

YALE LAW JOURNAL

Vol. XXXI

MAY, 1922

No. 7

THE GENERAL ADMINISTRATION OF EQUITY RECEIVERSHIPS OF CORPORATIONS

CHARLES THOMAS PAYNE

New York and Connecticut Bars

Within the compass of a single paper it is possible to discuss only a few of the many mooted points in the decisions of courts on the general administration of receiverships. One can do little more than outline in a broad way such methods and principles of administration as have been widely adopted, and to point out important phases of development which are even now taking place. For the administration of equity receiverships of corporations is a field in which the functions of the courts are still in a state of active growth and extension. Nor can it be the purpose of this article to discuss the extent to which a court's administration of corporate property may properly go in the several sorts of limited receiverships, such as those secured under foreclosure of corporate mortgages, or a stockholder's bill.

It is apparently true that the class of receivership where the court has the most nearly complete scope of administration is that obtained under the familiar creditor's bill, and in that case it is only the court of domiciliary appointment which has untrammelled power.

Decade by decade the courts have made less rigorous the terms under which equity will undertake the administration of the assets of a corporation in financial difficulties. Now the corporations need not be solely of the class which cannot be administered in bankruptcy. Now the creditor need have no judgment; though the debt to him must be acknowledged by the answer of the corporation¹; nor is it even necessary that the corporation be declared insolvent in the bill.² It is sufficient that it be unable at the date when the bill is filed to meet its obligations with a money-payment.

¹ *In re Metropolitan Ry. Receivership* (1908) 208 U. S. 90, 28 Sup. Ct. 219; *Horn v. Pere Marquette Ry.* (1907, C. C. E. D. Mich.) 151 Fed. 626.

² *Cincinnati Equipment Co. v. Degnan* (1910, C. C. A. 6th) 184 Fed. 834.

THE APPOINTMENT OF THE RECEIVER

The purpose of the filing of a creditor's bill is to obtain the exclusive administration of the assets of a corporation by a court of equity. An essential feature of the relief there sought is necessarily freedom from attachment, execution and other process against the assets instituted by individual creditors, which would shortly dismember the property and lessen or extinguish its value as a whole. This protection can only be obtained by a receivership. It is therefore probably universal, that, upon the filing of a creditor's bill and the usual answer of the corporation admitting the facts alleged in the bill, an *ex parte* application is instantly made to a judge of the court, for the temporary appointment of a receiver.³ It is obvious that any delay would precipitate a "race of diligence" among the creditors.

By the appointment of the receiver the court takes into possession all the assets of the corporation within its jurisdiction. Its possession is exclusive, and all rights to possession or sequestration of any asset so taken must be in the end adjusted by the court which has then taken possession, provided, of course, its jurisdiction is complete, and the assets, or any of them, have not previously been taken into possession by some other court with adequate jurisdiction.

Administration of corporate assets by a court of equity almost invariably means continued operation of the business of the corporation, for a period of time. Otherwise a corporate asset of potentially great value, that is, the "going concern" value, would be dissipated and lost. In fact it is continuance of operation under full protection from attacks of individual creditors, which induces both owners and large creditors to submit the property of any foundering corporation to administration by a court of equity. It is this element which accounts for the amazing growth of this branch of equity jurisdiction within the last fifty years.

Numerous cases arise in which certain of the assets of the distressed corporation lie outside the jurisdiction of any single court. Were it not possible to extend the protecting arm of receivership beyond the boundaries of a single jurisdiction, great hardship would result in many instances; for example, in the case of a railroad passing through several states, or in the case of a manufacturing concern having factories and service stations scattered throughout the land. Here a procedure is successfully applied which has been apparently borrowed from the administration of decedents' estates—the procedure of ancillary receiverships. So soon as the original creditor's bill and the answer of the corporation thereto have been filed and a temporary receiver appointed in the domiciliary jurisdiction, ancillary bills are speedily filed in the proper court in every other jurisdiction where property of the corporation exists, the answer of the corporation is also filed, and application

³ *Horn v. Pere Marquette Ry.*, *supra* note 1, at p. 635.

instantly made *ex parte* to a judge for the appointment of an ancillary receiver.⁴ Thus within a few days a widely scattered and valuable property may be brought fully under the protection of the courts. In the United States courts, where this procedure is common, it is customary for the judges of the ancillary jurisdictions to appoint the domiciliary receiver, though in some cases a local receiver is added.

The order appointing the receiver is the charter of the receiver's power, duties, and protection.⁵ Without authority for action or without injunction against interference definitely stated or clearly implied therein, the receiver is helpless. In the early days of the modern development of receiverships it was usual, though perhaps not universal, to impose conditions upon the appointment of the receiver in the order of the appointment, conditions which had to be carried out in course of administration, many of which, it would now seem, were actually infringements upon the rights of whole classes of interested parties. The right of the court to impose conditions is now rarely evoked.

Upon his temporary appointment the receiver files his bond, secures its approval, and goes into possession of the property. Inasmuch as the temporary appointment of a receiver partakes of the character of a temporary injunction, it would follow that the sole immediate duty of the temporary receiver should be to conserve the property placed in his hands in accordance with the directions of the order of appointment, and to familiarize himself with the nature and condition of the assets and the business which is being carried on. Such conservation almost invariably includes normal operation.

It is good practice to have the order appointing the temporary receiver contain a direction to the parties to show cause before the court on a day named why the receivership should not be continued during the pendency of the suit. The direction should also permit any creditor of the defendant and any other person having an interest to be heard. Upon the return day, the court will hear all interested parties who may appear, and in the usual course of events sign an order continuing the receivership during the pendency of the action unless good reasons develop upon the hearing why it should not do so. The court will assume that the facts alleged in the pleadings, which must show grounds for the appointment of a receiver, are true, unless they are attacked at the hearing. All parties and interested persons may also be heard at this hearing upon the provisions of the order to be signed. The court will usually entertain all proper suggestions upon the form of the order and in respect to the directions it should contain.

⁴*Williams v. Hintermeister* (1886, C. C. W. D. Pa.) 26 Fed. 889; *Platt v. Philadelphia & Ry.* (1893, C. C. D. Mass.) 54 Fed. 569.

⁵*Hooper v. Winston* (1860) 24 Ill. 353; *Receiver of State Bank v. First Nat. Bank* (1881) 34 N. J. Eq. 450.

A receivership *pendente lite* created by appointment under a creditor's bill appears to be the least limited form of receivership known to equity. It should not be confused with a "permanent" receivership—a statutory form known to some jurisdictions.⁶ The receiver *pendente lite* takes no title to the property placed in his hands.⁷ But his only is the right of possession in that property, until the court shall by its decree otherwise direct. A "permanent" receiver is usually one appointed upon the dissolution of a corporation under the provisions of a state law. He has title to the property in the place and stead of the dissolved corporation.

The right of the receiver to possession is construed in generous terms. For example, a receiver of a railroad was appointed under a creditor's bill. Funds in the hands of agents of the railroad were sent by them the day after the appointment to the bank where they were accustomed to make deposits. The bank knew of the receivership but was not a party. It was not allowed to set off against these deposits then made a claim it had against the railroad. Judge Lurton in deciding the case said:⁸

"If the funds in question did not come into the actual possession of the bank prior to the appointment of the receiver, the conduct of the bank in preventing the receiver from obtaining the possession of that which he was appointed to receive is a defiance of the court's order."

FILING AND PROOF OF CLAIMS

One of the first among the duties of the receiver is to see to it that an order is entered requiring the prompt filing of claims of creditors. The order must provide that unless claims are filed before a date named, they cannot be proved against the estate of the corporation which is being administered by the Court.⁹ This provision is a necessary one. At first blush it seems a short statute of limitations imposed by the court. A second thought will show it to be essential to prompt administration. It nowise affects the right of any creditor against the corporation, but only against the assets which the court has undertaken to administer. The date set is usually several months after the date of the order, and publication of the provisions of the order is always directed to be made in the newspapers. In practice the court will allow a claim to be filed late, *nunc pro tunc*, as of the date named in the order, on any reasonable excuse for the delay. This, however, will usually be done only in the early stages of the receivership.

⁶ *Decker v. Gardner* (1891) 124 N. Y. 334, 26 N. E. 814; *McNabb v. Porter Air-Lighter Co.* (1899) 44 App. Div. 102, 60 N. Y. Supp. 694.

⁷ *Quincy, etc. Ry. v. Humphreys* (1892) 145 U. S. 82, 12 Sup. Ct. 787.

⁸ *Horn v. Pere Marquette Ry.*, *supra* note 1, at p. 629.

⁹ *Pennsylvania Steel Co. v. N. Y. City Ry.* (1912, C. C. A. 2d) 198 Fed. 721, 738.

It is the usual practice for the court to refer the proof of all claims to a master in chancery or a special master. Claims are tried before him as before a court without a jury. Occasionally unusual claims are first tried before the court itself.

All claims heard by the master in chancery are reported by him to the court. In the federal courts, unless exceptions are filed to the report within the required interval, the report stands confirmed. If exceptions are duly filed, the court will hear argument thereon, and render its decisions, either confirming, modifying, or reversing the report of the master. The usual appeals may be taken from the decision of the court.

In receiverships of large corporations there may be a great number of claims to be passed upon. Thus in the now pending receivership of the New York Railways Company in the United States District Court for the Southern District of New York, upwards of three thousand claims have been filed. It would mean years of work and hundreds of thousands of dollars of expense if all these claims were tried before a master and the usual procedure followed. So in that receivership a clause was inserted in the order directing the filing of claims giving the receiver the right to compromise and settle (subject to the approval of the court) the amount of any claim which might be filed.¹⁰ By effecting settlements in all but a handful of claims the receiver has saved a vast amount of time and much expense. The procedure adopted is as follows: as soon as a large group of provisional settlements has been made, the receiver addresses a petition to the court giving the essential facts with regard to each such claim, and prays the court to make an order approving the settlements. Notice of the application is given to all parties. The settlement papers in each case are open for examination in the receiver's office. In no case in the New York Railways receivership has such a provisional settlement been objected to by any party.

It must be borne in mind that the term "settlement" used in the foregoing paragraph does not include payment, but only covers the determination whether or not the claimant has a valid cause of action, and, if so, what amount is due him thereon. When such a "settlement" has been approved by the court, the claim is in exactly the same position in which it would be if it were allowed upon evidence before a master and the master's report confirmed by the court.

PRIORITIES

The granting of priorities to certain classes of unsecured creditors of public utility corporations is a doctrine which has been developed largely in the American federal courts. In state courts the practice is in most instances controlled by statute.

¹⁰ It has been specifically held that a receiver may compromise a claim, when a saving of expense or time will be effected. *Pennsylvania Steel Co. v. N. Y. City Ry.* (1910, C. C. S. D. N. Y.) 180 Fed. 514.

In the federal court doctrine a sharp distinction has been drawn between corporations having the right of eminent domain and other corporations of every sort,¹¹ when it comes to according priorities in payment to certain creditors of the corporation. It is on the ground of public policy that certain classes of creditors of these public corporations are given a priority. A railroad, for instance, might find difficulties in obtaining supplies to run its road if rumors of financial distress should arise, unless the persons furnishing such supplies were secure in the knowledge that they had certain rights of preference in payment, in case of insolvency.¹²

There are no grounds of priority in payment granted by the federal courts to any class of unsecured creditors of the usual industrial corporation except in those cases where by statute employees have been given such rights in varying degrees.¹³

It is, of course, only in cases where there are not sufficient funds to pay off all creditors that the question of priority in payment arises at all. In receiverships which are so successful that the properties are returned to the former stockholders it does not become necessary to establish priority to the right of payment of one creditor over another. In such a case the claims of all creditors are satisfied in full. Take, however, the typical case of an insolvent railroad system, encumbered with mortgages. There are likely to be note holders and lessors. There are bound to be tort creditors, supply creditors, and other contract creditors of sundry kinds besides the bondholders secured by mortgages. There will be mortgaged and unmortgaged assets. The respective rights of all these classes has been established in numerous well-known decisions, and with a single exception, it does not seem likely that these decisions will be overturned. That single exception is the right of the tort creditor. In one or two western districts of the United States courts and in an early case in Georgia, a preference has been accorded him.¹⁴ Nowhere else in the world has he been similarly favored, so far

¹¹ See the excellent discussion of this subject by Judge McKenna in *Atlantic Trust Co. v. Woodbridge Canal and Irrigation Co.* (1897, C. C. N. D. Calif.) 79 Fed. 39.

¹² For rules as to according preferences to supply and labor creditors of public utility corporations, see *Pennsylvania Steel Co. v. N. Y. City Ry.* (1914, C. C. A. 2d) 216 Fed. 458, 471; *ibid.* (1913, S. D. N. Y.) 208 Fed. 168, 182; *Miltenberger v. Logansport Ry.* (1882) 106 U. S. 286, 1 Sup. Ct. 140; *Southern Ry. Co. v. Carnegie Steel Co.* (1900) 176 U. S. 257, 20 Sup. Ct. 347; *Gregg v. Metropolitan Trust Co.* (1905) 197 U. S. 183, 25 Sup. Ct. 415; *Lackawanna, I & C. Co. v. Farmers' L. & T. Co.* (1900) 176 U. S. 298, 20 Sup. Ct. 363; *Texas Co. v. International Ry.* (1916, C. C. A. 5th) 237 Fed. 921.

¹³ *Sinzely v. Coal Co.* (1895, C. C. E. D. Mo.) 69 Fed. 204.

¹⁴ *Farmers' Loan & Trust Co. v. Northern Pac. Ry.* (1895, C. C. D. Wash.) 71 Fed. 245; *Farmers' Loan & Trust Co. v. K. C. etc. Ry.* (1892, C. C. D. Kan.) 53 Fed. 182; *Green v. Coast Line Ry.* (1895) 97 Ga. 15, 24 S. E. 814.

as the writer knows. The argument against him is a negative one. He cannot claim any of the grounds for preference given to supply creditors. The liability to him is not, in theory, an "expense of operation." During the last decade, however, a tendency can be discovered to favor the tort creditors. In 1911 the tort creditors of the Metropolitan Railway system were accorded, on reorganization, the rights of bondholders. Certainly every humanitarian impulse is in his favor. In the opinion of the writer, it would cause surprise to few should the courts reverse their former decisions refusing a preference to tort creditors of railroad corporations. A public enterprise may well be considered a public trust even to recompensing members of the public for personal injuries. The argument that injuries to persons resulting from operation of a railroad are unavoidable and constant concomitants of such operation has a strong appeal.

These observations are, however, a digression. We are here concerned only with the manner of establishing priorities. After claims have been filed and proof is under way, it becomes again the receiver's business to see to it that an order is made requiring that all claims for preference with respect to filed claims of creditors shall be asserted and decided. The requirements of prompt administration compel a date to be fixed, after which such claims for preference will not be received. The order should require notice of the provisions to be mailed to all claimants or published in the daily press. A master should be named to receive proof and report to the court his conclusions on all claims for preference.

When the master has heard the proofs and reported, exceptions to the conclusions of the master can be argued before the court, and from its decision appeals can be taken in the usual manner.

In many receiverships there are hundreds and sometimes thousands of such claims. Strict proof before the master upon each one, and argument over the merits of each claim might prove an endless undertaking, and vastly expensive. The facts are usually undisputed. In some receiverships known to the writer the parties have agreed upon a relatively small number of "type cases," presenting single instances of every question of law which can be suggested.¹⁵ In such an event the parties agree to allow all other claims, the facts of which are similar to any one of the "type cases," to be disposed of in the manner indicated by the final decisions of the courts in the "type case." The "type cases" are then carefully proved and argued, and if necessary, carried to an appellate court. The several classes of claims grouped with each type case are then disposed of as their types have been disposed of, without further contest.

¹⁵ *Pennsylvania Steel Co. v. N. Y. City Ry.* (1913, S. D. N. Y.) 208 Fed. 168.

OPERATION OF BUSINESS

Certain fundamental considerations make a distinction between the operation of the business of a quasi-public corporation and the operation of the business of a private corporation by a receiver. In the former case the public must continue to be served unless such service cannot be given without a continuous loss.¹⁶ Consequently a receiver continues the operation of a public utility as a matter of course until reorganization takes place or the public franchises of the corporation are abandoned after a period of operation has taken place sufficient to show conclusively that operation cannot be carried on except at a loss, even upon reduced schedules.¹⁷ In the case of a private corporation no public duty dictates a continuance of operation. The court will apply the rules of sound business discretion in both instances, but in the latter case it is unhampered by a duty to the public. Almost invariably the receiver must operate for a period sufficient to enable him to form a judgment whether the business can be made to pay. General economic conditions may be adverse. Other temporary conditions may exist to warrant him in continuing business for some time even at a loss. Creditors may unite in desiring a continuance even though they have to advance money to the receiver. But while the receiver may borrow money, on good cause shown, for purposes which will enable him to carry on the business of the corporation, he cannot secure the displacement of prior liens upon the property of a private corporation without the assent of the lienholders "save to the extent actually required for necessary expenditures incident to administering the assets and preserving the property from deterioration pending the winding up of the business and the settlement of the receivership."¹⁸ If it is desired that the receiver shall conduct the business of the corporation, even for a short period, his order of appointment should so provide, and such provision should be carefully drawn so as to give him all necessary powers. Without such provision any operation by the receiver will make him personally responsible for losses.¹⁹ A receiver should never turn over the property placed in his charge to another person to operate.²⁰ His is a quasi-trust capacity. He is the hand of the court and he should not delegate his trust powers.

The receiver who is operating a property has implied power to make contracts which are reasonably necessary for the proper management of

¹⁶ *Central Bank & Trust Co. v. Cleveland* (1918, C. C. A. 4th) 252 Fed. 530.

¹⁷ *Royal Trust Co. v. Washburn, etc. Ry.* (1902, C. C. W. D. Wis.) 113 Fed. 531.

¹⁸ *Central Bank & Trust Co. v. Cleveland*, *supra* note 16, at p. 533, citing *International Trust Co. v. Decker Bros.* (1907, C. C. A. 9th) 152 Fed. 78, and *Lowell v. International Trust Co.* (1909, C. C. A. 9th) 169 Fed. 497, 505.

¹⁹ *State Bank v. Fanning, etc. Co.* (1902) 118 Iowa, 698, 92 N. W. 712; *Villere v. New Orleans Milk Co.* (1908) 122 La. 717, 48 So. 162.

²⁰ *Shadewald v. White* (1898) 74 Minn. 208, 77 N. W. 42.

the business.²¹ But he should have the protection of the court in so doing, either by the terms of the order of his appointment, or by specific authorization by the court. Such authorization may take the form of an order specifically approving the contract, or of an indorsement by the court upon the contract itself. In any event every written contract made by a receiver should specifically provide that he is not liable individually.

In the course of operation many occasions will arise where the receiver desires to have or should have the direction of the court. In every such event, the receiver should address a petition to the court setting forth the facts and praying for the relief desired.²² Notice, of course, should be given to the several parties. When such an application should be made to the court for instruction is usually a matter of discretion. In general, this method should always be pursued if any property right, however worthless, is to be affected.

RECEIVERS' REPORTS

In order that the court and the interested parties may not be in ignorance of the condition of the receivership, it is advisable that a receiver, who is operating a property, should make a report to the court from time to time, particularly if the receivership is of long duration. Such a report should contain an account of the events of the receivership with respect to operation of the property not found in papers on the files of the court. It may be an informal statement of events grouped under appropriate headings, or it may be or contain a comparative balance sheet showing financial changes since the beginning of the receivership or the last previous report.

Such a report should not be confused with the receivers' accounts, to which reference is made on another page. If the receiver desires the instruction of the court on such a general statement, he should prepare it in the form of a petition to the court, praying for the relief desired, with notice to all parties.

UNCOMPLETED CONTRACTS

The office of the receiver is primarily to husband the assets of the corporation for the benefit of all persons having an actual interest, whether they are parties to the suit or not.²³ In the case of going concerns, sometimes one or more contracts which are in the process of

²¹ *Central Trust Co. v. Wabash Ry.* (1892, C. C. S. D. Iowa) 52 Fed. 908; *Jourdain v. Long Island Ry.* (1886, N. Y.) 42 Hun, 657.

²² *Missouri Pac. Ry. v. Texas, etc. Ry.* (1887, C. C. E. D. La.) 31 Fed. 862; *Ledoux v. La Bee* (1897, C. C. D. S. D.) 83 Fed. 761.

²³ *American and British Sec. Co. v. American and British Mfg. Corp.* (1921, S. D. N. Y.) 275 Fed. 121.

fulfillment constitute the chief asset of the corporation, and in consequence the chief asset of the receivership. Conversely one or more uncompleted contracts may be the sole reason for the receivership, if they are causing constant recurring losses. A typical instance of the latter is a long lease made to the corporation years before of a property, the yield of which has decreased to a point where the rent cannot be paid without loss.²⁴

It is the duty of the receiver to test the value of all uncompleted contracts. Is a given contract profitable or a losing proposition? If it is profitable it is an asset to be retained as part of the *res* in the hands of the receiver. If it is unprofitable it is the receiver's duty to get rid of it.

Courts of equity give a receiver a reasonable time to make these tests—a "breathing space." What is a reasonable time differs of course in every case. The best practice is to secure an order of court fixing a period within which the receiver may come to a decision.

There is probably no branch of receivership law in which decisions of courts vary so widely as they do with respect to the various aspects of uncompleted contracts.²⁵ There are however certain principles which are quite uniformly followed.

If the receiver adopts the contract by act or formal statement it becomes binding on the fund in his hands.²⁶ If he fails to adopt it, it remains binding on the corporation, and the contractee is free to pursue his remedies, hampered only by the injunction contained in the order appointing the receiver. Those remedies usually crystallize into filing a claim for damages as a creditor against the estate, proving the claim and receiving the allowance paid to the class of creditors to which the contractee proves to belong.

It is not every uncompleted contract, however, which the receiver may refuse to adopt. Take, for instance, a lease from the corporation in receivership to another. It might be asserted (and sometimes has been) that a receiver may refuse to adopt such a lease if the rental were inadequate. But this assertion is based on a misconception. Ownership of real property has been compared to the possession of a bundle of rods. The owner may deliver possession of one or more of these rods to another. A lease made by a corporation to a tenant may be compared to the delivery from the bundle of one rod, the rod of posses-

²⁴ *Pennsylvania Steel Co. v. N. Y. City Ry.* (1911, C. C. S. D. N. Y.) 192 Fed. 135.

²⁵ Leading cases on this subject are: *Pennsylvania Steel Co. v. N. Y. City Ry.* (1912, C. C. A. 2d) 198 Fed. 721; *ibid.* (1908, C. C. S. D. N. Y.) 165 Fed. 472; *ibid.* (1915, C. C. A. 2d) 225 Fed. 734; *Coy v. Title Guarantee & Trust Co.* (1912, D. Or.) 198 Fed. 275; *Wells v. Hartford Manilla Co.* (1903) 76 Conn. 27, 55 Atl. 599.

²⁶ *Empire Distillery Co. v. McNulta* (1897, C. C. A. 7th) 77 Fed. 700.

sion, to the tenant. A receiver of the corporation is appointed. He finds the rent paid by the tenant inadequate. But receivership cannot change legal rights. The tenant must not be deprived of his bargain solely because his landlord's property is being administered by the courts. The rod of possession should not be wrested from him who has paid his rent and continues to pay it because his landlord's assets have been impounded for the benefit of creditors. In so far as the lease is executory on the part of the lessor, it is probably true that the receiver may refuse performance, with whatever consequences may flow therefrom. Thus a covenant in the lease to make a renewal lease on terms stated need not be carried out by the receiver.²⁷ Judge Julius M. Mayer, in the United States District Court in New York, in *American Brake Shoe and Foundry Company v. New York Railways Co.*,²⁸ has held:

"But a court of equity should not instruct a receiver to disaffirm a lease as landlord merely because the corporation lessor made what, at this moment, might be a bad bargain, although a good enough bargain originally. It is the duty of the receiver to make every proper effort to increase the assets of an estate but not at the expense of fundamental principles of fair dealing. When a lessee under a lease takes possession, the lease pre-supposes continuance even in the face of a receivership of the landlord so long as the landlord's receivership estate is not burdened or put to loss; and by 'burdened' is not meant that the lease could be more profitable but that it entails a positive loss or encroachment on the *corpus* or capital of the estate.

"The real question, therefore, is whether the receiver should be instructed to refuse to carry out the executory covenants as to heat, electric current, etc."

FORECLOSURE OF MORTGAGES

The function of the receiver with respect to the actual foreclosure of any mortgage which may be on the property in his possession is relatively minor. A receiver appointed under a creditor's bill should always be made a party defendant to any suit for foreclosure of a mortgage lien on the property in his possession. But his is not the burden of proceeding with the several steps of any such foreclosure suit. If he has been appointed receiver in the foreclosure suit, his accounts must be kept in such manner that the usufruct of the property subject to the mortgage may be ascertained and delimited. Usually the extent of the lien of the mortgage is the chief question in such a foreclosure. Committees of creditors whose interests are opposed to the interest of the mortgagee ordinarily undertake the laboring oar in opposing the claims of the mortgagee. If, however, there is any class of interested persons not otherwise represented in the suit, the receiver

²⁷ *Coy v. Title Guarantee & Trust Co.*, *supra* note 25.

²⁸ (1922) not yet reported.

must undertake to see that their rights are presented and adequately prosecuted. If any remedy is sought by the mortgagor which adversely affects the remainder of the property, his is ordinarily the duty of opposing it. This principle applies particularly to the terms of the decree in foreclosure, which it is his duty to scrutinize with the utmost care when presented for consideration.

RECEIVER'S CERTIFICATES

The term "receiver's certificates" is generally applied in America to all obligations of a receiver in the form of promises to pay money. It should be applied solely to those promises to pay, made by a receiver, which have been authorized by an order or decree of the court, and which have a lien on certain assets of the receivership defined by the order or decree. Numerous instances have occurred where a receiver has issued a promise to pay money, unsupported by the authority of the court. In such an event the paper can only be collected from receivership funds, if at all, upon showing that the proceeds were actually used for the benefit of the estate.²⁹ The receiver, however, is personally liable to the holder of the paper, if the latter has no right of recovery from the estate.³⁰

In England the term "receiver's certificate" is unknown. Nevertheless, loans to the receiver are frequently authorized by the courts, with priority over all obligations except costs and expenses of the receivership.³¹

The principles applicable to the issue, purpose, and lien of receiver's certificates have been evolved from a long series of litigations and are now generally fixed. To this statement there is at least one apparent exception.

There is still some confusion about the extent of the power of the court to give the certificates of a receiver of a private corporation a lien superior to the lien of existing mortgages and other liens. The obligation to continue a service upon which the public depends tends to support the power to authorize certificates of a receiver of a public service corporation and to justify the displacement of existing liens. No such reason exists in the case of a private corporation. Receiver's certificates with a paramount lien may of course be issued upon consent of the existing lienors. That consent should always be obtained when possible. But when such consent is not obtainable the true rule would seem to be that displacement of prior liens on the property of a private corporation can only take place when it appears imperatively necessary for the actual preservation from destruction of the property placed in the

²⁹ *Wesson v. Chapman* (1894) 77 Hun, 144, 28 N. Y. Supp. 431.

³⁰ *Ibid.*

³¹ *Strapp v. Bull, etc. Co.* [1895, C. A.] 2 Ch. 1.

hands of the receiver.³² In such a case of course notice of the application must be properly given to the lienors and they must have full opportunity to be heard. Vice-Chancellor Howell of New Jersey has summed up this situation in the following pertinent language:³³

“The Court should be satisfied by a preponderance of circumstances that no other course could be successfully adopted, and that practical ruin would ensue if the authority were withheld. All the facts should be exhibited which make the necessity apparent, all the parties affected should be notified, and a full hearing accorded to all objectors.”

In general, also, the receiver must bear in mind that experience has proved that the power to authorize receiver's certificates should be sparingly exercised in every case. Not only common principles of economical operation suggest this, but it is further emphasized by many cases now in the reports, which afford painful object lessons of bankrupt receiverships, with consequent reflection on the wisdom of the court.

RECEIVER'S ACCOUNTS

A receiver is of course accountable to the court for his receipts and payments. The interested parties have a right to examine these accounts and to hold the receiver responsible for their correctness and to insist that allocation of receipts be made to and the burden of payments be charged against the proper interest. Many thousands of dollars have been spent in litigation over receiver's accounts. Thus in a receivership where the receiver has been appointed under foreclosure of a general mortgage, and also under foreclosure of one or more underlying divisional mortgages, the allocation of receipts from the operation of the whole property may prove intricate. It often needs the extended services of both expert accountants and expert engineers versed in the business of the corporation in receivership, as well as the decision of sometimes complicated questions of law, to evolve the principles to be applied. No principles, save general ones, can be laid down in advance. Each case must be determined on its own facts.

It is usual and advisable that upon the appointment of the receiver, or immediately thereafter, an order should be made by the court directing that the receiver shall file accounts of his receipts and payments periodically. The order should reserve the final allocation of the receipts and payments until the rights and equities of interested parties shall have been determined. A method should, however, be provided for foreclosing every party with reasonable promptness once and for all from questioning the correctness of the accounts filed under such an order. A method of this character which has proved readily workable and efficient and at the same time economical in expense and labor is as

³² *Lockport Felt Co. v. United Box, etc. Co.* (1908) 74 N.J. Eq. 686, 70 Atl. 980.

³³ *Ibid.* at p. 695, 70 Atl. at p. 983.

follows: the order directs that the receiver shall file his accounts with a special master or referee periodically, say quarter-yearly, thirty or sixty days after the expiration of each quarter; objections to the account must be filed with the special master within a limited time thereafter, say, thirty days; the special master must examine the accounts, check them over with the vouchers and report to the court his findings thereon; if objections are filed, he must have hearings thereon and include in his report his conclusions upon those objections. These reports may be made at convenient intervals, say, yearly. With them are filed the accounts of the receiver which the special master has examined. Notice of the filing of the report should be served on all parties. The report will then follow the usual course provided by the rules of the court with respect to the filing and confirmation of reports of a special master or referee.

The final accounting of the receiver which will determine what interests in the property shall bear the burden of the payments made by him and enjoy the benefit of his receipts, may often be dispensed with if there is a reorganization. Otherwise, short of agreement among the interested parties, it must be had. The usual method is to refer it to a special master, who will make a report to the court on his findings of fact and of law after full hearing of all parties.

By dividing the accountings of the receiver in the manner indicated, experience has shown that a saving of expense and time can be made, sometimes in very large amounts.

REORGANIZATION

Until within the last decade in America, neither courts nor their receivers have considered themselves concerned with reorganization. Judge Lacombe, of the United States Circuit Court for the Southern District of New York, in an unreported opinion in the Metropolitan Street Railway receivership, delivered in 1907, said:

"In this circuit it is not the practice for receivers to concern themselves with plans of reorganization. *Fowler v. Jarvis Conklin*, 63 Fed. Rep. 888. Their sole functions are to hold the property intact, operating it as efficiently for the public service as their resources will permit; to ascertain the liabilities; to marshal the assets and eventually to sell to the best advantage"

In the same year a judge of the United States Circuit Court for the Northern District of Illinois attempted to compel certain bondholders to accept a plan of reorganization. The United States Circuit Court of Appeals for the Seventh Circuit, however, promptly set aside his order.³⁴

These views appear to have been those of the bench and bar almost

³⁴*Merchants Loan & Trust Co. v. Chicago Rys. Co.* (1907) 158 Fed. 923.

uniformly as late as 1916. In that year Mr. Paul D. Cravath, in a lecture on the Reorganization of Corporations delivered before the Bar Association of the City of New York, asserted:³⁵

"Reorganizations of industrial corporations in this country are not under governmental supervision, nor are they, nor for that matter are railroad reorganizations in this country, subject to the supervision of the courts."

In practice it has been the function of groups of powerful creditors and stockholders to plan and to carry through such reorganizations as those powerful groups thought wise, without regard in many cases to the equities of minor groups and in most cases without regard to the wishes of many interested parties who were without the necessary funds or ability to combat the plans of the majority. This practice is still the rule, but serious inroads have been made upon it.

Public service commissions have been created in the several states, which have varying degrees of control over reorganization of quasi-public corporations. A series of decisions in the United States Supreme Court has placed on insecure ground indeed reorganizations of corporations in which attempts have been made to ignore or "squeeze out" groups of creditors. These cases were foreshadowed by the so-called *Monon* case³⁶ decided in 1899, and are centered about the well-known *Boyd* case³⁷ decided in 1913.

The late Adrian H. Joline of New York said, in a lecture delivered before the Harvard Law School in 1910:

"The opinion of Justice Brewer in the *Monon* case stands . . . upon the pages of the reports a dangerous weapon in the hands of guerillas, who hang about the outskirts of reorganizations and endeavor to levy tribute as a condition of abating the nuisance of their presence, and that even to this day, reorganizers stand in more or less terror of the *Monon* case, and it looms up as a perpetual spectre in their path."

Six years later, in the lecture on the Reorganization of Corporations delivered before the Bar Association of the City of New York, previously referred to, Mr. Cravath, after quoting the foregoing extract from Mr. Joline's lecture, said:³⁸

"If this were true of the *Monon* case, may we not say that the spectre of six years ago has now become materialized into a veritable demon incarnate standing across the path of the reorganizer to-day?"

Many difficulties that attend reorganization in this country are avoided in England by certain provisions of the English Companies Act.³⁹ By

³⁵ *Some Legal Phases of Corporate Financing, Reorganization, and Regulation* (1917) 153.

³⁶ *Louisville Trust Company v. Louisville, New Albany, etc. Ry.* (1899) 174 U. S. 674, 19 Sup. Ct. 827.

³⁷ *Northern Pac. Ry. v. Boyd* (1913) 228 U. S. 482, 33 Sup. Ct. 554.

³⁸ *Op. cit.* 197.

³⁹ English Companies Act, (1908) 8 Edw. VII, c. 69, secs. 129, 182, 199.

these provisions any plan of "reconstruction" approved by three-fourths of each of the several classes of security holders becomes binding upon all parties interested when it has received the sanction of the court. In America, the restriction of our Federal Constitution against the impairment of the obligation of contracts, limits seriously the scope of any possible statute such as the English one referred to. However, an attempt was made a number of years ago in Kentucky⁴⁰ where a law was passed regulating the reorganization of insolvent railroad companies, apparently modeled upon the English statute. This statute attempted to bridge the constitutional difficulty by giving holders of claims which arose or securities which were issued prior to the passage of the act, the right to compel insertion in the plan of provisions which would preserve their rights, so as not to impair the obligation of their contracts.

Into this welter of conflicting rights and growing difficulties came Judge Hook of the United States Circuit Court for the Eighth Circuit, in the very year that Mr. Cravath voiced his concern at the situation. In the case of *Guaranty Trust Company v. Missouri Pac. Ry.*,⁴¹ he said:

"It has sometimes been claimed that plans of reorganization formulated by bondholders and stockholders of a railroad in the hands of receivers are exclusively of private concern, free from judicial action or interference. But for various reasons the view cannot be sustained in principle. After all that can be said from the standpoint of theory and strict right, the fact remains that many railroad receiverships, and the one here is typical of them, are but instruments for consummating plans of reorganization, and courts have come to realize that such use of their jurisdiction and processes entails a correlative duty to those affected by the result."

It is true that this opinion was given upon a minor motion—one to strike from the files a petition of certain bondholders who objected to a reorganization plan. But it is probably the first blaze upon a new path for equity which has found its way into the reports. The principles of this decision were not entirely novel to Judge Hook, because in 1915 he had himself prepared the plan of reorganization of the street railway and electric light systems at Kansas City, Missouri, which were in the hands of receivers of the federal court. In that case the plan of reorganization provided for a representative of the Judge to act as one of the reorganization managers.

In 1919 in the District Court of the United States for the Southern District of New York, Judge Julius M. Mayer had before him the receivership of the Aetna Explosives Company, which had prospered so greatly that all indebtedness, except bonds secured by a mortgage, was paid off, and instead of being wound up, it became the duty of the court and its receivers to return the property to its owners. There were many differences among the several classes of security holders and among different groups of holders of the same class of securities.

⁴⁰ Ky. Gen. Sts. 1915, sec. 771a.

⁴¹ (1916, E. D. Mo.) 238 Fed. 812, 815.

These had arisen largely by reason of defaults which had occurred in the dark days before the receivership and just after its beginning. Judge Mayer appointed a readjustment committee, composed of lawyers representing various contending factions, to formulate a plan. They could not agree. Thereupon the Judge received their reports, and at a meeting before him of representatives of the several interests, announced his own plan for reorganization or readjustment. This plan was not opposed. It was reduced to terms of settlement, submitted to the security holders, advertised in the public press and formally approved by court order. Although there had been violent disagreement among the various interests, Judge Mayer received unanimous approval for his plan, largely, it would seem, because it was the plan of a wholly disinterested tribunal. The writer believes that the foregoing cases are the first two where a court of equity has itself effected a reorganization. It seems overwhelmingly probable that the precedent will be followed in many instances. Such a course does not solve the difficulties raised by the *Monon* and the *Boyd* cases, but it goes far, it would seem, to provide a method and a machinery whereby they may be avoided in many cases.

What, it will be asked, has a receiver to do with such a reorganization? He has a great deal to do. He must be constantly at the elbow of the court to furnish the court with all necessary information. He must be prepared to see to it that any unrepresented class of security holders or creditors or unrepresented individuals of any such class, have a fair opportunity to share in the proposed readjustment. The receiver is appointed upon the theory that he is the hand of the court, as disinterested in handling the property for those entitled thereto as the court itself. Is it too much to predict that there will be cases in the future where a court of equity may depend upon the receiver for outlining the plan of reorganization itself, subject to objection and criticism constructive and adverse, by all interested parties, and subject to its own approval or alteration?