

Department of Legislative Services
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FISCAL AND POLICY NOTE
First Reader

House Bill 1180
Economic Matters

(Delegate Kramer)

Maryland Commercial Receivership Act

This bill establishes a comprehensive process for the appointment, powers, and duties of a receiver for commercial real estate and related personal property. Unless displaced by a particular provision of the bill, the principles of law and equity supplement the bill's provisions.

Fiscal Summary

State Effect: The bill's requirements can be handled with existing budgeted resources.

Local Effect: Potential minimal increase in local expenditures for circuit courts, as discussed below.

Small Business Effect: Potential meaningful, to the extent that the bill stabilizes the process for troubled small businesses that are subject to receivership.

Analysis

Bill Summary:

Scope: The bill applies to (1) a receivership for an interest in real property and any personal property that is related to or used in operating the real property; (2) a receivership in voluntary dissolution or involuntary dissolution of a corporation or similar entity, including insolvency; or (3) any other receivership in which a receiver is appointed to take possession and control of all or substantially all of a person's property with authority to liquidate the property and, in the case of a business for which the receiver is appointed, wind up its affairs.

The bill does not apply to a receivership for an interest in real property improved by one to four dwelling units unless (1) the interest is used for agricultural, commercial, industrial, or mineral extraction purposes, other than incidental uses by an owner occupying the property as a primary residence; (2) the interest secures an obligation incurred when the property was used or planned for use for agricultural, commercial, industrial, or mineral extraction purposes; (3) the owner planned or is planning to develop the property into one or more dwelling units to be sold or leased in the ordinary course of the owner's business; or (4) the owner is collecting or has the right to collect rents or other income from the property from a person other than an affiliate of the owner. The bill also does not apply to a receivership authorized by another State law in which the receiver is a governmental unit or a person acting in an official capacity on behalf of the governmental unit (designee), unless (1) the governmental unit or designee elects to have the bill's provisions apply to the receivership; (2) a court, for good cause, orders that the bill's provisions apply to the receivership; or (3) the law authorizing the receivership for the governmental unit or designee applies the bill's provisions to the receivership.

Appointment: The bill establishes standards under which a court may appoint a receiver.

Before judgment, a court may appoint a receiver to protect a party that demonstrates an apparent right to the property if the property or its revenue-producing potential (1) is being subjected to or is in danger of waste, loss, dissipation, or impairment or (2) has been or is about to be the subject of a voidable fraudulent conveyance. After judgment, a court may appoint a receiver to (1) enforce the judgment or (2) preserve nonexempt property pending appeal or when an execution has been returned unsatisfied and the owner refuses to apply the property in satisfaction of the judgment. In addition, a court may appoint a receiver in an action in which a receiver for property may be appointed on equitable grounds.

A mortgagee is entitled to appointment of a receiver in connection with or anticipation of a foreclosure or any other enforcement of a mortgage.

On request, a court must appoint a receiver for the mortgaged property if there is a default under the mortgage and (1) appointment of a receiver is necessary to protect the property from waste, loss, transfer, dissipation, or impairment; (2) the mortgagor agreed to the appointment of a receiver on default, as specified; (3) the owner agreed, after default and in a signed record, to the appointment of a receiver; (4) the property and any other collateral held by the mortgagee are not sufficient to satisfy the secured obligation; (5) the owner fails to turn over to the mortgagee proceeds or rents the mortgagee was entitled to collect; or (6) the holder of a subordinate lien obtains the appointment of a receiver for the property.

If the court appoints a receiver on an *ex parte* (without notice and without a hearing) basis, the court may require the party seeking the appointment to post security for the payment

of damages, reasonable attorney's fees, or costs incurred by any person if the court later concludes that the appointment was not justified. If the court later concludes that the appointment was justified, the court must release the security.

Ancillary Receivership: For a receiver appointed by another state, a court may appoint that person or a nominee of that person as an ancillary receiver for the purpose of obtaining possession, custody, and control of receivership property located within this State. Unless the court orders otherwise, an ancillary receiver appointed has the same rights, powers, and duties of an appointed receiver under the bill's provisions.

Identity and Independence of Receiver: Because the receiver holds receivership property for the benefit of all interested parties, the bill requires the receiver to provide a sworn statement under the penalty of perjury that the person is not disqualified. Generally, except as specified, a person is disqualified from appointment as a receiver if the person:

- is an affiliate of a party, as specified;
- has a material financial interest in the outcome of the action, other than compensation the court may allow the receiver;
- has a debtor-creditor relationship with a party;
- holds an equity interest in a party, other than a noncontrolling interest in a publicly traded company;
- is or was a director, an officer, or an employee of the owner within the two-year period immediately preceding the appointment of the receiver;
- has been convicted of a felony or any other crime involving moral turpitude or is under the supervision or employment of a person who has been likewise convicted;
- has been found liable in civil court for fraud, breach of fiduciary duty, theft, or similar misconduct or is controlled by a person who has been found liable in civil court for the same offenses; or
- otherwise has an interest materially adverse to an interest of a party or the receivership estate, or of any creditor or equity security holder, by reason of any direct or indirect relationship to, connection with, or interest in the owner.

A person seeking appointment of a receiver may nominate a person to serve as receiver; however, a court is not bound by the nomination.

The court may require a receiver to post a bond or security with the court, authorize a receiver to act without posting a bond or other security, or authorize a receiver to act before the receiver posts any bond required by the court. The court may also permit a receiver to act without posting a bond or other security.

A court that appoints a receiver under the bill's provisions has exclusive jurisdiction to direct the receiver and determine any controversy related to the receivership or receivership property wherever located within the State, including all specified controversies. The court may, on motion by a party in interest or on its own initiative, assign the receivership to a judge who is responsible for the entire case during the course of the receivership.

Rights, Powers, and Duties of a Receiver: The bill establishes the presumptive powers of a receiver as well as those powers that a receiver may only exercise with court approval. The powers and duties of a receiver may be expanded, modified, or limited by court order.

Generally, except as otherwise specified, a receiver may:

- collect, control, manage, conserve, and protect receivership property;
- operate a business constituting receivership property, including preservation, use, sale, lease, license, exchange, collection, or disposition of the property in the ordinary course of business;
- in the ordinary course of business incur unsecured debt, as specified, or pay ordinary, reasonable, and necessary expenses, as specified;
- employ and discharge agents, contractors, and employees that are necessary to manage, operate, preserve, improve, secure, and market the business or receivership property;
- assert a right, claim, cause of action, privilege, or defense of the owner that relates to the business or receivership property, provided that, in the case of a specified receivership, the claim, cause of action, privilege, or defense is not barred by the doctrine of *pari delicto* (equal fault);
- seek and obtain instruction from the court regarding managing or disposing of the business or receivership property or exercising the powers or performing the duties of the receiver;
- after being issued a subpoena, as specified, compel a person to submit to examination under oath or produce and permit inspection and copying of records or other tangible property;
- engage and pay professionals for assistance, as specified;
- apply to a court of another state for appointment as ancillary receiver with respect to receivership property located in that state;
- in a receivership in voluntary dissolution or involuntary dissolution of a corporation or similar entity, including insolvency, exercise any rights or powers provided; or
- exercise any other power conferred, as specified.

Generally, with court approval, a receiver may:

- incur debt on an unsecured or secured basis for the use or benefit of the business or receivership property, other than in the ordinary course of business;
- pay obligations incurred before the receiver's appointment;
- make improvements to receivership property;
- use or transfer receivership property, other than in the ordinary course of business;
- assume, reject, or assume and assign an executory contract of the owner;
- pay compensation to the receiver as specified or to each professional engaged by the receiver;
- recommend allowance or disallowance of a claim of a creditor;
- abandon any property that is burdensome or not of material value to the receivership; and
- make a distribution of receivership property.

A receiver must prepare and retain appropriate business records; account for the business or receivership property; file in the land records of the county in which the real property is located a copy of the order appointing the receiver, as specified; disclose to the court any fact arising during the receivership that disqualifies the receiver; and perform any duty imposed, as specified.

Claims: A receiver is required to notify creditors of the appointment of the receiver unless the court orders otherwise. A creditor is required to file a claim with the receiver in order to obtain any distribution from the receivership property.

Engagement and Compensation of Professionals: A receiver may engage and pay professionals, as specified, to assist in the administration of the receivership with court approval.

Use, Sale, Lease, License, or Other Transfer of Receivership Property Other than in Ordinary Course: With court approval, a receiver may use, sell, lease, license, exchange, or otherwise transfer receivership property other than in the ordinary course of business. Unless the agreement of sale provides otherwise, the court may order a sale to be free and clear of a lien or other interest other than liens that are senior to the lien of the person who obtained the receiver's appointment. Liens extinguished by the receiver's sale attach to proceeds with the same validity, perfection, and priority as they had with respect to the property sold. A creditor holding a valid lien on the receivership property to be transferred may purchase the receivership property and offset against the purchase price all or part of the allowed amount secured by the lien.

Executory Contracts: With court approval, generally a receiver may assume or reject an “executory” contract of the owner relating to receivership property. “Executory contract” means a contract, including a lease, under which the obligations of all parties are not fully performed and the failure of a party to complete performance of its obligations would constitute a material breach. The bill sets forth the process for adoption or rejection of executory contracts. Any obligation or liability incurred by a receiver as a result of the receiver’s assumption of an executory contract must be treated as an expense of the receivership.

Effect of Receivership: Generally, with specified exceptions, entry of the order of appointment effects a stay of an act to (1) commence or continue a judicial, administrative, or other action or proceeding; (2) collect, assess, or recover a specified claim; (3) obtain possession, exercise control over, or enforce a judgment; or (4) create, perfect, or enforce a lien or other claim. A court can order a stay of an act against or relating to an owner if the stay is necessary to protect the receivership property or business or facilitate administration of the receivership. A person whose act is stayed may apply to the court for relief from the stay for cause shown after giving notice and requesting a hearing.

The stay relating to receivership property terminates when the property is no longer receivership property or the court enters an order approving the final report or dismissing the case. The court may void an act that violates a stay. In addition, if a person willfully violates a stay, the court may award the receiver actual damages caused by the violation, including reasonable fees and costs, and sanction the violation as civil contempt. A violation for civil contempt subjects the offender to incarceration, which may continue until the court is satisfied that the violation has been rectified, or that the offender will take action to immediately rectify the violation.

Unless otherwise ordered by a court, a person that has possession, custody, or control of receivership property must turn the receivership property over to the receiver on demand of the receiver. If a creditor has possession, custody, or control of receivership property and the validity, perfection, or priority of the creditor’s lien on the receivership property depends on the creditor’s possession, custody, or control, the creditor may retain possession, custody, or control until the court enters an order providing adequate protection of the creditor’s lien.

A person that has notice of the appointment of a receiver and owes a debt that is receivership property may not satisfy the debt by payment to the owner.

In the absence of a bona fide dispute with respect to the receiver’s or the respondent’s right to possession, custody, or control of receivership property, the court may sanction as civil contempt a person’s failure to turn the property over when required.

Appointment of a receiver does not affect the validity of a pre-receivership security interest in receivership property. In addition, property acquired after appointment is subject to any pre-receivership security agreement to the same extent as if no receiver had been appointed.

Duty of Owner: The bill specifies the duties of the owner of receivership property. Generally, except as provided by court order, an owner must:

- assist and cooperate with the receiver in administering the receivership and discharging the receiver's duties;
- preserve and turn over to the receiver all receivership property in the owner's possession, custody, or control;
- identify and turn over all records and other information relating to receivership property;
- make available and turn over to the receiver the records and information in the owner's possession, custody, or control;
- after being issued a subpoena, submit to examination by the receiver that is under oath regarding the acts, conduct, property, liabilities, and financial condition of the owner or any matter relating to receivership property or the receivership;
- refrain from entering the receivership property at any time without the prior express written consent of the receiver;
- refrain from interfering with, obstructing, or preventing in any way, the receiver's actions regarding the receivership property; and
- perform any duty imposed, as specified.

If a person knowingly fails to perform a duty imposed, the court may sanction the failure as civil contempt or award the receiver actual damages, reasonable attorney's fees, and costs.

Receivership in Context of Mortgage Enforcement: A request by a mortgagee for the appointment of a receiver, the appointment of a receiver, or the application by a mortgagee of receivership property or proceeds to the secured obligation does not:

- make the mortgagee a mortgagee in possession of the real property;
- make the mortgagee an agent of the owner;
- constitute an election of remedies that precludes a later action to enforce the secured obligation;
- make the secured obligation unenforceable; or
- limit any right available to the mortgagee with respect to the secured obligation.

Authority of the Court: With specified exceptions, the court may issue an order only after notice and an opportunity for a hearing. The court may remove, replace, or discharge a receiver as specified.

Appeal: A party may file an appeal from an interlocutory order with the Court of Special Appeals from any court order in a receivership proceeding by filing an application for leave to appeal as provided in the Maryland Rules. Following receipt of a specified written certification from the court, the Court of Special Appeals must determine whether to grant or deny the application for leave to appeal.

Receiver's Reports: The receiver must file interim reports (as directed by the court) and on completion of the receiver's duties, a final report.

Immunity of Receiver: The bill extends to the receiver with immunity for acts or omissions within the scope of the receiver's appointment.

Assignment: The bill's provisions govern all proceedings following the filing of an assignment. An assignee for the benefit of creditors is treated the same as an appointed receiver and the property assigned must be treated as receivership property.

Repealed Provisions: The bill repeals existing law prohibitions on the transfer of title in insolvency.

Current Law: In the absence of comprehensive statutes governing the process, the appointment of a receiver is an equitable judicial remedy.

A receivership is a creditor remedy. In a situation where a debtor is wasting or destroying assets, a creditor may petition the circuit court for the appointment of a receiver to take control of the debtor's assets and liquidate the assets in an orderly manner for the benefit of creditors. Also, loan documents usually authorize a lender to seek appointment of a receiver if the borrower defaults in payment of the loan.

An assignment for the benefit of creditors is a debtor remedy. In a situation where a business entity needs to liquidate assets and distribute the proceeds equitably among creditors, an assignment for the benefit of creditors is an option in place of filing for bankruptcy protection. Through assignment, the business owner can select the assignee who takes control of the assets. In a bankruptcy proceeding, the trustee is selected by the court or creditors.

Generally, Maryland commercial receivership practice is governed by Title 13 of the Maryland Rules. Many issues related to commercial receivership are decided on a case-by-case basis.

Under the Maryland Rules, with specified exceptions, a person may not serve as a receiver or assignee, or other professional assisting the receiver or assignee, if the person is employed by or has a professional or formal relationship with a creditor or the debtor that is considered a conflict of interest. A receiver or assignee is required to post bond. If the receiver or assignee makes a sale before filing a bond, the sale is not valid and does not pass title to the property sold.

For assignment of benefits in insolvency, statute prohibits transfer of title to property to an assignee for the benefit of creditors until the assignee files a bond as required by the Maryland Rules. If the assignee makes a sale before filing a bond, the sale is not valid and title does not pass for the property sold. If all other legal requirements were met, a conveyance made by an assignee for the benefit of creditors when two sureties on the bond were required is valid even though a bond was given with only one surety. A sale by an assignee for the benefit of creditors is not valid unless ratified by the court.

Under the Maryland Rules, the receiver or assignee must give notice to creditors after appointment. Creditors must file verified proof of claims with the clerk of the court (within 120 days of notice). A receiver or assignee for the benefit of creditors or receiver of the assets must be vested with full title to all the property and assets subject to receivership and with full power to enforce obligations or liabilities in favor of the subject receivership.

With court approval, a receiver may employ professionals for assistance with the administration of the receivership. A receiver must file an annual report summarizing the property held and changes that occurred during the year (including collections, expenditures, and property sold). Until the final account is audited, as specified, a final distribution may not be made to creditors and the posted bond may not be returned to the receiver. A sale by a receiver or an assignee for the benefit of creditors is not valid unless ratified by the court.

The power of a court of equity to appoint a receiver is a discretionary one, and a receiver generally is not appointed without a showing of fraud, spoliation, or imminent danger of the loss of the property unless immediate possession is taken.

Background: This bill is the result of recommendations of the Maryland Commercial Law Legislative Initiative of the Maryland State Bar Association to bring statutory consistency and certainty in law relating to commercial receivership. The recommendations are derived from draft language prepared by the National Conference of Commissioners on Uniform State Laws as a template for the appointment of commercial real estate receivers, to provide consistent and predictable receivership proceedings across jurisdictions.

Local Fiscal Effect: The Judiciary advises that the bill's provisions may require additional hearings relating to receivership cases in the circuit courts. However, the actual increase in hearings can only be determined with actual experience under the bill. Since the Judiciary already handles commercial receivership cases, the Department of Legislative Services advises that any increase due to enforcement of the comprehensive set of standards proposed by the bill is likely to be minimal and can likely be handled with existing resources.

Additional Information

Prior Introductions: None.

Cross File: SB 895 (Senator Feldman) - Finance.

Information Source(s): Judiciary (Administrative Office of the Courts); Department of Housing and Community Development; Department of Labor, Licensing, and Regulation; National Conference of Commissioners on Uniform State Laws; Maryland State Bar Association; Department of Legislative Services

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