

CONTRACT LIABILITIES INCURRED IN THE ADMINISTRATION OF RECEIVERSHIPS

I.

One approach¹ to the question of the liability of a receiver² on contracts³ entered into in the course of the receivership is to consider the respective interests of the obligee who extends the credit and the receiver who incurs the debt.⁴ Such an approach simplifies, but does not solve, the problem. Viewed from the standpoint of the obligee⁵ and the receiver, the truth is that it does not make very much difference whether the rule of law is that the receiver is personally responsible for his contractual receivership obligations in the same manner as executors, administrators, guardians or trustees,⁶ or whether the receiver's

¹The second approach is discussed under Part II of this article.

²As used herein, receivers connote court liquidators or conservators, including bankruptcy receivers and trustees, statutory dissolution receivers (as under the New Jersey Corporation Act), equity receiverships (of partnerships or corporations), public utility receivers, English managers, etc. For an interesting discussion of the distinctions which "have been drawn between receivers appointed to carry on the business of a corporation with a view to the continuance of its corporate life, and receivers appointed in aid of the dissolution of the corporation or the liquidation of its business", see the remarks of Mr. Justice Cardozo, speaking for the United States Supreme Court in the recent case of *People of State of Michigan v. Michigan Trust Co.*, 286 U. S. 334 (1932).

³As to the liability of receivers for torts, see 1 CLARK ON RECEIVERS, (2d Ed) 509 to 519. 1 TARDY'S SMITH ON RECEIVER'S, (2d Ed.) 1120-1134.

⁴As a receiver's liability on contracts arises, in the main, when the receiver is operating a business, this article particularly deals with this phase of receivership liability.

⁵For the purposes of clarity, it is well to use the term "obligee" to designate the creditor, promisee, or covenantee to whom the receiver is obligated on the contract which the receiver makes.

⁶An authoritative exposition of the law as to liabilities incurred in the administration of trusts is given by Professor Austin W. Scott of the Harvard Law School in an article in 28 HARV. L. REV. 725, and under the title *Liabilities Incurred in the Administration of Trusts*. At the outset of the article, Professor Scott says:

"In the absence of an express stipulation relieving him from liability, a trustee is personally liable on contracts made by him for the benefit of the trust estate. He may be sued at law and execution may be levied upon his individual property. This is true whether he was acting without authority in incurring the liability, or whether he was acting in accordance with the directions of the will or deed of settlement or under the direction of the court."

In support of these propositions, Professor Scott, in the footnote, cites the following cases:

"*Duwall v. Craig*, 2 Wheat. (U.S.) 45 (1817); *Taylor v. Davis*, Adm'r, 110 U.S. 330 (1884); *Hall v. Jameson*, 151 Cal. 606, 91 Pac. 518

liability is limited to the funds or assets of the estate. The important point is to have the rule of law established and definite. Both the receiver in incurring the debt and the creditor in extending the credit⁷ should act, in theory at least, with a realization of the legal implications of the transaction.⁸ The party who sells merchandise to the receiver or who lends money,⁹ knowing of the limited liability, should not at a later date demand that the receiver individually meet the obligation. On the other hand, the receiver, in jurisdictions which disregard the limited liability doctrine, should not be surprised when demand is made upon him for personal payment of the debt, since he knew or should have known when incurring the debt or entering into the contract, that he would be personally liable if the *corpus* of the estate should be unable to meet the indebtedness.

From the standpoint of the obligee and the receiver, the question is one of emphasis. If the rule is that the receiver is not personally liable, the initiative of the obligee is emphasized. The intelligent obligee will act cautiously in extending credit to, or entering into a contract with, the receiver. This type of creditor will analyze the balance sheet of the estate as he would

(1907); *Bradner Smith & Co. v. Williams*, 178 Ill. 420, 53 N.E. 358 (1899); *McGovern v. Bennett*, 146 Mich. 558, 109 N.W. 1055 (1906); *Koken Iron Works v. Kinealy*, 86 Mo. App. 199 (1900); *Blewitt v. Olin*, 14 Daly (N.Y.) 351 (1888); *Whalen v. Ruegamer*, 123 N.Y. App. Div. 585, 108 N.Y. Supp. 38 (1908); *Dunlevie v. Spangenberg*, 66 N.Y. Misc. 354, 121 N.Y. Supp. 299 (1910); *Mitchell v. Whitlock*, 121 N.C. 166, 28 S.E. 292 (1897); *Fehlinger v. Wood*, 134 Pa. 517, 19 Atl. 746 (1890); *Connally v. Lyons & Co.*, 82 Tex. 664, 18 S.E. 799 (1891); *Wardwell v. Williamson*, 72 Vt. 183, 47 Atl. 786 (1900). See a collection of authorities in 40 L.R.A. N.S. 201."

And Professor Scott, in the same footnote, makes the following remarks:

"An executor or administrator who makes a contract for the benefit of the estate is likewise personally liable thereon. WILLIAMS, EXECUTORS, 10 ed., pp. 1417 *et seq.*; WOERNER, AMERICAN LAW OF ADMINISTRATION, 2 ed., Sections 328-356. In many of the cases hereinafter cited the liability was incurred by an executor."

⁷ Or in fact both parties to any receivership contract.

⁸ See *Lehigh Coal and Navigation Co. v. Central R. R. of N. J.*, 35 N.J. Eq. 426, 430 (1882).

⁹ Money is lent generally through the medium of receiver's certificates. See *infra*.

the balance sheet of any debtor.¹⁰ The creditor, before extending the credit, can, if he sees fit, seek definite assurances of payment, even to the extent of requiring the receiver to assume payment of the debt personally.¹¹ If the rule is that the receiver is personally liable for his contracts, it is the conservatism of the receiver that requires the emphasis. Where the latter rule prevails, the receiver, in obtaining credit or entering into a contract, endeavors to avoid any personal liability.¹² Undoubtedly a conservative administration of receivership estates is desirable, and from this viewpoint, much can be said in favor of a rule making the receiver personally liable for debts incurred in the administration of the receivership.¹³ Placing the responsibility upon the receiver would necessitate advising new creditors that individual liability for the indebtedness was eliminated—the creditor would thereby be expressly informed of the problem and enlightened as to the exact nature of the transaction.¹⁴

The authorities which have been examined undoubtedly are to the effect that the receiver's liability is limited to the funds in his hands—to the *corpus* of the estate,¹⁵ although there are sur-

¹⁰ 1 TARDY'S SMITH ON RECEIVERS (2nd Ed. 1920), 171.

"In other words, a creditor in dealing with a court acting through its receiver is bound to use the same common sense in extending credit as he would expect to use in dealing with an individual, namely, look to the assets behind the individual or take chances upon the individual not succeeding with the enterprise, which he is conducting."

¹¹ 1 TARDY'S SMITH ON RECEIVERS (2nd Ed. 1920), 171:

"The creditor will be obliged to look to the receivership fund for his payment unless the receiver has in his individual capacity guaranteed the debts."

"They (creditors) were at liberty * * * to require the receiver to bind himself in his individual capacity." *Lehigh Coal and Navigation Co. v. Central R.R. Co. of N. J.*, 35 N.J. Eq. 426, 430. (1882).

¹² *In re Glasdir Copper Mines*, (1906) 1 Ch. 365, 367. See Clark, *English and American Theories of Receiver's Liabilities*, 27 COL. L. REV. 679, 681 (1927).

¹³ Some talk may be found to the effect that a reason for not making receivers personally responsible is that such a rule would make it difficult to obtain competent receivers. See *Farmers' Loan and Trust Co. v. Central R. R. of Iowa*, 7 Fed. 537, 538 (1880); *Jeffers v. N. J. & P. R.*, 86 N. J. Eq. 68, 74; 97 Atl. 32, 34.

¹⁴ What are the intentions of the parties—obligee and receiver—when the contract is entered into? Individual or limited liability? See *Southern Supply Co. v. Mathias*, 147 Md. 256 (1925), especially concurring opinion of Bond, C. J.; *Nessler v. Industrial Land Development Co.*, 65 N. J. Eq. 491, 495 (1903); *In re Boynton*, (1910) 1 Ch. 519, 524.

¹⁵ See cases in foot-notes 23, 24, 25—53 C. J. 175; note entitled "*Receivers—Personal Liability on Negotiable Instruments and Contracts*," 9 MINN. L. REV. 666

prisingly few reported cases dealing directly with this question of the nature of contract liabilities incurred in the administration of receiverships. This paucity of authority may be attributed to the fact that receivers generally meet their contractual obligations. Often these obligations are met by diverting or entirely consuming funds which would otherwise have been available for distribution to general creditors.¹⁶ But at any rate, the obligations are met and the indebtednesses paid. Sufficient motive for payment can be found in the rational satisfaction that any individual has in meeting his obligations.

There has been some intimation that the English Courts have adopted theories of receiver's liabilities which would make all receivers personally responsible on contracts entered into in the course of the receivership.¹⁷ However, the English cases hold that while the receiver may be primarily liable, yet he has such a right of indemnity out of the *corpus* of the estate, that if the estate is inadequate to indemnify him, his liability terminates.¹⁸ In the case of *In Re Boynton*,¹⁹ the receiver borrowed money from a bank, the agreement not expressly exempting the receiver from personal liability to repay the loan. After liquidation, it was found that the receiver did not have sufficient funds on hand to satisfy all claims, including the bank's loan and the receiver's own claim for compensation. Warrington, J., disposes of the case as follows:²⁰

"What then is their position?"²¹ They come in and take a charge upon the assets of a business which is in

(1925); also cases and other authorities cited throughout this article, *supra* and *infra*.

¹⁶ Receiver's obligations as expenses of administration must be paid prior to the claims of the creditors of the estate. *People of State of Michigan v. Michigan Trust Co.*, 286 U.S. 334, 344 (1932).

Cf. Sec. 85 of the General Corporation Act of New Jersey (L. 1896, ch. 185, p. 304, Sec. 85; C.S. p. 1652, Sec. 85).

Cf. also Sec. 64 of the National Bankruptcy Act as amended by Acts of February 5, 1903, June 15, 1906, and May 27, 1926 (GILBERT'S COLLIER ON BANKRUPTCY, 1927 Ed. 932).

¹⁷ See Clark, *English and American Theories of Receiver's Liabilities*, 27 COL. L. REV. 679 (1927). See also 9 Minn. L. Rev. 666, 667 (1925).

¹⁸ *Strapp v. Bull & Sons*, (1895) 2 Ch. 1; *In re Glasdir Copper Mines, Ltd.*, (1906) 1 Ch. 365; *In re Boynton*, (1910) 1 Ch. 519.

¹⁹ *Supra*, note 18.

²⁰ On p. 525.

²¹ Referring to obligees who have extended credit to the receiver.

course of realization by the Court, and in my opinion they can take in satisfaction of their charge no more than that which is actually realized. The plaintiff²² has incurred his costs of the action, and the receiver has given his services, in the endeavor to realize as large a fund as possible for the benefit of the several persons having charges on it, and I think they are both entitled to be indemnified before the fund is applied in payment of these charges. The principle of *In Re New Zealand Midland Ry. Co.*,²³ in my opinion, applies, as does the latter part of the passage of the judgment of Cozens-Hardy, L. J., read above.²⁴ I think, therefore, that the plaintiff's costs of action as between solicitor and client and the remuneration of the receiver must first be paid, and the balance of the fund will be paid to the bank in part discharge of their debt."

It must be apparent that the supposed personal liability of the English receiver is in reality merely a procedural question. While the procedure may be logical, in substance the liability of the receiver is limited to the *corpus* of the estate.

In the United States, the courts, when dealing with or adverting to the subject, definitely point out that the receiver is not personally liable for the obligations incurred in the course of the receivership. A typical statement is that of Mr. Justice Brown of the United States Supreme Court, in the case of *McNulta v. Lockridge*.²⁵

"Actions against the receiver are in law actions against the receivership or the funds in the hands of the receiver, and his contracts, misfeasances, negligences and liabilities are official, and not personal, and judgments against him as receiver are payable only from the funds in his hands."²⁶

²² Referring to the party who filed the bill of complaint upon which the receiver was appointed.

²³ (1901) 2 Ch. 357.

²⁴ In the case of *In re Glasdir Copper Mines, Ltd.*, (1906) 1 Ch. 365, 383, 384.

²⁵ 141 U.S. 327, 338 (1891).

²⁶ These remarks are dicta—although often cited. The case did not deal with a receiver's liability for his contracts.

Occasionally the courts intimate that the sounder rule is that which would make the receiver personally responsible, although recognition is given to the undoubted weight of authority limiting the receiver's liability to the assets of the estate.²⁷ And it can be stated with positiveness that in the State of New Jersey, receivers appointed in the Court of Chancery, have no personal responsibility whatever in the incurring of obligations. In the case of *Vanderbilt v. Central R. R. of N. J.*,²⁸ the court in plain language, states:²⁹

"The liability of a receiver upon such contracts is not personal, but as a representative of the trust. The enforcement of them, or the payment of damages for his non-performance of them, must fall primarily upon the property and fund in the hands of the court."

While this case dealt with a railroad receivership, the reasoning indicates that the same rule is applicable in all court receiverships.

Adding to the conviction that the rule in New Jersey is as just stated, is a line of cases in which decisions were rendered to the effect that the receiver's fee is a charge against the estate payable prior to the contract obligations incurred by the receiver.³⁰ It seems strange that a receiver can incur indebtednesses, and in the end obtain his own compensation before these indebtednesses are paid, but the New Jersey courts and other

²⁷ See the remarks of Mr. Justice Holmes in *Archanbeau v. Platt*, 173 Mass. 249, 250 (1899):

"A receiver is not a corporation sole, and therefore his liability must be personal, even if he is entitled to indemnity out of the funds in his hands, according to the general principle applied to trustees, executors and the like. And yet the decisions have gone very far in distinguishing between the receiver's official and personal liability. The universal practice of the court, bold as it may seem in its origin, appears to us to be too well established to be departed from."

This case involved a receiver's liability for negligence.

²⁸ 43 N. J. Eq. 669 (1887).

²⁹ On p. 684.

³⁰ *Jeffers v. New Jersey & P. R. Co.*, 86 N. J. Eq. 68; 97 Atl. 32 (Ch. 1916), affirmed and modified 86 N. J. Eq. 402; 99 Atl. 189 (E. & A. 1916); *Chesapeake & Ohio Ry. v. Atlantic Transportation Co.*, 62 N. J. Eq. 751; 48 Atl. 997 (E. & A. 1900).

³¹ *E.g. In re Boynton*, (1910) 1 Ch. 519; *Petersburg Sav. & Ins. Co. v. Dellatorre*, 70 Fed. 643 (C. C. A. 5th, 1895).

courts⁸¹ have concluded that this disposition is rational.⁸² The point is that if the courts in New Jersey hold, as they do, that the receiver's fee must be paid in full,⁸³ prior to the receivership obligations, the conclusion becomes irresistible that the receiver's liability is limited to the funds in his hands.

As has been stated, not much complaint can be made against the rule limiting the liability of a receiver (or a contrary rule), if the problem is viewed simply from the standpoint of the obligee and the receiver. These two interests enter into the particular contract voluntarily⁸⁴ and supposedly with a full realization of the rule. The subject, however, cannot be adequately studied unless consideration is given to the interests of a class vitally concerned with the whole problem—that class being the creditors of the estate (prior, preferred, and general).

⁸¹ It is submitted that a fairer rule would at least require the receiver to pay his receivership bills and perform his receivership contracts before getting his own compensation.

⁸² Emery, V.C. in *Nessler v. Industrial Land Development Co.*, 65 N. J. Eq., 491, 494; 56 Atl. 711 (Ch. 1903) suggests that the receiver's allowance and his receivership obligations stand on the same footing. Where the *corpus* of the estate cannot meet both in full, there should be a pro rating. The Court says:

"Receivers' services, in themselves, stand on no higher plane than the receivers' debts for the services and advances of other persons for the benefit of the trust, and where, as in this case, the fund in the receivers' hands is not sufficient to pay all the receivers' debts and their compensation, the distribution must be *pro rata*. They are all and equally debts or claims which should be paid by the trust funds, as expenses of the receivership, and if the fund is not sufficient to pay all in full, then they must be paid *pro rata*. If receivers desire or intend to claim a preference in payment for their own compensation, they must apply to the court, not only for such order, but also for the authority to incur indebtedness, which will be subject to their claim. Upon such application the court can, by proper inquiry into the condition of the estate, make the orders necessary to control its receivers in the incurring of indebtedness, and also to give notice to persons dealing with the receivers, for services to the trust, that the receivers' personal claims for services are preferred. All claims for services rendered to the trust should be paid in full, if possible, as preferred claims and as expenses of the trust, and where the fund in hand is not sufficient to pay in full, the claim should, in the absence of special equities, be paid *pro rata*."

The Vice Chancellor made no reference to and gave no consideration to the Court of Errors & Appeals case of *Chesapeake & Ohio Railway v. Atlantic Transportation Co.*, *supra* (note 30).

The Supreme Court of Pennsylvania in the case of *Pennsylvania Engineering Works v. New Castle Stamping Co.*, 259 Pa. 378, 103 Atl. 215 (1918) is in accord with the views of Emery, V.C. and places the receiver's allowance and his receivership obligations on the same footing.

⁸⁴ Sometimes the obligee has the relationship thrust upon him, *e.g.*, a receiver continuing to occupy premises formerly occupied by the estate.

II

A second approach to the question of the liability of a receiver on contracts entered into in the course of the receivership is to consider the status of creditors, as affected by the incurring of the receivership obligation.³⁵ From this viewpoint, the problem attains complexities not involved when the issue is considered as solely one between the obligee and the receiver. Bearing in mind that the primary purpose of the receivership is the liquidation of the estate for distribution amongst creditors,³⁶ is it not apparent that the question is not so much whether the receiver's liability on contract is personal or limited, but rather to what extent is the receiver justified in making the *corpus* of the estate responsible for the debts which he incurs? And is it also not apparent that whenever the issue is presented of the receiver's liability to his obligee, this circumstance stands to the fore, *viz*, that the receiver has found it necessary to consume or divert funds which would ordinarily be distributed to general creditors?

A receiver, in whose charge an estate has been placed by court order, lacking cash on hand, must ordinarily incur indebtednesses for the preservation of the estate pending liquidation.³⁷ The receiver of property, real or personal, for this purpose may be obliged to incur obligations for insurance, for custodial services, for rent and for similar indebtednesses.³⁸ The

³⁵ Referring, of course, to secured, unsecured, and priority creditors whose claims arose prior to receivership.

³⁶ Speaking, of course, primarily, of private corporations, and not of public utilities.

"The purpose of a court in appointing a receiver is to preserve moneys, funds, or property for those entitled to receive the same at the close of the case upon which the receivership is predicated." 1 CLARK ON RECEIVERS (2 Ed. 1929) 531.

And in bankruptcy practice it has been stated that "the chief function of a bankruptcy law is to distribute an insolvent's assets *pro rata*." GILBERT'S COLLIER ON BANKRUPTCY (1927 Ed.), 54.

³⁷ No matter how speedy the liquidation.

³⁸ *Vanderbilt v. Central R.R. Co. of N. J.*, 43 N. J. Eq. 669, 682 (1887); *Raht v. Attrill*, 106 N. Y. 423, 434 (1887), the court saying: "The act of the court in taking charge of property through a receiver is attended with certain necessary expenses of its care and custody, and it has become the settled rule that expenses of realization, and also certain expenses which are called *expenses of preservation*, may be incurred under the order of the court on the credit of the property, and it follows from necessity in order to the effectual administration of

power of the court or receiver to conduct the liquidation includes the right to incur these preservation charges,³⁹ and such charges are justly payable out of the assets of the estate. The general creditors cannot object to this essential incident of liquidation⁴⁰ any more than they can object to the payment of the receiver's allowance and other expenses of administration,⁴¹ out of the assets of the estate.

But what about obligations incurred by the receiver in the continuing of a private business⁴²—the receiver, so to speak, engaging in trade?⁴³ To what extent has the obligee who extends credit to the receiver a right to fall back upon the estate for payment of his claim and performance of his contract?⁴⁴ From the standpoint of the obligee, it is quite satisfactory to have the estate to fall back upon. Indeed, the obligee has enormous protection where he can do so, a protection peculiarly often superior to what he would have if the receiver was personally liable. But the interests of general creditors, it might be said, would receive logical protection, only if the receiver, who is running the business, is compelled to meet his obligations out of the business. The thought is advanced that an equitable disposition of the whole matter could be effected by

the trust assumed by the court that these expenses should be paid out of the income, or when necessary out of the *corpus* of the property before distribution or before the court passes over the property to those adjudged to be entitled." Hooper v. Central Trust Co., 81 Md. 559, 591 (1895), the court saying: "When the property of private corporations or of individuals has been placed in the hands of a receiver, all expenses for safekeeping and preservation are properly payable out of the income, if there be any, or, if there be none, then out of the proceeds of the *corpus* of the estate when sold."

On the question of a receiver's liability for rent, see 59 L.R.A. 673 *et seq.*

³⁹Lockport Felt Co. v. United Box Board & Paper Co., 74 Eq. 686, 690, 691 (1908).

⁴⁰The extent to which receivers may go in incurring expenditures for preservation charges, may be gathered from Rielly v. P. Rielly & Son, a corporation, 101 N. J. Eq. 432, 139 Atl. 482 (1927).

⁴¹Such as filing fees, appraisers' fees, costs of mailing notices, etc.

⁴²As has been said, public utility businesses perhaps are in a separate category.

⁴³"It is not the receiver's business by attempt to trade to increase the assets for the creditors; on the other hand, the creditors have a right to expect that these assets will be presented and not depleted by the receiver's operation." Clark, *English and American Theories of Receiver's Liabilities*, 27 COL. L. REV. 679, 684 (1927).

⁴⁴See Clark, *Specific Enforcement of Contracts Against Receiver*, 33 HARV. L. REV., 64 (1919), indicating that there are receivership obligations other than money debts.

limiting the obligee of a receiver conducting a private business to the intake, so to speak, of the business operated by the receiver, and excluding him from the general fund otherwise available to creditors.

Commendably enough, the courts are alert to the problem. In dealing with the question of contractual liabilities incurred in the administration of receiverships, particularly those in which businesses are conducted, the courts, without advertent definitely to it, are concerned about the diversion of assets to the payment of these liabilities. In the first place, there is a decided tendency against permitting or having the receiver continue the business of the estate as a going concern; and in the second place, there is a general insistence that receivers refrain from running businesses unless expressly and definitely authorized so to do by order of the court.

The courts have deprecated the whole idea of a receiver undertaking to manage and carry on the business of the estate.⁴⁵ The business can with difficulty be run at a profit, especially as the picture is generally presented of a receiver succeeding to a business which has previously been run at a loss.⁴⁶ Some justification exists for running the business for a very short time, if the business can be liquidated more advantageously as a going

⁴⁵ "It will be seen from this general statement that the efforts of the receiver to administer the property 'for the benefit of all concerned' were terminated after a million dollars had been expended in improving it, in a sale of the whole property of the corporation for a sum of less than \$200,000, and all that is left from the wreck for the payment of creditors, whose aggregate claims exceed \$800,000, is the salvage of \$86,000. This case illustrates what I apprehend has been the common experience where a court departing from its appropriate judicial function has undertaken to manage and carry on the business of a failing and insolvent corporation." Andrews, J. in *Raht v. Attrill*, 106 N. Y. 423, 430 (1887); *Dalliba v. Winschell*, 11 Idaho, 364, 372, 82 Pac. 107 (1905); *Fleming v. Fleming Hotel Co.*, 70 N. J. Eq. 509, 514; 61 Atl. 739 (dicta) (1905).

⁴⁶ See 1 CLARK ON RECEIVERS, (2nd Ed. 1929) 532.

In *Glaser v. Achtel-Stetter's Restaurant, Inc.*, 106 N. J. Eq. 150; 149 Atl. 44, 46 (E. & A. 1930), the court says: "Notwithstanding that the receiver was confronted with a hopelessly insolvent estate, the assets being insufficient to pay preferred debts, he nevertheless, without any experience in the restaurant business, and with the example before him of an experienced restaurateur being unable to make the business pay, and without any order of the court to carry on the business, conducted the business for one week, which undertaking resulted in a loss of \$1,472.56."

concern⁴⁷ or if there is a fair chance of reorganization.⁴⁸ Otherwise, the sanest policy for the courts, the receivers, the creditors and even the obligees of the receivership, is to steer clear of this task of operating a private business.

The courts have consistently maintained that receivers must first obtain the express authorization of the court before embarking upon the precarious business of operating the estate as a going concern.⁴⁹ This is the rule of law despite the fact that the receiver is an important officer of the court, and his initiative and independence should be encouraged rather than restricted. This independence of action, however, must be related to the receiver's sphere of authorized activity, not beyond. For instance, nothing can be found in the sections of the New Jersey Corporation Act⁵⁰ relating to insolvent corporations and statutory receivers which give these receivers any power to continue and operate a business.⁵¹ And a bankruptcy receiver or trustee cannot run a private business without a court order,

⁴⁷ See *Cake v. Mohun*, 164 U.S. 311, 316 (1896).

GILBERT'S COLLIER ON BANKRUPTCY (1927) Ed. 54.

The argument is that the sale of the estate as a going concern brings more in cash, than piecemeal liquidation, even including losses sustained in running the business.

⁴⁸ *Quaere!* Why shouldn't those interested in the reorganization guarantee the receiver against losses incurred in running the business for the reorganizers—especially so, if the reorganization plans go awry. There is no reason why general creditors should bear the brunt of the loss upon the running of the business (a dissipation of the *corpus* of the estate) when reorganization plans do not mature.

⁴⁹ See 53 C. J. 166 and cases cited. See also *Lehigh Coal and Navigation Co. v. Central R. R. Co. of New Jersey*, 35 N. J. Eq. 426, 428 (Ch. 1882); *Haines, Receiver v. Buckeye Wheel Co.*, 224 Fed. 289 (C.C.A., 6th Cir. 1915).

⁵⁰ See THE GENERAL CORPORATION ACT OF NEW JERSEY, Sections 63 to 86, particularly Section 66, which gives the receiver or receivers full power and authority "to demand, sue for, collect, receive and take into their possession all the goods and chattels, rights and credits, moneys and effects, lands and tenements, books, papers, choses in action, bills, notes and property of every description of the corporation, and to institute suits at law or in equity for the recovery of any estate, property, damages or demands existing in favor of the corporation, and in his or their discretion to compound and settle with any debtor or creditor of the corporation, or with persons having possession of its property or in any way responsible at law or in equity to the corporation at the time of its insolvency or suspension of business, or afterwards, upon such terms and in such manner as he or they shall deem just and beneficial to the corporation."

(L. 1896, ch. 185, p. 298, sec. 66; C.S. p. 1643; sec. 66).

⁵¹ The right of the court to empower the receiver to conduct the business is correctly implied from the powers expressly set forth in Section 66 of the New Jersey General Corporation Act, *supra*.

See *Vanderbilt v. Central R.R. Co. of New Jersey*, 43 N. J. Eq. 669, 682. (E. & A. 1887.)

although the Bankruptcy Act contains a provision to the effect that "the courts of bankruptcy . . . are . . . invested . . . with such jurisdiction at law and in equity as will enable them to exercise original jurisdiction in bankruptcy proceedings, . . . to . . . (5) authorize the business of bankrupts to be conducted for limited periods by receivers, the marshals, or trustees, if necessary, in the best interests of the estates."⁵²

It is submitted that, upon analysis, the underlying reason for the requirement of the court order is the basic fact that in running the business, liabilities will be incurred, the payment of which in its effect upon the *corpus* of the estate, may disrupt the whole scheme of liquidation.⁵³ The order authorizing the receiver to conduct the business as a going concern is in reality an order authorizing the receiver to incur obligations and indebtedness, and permitting him to meet these obligations, if necessary, out of the *corpus* of the estate.

If the thesis herein advanced (to the effect that the problem of contractual liability of receivers is essentially a question affecting general creditors) is correct, no order empowering the receiver to continue the business should be entered except upon notice to all of the creditors of the estate and other parties in interest.⁵⁴ These latter are the people who should say whether the *corpus* of the estate should be risked in the incurring of receivers' obligations in the running of a business. And an *ex parte* order of the court signally fails to meet the test of having the parties in interest determine whether this risk should attach to the *corpus* of the estate.⁵⁵

⁵² Section 2 of the National Bankruptcy Act.

See GILBERT'S COLLIER ON BANKRUPTCY (1927 Ed.) 22; II U.S.C.A., sec 11.

⁵³ It is suggested that conceivably a receiver can operate a business without a court order if no debts are incurred, provided there has been a disinterested and adequate appraisal of the assets of the estate before commencement of the business, and provided no losses are sustained.

⁵⁴ See 1 CLARK ON RECEIVERS (2nd Ed. 1929) 533, 535.

As to the difficulties which a receiver may find himself in upon failure to give adequate notice, see *Rabt v. Attrill*, 106 N. Y. 423 (1887).

⁵⁵ It is apparent that a court order authorizing a receiver to borrow money on receiver's certificates involves similar problems to those here under discussion. It is of interest, therefore, to note that in the case of *Lockport Felt Co. v. United Box Board and Paper Co.*, 74 N. J. Eq. 686 (Ch. 1908) which is recognized as the leading case on this subject in the State of New Jersey, Vice Chancellor Howell says, on page 697: "It must likewise be remembered that the court has

This approach to the problem can be tested from another angle. When a receiver has concluded his operation of the business, one of three situations is presented, viz:

(a) The receiver has run the business at a profit thereby creating an additional fund for distribution to creditors.

(b) The receiver has run the business at a loss but the losses can be met by resort to the general fund or assets of the estate.

(c) The receiver has run the business at a loss, and the losses can only be partially met by resort to the general fund or assets of the estate—and many claims against the receiver cannot be paid.

Is it not obvious that Situation (b) or (c) is more serious from the standpoint of the general creditors than from the standpoint of the obligee? If the receiver has funds in his hands—Situation (b)—the obligee will be paid. If the receiver has insufficient funds—Situation (c)—the obligee will pro rate with other obligees.⁵⁶ As for the general creditors, the question of the receiver's obligation to the obligee falls into the background, and there comes to the fore a contention that the receiver should account to the estate for the losses sustained in the operation of the business. This contention can logically be disposed of by declaring that the receiver is not responsible for the loss where the operation of the business was pursuant to an order of the court⁵⁷ and with notice to creditors, and that in the absence of such an order of the court,⁵⁸ the receiver must certainly account

no authority to hear an application of this nature (application for receiver's certificates) unless notice thereof shall have been given to all the security holders whose rights are sought to be affected." The learned Vice Chancellor should have gone much further. Notice should not only be sent to all the security holders whose rights are sought to be affected, but to all of the general creditors and other parties in interest. The rights of creditors are, of course, affected because the money borrowed will, as has been brought out in this article, be paid, if necessary, out of funds which would otherwise have been available to creditors.

⁵⁶ *Nessler v. Industrial Land Development Co.*, 65 N. J. Eq. 491 (1903); *German Nat. Bank v. Young*, 114 Ark. 370; 169 S.W. 1178 (914).

⁵⁷ *Pennsylvania Engineering Works v. New Castle Stamping Co.*, 259 Pa. 378; 103 Atl. 215 (1918); *German Nat. Bank v. Young*, 114 Ark. 370; 169 S.W. 1178 (1914); See 12 A.L.R. 296, *et seq.*

⁵⁸ The receiver is responsible for losses due to negligent operation of a losing business whether he has a court order or not. *Gutterson v. Lebanon Iron & Steel Co.*, 151 Fed. 72 (1907).

to the estate for the losses sustained.⁵⁹ In the latter case, the question might well be asked, by what authority did the receiver continue the business, incur the obligations, and jeopardize the *corpus* of the estate? He should be made to account to the estate for the losses sustained, as the responsibility for running the business is entirely his own.⁶⁰ If, however, creditors have been notified in advance of the proposed policy of the receiver, and the court at a hearing authorizes the receiver to operate the estate as a going concern with express or implied powers of incurring contract obligations, the risk of loss is justly that of the estate and its general creditors.⁶¹

As with most problems, an ounce of prevention is worth a pound of cure. These matters can and should be definitely planned before the receiver commences his business. The perfunctory permissions⁶² granted to receivers to conduct businesses are inherently unsound.⁶³ The receiver in his petition for leave to continue the business as a going concern, should set forth the considerations which influence him in deciding to continue the business and incur obligations, the likelihood of profit, the extent to which the receiver will limit the liability incurred by him,⁶⁴ and the extent to which the losses will be confined. A

⁵⁹ *Hendrie & B. Mfg. Co. v. Parry*, 37 Colo. 359; 86 Pac. 113 (1905); *Terry v. Martin*, 7 N. Mex. 54; 32 Pac. 157 (1893); *Face v. Hall*, 183 Mich. 22; 148 N.W. 777 (1914). See 12 A.L.R. 301, *et seq.*

The New Jersey Court of Errors & Appeals in the case of *Glaser v. Achtel-Stetter's Restaurant, Inc.*, 106 N. J. Eq. 150; 149 Atl. 44, 46, says very definitely in this regard: "The receiver not having been authorized by the court to conduct the business, as a matter of course, his responsibility for such an unauthorized act rested upon him personally, and he should therefore have been made to sustain the loss resulting therefrom."

⁶⁰ The ascertainment of the loss is a simple problem in accounting—operating income minus operating disbursements.

⁶¹ When it becomes apparent that the business is being operated at a loss, the receiver should discontinue the same. *Gutterson v. Lebanon Iron & Steel Co.*, 151 Fed. 72 (1907). See 12 A.L.R. 292 to 294.

⁶² Reference is made to the case of *New Jersey Carpet and Rug Cleaning Co., Inc. v. Ajax Cleaners Service, Inc.*, N. J. Chancery Docket 91-137. The sole provision in the order appointing the receiver was in these words: "ORDERED, that the said receiver be and he hereby is ordered and permitted to continue the said business until the return day of this order or the further order of this Court."

⁶³ For a well considered form of order, see *In re Erie Lumber Co.*, 158 Fed. 817, 819, 820 (Dist. Ct. S.D. Ga., 1906). Of course, in this case the form of the order didn't prevent trouble but at least some one could be held responsible for the difficulties which ensued.

⁶⁴ See *In re Erie Lumber Co.*, *supra*; *Haines, Receiver v. Buckeye Wheel Co.*,

satisfactory administration of receiverships could be obtained if in situations which warranted it, the order permitting the continuance of the business would provide that the receiver or some other party,⁶⁵ assure the court that the continuance will be at a profit.

The prevalence of receiver's certificates⁶⁶ suggests a practical solution of an important phase of this problem, and that is, should not the receiver's indebtedness in the operation of a private business, be confined entirely to indebtednesses for moneys loaned pursuant to court order? In other words, the receiver should conduct the business on a cash basis,⁶⁷ purchasing merchandise, using transportation facilities, hiring employees, renting premises, etc., for cash and for cash only. Of course, it is not an easy matter to run a business for cash, but

224 Fed. 289 (C.C.A. 6th Cir. 1915); *In re Veler*, 249 Fed. 633 (C.C.A. 6th Cir. 1918). In these three cases the receiver was expressly directed to incur liabilities no larger than the definite amount set forth in the orders—these liabilities to be incurred by receiver's certificates.

⁶⁵ See *Atlantic Trust Co. v. Chapman*, 208 U.S. 360, 372, 377 (1908), for a suggestion that the party who obtains the appointment of the receiver guarantee the receiver's liabilities.

⁶⁶ For a discussion of the subject of receiver's certificates, see 53 C.J. 176 to 203 incl. Also see note under the title *Displacement of Prior Liens By Receiver's Certificates Issued to Preserve the Property of a Private Corporation By Continuing Its Business*, 79 U. of P.A. L. REV., 788 (1931). See also *Lockport Felt Co. v. United Box Board and Paper Co.*, 74 N. J. Eq. 686 (1908).

⁶⁷ See the interesting remarks of Speer, D. J., in the case of *In re Erie Lumber Co.*, 150 Fed. 817, 830 (D.C. S. D. Ga., 1906).

"We now approach the consideration of a class of claims which has given the court unfeigned concern. These are the claims of merchants and others who furnished goods to the receivers for an amount in excess of the indebtedness which the receivers were authorized to contract. A casual scrutiny of the order appointing the receivers will disclose the purpose of the court that they should be allowed to borrow money and conduct a cash business. They had no authority whatever to buy goods on credit. In its original order the court used this language:

"It is ordered that, for the purpose of starting the operation of said mills and the defraying of necessary expenses until such time as moneys shall be coming in from the operation of the business sufficient to defray expenses of operation, and the said receivers shall have authority to borrow money and incur obligations to an amount, however, not to exceed in the aggregate \$3,000."

"* * * It was the duty of merchants and others so dealing to look to the extent of the authority of the receivers. Since it is clear from the record that they had no authority whatever to incur a general indebtedness subsequent to the order authorizing receivers' certificates for the \$3,000, it is unhappily not in the power of the court to pay for goods or supplies furnished the receivers subsequent to that date, to wit, the 5th day of January, 1905."

in the case of receivers there are advantages in running the business for cash (the cash to be obtained solely on receiver's certificates). These advantages may be tabulated as follows:

- (a) Reckless expenditures by the receiver would be eliminated.
- (b) Hearings on the application for receiver's certificates are usually extensive enough to include a consideration of most of the problems.
- (c) Notice is generally given to all of the parties in interest where an application is made for leave to borrow money on receiver's certificates.⁶⁸ Notice should be given in all cases.
- (d) In the case of receiver's certificates, the obligee who lends the money is becoming more and more able adequately to protect his own interests. (This is not the case with most merchandise creditors who do not seem to have a sufficient comprehension of the nature of the transaction.)
- (e) In the case of receiver's certificates, the nature of the lien of the obligee is definitely determined upon in advance.⁶⁹
- (f) The amount of liabilities which the receiver can incur is definitely limited.
- (g) In financing the receivership business through receiver's certificates and confining the receiver to that indebtedness alone, the whole matter is dealt with on a more businesslike basis.

Finally the need is for intelligent and alert receivers who understand the theory of their functions and the interests they are appointed to protect. This type, by the caution of their administrative conduct, will avoid most of the difficulties. The obligee will at the outset understand the transaction—and the nature and scope of the receiver's liability. The general credi-

⁶⁸ See *Lockport Felt Co. v. United Box Board and Paper Co.*, 74 N. J. Eq. 686 (1908).

⁶⁹ See note entitled *Displacement of Prior Liens By Receiver's Certificates Issued to Preserve the Property of a Private Corporation By Continuing Its Business*, 79 U. PA. L. REV., 788 to 801 (1931).

tors can be assured that no inroads will be made into the *corpus* of the estate by the performance of receivership contracts and by the receiver's trade losses, unless they consent preliminarily to the incurring of the risk.

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