A Publication of the
California Receivers Forum

Fall 2006 • Issue 23

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RECEIVERSHIP NEWS

THE END OF THE WORLD DEPARTMENT?

IRS Says All Receivership Estates are Qualified Settlement Funds and Receivers Must File Form 120-SF Returns or Face Personal Tax Liability

BY CHARLES F. ROSEN, ESQ.*

The IRS has begun appending a proviso to proofs of claim it has filed in receivership cases stating that all receiverships have an obligation to prepare and file a Form 1120-SF "U.S. Income Tax Return for Settlement Funds" the proviso adds that failure to do so will result in personal liability.[1]

The proviso makes reference to United States v. Brown, a 2003 10th Circuit decision dealing with when a receivership estate is a "Qualified Settlement Fund" ("QSF") as defined by Treasury Regulation 1.468B-1(c).

The Brown case concerned German citizens who thought they were investing in securities but were, in fact, defrauded. A receivership was created and some of the improperly obtained funds were recovered from the perpetrators. This fund in the receiver's hands was at the center of the dispute.

The IRS maintained that this fund was a QSF that was liable for income taxes. Opponents stated that the funds should be treated as if owned by the claimants (the defrauded investors) and because the claimants were foreign citizens, the fund was not taxable under an international treaty designed to prevent double taxation. The trial court agreed with the opponents but the Tenth Circuit reversed.

Most of the court's analysis is not germane to this discussion, and the characteristics of a QSF are not easily pried out of the arcane language of the statute. But a few key provisions are enlightening.

A "designated settlement fund" under Treasury Reg. 1.468-1(d) is (generally speaking) a fund established pursuant to a court order to resolve and satisfy present and future claims against an entity arising out of personal injury, death, or property damage and which extinguishes completely the taxpayer's tort liability to such claimants. One thinks of class actions designed to win damages from major corporations, like tobacco companies, as an example.

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Publisher's Comments

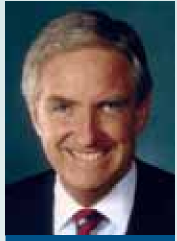
By Robert Mosier, Publisher*

Happy Holidays. This issue of Receivership News describes an IRS shot across the bow regarding the tax filing (and paying!) obligations of every receivership. Please read it carefully — our resident tax guru Chuck Rosen, Esq. (formerly of the IRS Special Procedures office in Laguna Niguel, California) says the precedent case – United States v. Brown — is important and may have a profound impact on every receiver's tax obligations in future cases.

This issue also features a useful article on selling a "mom and pop" business provided by Kevin P. Cavanaugh, a CPA, and Managing Director of the Douglas Wilson Companies' San Francisco office. Speaking of San Francisco, we are pleased to profile Kyle Everett, former President of the California Receivers Forum, as our receivership professional in this issue. Kyle hails from San Francisco where he works with Development Specialists, Inc. aka DSI, both as a receiver and as a turnaround specialist. During his tenure as president of the state organization Kyle was instrumental in bringing our organization's web site up to its new, greatly improved status. If you have not had the opportunity to visit the CRF website, please do so. We are at www.receiverships.com. Last but not least, Bryan Sampson and Seana Scholtemeyer have provided an article on the use of limited scope receivers and receiverships to accomplish specific delineated tasks.

I conducted a brief and decidedly unscientific survey of a dozen receivers around the state to those hypotheses. All but one forecast that the number of receiverships will increase in 2007 as the economy continues to slip. Most report that the level of activity today is better than a year ago, but caution that there are significantly fewer receivership appointments today than existed 5 years ago. Today, the focus seems to be on equity receiverships (rather than rents and profits receiverships), and, instead of insolvency or foreclosure, the common denominator is often a dispute among business owners or partners requiring the caretaking of a receiver. A consensus emerged from my poll that the recent changes to the Bankruptcy Code have not had a material impact on the number of receiverships being created.

Happy Holidays!



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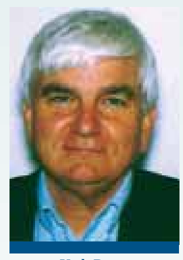
**Robert P. Mosier is a Southern California trustee and receiver and principal of Mosier & Company, Inc., a firm that has specialized in managing and turning around troubled companies for more than 25 years.*



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Receivership News

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Gross income to such a QSF is to be taxed at a rate equal to the "maximum rate in effect for such taxable year under section 1(e)," says Reg. 1.468B(b)(1).

Under ordinary circumstances the facts of the Brown case are sufficiently odd that its precedential value would be quite limited. The IRS has changed this with its new proviso. The government's strained reading of the Brown case and Code Section 468B is apparently that all receivers are required to file a Form 1120-SF, U.S. Income Tax Return for Settlement Funds, because all receivers oversee settlement funds.

When pressed informally, a government attorney indicated this would include equity receiverships and other types of receiverships for which a receiver is merely taking control and management of property until such time as the appointing court has determined who is the true owner of the property.

How can this be challenged? As mentioned, this proviso has been attached to government proofs of claim filed in receivership cases. These allege claims for uncertain amounts, but do not set forth any particular tax period or estimated amount of tax, and are likely to be interpreted as a notice or warning. A receiver might object to such an uncertain claim, but this would not resolve the issue of whether the receiver is required to file such a special tax return.

Further, 28 U.S.C. Section 2201 prohibits any court from granting declaratory relief to parties if the matter relates to a federal tax. And IRS Code Section 7421 (26 U.S.C. section 7421) – the so-called Anti-Injunction Act – prohibits any party from enjoining the I.R.S. from collecting a tax.[2]

While courts do permit a party to challenge a proof of claim filed by the IRS in a receivership, probate or bankruptcy case (thus waiving sovereign immunity), this challenge would not go to the question of whether preparation and filing of a special 1120-SF return is required.

In a receivership with which I am currently associated, one of the I.R.S. area counsel attorneys assigned to the case has agreed to accept a series of questions of utmost importance to receivers concerning the government's interpretation of Section 468B. These questions will be forwarded to Chief Counsel attorneys directly responsible for interpreting this Code section.

I hope we will receive a response that clarifies and corrects what can only be a misinterpretation of the indicated code section. A second attorney in my office has an analogous situation and will be requesting a private letter ruling from the I.R.S. on the issue.

I will keep readers of the Receivership News posted as matters progress.

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[1] The full text of the proviso is:

"In addition to the liquidated claim amount listed above [i.e. typically an amount related to pre-receivership conduct by the taxpayer], the Internal Revenue Service asserts that the receivership has an obligation to file Forms 1120-SF, U.S. Income Tax Return for Settlement Funds (Under Section 468B). See, I.R.C. Section 468B and the related Treasury Regulations and United States v. Brown, 348 F.3d 1200 (19th Cir. 2003) which treat a receivership as a settlement fund. The receiver has an obligation to report income from, among other things, the sale of receivership assets. Section 468B…imposes a tax on settlement fund taxable income at a rate equal to 35 per cent. Accordingly the Internal Revenue Service asserts a contingent and unliquidated claim for the income taxes of the receivership estate for all years in which the receivership was operated and for the years in which it continues in existence. After the receiver has filed returns for the receivership estate, the Internal Revenue Service will have those returns reviewed and/or audited and will amend this claim accordingly. The Internal Revenue Service notes that any failure by the receiver to fulfill his duties and provide for the appropriate Federal taxes can result in personal liability of the receiver for the tax obligations of the receivership pursuant to 31 U.S.C. 3713(b)."

[2] The rule is that the taxpayer must pay the tax in full, including penalties and interest, file a claim for a refund and have the claim denied, and only then may the taxpayer sue to recover the fund.

**Charles F. Rosen is an attorney with the firm Law Offices of A. Lavar Taylor and is an expert in receivership and bankruptcy tax law. Mr. Rosen served as bankruptcy advisor for the Special Procedures Branch of the Internal Revenue Service for more than twenty years.*

Charles F. Rosen

WHEN MUST A RECEIVER ORDINARILY PREPARE AND FILE TAX RETURNS?

Before this new apparent IRS mandate, whether or not receivers were obligated to prepare and file tax returns depended on the type of receivership and whether the receiver had complete control of the defendant. For example, if a receiver only had control of one income parcel of land owned by a corporation that owned many parcels (because there was a fight over ownership and/or distribution of profits from the one parcel), there was no obligation to file a tax return, but there was an obligation to report the income and expenses to the conflicted parties. The receiver must have control of all or substantially all of the property of an individual to be obligated to file a tax return for that individual. In most cases, the receiver never knows if he has all or most of the property, however.

A receiver with custody or control of substantially all of a taxpayer's assets is required to file missing returns for pre-receivership periods as well as for the term of the receivership. Form 1041 (with "dummy" form 1040's attached as schedules) is used for individuals, Form 1065 for partnerships, Form 1120 or 1120s for corporations, Form 1041 for trusts, and Form 1065 or 1120s is to be used for an LLC, depending on whether the taxpayer elected to be treated as a partnership or corporation for tax purposes.

In many instances a new tax ID number is obtained for the receivership entity. This is done where no tax ID number is known for the entity in receivership, or when assets of several entities are commingled.

Sometimes these returns are informational only for partnerships for example. LLC's that have elected to be treated as partnerships file informational returns, but LLC's that have elected corporation treatment must file a tax return. There are also certain state 'franchise' taxes that are reported on LLC returns that are to be declared on, taxed to, and paid with an LLC return, depending on circumstances.

In other cases the Receiver may be required to pay the applicable taxes owing. It is a rare case where a receiver is not obligated to file at least an informational return, and failure to do so may result in personal liability to the receiver.

—C. Rosen

ASK THE RECEIVER

By Peter A. Davidson, Esq.

*Have a receivership question you want answered? E-mail it to **pdavidson@mdfslaw.com** and your question and the answer may appear in an upcoming column.*

Peter A. Davidson

Q I have noticed language in a number of receivership orders providing that the receivership entities' officers and directors are removed and their powers are vested in the receiver and further enjoining the officers and directors from filing a bankruptcy petition on behalf of the entity placed in receivership. Are such provisions effective in preventing former management from commencing a bankruptcy for the receivership entity and, if a petition is filed, can the receiver easily have the case dismissed because the persons filing the bankruptcy petition have no authority to do so?

A Had you me asked me this question a month ago, I would have said: "of course the provisions are effective". The court, by its order, has removed the former officers and directors from their positions and vested their authority in the receiver. Therefore, only the receiver has the ability to file a voluntary bankruptcy petition on behalf of the entity placed in receivership. This view follows a long line of receivership cases that hold that when a receiver is appointed for a corporation, former management loses its power to control the corporation and run its affairs, and that power is instead vested in the receiver. First Savings & Loan Ass'n v. First Federal Savings & Loan Ass'n., 531 F. Supp. 251, 255-256 (D. Hawaii 1981) ["When a receiver is appointed for a corporation, the corporation's management loses the power to run its affairs and the receiver obtains all of the corporation's powers and assets."]; SEC v. Spence and Green, 612 F. 2d 896, 903 (5th Cir. 1980) ["as a general rule a receiver, standing in the shoes of management, holds the full right…to direct the litigation of the corporation whose care he is entrusted."]. Prairie States Petroleum Company v. Universal Oil Sales Corp., 88 Ill. App. 3d 753 (1980) ["Upon appointment of a receiver, the functions of the corporation's managers and officers are suspended and the receiver stands in their place".].

However, a very recent case from the bankruptcy court in Arizona has called this into question and, indeed, has held that such provisions are not valid and cannot prevent the removed officers and directors from commencing a voluntary bankruptcy case for the entity placed in receivership. In In re Corporate and Leisure Event Productions, Inc., ___B. R. ___, 2006 WL 2559816 (Bankr. D. Ariz. Sept. 5 2006), creditors filed various state court actions asserting they had been defrauded by 13 related corporations and sought the appointment of a receiver. The superior court in Arizona appointed a receiver for the entities and the receivership order authorized the receiver to remove any officers, directors, employees or agents of the receivership defendants from control of, management of, or participation in the affairs of the receivership defendants. The order further enjoined the former officers and directors from taking any action to interfere with the receiver's custody and management of the receivership assets and specifically enjoined them from filing "any petition on behalf of the Receivership Defendants for relief under the United States Bankruptcy Code…without prior permission of this court".
One of the former officers, in violation of the superior court's orders, filed Chapter 11 petitions for the entities and removed the receivership proceedings to the bankruptcy court. The receiver then filed a motion to dismiss, on the ground that the former officers were not authorized to file the bankruptcy petitions.

The bankruptcy court, while conceding the dispute over the authority to file a bankruptcy petition in such instance is not governed by the Bankruptcy Code and that, ordinarily, it would be governed by the law of the state of incorporation of the entity, held that because creditors had sought the appointment of the receiver federal common law applies. After going through a lengthy analysis and reviewing numerous cases, the court held that the appointment of a state court receiver with full power to act for the corporations does not affect the right of the former officers or directors to act on behalf of the corporation and file bankruptcy proceedings.

The court held that the receivership orders and injunctions preventing bankruptcy filing are unconstitutional. "[I]t is fundamental that a state court receivership proceeding may not operate to deny a corporate debtor access to the federal bankruptcy courts…a state court receivership specifically restraining the debtor corporation, its stockholders, officers, and directors from instituting federal reorganization proceedings is an unconstitutional deprivation of the right to bankruptcy relief." The court went on to say that it makes no difference whether the corporate officers and directors are actually removed by the receiver or the receivership order merely enjoins their interference or filing of a petition. "In either case, the state law withdraws their authority to file for bankruptcy relief and yet in both cases unanimous federal common law holds that they are nevertheless entitled to do so."

The court goes on to note that if the removal of corporate officers and directors by a receivership order were sufficient to prevent a bankruptcy filing "creditors who seek their state court remedies…would routinely obtain receivership orders with such boilerplate language."

The bankruptcy court's decision is disturbing on a number of grounds. First, it ignores other established federal and state law on who controls a corporation once a receiver is appointed. If former officers and directors have been removed from their positions, it seems illogical that, despite their removal and the vesting of their corporate authority in someone else, that they can still take the corporate action necessary to institute a bankruptcy proceeding. Second, despite the court's repeated statement in its decision that there is no authority holding otherwise, the court not only ignores the cases cited above, concerning who controls a corporation when a receiver is appointed, but it actually cites to a Ninth Circuit case that seems to hold just the opposite, which the court apparently relegates to dicta because the debtor in that case was ineligible to file bankruptcy anyway.

The case in point, Oil & Gas Company v. Duryee, 9 F. 3d 771 (9th Cir. 1993), though not a receivership case, has language that

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Selling the Mom and Pop Business

Cap Rates and Cash Flows — Determining the FMV of a Small Business in Receivership

By: Kevin P. Cavanaugh, CPA*

A basic question must be answered when evaluating a proposed sale of any fiduciary-controlled asset: "Does the proposed sales price equal or exceed the asset's fair market value?"

What Is Fair Market Value?

To answer this question, we must first define fair market value ("FMV"). FMV is said by economists to be the hypothetical cash equivalent consideration for which an asset will trade hands in an open and unrestricted market, where the market consists of reasonably informed, willing and able buyers and sellers who are acting at arms-length with neither buyer nor seller under any compulsion to trade.

Granted, these are utopian circumstances. In most situations there may be uneven access to information about the item being sold, some need to sell (or purchase) quickly (even at a discount or premium), and similar intervening circumstances.

It is worth noting that if a sale were to occur in these utopian circumstances, the parties more than likely would have arrived at the same notion of FMV based upon vastly different assumptions. A representative illustration of such convergent calculations is presented later in this article.

Calculating FMV

The most common method to calculate FMV is to determine the normalized economic benefit (a/k/a "normalized cash flow") and apply a risk-adjusted rate of return (capitalization rate). "Normalization" means to project cash flow in the absence of any unusual events, related-party transactions and / or any other extraordinary items that might skew the cash flow. The capitalization rate is a number which, when applied to the cash flow, yields a projected return on investment sufficiently large to entice an investor/buyer. The greater the perceived risk of any investment or purchase, the greater the cash flow from the investment or purchase must be.

In the case of a small business, the cash flow/economic benefits as stated in its financial statements are rarely useable as-is to determine the normalized economic benefit. The information in the financial statements should be adjusted to take into account real-world aspects of the proposed transaction, such as related-party transactions (bargain sales), owner compensation issues (over or under the market), nonrecurring items (one time spike in the price of the goods produced), non-operating items (condominium at a resort area) or other extraordinary items.

Once the normalized economic benefit is calculated, the receiver (or receiver's accountant) must develop a risk-adjusted rate of return. This rate is determined based on alternatives available in the marketplace. Alternatives include long-term bonds (relatively risk-free historic return 5% annually) and the stock market (somewhat riskier historic return 12% annually).

Based on the logical assumption that investing in a small company carries more risk than either investing in bonds or the stock market, professional judgment must be applied to determine the appropriate risk-adjusted rate of return commensurate with investing in a particular small business. Briefly stated, the greater the risk of achieving desired returns, the lower the fair market value should be.

Back to Our Utopian Illustration

Now it is time to return to our utopian transaction for a simple illustration of how different FMV assumptions arrive at the same FMV. Assume that the Seller has correctly calculated that his small business is generating an annual cash flow of $300,000. As the Seller/Owner, he/she has a personal bias. He/she will likely be aggressive, setting an asking price for the asset based upon a risk-adjusted rate of return of only 25%. This means, in essence, that the Seller/Owner has a higher opinion of the value of the asset than does the market. This is why homes are usually initially priced higher than their ultimate selling prices.

On the other hand, the hypothetical Buyer notes that the Seller employs his own son-in-law in the business who the Buyer believes is being paid $100,000 over market for his services. Therefore the Buyer's normalized cash flow for this small business would be $400,000 – the $300,000 annualized cash flow used by the Seller plus the additional $100,000 the son-in-law is being overpaid.

Further, our hypothetical Buyer has a more conservative view of the risks associated with this business and assigns a risk-adjusted rate of return of 33 1/3% (rather than 25%) to the normalized cash flow.

The Seller calculates FMV by dividing the annual cash flow of $300,000 by a .25 (twenty-five percent) cap rate, which yields 12,000.00 — a projected FMV value of $1,200,000. The Buyer's calculation is $400,000 divided by a 33 1/3% cap rate, which also yields 12,000.00, or a projected FMV of $1,200,000. Although the Buyer and Seller were working from different value and cap rate assumptions, they reach the same calculation of FMV. The result is that, hypothetically, the asset changes hands.

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SUMMING UP

Though our example is rather simplistic, it generally reflects the broad market for small businesses. Most small businesses sell for between three to five times cash flow, suggesting a risk-adjusted rate of return assumption of 20% (five times normalized cash flow) to 33 1/3% (three times normalized cash flow).

In the real world many different approaches may be utilized to determine the FMV of a small business. The results of these different appraisal methods are then weighted differently, based upon the appraiser's professional judgment as to which method is most appropriate given the reliability of the available information.

As can be seen, determining FMV is a complex art. But with well-substantiated reasoning for the assumptions used and an understanding of normalized cash flows and risk-adjusted rates of return, a sound calculation for a small business's FMV can be made and persuasively defended.

**KEVIN P. CAVANAUGH, CPA is the Managing Director of Douglas Wilson Companies' San Francisco office. He is a licensed real estate broker in California and Florida and is a November 2006 candidate for the American Institute of Certified Public Accountants "Accredited in Business Valuation" designation.*

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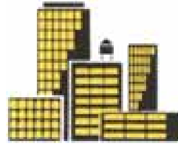

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To secure assets and implement monetary controls

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Central District

Continued from page 5.

appears to call into question the bankruptcy court's decision. Oil & Gas Company was an insurance company and the Ohio state court had appointed a rehabilitator to run it. The state court issued a temporary restraining order enjoining the company's former president from filing bankruptcy on its behalf. Undaunted, he filed a chapter 11 petition anyway. The bankruptcy court dismissed the petition because Oil and Gas Company was a domestic insurance company and, hence, was precluded from filing bankruptcy. An attorney purporting to represent the company filed an appeal to the District Court which affirmed and then the attorney appealed to the Ninth Circuit. The Ninth Circuit noted that it had "difficulty figuring out who the appellant talent is". It noted the state court's order appointing the rehabilitator specifically provided that he "shall have all the powers of the directors, officers and managers of the Defendant, whose authorities are hereby suspended". Based on that language, the Ninth Circuit held "The only person then, who could go to court on behalf of Oil & Gas was Fabe [the rehabilitator]. And he not only failed to authorize these actions; he opposed them. Therefore, when Becker-Jones purported to file the bankruptcy petition on behalf of Oil & Gas he was an imposter; his action is null and void. The same is true of whoever appealed the dismissals of that petition in the bankruptcy court and the district court. We, therefore, remand to the district court for dismissal of the petition as fraudulently filed".

Based on the Ninth Circuit's language, the bankruptcy court's relegation of this opinion as dicta seems questionable: the remand was not because the company did not qualify as a debtor, but because the persons who commenced the case had no authority to do so because their powers had been suspended by the state court's order. It seems right on point.

There are a few other lower court decisions that also conflict with the holding of the Arizona bankruptcy court, which it ignored, despite its pronouncement that there is no case law to the contrary. See, Commodity Futures Trading Commission v. FITC Inc., 52 B.R. 935 (N.D. Cal. 1985) where the district court had appointed a receiver and issued a TRO. The president then filed a chapter 11. The district court held, citing the cases at the beginning of this article, "Once a court appoints a receiver, the management loses the power to run the corporation's affairs. The receiver obtains all the corporation's power and assets. Thus it was the receiver, and only the receiver, who this court empowered with the authority to place FITC in bankruptcy". See also, U.S. v. Vanguard Inv. Co. Inc., 667 F. Supp. 257 (M.D.N.C. 1987).

Despite the Ninth Circuit's decision and the general case law regarding the affect of the appointment of a receiver on the powers of former management, it appears, at least for now, that an order appointing a receiver, removing former management, or enjoining the filing of a bankruptcy petition may not be effective in preventing a subsequent bankruptcy filing. It should be noted that much of the underlying reasoning for the Arizona bankruptcy court's decision seems to come from the fact that it was a state court order that appointed the receiver and the preemption argument that the bankruptcy laws supersede state law remedies. Had the receivership order and injunction been issued by a federal court, the bankruptcy court may not have reached the same result.

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Using Limited Receivers to Accomplish Limited Tasks

By: Bryan D. Sampson, Esq. & Seana K. Scholtemeyer, Esq.*

Editor's note: Tailoring your motion for appointment of a receiver to a particular task may limit expense, focus the receiver's attention and improve your chance of prevailing at the hearing. Bryan Sampson and Seana Scholtemeyer first discuss the basics of obtaining appointment of a receiver, then explore some of the limited purpose receiverships authorized by statute.

One of the more difficult and critical junctures in a receivership proceeding is the initial appointment of the receiver. Courts are often either unfamiliar with receiverships or are wary of issuing an order to appoint a receiver. The common perceptions associated with receiverships are the potential sizeable expense, the harm to a defendant's business and the substantial administrative requirements. In fact, it is well settled law that an equity receivership is a drastic remedy that should be used only in extreme or unusual situations. 65 Am. Jur. 2d Receivers ß8; IFS Industries, Inc. v. Stephens, 159 Cal. App. 3d 740 (1984); Hoover v. Galbraith, 7 Cal. 3d 519, 528 (1972).

When applying for appointment of a receiver, it is important to understand that a receiver is an equitable remedy authorized only by statute. Miller v. Oliver, 174 Cal. 407, 410 (1917). The appointment of a receiver rests in the sound discretion of the court. Goes v. Perry, 18 Cal. 2d 373, 381 (1941). The primary purpose of a receiver is simply to preserve property for the parties pending a judgment or disposition of the property. Kreling v. Kreling, 118 Cal. 421, 422 (1897). Furthermore, a receiver is an agent of the court, not an agent of either party. C.R.C. 1903(a); Shannon v. Superior Court, 217 Cal. App. 3d 986, 992 (1990). Therefore, a court will require a good reason to authorize the initial appointment of a receiver, especially on an ex parte basis. Turner v. Sup. Ct. (Cooke), 72 Cal. App. 3d 804, 809 (1977).

If a court is initially reluctant or unwilling to appoint a receiver, consider a lesser remedy. Ask the court to appoint a "limited purpose receiver." First Interstate Bank of Lea County v. Heritage Square, Ltd., 113 N.M. 763, 766, 833 P. 2d 240, 243 (1992); Ahart, Cal. Prac. Guide: Enforcing Judgments & Debts, ß4:855 (The Rutter Group 2006). This concept has many different names, such as a special receiver, an interim receiver, a pendente lite receiver, a temporary receiver, a limited receiver or a limited purpose receiver. 65 Am. Jur. 2d Receivers ß3. The effect of a limited receiver is to protect the rights of a party while not upsetting the entire business relationships of the other party. Gold v. Gold Realty Co., 114 Cal. App. 4 791, 802 (2004).

The key to successfully obtaining the initial receiver order is to convince the court of the need to appoint a receiver, even if the appointment is only on a limited basis. Once appointed, the court may modify the receiver's powers as appropriate. Code of Civil Procedure ß568. However, the receiver's powers are limited to those authorized in the receiver's order. Morand v. Superior Court, 38 Cal. App. 3d 347 (1974).

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• The bullet indicates those receivers who completed a comprehensive 16-hour course on receivership administration and procedures presented at Loyola Law School in April 2000.

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Drafting the order appointing a receiver is crucial to define the future course of the receivership. The language of the appointment order must specify the receiver's powers carefully and precisely. Ahart, Cal. Prac. Guide: Enforcing Judgments & Debts, ß4:900 (The Rutter Group 2006). This will minimize future disputes regarding the receiver's conduct. For a limited receiver, tailor the appointment order to fit the particular circumstances of the case. Id. Ideally, the appointment order's instructions will foresee any future problems and eliminate the need to ask the court for further instructions. Id. A self-sufficient receiver order will result in fewer charges to the parties.

From the defense perspective, if the court agrees to appoint a receiver, try to limit the receiver's duties to minimize the expense and potential harm to the defendant. Morand v. Superior Court, 38 Cal. App. 3d 347 (1974). Also, be aware that a court may sua sponte appoint a receiver for a general or for a limited purpose. Venza v. Venza, 94 Cal. App. 2d 878, 883 (1949).

Courts have authorized limited purpose receivers in a variety of cases. Some examples of cases where courts have appointed limited receiverships follow.

Audit or Discovery Issues. A court may appoint a receiver to review financial records, assets and liabilities of a company, then report the results to the court. Leone Industries v. Associated Packaging, Inc., 795 F. Supp. 117, 121-122 (U.S. Dist. N.J. 1992).

Assignment of Rents. Another type of limited receiver is an assignment-of-rents receiver. Civil Code ß2938(g); Code of Civil Procedure ß564(b)(11),(12).

Corporate Matters. A court may appoint a receiver to handle certain corporate matters if reasonable grounds exist to show that a receiver is necessary to protect the interests of the corporation and its shareholders. Code of Civil Procedure ß564(b)(5),(6); Corp. Code ßß1801(c) & 1803; Merlino v. Fresno Macaroni Mfg. Co., 64 Cal. App. 2d 462, 463 (1944). The appointment may be for a limited purpose, such as selling property of the corporation. 9 Witkin Summ. Cal. Law, Corp. ß217; Merlino v. Fresno Macaroni Mfg. Co., 64 Cal. App. 2d 462, 463 (1944).

Marital Dissolution Proceedings. A court may appoint a limited receiver in a divorce action to locate, hold or liquidate property for the benefit of a party. Cal. Family Code ß290; Rosenthal v. Rosenthal, 240 Cal. App. 2d 927, 933 (1966). Additionally, a receiver may be appointed to effect a sale of community property. Darter v. Magnussen, 172 Cal. App. 2d 714, 720 (1959).

Enforcing a Court Order. If a defendant refuses to obey a court order, such as delivering documents, a court may appoint a receiver to take the records. Aviation Supply Corporation v. R.S.B.I. Aerospace, Inc., 999 F.2d 314, 316 (8 Cir. 1993). Such an appointment may defuse 5th Amendment issues raised by a defendant. United States v. Doe, 465 U.S. 605, 611612 (1976).

Appointment in Federal Courts. A federal court has the inherent equitable power to appoint a receiver. F.R.C.P. 66; Levin v. Garfinkle, 514 F. Supp. 1160 (U.S.D.C., E.D. Pa. 1981). Notably, this power may vary from state to state under the laws of the state where the federal court resides.

Receivers and Foreign Entities. Generally, a court will not appoint a receiver for a foreign entity. Dropelman v. Illinois Sur. Co., 95 Wash. 476, 164 P. 70 (1917). However, as is the case with most rules, exceptions exist. A receiver may be appointed for a limited purpose when circumstances justify an appointment to preserve property. Citronelle-Mobile Gathering, Inc. v. Watkins, 934 F. 2d 1180 (11 Cir. 1991). The test for appointing a receiver over a foreign

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corporation is whether there is a substantial possibility of fraudulent conduct, a real danger property will be taken from the court's reach or an inadequacy of legal remedies due to the foreign entity's ability to remove assets from the court's jurisdiction. Select Creations, Inc. v. Paliafito America, Inc., 828 F. Supp. 1301 (E.D. Wis. 1992).

Enforcing a Judgment. Generally, a court may appoint a receiver to enforce a judgment. Select Creations, Inc. v. Paliafito America, Inc., 828 F. Supp. 1301 (E.D. Wis. 1992). Even a limited jurisdiction court may appoint a receiver to enforce its judgment. Cal. Code of Civil Procedure ß86(a)(8). The appointment may be for a limited purpose, such as seizing, marketing and disposing of a judgment debtor's property. Gold v. Gold Realty Co., 114 Cal. App. 4th 791 (2004). Also, a receiver appointed to enforce a judgment is not necessarily an agent of the court, but is appointed to represent the creditor. Morand v. Superior Court, 38 Cal. App. 3d 347 (1974).

In Connection With Partnership Disputes. A court may appoint a limited receiver to preserve assets in a partnership dispute. Morand v. Superior Court, 38 Cal. App. 3d 347 (1974). The partnership appointment may specify the receiver enforce a court order. Band v. Livonia Associates, 176 Mich. App. 95, 439 N.W. 2d 285 (1989). A limited receiver may be appointed to prevent dissipation of assets. Puma Enterprises Corp. v. Vitale, 566 So. 2d 1343 (Fla. Ct. App. 3d Dist. 1990). A court may appoint a special receiver to hold proceeds pending resolution of a dispute. O&G Carriers, Inc. v. Smith Energy 1986 - A Partnership, 826 S.W. 2d 703 (Tex. App. 1st Dist. 1992). A court may also appoint a receiver simply to obtain an accounting. Moran v. Park, 93 Okla. 201, 220 P. 589 (1923). A court may consider a receiver to dissolve the partnership. McKinley v. Long, 227 Ind. 639, 88 N.E. 2d 382 (1949).

To Preserve an asset. A special receiver may be appointed for control of specific property, such as one parcel of real property, as opposed to a general receiver for control over all property of a party. Cal. Code of Civil Proc. ß564(b)(4); First Interstate Bank of Lea County v. Heritage Square, Ltd., 113 N.M. 763, 766, 833 P. 2d 240, 243 (1992). However, a receivership for real property will not be ordered unless the creditor/vendor can show why recording a lis pendens alone would not protect the property. Barnes v. Morrison, 102 Cal. App. 152, 159 (1929).

To Seize and/or Sell Assets. A court may appoint a limited receiver to hold an asset pending resolution of a dispute. Cal. Code of Civil Procedure ß564(b)(1)&(9). A receiver also may be appointed to sell all or a part of an asset. Cal. Code of Civil Procedure ßß568 & 568.5; Lesser and Son v. Seymour, 35 Cal. 2d 494 (1950). The court has continuous jurisdiction to direct the receiver as to when, where and how to sell an asset. Title Ins. & Trust Co. v. California Dev. Co., 159 Cal. 484, 492 (1911).

Additional types of limited purpose receiverships may be crafted for court approval by creative parties. Possible examples include executing documents (similar to an elisor), entering into contracts, issuing receiver certificates, compromising debts, creating liens on property or filing and prosecuting a legal action. Nulaid Farmer's Ass'n v. La Torre, 252 Cal. App. 2d 788, 791-793 (1967).

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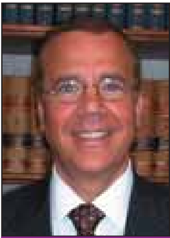
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San Francisco's Kyle Everett: A Man for All (Financial) Seasons

(Editor's note: This issue's Professional Profile is of Kyle Everett, a past president of the CRF and member of the Forum's San Francisco Chapter. Mr. Everett has had dozens of forensic accounting assignments, has acted as consultant and expert in many litigation matters, has served as trustee and been employed by trustees, and has had many receiver assignments over the years. Mr. Everett describes where his practice is now and how he got there.)

I made the move to Development Specialists, Inc. ("DSI"), a national insolvency and financial consulting firm where I currently manage the San Francisco office, in 2002. DSI has a terrific reputation and a huge depth of expertise. It's been a delight to work on larger, more complex national cases with my highly regarded, energetic colleagues located all over the country. This move has allowed my career to evolve to yet another level. My beginnings, however, were more humble.

Like many of my peers, when I started college I did not know what I wanted to do with my life. My father was a tax attorney in Los Angeles and had many well-known Hollywood clients. Others in my family were doctors or nurses. None of those professions sounded interesting to me. In my second year I began taking accounting courses. It seemed with accounting you could fit things precisely together. It was like a language with numbers. I found it an environment in which I thrived.

I worked for a small accounting firm in the San Fernando Valley during college, primarily doing bookkeeping. I learned a lot, but there was one event I recall more than any other. One day I was trying to reconcile a particularly difficult problem for one of the firm's more complex clients. When I could not figure it out, I went to discuss it with one of the partners. His only response was "there are no mysteries here." I thought to myself, "Gee, thanks, I'm working for the Zen accountant." I later thought about it some more and realized that he was right. I learned that most things can be figured out given time, persistence and some creativity.

I recall with both elation and dismay the first time I uncovered a fraudulent accounting scheme. Elation because to find fraud (many of the partners in my firm at that time had never done so) was like finding the Holy Grail. Dismay because the person who was stealing money from the client was well liked by everyone, including our firm, and was part of the client's "inner circle." It was devastating for everyone involved. The lesson for me was to keep a level of skepticism at all times. It was a good lesson for a young accountant.

As time went on I continued to do the typical accounting things, like preparing financial statements and tax returns. There were instances where fraud reared its ugly head, though. I remember many years ago I took a call from the administrator of an investment management firm that specifically traded options. They had a trader who basically could do no wrong. Every investment decision he made was right and he made an enormous amount of money for his clients. The trader was

Kyle Everett covers the financial waterfront for the San Francisco office of Development Specialists, Inc., a national insolvency/consulting firm.

approached at year end by the brokerage company where he made his trades and was shown a completely different set of statements for his accounts which would significantly alter the "marked-to-market" results for him and his clients; in his favor, of course. The brokerage company thought that it was doing a favor for a valued client.

The partner on the engagement in my firm, for whom I had and still have tremendous respect, met with the client and the brokerage house and informed them that the client would be filing their tax returns based upon the original statements. Even though it cost the client more money, the client wholeheartedly agreed and did the right thing. The obvious lessons here were that people can still do the right thing for the right reasons, and also that large companies (and the individuals who run them) can succumb to greed. I probably should not have been surprised later by the likes of Enron and others, but I confess I was.

Soon afterwards I moved from Los Angeles to San Francisco and began working for an accounting firm. Though I was hired for the accounting side of the firm's practice, it also had a large insolvency/litigation/fiduciary practice, to which I eventually gravitated. It was there that I gained my first experience in the receivership arena.

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A building in Pacific Heights was under construction and the lender had decided not to advance additional funds because they could not get any financial information from the borrower on costs expended to date and costs to complete. Further, there were potential complications with the neighbors, who objected to the project with regular complaints to City Hall and made threats of litigation to stop the project. These were scions of San Francisco society and definitely had the ability to create problems. Innumerable meetings became necessary. I had meetings with the borrower and its contractors, meetings with other contractors to obtain bids for completing the project, and meetings with the city to discuss the future of the project as planned and explore alternative uses for the property.

Ultimately the protesting neighbors got their wish, but the result was a little bit of be careful what you wish for, you may actually get it. The lender took back the property and, because of the uncertainty of the market and potential change of use, the construction did not continue. The property stayed in the same shape — partially constructed and boarded up — for over a year. It was an amazing eyesore in that expensive area of San Francisco.

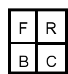
Another memorable matter was when I was appointed the receiver for what was then known as The Fashion Center in San Francisco. It was supposed to be San Francisco's answer to the California Merchandise Mart in Los Angeles. It consisted of 750,000 square feet of textile manufacturer and distributor offices on three floors, with a basement exhibition hall. Unfortunately, for a number of reasons the idea never worked up here. The structure was never more than 50% occupied and the secured lender put me in when the borrowers defaulted. The lender ultimately foreclosed on the building.

Every day of my administration was truly amazing in that many of the tenants believed that they should not have to pay rent since the building was not fully occupied for the purpose it was built for, regardless of the language of their lease agreements. I don't think in my entire career I have collectively given out as many 3-day-notices or filed as many unlawful detainers as I did in the time that I operated The Fashion Center. To borrow an expression from Edy, it really was like herding cats. Every day was another crisis. One of the more interesting aspects of the operation was that the atrium and basement were perfect for large corporate and seasonal parties. This use eventually turned out to be a fiscally larger part of operations than the rents. In addition to the many special events we rented the space for, we also held two great New Years' Eve parties there, including the Exotic Erotic Ball. No, I did not attend.

In one of my many recent engagements I was appointed receiver for CHL Mortgage Group, which proved to be a mortgage banking business in which the owner and CEO had double and triple booked loans and defrauded millions from its warehouse lenders. The day that I was appointed the FBI raided the company's offices, taking many of the records, and a warrant was issued for the CEO's arrest. It promised to be an interesting case, but just as I was looking forward to the investigation of the fraud, an involuntary bankruptcy was filed and I was out of the case. In a more recent case I was appointed Chapter 11 trustee for a debtor company in a similar situation, and our investigation into assets and real estate transactions is still ongoing.

I met my wife, Janet, some 20 years ago at an L.A. Dodgers home game against the San Diego Padres – which is the only reason she came (with a friend of mine), having grown up in San Diego. I can't recall the score – chances are my mind was occupied with more important things. Janet holds a degree in environmental design from San Diego State University and has her own architectural lighting firm. I earned my BS degree in business administration (with an option in accounting) from Cal State Northridge [now California State University Northridge – Ed.]

As many of my friends and colleagues know, my hobbies include cooking and wine collecting. I have taken many classes at the California Culinary Academy and continue to hone my skills in the kitchen. Janet and I enjoy traveling, especially when we can take our big babies Wagner and Lizzie – two Alaskan Malamutes – with us. They travel well and truly enjoy staying at fancy hotels, as long as they get to go out to eat with us and play on the beach!



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