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THE ABUSES OF RECEIVERSHIPS

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THE ABUSES OF RECEIVERSHIPS

A receivership may properly be defined as one of the remedial agencies of a court of equity to preserve a fund or property from spoliation, waste or removal beyond the jurisdiction of the court pending litigation, so that it may, by final decree, be appropriated according to the rights of the parties. Unless authorized by statute, it is solely the creature of courts of equity, frequently denominated "courts of conscience," for the reason that they are not bound by the strict rules of the common law, but will grant relief when the common law remedies are inadequate, and an appeal to the conscience of the chancellor alone will enable the parties to obtain justice. Being a creature of equity, the maxims governing courts of equity naturally apply, especially that which requires that "he who seeks equity must do equity."

The appointment of a receiver and the granting of a temporary injunction, like the granting of specific performance of contracts, is not a matter of absolute right, but is within the sound discretion of the court, guided by the established principles, rules and practices in equity. One of the well established rules is that courts of equity will not grant any interlocutory relief if the injury caused the defendants by reason thereof will prove very great, while the benefits to the party applying therefor will be but small compared with the injury inflicted upon the defendant. Still, in spite of these well settled equitable principles, it is not unusual for appointments of receivers to be made upon the most flimsy allegations, and sometimes even without notice to the parties directly affected thereby. For all practical purposes the appointment of a receiver of a corporation, or firm engaged in manufacturing, transportation or other commercial business, means practically absolute destruction of its business. Not only is its credit destroyed, but its organization as a going concern, its trade and its good will is in most instances made valueless. If such is the effect of an appointment of a receiver, or if such is likely to be its effect, a chancellor would only be justified in making it if the evidence is of such a nature as to be practically conclusive that great loss is likely to be sustained by the petitioner unless an appointment is made, and that there are no other means by which his rights can be protected. That the defendants
should be given an opportunity to be heard in a matter which may prove so destructive all will admit as a matter of course. In many instances the defendants may be able to execute bonds with sufficient sureties to perform whatever decree may, upon final hearing, be rendered against them, and in such cases there is no reason for the appointment of a receiver, as the interests of the complainant can thus be fully safeguarded without pursuing a course which is likely to result in doing irreparable mischief to the defendants by practically destroying their business.

The recklessness with which receivers are sometimes appointed by courts has caused such a widespread feeling of uneasiness among large corporations and commercial houses that the mere threat to apply for a receiver, especially when the application is to be made to a court whose judges are known to grant them easily, is frequently sufficient to cause the parties threatened, even if there be no substantial cause for such an appointment, to submit to any terms demanded rather than take the chances of having business destroyed by the appointment of a receiver. In fact, in some of the large financial centers of the country, it has become an established occupation for unscrupulous parties to buy a few shares of stock in a corporation for no other purpose than that of blackmailing by asking or threatening to ask for temporary injunctions or the appointment of a receiver. This is particularly true when large transactions are about to be entered into or some mismanagement is discovered, as was the case when the results of the life insurance investigations were published a few years ago, although at no time did it appear that there was any danger of insolvency of any of these companies or threatened loss to its policy holders.

Another great abuse in this matter is when the proceedings are solely for the benefit of the defendant. By this I do not mean where it is sought in good faith to reorganize a large corporation or prevent, during a financial stringency, the destruction of a valuable business by seizure and sale on execution or attachment, which could be easily satisfied by the grant of a short delay until the crisis has passed. But in many instances such proceedings are instituted solely for the purpose of repudiating unsecured claims or depriving minority stockholders, and at times all stockholders, of their interests, for the benefit of a few. A resort to receiverships has become quite common, especially when the holders of a large amount of the stock of the cor-
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poration are also the holders of the secured indebtedness. In such cases a reorganization is effected upon terms most favorable to these large holders by making heavy assessments on the stock or even bonds, and excluding all who are unwilling to submit to these terms, from participation in the reorganization. This is made possible by reason of the fact that those usually engaged in the reorganization are the owners of most of the secured indebtedness, and for this reason are able to purchase the property at the foreclosure sale at their own price, paying therefor principally with the securities owned by them and leaving for distribution among the outside security holders but a small percentage and for the stockholders nothing. After the purchase by a committee acting for these bondholders, it is no unusual thing for the property to be conveyed to a new corporation for bonds and stock representing from ten to twenty times the purchase price paid at the foreclosure sale. The reorganizers, calling themselves "the committee of reorganization," are usually allowed for their alleged services sufficient sums to protect them from loss, and sometimes even to leave them a considerable margin of profit.

But the abuses do not end with the appointment of the receiver. Usually that is only the beginning. In the selection of receivers it would naturally be supposed that courts would be guided solely by the qualifications of the receiver appointed to manage the business entrusted to him when the lack of proper management by the officers of the corporation has, perhaps, been the cause of the failure and the necessity for the appointment of a receiver. In any event, one would naturally suppose that when it becomes necessary for a court to take charge of valuable property of an insolvent concern that the person selected as such manager or receiver would be a person peculiarly qualified for that position and willing to devote his entire time, ability and energy to the discharge of the duties of the office, and for which he expects to be and always is amply paid. But how often is that done? Frequently, the receiver appointed has no knowledge of the business entrusted to him, and the first thing he does, assuming that he is one who desires to do the best thing for all parties, is to employ a competent manager at a high salary to discharge the duties which he was appointed to perform. In some instances the man employed by him as manager will perhaps have no other recommendation than that he is a friend or relative
of the receiver or of the party upon whose recommendation the receiver was appointed.

Usually the receiver is a man who stands high in the community, and who has large interests of his own to conserve. He does not want to neglect them, so his duties as receiver will be entrusted to clerks and employes whose salaries are charged as expenses of the receivership and paid out of the property which was placed in the hands of the court for the purpose of being conserved, while he continues to give, if not all, most of his time to the conduct of his own affairs in the same manner as he did before his appointment as receiver. Next he feels that he must have the advice of counsel in every step he takes. In the management of his own business he manages to get along very well without such assistance, but as it will relieve him of considerable work and the expense is borne by the estate, he feels that he can afford the luxury. For these services allowances are usually made to the receiver, and also to his counsel, so large as to be entirely out of proportion to the value of the actual services rendered or what would be allowed if he in fact performed all the services of general manager of that corporation under employment of the corporation itself. The result is that the expenses of winding up the business of a receivership proceedings are from five to ten times as great as sound business management justifies.

To be appointed as receiver of a large concern is considered in the vernacular of the politician, "the richest plum on the tree." While there are some few instances in which appellate tribunals have corrected these abuses, notably in the New York Bank cases in 1908, when they reduced the allowances made by the trial judges very materially, these cases are rare, as the appellate courts feel that the trial judges are more familiar with the services rendered, hence better qualified to determine the compensation. It is true courts are not solely to blame for these conditions, for but too often they follow blindly precedents made by other courts. Many of the judges possessing but little practical business experience, fail to realize the great wrong perpetrated with their sanction under the forms of law and in the name of justice.

The remedy lies primarily with the courts. They can refuse to appoint receivers when it is not absolutely necessary for the protection of the parties or when they can be protected without
resort to this expensive remedy; they can exercise the same care in the selection of receivers that they would exercise in the selection of an executor to carry out the provisions of their will; they can reserve to themselves the right to determine when a receiver needs the aid of counsel and appoint them for him with such compensation as would be allowed for similar services when performed for individuals or corporations, and they can see to it that the compensation of receivers and their counsel is no greater than what would be allowed for like services under employment from individuals.

Perhaps the best manner of regulating such compensation would be by legislation. The compensation of executors, administrators, guardians and trustees in bankruptcy is regulated by statute, and the similarity of such services with those of a receiver would afford a proper scale for the compensation and justify such legislative action. Other remedies may easily be suggested. These great abuses which in many instances have given just cause for criticism of the courts in these matters would justify the American, as well as the State Bar Associations, to give the subject careful consideration and suggest some remedy to relieve the judiciary of this odium.

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Note—Mr. James Bryce in The American Commonwealth mentions some of these abuses which existed in some of the courts of the city of New York in the seventies, and in a note he quotes the following, alleged to have been said by a well-known writer of that city: "In the minds of certain New York judges, the old-fashioned distinction between a receiver of property in a court of equity and a receiver of stolen goods at common law, may be said to have been lost."