

Examining the Uniform Commercial Real Estate Receivership Act in Shaping Arizona's Real Estate Receiverships

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Introduction: History of Real Estate Receivership Authority in Arizona

Historically, Arizona courts have granted receivers certain powers and duties related to commercial real estate and certain residential property in accordance with A.R.S. § 12-1241, [1] and A.R.S. § 12-1242. [2] For example, receivers are appointed where real property is being subjected to or is in danger of:

- waste, loss, transfer, dissipation, or impairment;
- has been or is about to be the subject of a voidable transaction; or
- the property or rights of the parties must be preserved and protected.

However, prior to the adoption of the Uniform Commercial Real Estate Receivership Act ("UCRERA"), there was no standard or uniform set of receivership rules, and courts applied widely varying standards with respect to receiverships.

This article examines the impact of UCRERA in Arizona and analyzes the important differences between UCRERA and Arizona's pre-UCRERA receivership process, as well as the potential legal issues and / or pitfalls that may arise. The insights on UCRERA provided by this article will prove helpful to lenders, lawyers, title insurance companies, receivers, secured creditors and other firms or professionals operating in the receivership space in Arizona.

In 2015, the Uniform Law Commission (ULC) finalized a model Uniform Commercial Real Estate Receivership Act with hopes that it would be adopted across the United States. UCRERA is intended to provide a standard set of rules for courts to apply in receiverships involving commercial real estate with the goal of resulting in greater predictability for litigants, lenders, and other parties doing business with a company

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subject to receivership. [3] In 2019, Arizona adopted UCRERA at A.R.S. § 33-2601 *et seq.* Since the ULC passed UCRERA (the “Act”), 12 states, including Arizona, have adopted versions of the Act. [4]

Benefits of UCRERA in Receiverships

The circumstances under which an Arizona court may appoint a receiver under UCRERA are enumerated in A.R.S. § 33-2605. These include situations such as:

- prior to judgment to protect a party that demonstrates an apparent right, title or interest in the real property that is the subject of the action,
- after judgment to carry out the effect of the judgment or to preserve real property pending appeal,
- in actions where a receiver may be appointed on equitable grounds, and
- to preserve real property sold in an execution or foreclosure sale and to secure rents to the person entitled to the rents.

Moreover, under A.R.S. § 33-2605(B.3), lenders can include language in the deed of trust or mortgage that requires the borrower to agree to the appointment of a receiver in the event of a default.

As adopted in Arizona, UCRERA creates a standardized and more efficient method for conducting receiverships. UCRERA includes many of the powers historically given to receivers by the courts in receivership orders. The Act also grants receivers additional powers and protections typically granted to bankruptcy trustees. This hybrid approach allows for many of the benefits and protections granted in bankruptcy court at a lower cost while maintaining many of the elements of a traditional receivership.

UCRERA grants greater flexibility to senior lenders who seek to appoint a receiver over their collateral. In Arizona, one of UCRERA’s most significant powers is codified in A.R.S. § 33-2613, which states that (with certain exceptions) an order appointing a receiver operates as an automatic stay against collection and lien enforcement actions against the receivership property, and the court may enjoin any act, action or proceeding against or relating to the receivership property if the injunction is necessary to protect the property or facilitate the administration of the receivership. Other significant powers vested in the receiver under UCRERA in Arizona include:

- Granting the receiver the status of a lien creditor (A.R.S. § 33-2608);
- Authority to engage professionals to assist the receiver in performing duties or exercising powers (A.R.S. § 33-2614);
- Operate a business constituting receivership property; incur unsecured debt and pay expenses incidental to the receiver’s preservation, collection, or disposition of receivership property; assert a right, claim, cause of action or defense of the owner that relates to the receivership property (A.R.S. § 33-2611);
- With court approval, incur debt for the use or benefit of the receivership property other than in the ordinary course of business and make improvements to the receivership property (A.R.S. § 33-2611);
- Use or transfer receivership property other than in the ordinary course of business

(A.R.S. § 33-2615);

- Adopt or reject executory contracts of the owner (A.R.S. § 33-2616); and
- Pay compensation to the receiver (A.R.S. § 33-2619) and professionals engaged by the receiver.

Receivers are also allowed to sell property free and clear of liens under A.R.S. § 33-2615, including liens of junior lenders and judgment creditors. In addition, the senior lender can use a receivership to strip away junior liens from the property to allow the sale of collateral to occur. Prior to the adoption of UCRERA, a free and clear sale of collateral that was subject to multiple liens was not possible without the consent of all the lienholders. Under UCRERA, a receiver can sell collateral free and clear of junior liens with court approval. Any junior liens will attach to the proceeds of the sale.

Interpreting UCRERA: Important Provisions and Pitfalls

There has been little — if any — interpretative guidance from state legislatures or courts since Arizona's Act went into effect in 2019, leaving practitioners, receivers, and other stakeholders wondering how the statute will be applied and whether pre-UCRERA receivership flexibility still exists. [5]

Courts and the ULC rely on the Bankruptcy Code for guidance in interpreting certain provisions of UCRERA given the many similarities between the two. [6] The ULC's comments on UCRERA suggest that while the Act provides more predictability to the receivership process, courts still retain discretion via their equitable powers to fashion relief. [7] According to the ULC's comments, a party requesting the appointment of receiver may seek court approval to clarify, supplement, or condition a receiver's powers under the Act through a well-crafted receivership order. [8] Accordingly, the importance of a robust receivership order to clarify any ambiguities under the Act cannot be overstated.

The ULC's comments on UCRERA shed light on how the major provisions of Arizona's UCRERA will work in practice, the risks to avoid, and why proceeding under UCRERA may be a favorable option for a lender seeking to protect its real estate collateral and maximize value.

Retention of Professionals and Compensation

Prior to UCRERA, there was no statutory scheme in Arizona regarding the hiring and / or compensation of a receiver or their professionals. Receivers routinely paid themselves and their professionals without court oversight. [9] Under Arizona's UCRERA, the court is more involved in the process of hiring and compensating the receiver and his or her professionals, providing a new level of transparency to the receivership process. [10]

A.R.S. § 33-2614(A) provides that a receiver may engage professionals only with court approval after disclosing (1) the identity and qualifications of the professional, (2) any potential conflict of interest, (3) the scope and nature of the proposed engagement, and

(4) the proposed compensation. [11]

The ULC's comments make clear that while a court has discretion to approve "de minimis conflicts of interest," a court should not approve the engagement of a professional where "serious or substantial conflicts of interest exist." [12] A.R.S. § 33-2614(B) expressly allows a receiver to serve two roles during the receivership by providing other professional services. For example, a receiver's firm may also serve as the broker of the receivership property. Allowing a receiver to serve two roles during the receivership process may allow for certain efficiencies and costs savings but raises the question of when a conflict or the appearance of a conflict rises to an inappropriate level under A.R.S. § 33-2614(A). UCRERA leaves this question up to the courts based on the particular facts of the case. However, the ULC's comments on UCRERA make clear that an "inappropriate conflict" would exist where a receiver also serves as the appraiser of receivership property. [13] A receiver should think through potential conflicts that could arise before his or her firm agrees to provide professional services outside of their role as a receiver. [14]

Moreover, the receiver and their professionals must adequately document the work they perform. [15] Under UCRERA, a receiver and his or her professionals must provide the court with an "itemized statement" documenting their time, the work performed, and the expenses incurred so that the court may assess the reasonableness of the professionals' fees. [16] The increased oversight over a receiver and their professionals' compensation, while providing greater transparency, also provides an avenue for interested parties to challenge the "reasonableness" of the professionals' fees. For example, receivers and their advisors should break up tasks, identify time spent, provide sufficiently detailed descriptions for each individual task performed and avoid "block billing" that combines several tasks into one time entry. Receivers may competitively bid out and negotiate pricing for vendors to secure appropriate pricing.

Finally, A.R.S. § 32-2619(B) provides that the person who requested the receiver's appointment or the party whose actions necessitated the receivership may be held liable for the receiver's fees and those of his or her professionals if the receivership does not produce sufficient funds. [17] Accordingly, before seeking appointment of a receiver, a lender should assess the value of the receivership property, determine the amount of all liens and encumbrances, and have a detailed conversation with the potential receiver regarding fees and costs.

Sale Free and Clear

A.R.S. § 33-2615 expressly provides that the receiver may sell receivership property "free and clear" of all liens, including "the lien of the person that obtained appointment of the receiver, any subordinate lien and any right of redemption..." [18] Any lien on the property attaches to the sale proceeds with the same validity and priority it had on the transferred assets. [19] However, a receiver may not sell property free and clear of a senior lien unless the senior lien is extinguished by the transfer. [20]

By statutorily granting courts power to approve a sale, A.R.S. § 33-2615 provides more

confidence in the receivership sale process than existed pre-UCRERA. Moreover, the sale process under UCRERA may increase buyer interest given the good faith protections provided by A.R.S. § 33-2615(E). The biggest advantage afforded lenders under A.R.S. § 33-2615 is the ability to sell and market the property via private channels, which are more orderly and often produce prices closer to market value than distressed sales.

However, a title company may be reticent to issue a title insurance policy for a property sold through a receivership due to concerns regarding the validity of the sale and the court's ability to conduct a sale free and clear of junior encumbrances. This reticence may present hurdles during the sale process. The receiver and the lender who sought the appointment of the receiver should think proactively about title issues. Additionally, the sale order issued by the court should include language that provides the title company assurances, including A.R.S. § 33-2615(E)'s good faith purchaser language and free and clear language, similar to a bankruptcy court's sale order. The receivership order itself should also clearly state that the receiver has the power to sell or convey the property. Finally, lenders should include the right to sell the property through a receivership as a post-default remedy in their loan documents.

Automatic Stay

Before UCRERA, a receiver had to seek an injunction from the receivership court to stay an action against receivership property. Under A.R.S. § 33-2613(A), any action to enforce a judgment or a lien over receivership property or obtain possession or control over receivership property is automatically stayed upon the appointment of a receiver. [21]

Additionally, under A.R.S. § 33-2613(C), any person may seek relief from the automatic stay upon showing "cause." While UCRERA leaves the definition of "cause" to judicial discretion, the ULC's comments clarify that "the right of a senior lienholder to obtain the appointment of a receiver under [the] Act or to proceed with a foreclosure after default" constitutes sufficient "cause" to lift the stay. [22] Under the Restatement (Third) of Property, a receiver appointed at the request of a junior lienholder may apply rents collected to the junior lienholder's lien until the senior lienholder takes appropriate steps to enforce its right to collect the rents. [23] Accordingly, a senior lender should move quickly to seek relief from the automatic stay where a junior lienholder requests the appointment of a receiver under UCRERA. [24]

While the automatic stay under UCRERA mirrors the automatic stay applicable in bankruptcy under 11 U.S.C. § 362, there are important differences. First, under UCRERA, the court may void an action that violates the stay or injunction. [25] Unlike the Bankruptcy Code, violations of the stay are not considered automatically void. As a result, UCRERA places the burden on the receiver to ensure that additional steps to secure the benefit of the Act's automatic stay are taken. [26]

Second, a receiver may recover actual damages, including costs and attorneys' fees, from a person that knowingly violates the stay. [27] There is no authority or legislative

guidance on what constitutes a knowing violation of the stay under UCRERA. Applying the literal definition of the word would result in a heightened mens rea compared to that of 11 U.S.C. § 362 of the Bankruptcy Code, which does not require a creditor to have actual knowledge of the automatic stay. [28] Consequently, a prudent lender seeking the appointment of a receiver should ensure that the receivership order references the automatic stay as well as provide notice of the automatic stay and the receivership order to all creditors with an interest in the receivership property. The receiver should also record the receivership order with the applicable county recorder's office so as to provide constructive notice to interested parties.

Executory Contracts

Like the Bankruptcy Code, UCRERA gives the receiver the power to “adopt” and “reject” executory contracts and unexpired leases with court approval. Currently there is no guidance on how the process for rejecting and assuming executory contracts occurs in practice under A.R.S. § 33-2616. Unlike the Bankruptcy Code, A.R.S. § 33-2616 does not provide a timeframe by which the receiver must adopt or reject an executory contract. [29] From a practical standpoint, the receiver will want to evaluate how to proceed with executory contracts and unexpired leases early to get an idea of the potential value of the property.

Furthermore, the Act does not specify the requirements for the assumption of an unexpired lease or executory contract. [30]

A court may condition a receiver's assumption of an existing contract based on the “terms appropriate under the circumstances,” including providing the counterparty adequate assurance of the receiver's ability to perform. [31]

Given the provision's similarity to 11 U.S.C. § 365(b), a court may condition the receiver's assumption of a contract in default on the purchaser curing the default and assuring future performance of the contract. [32]

The ULC's comments on other bankruptcy-like provisions of UCRERA rely on the Bankruptcy Code for interpretative guidance. [33]

The receiver should proactively discuss the terms and conditions for assumption with the counterparty and document the terms of any agreement in an order approved by the court.

Issues that May Arise in a UCRERA Environment

There is potential for situations in which UCRERA may be too rigid for a receivership. Previously, rules governing receiverships were not as well-defined, and the receiver would only act in accordance with the instructions and authorizations from the Court. The role of the receiver may vary case by case; and UCRERA receiverships may apply a cookie-cutter approach that does not fit every situation. Receivers may be appointed to serve in a limited capacity rather than to take over the operations of a company.

Additionally, junior lenders may be unaware of the provision that eliminates subordinated liens, leaving them fighting to receive proceeds from any sales or nothing. Junior lenders are left in a weakened position under UCRERA and need to be vigilant in monitoring their collateral before they are left empty-handed.

Finally, it is possible courts could narrowly interpret the real estate component of UCRERA receiverships with the idea that one must own real estate rather than be a commercial landlord.

Advantages of Applying UCRERA's Principles to Non-Real Estate Receiverships

Many of the features advantageous to receivers under UCRERA may also be beneficial to receiverships in a non-UCRERA (i.e., non-commercial real estate) setting. The ability to retain professionals, sell assets free and clear of liens, accept or reject executory contracts, and obtain an automatic stay may help receivers appointed to run a company in commercial disputes between owners. This authority may also help a receiver tasked with winding down the business. Receivers should familiarize themselves with UCRERA's provisions so they can seek to have these powers incorporated into a receivership order where appropriate.

Conclusion

UCRERA is an underutilized and powerful tool that has provided a much-needed standardized approach for receivers who are appointed in certain real estate matters. With Arizona's adoption of UCRERA in 2019, lenders, debtors, and any party with an interest in certain distressed real property in Arizona now have better expectations and a standardized framework to operate within a receivership setting. Lenders can draft security documents that allow for the application of UCRERA, and receivers can use the range of powers granted to them to operate businesses containing receivership property to preserve and maximize asset value. Alternatively, receivers can use their authority under UCRERA to transfer or dispose of receivership property outside of the ordinary course of business in a manner that maximizes value for lenders. Junior lenders and other creditors with claims on the property need to be aware of risks, including having liens eliminated by senior secured creditors, and determine the best way to protect their rights.

References

[1] A.R.S. § 12-1241 grants the superior court the power to appoint receivers to generally protect and preserve property or the rights of parties therein.

[2] A.R.S. § 12-1242 governs the application process for the appointment of a receiver.

[3] See National Conference of Commissioners on Uniform State Laws, Uniform

Commercial Real Estate Receivership Act (Jul. 29, 2016).

[4] See National Conference of Commissioners on Uniform State Laws, Uniform Commercial Real Estate Receivership Act (Oct. 17, 2023).

[5] Before UCRERA, Arizona courts relied on their equitable powers when making decisions regarding the extent of a receiver's powers. A receiver unsure of his or her power to take a certain action would simply seek court approval. As long as the receiver acted within the scope of the receivership order, the receiver enjoyed quasi-judicial immunity.

[6] See National Conference of Commissioners on Uniform State Laws, Uniform Commercial Real Estate Receivership Act, (July 29, 2016) (comparing adequate protection under UCRERA to 11 U.S.C. § 361, and comparing a receiver's turnover powers to a trustee or debtor-in-possession under 11 U.S.C. § 541(b); see also Nerko, L.L.C., v. Blue Bridge Benefits LLC, 2022 LEXIS 141 (N.C. Sup. Ct. Nov. 28, 2022) (finding the Bankruptcy Code's framework is instructive when interpreting UCRERA).

[7] See A.R.S. § 33-2603 and Section 4 of UCRERA stating "[u]nless displaced by a particular provision of this chapter, the principles of law and equity supplement this chapter"; see also Bero v. Name Intelligence, Inc., 195 Wash. App. 170, 178 (Wash. Ct. App. 2016) (finding that the court retains broad discretion and provides a general receiver with broad authority to manage receivership property under Washington's receivership statute).

[8] See National Conference of Commissioners on Uniform State Laws, *supra* note 3, at sec. 16, cmt. 3 (stating a senior lender can ask the court to condition the receiver's power under the Act in the receivership order to prevent the receiver from selling the property at a price that does not satisfy the senior debt); see also National Conference of Commissioners on Uniform State Laws, *supra* note 3, sec. 14(a) (noting the default rule unless otherwise "ordered by the court").

[9] Christopher Kaup, Arizona's New Receivership Statute: Reviewed, Interpreted and Applied, (2020).

[10] *Id.*

[11] A.R.S. § 33-2614(A).

[12] National Conference of Commissioners on Uniform State Laws, *supra* note 3, at sec. 15, cmt. 2.

[13] *Id.*

[14] While the authors were unable to find any court opinions discussing professional conflicts under UCRERA's new statutory scheme, the ULC's comments make clear that it would not be appropriate for a receiver to also serve as an "appraiser" where the receiver seeks to sell commercial real estate property through the receivership.

[15] See *Mony Life Ins. Co. v. Cissne Family L.L.C.*, 135 Wash. App. 948 (Ct. App. Wash. 2006) (challenging the receiver's compensation under RCW 7.60.180(4) because the receiver did not provide adequate documentation).

[16] A.R.S. § 33-2614(C).

[17] A.R.S. § 32-2619 (B).

[18] A.R.S. § 33-2615(B).

[19] A.R.S. § 33-2615(C).

[20] A.R.S. § 33-2615(B).

[21] A.R.S. § 33-2613(A).

[22] National Conference of Commissioners on Uniform State Laws, *supra* note 3, at sec. 14, cmt. 3.

[23] Restatement (Third) of Property: Mortgages § 4.5(b).

[24] Kaup, *supra* note 7, at 19.

[25] A.R.S. § 33-2613(F).

[26] See *In re Schwartz*, 954 F.2d 569 (9th Cir. 1992) ("[T]he Bankruptcy Code does not burden the debtor with a duty to take additional steps to secure the benefit of the automatic stay").

[27] A.R.S. § 33-2613(E).

[28] Under 11 U.S.C. § 362, a creditor does not have to intend to violate the automatic stay or have knowledge he is violating the stay so long as he intended the action that violated the stay. See *In re Schwartz*, 954 F.2d 569 (9th Cir. 1992); see also *City of Chicago v. Fulton*, 141 S. Ct. 585 (2021); *Taggart v. Lorenzen*, 139 S. Ct. 1795 (2019).

[29] The Bankruptcy Code sets forth special rules regarding the timing by which the trustee must act and the effect of not acting. For example, leases of nonresidential real property must be assumed or rejected within 120 days of the filing of the bankruptcy petition. Compare A.R.S. § 33-2616, with 11 U.S.C. § 365.

[30] Compare A.R.S. § 33-2616, with 11 U.S.C. § 365(b)(1).

[31] A.R.S. § 33-2616(A); *see also* National Conference of Commissioners on Uniform State Laws, *supra* note 3.

[32] *See* 11 U.S.C. § 365(b)(1).

[33] *See* National Conference of Commissioners on Uniform State Laws, *supra* note 3, at sec. 11, cmt. 3.