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SOUTH FLORIDA LEGAL GUIDE

Receivers to the Rescue!

Court-appointed ‘guardians’ play a growing role in resolving disputes

When investors are defrauded in a Ponzi scheme, when a lender wants to salvage a real estate asset without foreclosure, or when shareholders can’t decide on a dissolution of a partnership, a receiver can come to the rescue.

Today, court-appointed receivers play a key role in untangling difficult financial situations. Unlike special masters, receivers have the power to operate a distressed business, sell all or part of a company, or determine the best way to maximize the value of a real estate asset. In cases of fraud, a receiver’s role may include finding and recovering hidden assets on behalf of investors who were victimized by a criminal.

“We enjoy wearing the good guy hat,” says Miami attorney David Levine, who has acted as receiver in several high-profile fraud cases. “It’s very satisfying to get heartwarming letters from elderly victims who didn’t think they’d ever get any of their money back.”

However, the majority of receiverships today revolve around distressed real estate assets. Unlike foreclosures and bankruptcies, which are trending downward, receiverships are on the rise. In some cases, they offer the lender more flexibility, as well as a faster settlement and lower overall cost in resolving the matter.

“Receiverships can be extremely effective in stabilizing a property, adding value and recovering money,” says Miami attorney Peter Russin, an experienced receiver.

Depending on the nature of the distressed situation, a receiver may need to engage an attorney, accountant or forensic professional to handle various aspects of the case. “It’s important to appoint a receiver with the right skill set,” says accountant Maggie Smith, CPA, who often acts as a receiver. “You want to maximize the value of the business or real estate asset without costing an arm and a leg.”

Because of the growing importance of receiverships, South Florida Legal Guide interviewed

several leading professionals on recent trends in this sector. Here are their perspectives.

Recovering Investors' Funds

David M. Levine

David M. Levine, a founding partner at Levine Kellogg Lehman Schneider + Grossman LLP (LKLSG) in Miami and co-chair of the firm's Bankruptcy and Receivership Group, knows that Florida is an attractive state for con artists. "When the stock market is not performing well or interest rates are low, many retirees are susceptible to pitches to invest their money in "can't miss" schemes at higher rates of return," he says. "South Florida also has a highly mobile population, making it easier for criminals to blend in and flash the big boats, cars and houses they get from investors' money. It doesn't attract the same attention here as it would in Iowa or Ohio."

When the U.S. Securities and Exchange Commission (SEC) or other regulatory authority uncovers a Ponzi scheme or other type of investment fraud, and shuts it down, a receiver is often appointed to try to recover the victims' funds. For instance, Levine served as the federal equity receiver in the case of Securities and Exchange Commission vs. Viatical Capital, Inc., et al., where investor claims totaled more than $50 million. To date, investors have received returns of more than 55 percent of their losses.

Even though news articles about frauds and Ponzi schemes have made many Floridians cautious, Levine says this "cottage industry" continues to flourish. "A con man's pitch could still hold some attraction for investors who have lost a chunk of their net worth," he adds.

In these types of fraud cases, a receiver often needs to hire an attorney and a forensic accountant to pursue the paper trail and recover misappropriated funds.

"The bigger cases require a large investment in time by the receiver and other professionals," Levine says. "While the money returned to victims is usually not taxable – especially when the value of the assets recovered is less than the price the bad guys paid – a good tax professional is an important part of the team."

Exploring Varied Options

Soneet Kapila, CPA, founding partner, Kapila & Co. in Fort Lauderdale, has served as both receiver and federal bankruptcy trustee in a wide range of cases. A Tampa judge recently appointed Kapila as Chapter 11 bankruptcy trustee to oversee the liquidation of Universal Health Care Group Inc., a St. Petersburg insurer, and see if any assets could be found for its creditors.

“We have some shifts in our niche practice in fiduciary work,” says Kapila. “In the past six years, there has been a reluctance on the part of some creditors, financial institutions and lenders to enter the bankruptcy arena.” He adds that most Chapter 11 bankruptcy cases are self-liquidating, making them a less-preferred option for handling an ongoing business.

Therefore, a creditor who is not comfortable with the borrower’s management may try to send the case into a state or federal court receivership, especially when the goal is to preserve the business rather than shut it down. “In many cases, receiverships provide more flexibility and allow for more creativity in finding solutions,” Kapila adds, noting that the federal bankruptcy code is highly structured. For instance, there is no legislative structure governing the rights of parties to intervene in a receivership. “So the lender does not have to deal with a creditor’s committee,” he says. “In fact, there may be a higher level of success in dealing with them on a creditor by creditor basis.”

When it comes to appointing a receiver, Kapila says it’s usually important to engage a person familiar with operating a business. “Even with a receivership involving an office building, it’s not enough to just hire a property manager,” he says. “You need to put a team together to preserve the business and manage the case. There are substantial compliance, legal and tax issues involved in most receiverships,” he says. “Looking for a short-cut or taking a band-aid approach can expose you to a substantial amount of risk.”

Finding Lower Cost Solutions

Many commercial lenders find that appointing a receiver is an effective strategy for resolving a business loan in default, according to Craig Rasile, partner at DLA Piper in Miami. “There has been a clear increase in receiverships in recent years,” he says. “Receiverships are considered a more affordable way for a lender to acquire its collateral or to put a company that owns revenue-generating assets into a proceeding where those assets can be liquidated or monetized.”

Rasile says his clients – including major banks like Bank of America and Wells Fargo, as well as private equity and hedge funds – are also concerned about the costs associated with foreclosing on a debt or forcing a company into bankruptcy. “There is a perception today that bankruptcy is more expensive,” he says. “You have to pay all administration costs in full before you can confirm a liquidation plan.”

Other types of receiverships are also on the rise, adds Rasile who has acted as a receiver in Ponzi scheme matters and other cases handled by federal regulators. But with recent federal budget cuts, there may be a slowdown of SEC-related receiverships.

Most of the securities-related receiverships involve offshore bank accounts, says Rasile. “Even though the company’s books and records are always a mess, the banks keep records of their money transfers and you trace the assets all over the world,” he adds. “We hire professionals to chase those assets and recover those assets. These types of cases can be very challenging because they involve many aspects of international law.”

With distressed commercial real estate assets, Rasile points to a potential downside in a

receivership strategy. While the receiver can sell a property free and clear of liens, claims and other legal encumbrances, title companies have been reluctant to provide an insurance policy unless the owners consented to the sale. “Since a receivership means that management has been forced out of control, this position by the title companies has impacted the transfer of real property,” Rasile says. “No one wants to buy an asset without title insurance.”

One solution would be for the state Legislature to consider a statute that allows receivers to sell assets under terms similar to the bankruptcy code. “That would make it easier to clean up some of these problems,” he says.

Serving as a ‘Guardian’

In representing secured and unsecured creditors around the country, Fort Lauderdale attorney Charles “Chuck” Tatelbaum is familiar with foreclosures, receiverships and bankruptcy matters. “We have seen a growing use of receiverships in foreclosure cases, ownership disputes, corporate dissolution disputes and partnership disputes,” he says. “Appointing a receiver is like naming a guardian for a child in a custody dispute when the parents can’t get along.”

A partner at Hinshaw & Culbertson LLP in Fort Lauderdale, and a certified specialist in business bankruptcy law, Tatelbaum represented a major motor vehicle floor plan lender in a national dealer bankruptcy case, recovering more than $150 million – payment in full of principal, interest, attorney fees and costs.

Tatelbaum says the number of receiverships, like bankruptcies, is a direct reflection of the national and regional economy. “There will always be business failures, but they increase in bad times,” he says. But unlike other business downturns, this time around U.S. interest rates were at record lows. The real problem has been liquidity, since lending restrictions are currently so tight that businesses find it difficult to borrow when their loans are called. “Receiverships are likely to continue at a similar pace, since lenders are not willing to grant loan extensions and the borrowers can’t replace their current financing with another loan,” he says.

With a practice that spans the country, Tatelbaum says there are significant differences among states in handling failures of commercial assets. “Florida is looked on as an anomaly because we have non-lender-friendly foreclosure laws,” Tatelbaum says. “Our state is seen as a haven for debtors.”

In contrast, some states like Georgia take a non-traditional approach. “You can foreclose on an asset without going to court,” he says. “If there is a default on the loan, the lender just posts a legal notice that the property is for public sale.”

Another group of states, largely in the Northeast and Midwest, uses a deed of trust rather than a mortgage to secure a loan. The owner or developer who borrows the money signs a document that conveys the property to a trustee for the benefit of the lender. If there is a default, the trustee can go to court, ratify the matter and sell the property in six weeks.

Like other professionals who handle distressed assets, Tatelbaum says its essential for a receiver

to have appropriate experience. “When the dispute involves an operating business or multitenant property, a receiver needs to have the right skills and background,” he says. “Being a great attorney or mediator doesn’t necessarily make you a great receiver.”

Instituting Checks and Balances

Maggie Smith, CPA, a principal at Glass Ratner in Miami, has served as a court appointed receiver and as a Chapter 11 bankruptcy trustee since the 1990s. “The volume of receiverships has slowed down from the craziness of 2010-11, but is still higher than a decade ago,” she says. “I’m also seeing a change in the composition of receiverships. There are more single-asset types, where the receiver operates the commercial real estate until it’s sold, foreclosed or resolved in some other way.”

Smith is also seeing an uptick in the appointments of special masters as well as receivers to handle non-real estate businesses in financial distress. For instance, Smith was named a special master to examine the internal controls and cash flow records for a rock and sand mining company that is behind on its loan. “The lender wants to know the story and why it’s not getting paid,” she says. “There is more of this kind of activity on the loans that have been in forbearance, as the banks try to understand the business model and its operations.”

In addition to appointing the right receiver for each case, Smith emphasizes the importance of crafting an appropriate receivership order. “That’s dictates what a receiver can do or not do,” she says. “Sometimes, orders can be too broad and give the receiver too much authority. That’s an important consideration since South Florida has a history of past fiduciaries who have used and abused those funds.” That’s why checks and balances, like comprehensive monthly reporting with inclusion of bank statements and source documents, is an important aspect of a receiver’s responsibilities. “Everyone needs to understand the cash receipts and what’s really in the bank,” she adds.

On the other hand, sometimes receivership orders can be too specific or too detailed, such as limiting the receiver from spending more than a certain amount, such as $2,500, without court approval. In those cases, Smith says it may be better to word the order as “no more than $2,500 without approval in writing from both parties.” That ensures that “everyone is on board with what needs to be done without having to take precious court time,” she says.

Smith says lenders and creditors should also be careful about what they ask for when seeking a receivership appointment. “The receiver is an officer of the court, and if there are life safety or building code issues in connection with a property, the receiver needs to address them,” she says. “Therefore, sometimes the lenders have to open up and put more money into a distressed situation.”

Working with Criminal Prosecutors

One of the biggest challenges facing South Florida receivers is dealing with a criminal who is adept at hiding money, according to Peter Russin, co-founder, Meland Russin & Budwick. “Receivers need to be able to track and recover those assets,” he says. “They also have to find

the intermediaries involved in those criminal actions. Pursuing the institutions that aided and abetted a fraud is a challenging type of litigation, but it is often successful."

Russin, whose firm currently represents the Trustee in the Palm Beach Finance Partners bankruptcy case which entity was a victim of the Tom Petters Ponzi scheme, says federal or state prosecutors typically have two goals: convicting the perpetrator of a fraud and helping the injured parties recover as much as possible. On the other hand, a receiver or a bankruptcy trustee doesn't have to balance those two potentially conflicting goals. "Sometimes, we need to wait until there's an indictment, but in many cases we get information that helps prosecutors achieve their goals as well."

Russin says there may be a falloff in business and investment fraud cases in the next few years. "A lot of these cases came to light during the downturn," he says. "But because of human nature, frauds will exist from now until the end of time. It's just that they are more likely to get discovered in bad times than good."

Today, much of Russin's receivership work involves commercial real estate foreclosures. "Many times a lender includes a clause specifying the right to name a receiver," he says. "That can provide a valuable option if the loan goes into default."

Russin says residential real estate developers have learned to get larger deposits from their buyers, reducing the risk of default to a lender. "Since banks are not willing to lend at a high loan to value (LTV) percentage, you have a stronger financial foundation for many projects being created," he says. "However, there is always the question of the level of market demand, which serves as a check on over-ambitious developers."

In general, Russin says South Florida lenders have learned that receiverships can be very effective in handling distressed assets. "But if you don't find a good receiver or the costs pile up compared with the property's value, you can wind up with more problems than when you started," he says. "Having a professional with the right expertise is essential. For example, it's unusual for someone to be an excellent receiver for a hotel, an apartment complex and a retail center. Finding a receiver who is a good match for the case can result in a cost-effective solution."

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