatment by the receiver.

Similarly, a person asked to serve as a receiver should investigate exactly what issues are involved, including the nature of the receivership, the positions of the parties and the nature of their claims, the timing of anticipated receivership events, and the expertise that the parties or the court considers important. The prospective receiver should advise the parties, their counsel, and the court of the anticipated expenses involved and the receiver's compensation rate. Moreover, the prospective receiver should determine whether he or she can be neutral, given the identities of the parties and their counsel and the types of claims or allegations made in the case. Unpopular decisions must sometimes be made during a receivership, and the receiver may need to advise the appointing court that preferred activities or outcomes may be delayed or impossible. Although the desire to assist the parties or the court can be compelling, unforeseen difficulties in administering a receivership can destroy an existing reputation with the court or counsel. Disservice to the parties and the court can result if a prospective receiver does not candidly and honestly assess his or her background against the expertise required for a particular receivership role. It is far better to decline the appointment than to face removal.

The Receiver's Powers and Duties

Because of the broad scope of MCL 600.2926 and the myriad contexts in which a receiver can be appointed, there is very little helpful guidance in Michigan law to assist with the preparation of an order appointing a receiver. The order is the roadmap for the receivership. It officially appoints the receiver, but it also details the receiver's powers and duties and other critical receivership parameters and processes. Counsel must pay particular attention to the terms and the completeness of the order with respect to the parties, the court, and the prospective receiver, and should consider involving the prospective receiver when drafting the order. The prospective receiver may spot issues that are not apparent to counsel.

The order should *at least* detail all the following points:

- The receiver's identity.
- Any work product, reports, analyses, or decisions the receiver must prepare or render.
- The timing of any duties the receiver must perform.
- The formal standards, if any, the receiver must follow, such as Generally Accepted Accounting Principles or the Uniform Standards of Professional Appraisal Practice.
- The receiver's compensation and the process by which the receiver will request payment.
- The receiver's specific powers, such as the power to sell, assign, encumber, or liquidate any property.
- Whether the receiver is entitled to immunity and indemnity from claims by the parties or others.
- The parties' duties and obligations to the receiver, such as providing access or records.

Each order appointing a receiver should be tailored to fit the specific issues involved in the case and receivership. Some cases involve the forensic compilation and investigation of an entity's records, and the order should detail the specific process intended. Receiverships that involve the sale or liquidation of real property should set forth the process to be used, such as an open market sale, a private auction, or a public auction. If appropriate, the order should address whether an entity will be incorporated or organized to serve as a holding company for receivership property or if the receivership will hold proceeds or receipts in separate accounts set up specifically for the receivership. If a receiver might require the assistance of other professionals (such as a broker or counsel to prepare closing documents), the order should allow the receiver to locate, retain, and compensate them at a fixed rate, by a flat fee or percentage, or at a variable hourly rate.

A detailed, thorough order appointing the receiver should minimize future objections and disputes during the receivership. The order should be updated if circumstances change during the receivership or existing provisions become unworkable. Too often, the initial steps of thinking through and preparing a detailed order and the ongoing need to ensure that the order remains up to date get overlooked, and the results are delay, disputes, and disappointed expectations.

The Receiver's Role as a Neutral

The appointment of a receiver may occur following a motion by one party, by the stipulation of all parties, or through the court's exercise of its equitable powers. Regardless of how the receiver is appointed, the receiver must maintain the same position of neutrality as the court itself, because it is well established that a receiver is an arm of the appointing court.¹ A receiver is not appointed merely for the benefit of the party that applied for the appointment.² The relationship boundaries between the receiver and the parties must be maintained as the receivership progresses to avoid an appearance of bias that could cause unnecessary and unwarranted challenges to the receiver's actions and decisions. A receiver should avoid ex-parte communications unless the other parties consent. Attorneys serving as receivers have no attorney-client relationship with the party whose assets are subject to the receivership.³ A prospective receiver who is uncertain whether he or she could remain neutral because of relationships or other interests should decline to serve.

Compensation

Receivers have a right to compensation for their services and expenses.⁴ The amount of compensation is within the court's discretion.⁵ Professionals employed by a receiver are also entitled to compensation, and receivers have the right to employ legal counsel and other professionals when the need arises.⁶ For example, a receiver may charge to the receivership estate the fees for counsel retained by the receiver to respond to a party's legal maneuvering.⁷ A receiver, however, should avoid hiring others to provide services to the receiver if the receiver is considered to have the same expertise.⁸

Counsel should try to locate the receiver who has the most relevant skills and expertise.

The order appointing the receiver should detail the process by which the receiver will present claims for payment of his or her invoices and those of professionals the receiver has retained. There are a variety of methods for the proper payment of fees, ranging from automatic payment by the receiver without prior court approval or motion to no fees being paid without an evidentiary hearing if a party requests one. However, if the parties believe at the inception of the receivership that evidentiary hearings should be required, then perhaps another receiver should be selected, one in whom the parties have more trust and confidence.

When crafting an order appointing a receiver, counsel for a party sharing an interest in the receivership estate should consider that motions and requests by counsel for other parties may substantially increase the charges by the receiver. Those increased charges will, in turn, reduce the aggregate receivership estate available to the other parties. Over the course of a lengthy receivership proceeding, the excess charges can equal many thousands of dollars. Counsel should consider providing in the order that the nonprevailing party will pay the receiver's fees for any motions, while the requesting party will pay the fees related to requests for information or services from the receiver. The net result could be fewer motions filed and fewer requests made.

Closure and Wind-Up of the Receivership

Each receivership must, at some point, be closed. MCL 600.2926 allows the court to terminate the receivership and distribute the estate, if any, when it appears to be in the "best interest of the debtor, the creditors and others interested." This is vague, at best. When the receivership begins, counsel and the court should have clearly delineated the objectives of the receivership so that closure may occur once those objectives have been met. Without the benefit of a complete roadmap that provides the starting and ending points for the receivership, it is difficult for the parties and the receiver to know if they are progressing properly or have arrived at the end. Because the parties' interests and wishes may change or diverge over the course of the receivership, the order appointing the receiver, if properly prepared, can be very helpful in preventing a receivership from continuing and meandering unnecessarily.

Counsel can be guided by the parties' statements of the objectives of the receivership and, if necessary, help the receivership progress toward its objectives through motion practice. For example, if a receiver was appointed to conduct a detailed audit to ascertain the amount of partnership funds that a partner embezzled, counsel can press the receiver to proceed through the phases of the audit towards the preparation of an audit report. Provision must also be made for the transfer, storage, liquidation, auction, safekeeping, or destruction of receivership assets upon closure. These assets may include books of original entry, legal claims, or

personal or real property. If litigation is pending against the receiver, the court may consider escrowing funds from the receivership estate to reimburse the receiver for ongoing expenses and attorney fees. Any bond the receiver provided must be cancelled. Counsel should remember to obtain an order closing the receivership that discharges the receiver from any further responsibility.

The Receiver as Witness or Defendant

The appointing court must approve service of process, such as a subpoena or summons, on a receiver. Leave of the court must be obtained before bringing a lawsuit against a court-appointed receiver.⁹ For a party to sue a receiver to assert a personal claim against the receiver, the receiver must have acted with an "element of bad faith" during the receivership.¹⁰ If there has been no bad faith by the receiver, the court should deny a motion for leave to sue the receiver.¹¹ When possible, the receiver should seek court approval of actions that may be disputed or material to the receivership. An unfortunate consequence of receivership is that some parties may attempt to blame the receiver for their financial losses or failures to succeed in the litigation. Counsel should note that persons may improperly commence litigation or seek to depose a receiver without leave of the court, which will increase the cost of the receivership to all the other parties. The ongoing expenses of litigation against the receiver can be substantial, and courts may charge those fees and expenses against the receivership estate, which will, in turn, reduce the amount payable to those holding an interest in the receivership estate. This situation underscores the need to specify at the outset in the order appointing the receiver how the receiver's fees relating to motions or requests by the parties will be paid. ■



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FOOTNOTES

1. *In re Guardian Indemnity Co*, 256 Mich 671, 673-674; 240 NW 78 (1932).
2. *First Nat'l Bank v E T Barnum Wire & Iron Works*, 60 Mich 487, 499; 27 NW 657 (1886).
3. State Bar of Michigan Ethics Opinion, RI-330.
4. *Fisk v Fisk*, 333 Mich 513, 518; 53 NW2d 356 (1952).
5. *Band v Livonia Assoc*, 176 Mich App 95, 111; 439 NW2d 285 (1989).
6. *Id.* at 110.
7. *Cohen v Cohen*, 125 Mich App 206, 215; 335 NW2d 661 (1983).
8. See Am Jur 2d, Receivers, §§ 161, 294 (indicating that receivers who are attorneys themselves should not employ other counsel except in an extraordinary case, such as when unusual complications arise, to avoid the duplication of attorney fees being charged to the receivership estate).
9. *In re Motion for Leave to Sue Receiver of Venus Plaza Shopping Ctr*, 228 Mich App 357, 359; 579 NW2d 99 (1998).
10. *Id.*
11. *Id.* at 362.