How to force the sale of assets owned by not-for-profit companies

BY JOHN C. TISHLER

The United States Bankruptcy Code has blocked creditors from forcing companies operating as not-for-profit entities into bankruptcy proceedings. What does a secured creditor do when it needs to force the sale or some other transaction of a not-for-profit? The little-used remedy of a receivership works just fine.

Many hospitals and long-term care companies in the US are organised as not-for-profit entities. US law prohibits creditors from forcing not-for-profits into involuntary bankruptcy proceedings or from converting a Chapter 11 case into a Chapter 7. Individual state laws, however, typically have no such restrictions. Thus, when creditors need relief so that they may realise upon their collateral, a state or federal-court receivership action is the way to go.

It is not unusual for not-for-profit organisations, typically organised by communities or religious groups, to not be especially well-managed. The boards of such organisations are usually volunteers and are not necessarily familiar with the delivery of care or the operation of complex institutions such as hospitals or long-term care facilities. Because governance can be weak, these institutions often default on their obligations to creditors.

A receivership allows a creditor to have a Court appointed neutral third-party to operate the business and, typically at the receiver’s discretion, liquidate the business or its assets for the benefit of the creditors. The secured creditor starts the process by filing a lawsuit against its obligor, and asks the Court, typically early in the process, to have a receiver appointed to operate the facilities. Once the receiver has had a chance to investigate the situation, it is not unusual for the receiver to recommend a sale. The sale can be of the assets through liquidation, or a sale of the facilities as a going concern.

Sales can be accomplished in a manner similar to a bankruptcy sale. The facilities can be auctioned to the highest and best bidder and approved by the Court. Once a sale occurs, the receiver distributes the cash generated from the sale (less any fees and commissions owed to the receiver) to the party or parties entitled to such distribution (typically, secured creditors whose collateral is liquidated, get paid first). After all operations are wound down and sold, the receiver is dismissed and the case is generally at an end.

While not ideal for every situation, receiverships are especially effective for creditors dealing with a distressed not-for-profit organisation.

John C. Tishler is a partner at Waller Lansden Dortch & Davis, LLP. He can be contacted on +1 (415) 244 6380 or email john.tishler@wallerlaw.com