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## Interest Required of a Petitioner for Receivership in Missouri

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In the light of the strict tests laid down by the Missouri appellate decisions with regard to grounds justifying the appointment of a receiver, it is interesting to note that in the statistical report featured in this issue of the REVIEW,<sup>17</sup> it is pointed out that out of 603 applications for receivership during the eight years from 1925 to 1932, 330 of the cases resulted in appointments, and in only 31 out of the remaining 273 did the court formally deny the appointment after a hearing. This generosity in appointment would seem to indicate that the Circuit Courts of St. Louis seem hardly to have applied the strict tests of the appellate decisions considered in this note.

The percentage of receivership cases which have been taken on appeal to the higher courts of Missouri is very low. It is, however, probably not unreasonable to assume that this dearth of appeals has been due not to the fact that the circuit judge has not exceeded his discretion, but rather to the fact that once the receiver has been appointed the damage to the defendant has been done, and to appeal the case would be practically futile.

JOHN E. CURBY, '34.

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### THE INTEREST REQUIRED OF A PETITIONER FOR RECEIVERSHIP IN MISSOURI

The two student notes included in this receivership issue of the ST. LOUIS LAW REVIEW are intended to supplement the statistical report upon receiverships in the Circuit Courts of St. Louis, which is the feature article of the issue.<sup>1</sup> The note preceding this one considered the grounds for receivership in Missouri, in other words the factual set-ups in which the courts have deemed it necessary and proper that this drastic equitable remedy be applied. This note contemplates a consideration of the interest which a petitioner for receivership must show to give himself standing in court. The former note was an effort to answer the

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169 Mo. 177, 69 S. W. 4; Ashton v. Penfield (1911) 233 Mo. 391, 135 S. W. 938; Price v. Banker's Trust Co. (Mo. 1915) 178 S. W. 745; Sedberry v. Gwynn (1920) 282 Mo. 632, 222 S. W. 629; State ex rel. Caron v. Dearing (1921) 291 Mo. 169, 236 S. W. 629; Ward v. National Ice Cream Co. (Mo. 1922) 246 S. W. 554; Bushman v. Bushman (1925) 311 Mo. 551, 279 S. W. 122; Ingram v. Clover Leaf Lumber Co. (Mo. 1932) 55 S. W. (2d) 295; State ex rel. Lund and Sager v. Mulloy (1932) 330 Mo. 333, 49 S. W. (2d) 1; Laumier v. Sun-Ray Products Co. (1932) 330 Mo. 542, 50 S. W. (2d) 640; Blades v. Billings Mfg. Co. (1915) 187 Mo. App. 597, 174 S. W. 177; State ex rel. Priest v. Calhoun (1920) 207 Mo. App. 149, 226 S. W. 329.

<sup>17</sup> Treiman, An Analysis of the Statistical Data on Receivership Suits Filed in the St. Louis Circuit Court 1925-1932 Inclusive (1934) 19 ST. LOUIS L. REV. 87.

<sup>1</sup> 19 ST. LOUIS L. REV. 87.

question: Under what circumstances will the courts of Missouri apply the remedy of receivership? Here the problem under consideration is: Who may come into court and set out that his interest justifies him in asserting facts suitable to authorize the appointment of a receiver?

Generally speaking, according to the written decisions, it is not everyone with a beneficial interest or a legal right who may come into equity to pray the appointment of a receiver. The law of Missouri requires, as does the law of other states, a particular degree of petitioner's interest. In the case of *Merriam v. St. Louis, Cape Girardeau, & Fort Worth Railway Company*,<sup>2</sup> decided in 1896, the Supreme Court of Missouri laid down the following general proposition, from which subsequent decisions have not departed:

"It is fundamental that to authorize a receiver, the plaintiff must show that he has a right to the property itself, or that he has some lien upon it, or that it constitutes a special fund to which he has a right to resort to to the satisfaction of his claim."<sup>3</sup>

As a general statement of the law, the *Merriam* case declares the generally accepted rule in all jurisdictions,<sup>4</sup> in the absence of special state statute altering the interest requirements.<sup>5</sup> The application of the general proposition will be considered with especial reference to the interest, as petitioners for receivership, of (1) stockholders of a corporation; and (2) general unsecured contract creditors.

#### I. STOCKHOLDERS AS PETITIONERS FOR RECEIVERSHIP

By the great weight of authority, although a court of equity has no jurisdiction, in the absence of statute, to dissolve a corporation, or to wind it up, when such liquidation is the sole or principal relief sought,<sup>6</sup> it has the inherent power, in a proper case, to place the company in receivership, even in the absence of its insolvency, if the fraud or gross mismanagement of the officers or

<sup>2</sup> 136 Mo. 145, 36 S. W. 630.

<sup>3</sup> L. c. 136 Mo. 163, 36 S. W. 634.

<sup>4</sup> See cases cited from various jurisdictions in 54 C. J. 27.

<sup>5</sup> See, for example, application of the *Alabama* statute in *People's Auto Co. v. Manufacturers' Finance Acceptance Corporation* (Ala. 1933) 146 So. 145.

<sup>6</sup> "The authorities unanimously hold that a court of equity, unless so empowered by statute, is without jurisdiction to appoint a receiver to wind up the affairs of a corporation and dissolve it." *Laumeier v. Sun-Ray Products Co.* (1932) 330 Mo. 542, 50 S. W. (2d) 640. There is no Missouri statute authorizing dissolution of a corporation by appointment of a receiver. See also: *State ex rel. Donnell v. Foster* (1910) 225 Mo. 171, 125 S. W. 184; *State ex rel. Kopke v. Mulloy* (1931) 329 Mo. 1, 43 S. W. (2d) 806.

directors imminently threatens to endanger the interest of the petitioner in the business or assets.<sup>7</sup>

The right to petition for the appointment of a receiver for a corporation in a proper case exists in a stockholder of the company,<sup>8</sup> provided that he comes into court with clean hands.<sup>9</sup> Such appointment, however, will not be granted unless imperative for the preservation of the property of the corporation and for the protection of the minority stockholders or stockholder; as courts only as a last resort will take control of a corporation away from those in whose hands the corporation agreements and the law have placed it.<sup>10</sup> Generally speaking, it must be clear that those in control of the affairs of the company, by such conduct as can be deemed fraudulent, *ultra vires*, or in breach of trust, are endangering the investment value of the shareholder's interest, and that the stockholder has no remedy within the corporation.<sup>11</sup>

Assuming the existence of a corporate condition justifying, as a matter of substantive corporation law, the transfer of the property and business of a corporation from its officers, directors or majority stockholders to an officer of the court, there is one great limitation upon the right of a stockholder, as petitioner, to invoke the jurisdiction of equity in such *proper case*. This limitation is based upon the obvious requirement that the petitioner must have a beneficial interest to be enforced and protected. Consequently, where the petitioner alleges that the business for which he prays a receivership is *insolvent*, in the sense that it is so largely indebted that it cannot possibly be operated at a profit and cannot be liquidated so as to cover even all of the outstanding claims of creditors, the right of the petitioner to assert the otherwise proper prayer for relief is susceptible to challenge on the basis that he is asserting no real or substantial interest demanding protection.

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<sup>7</sup> 16 Fletcher, *Cyc. Corp.* (1933) Chapter 64.

<sup>8</sup> *State ex rel. Kopke v. Mulloy*, note 6 above. Cf. *Dickerson v. Cass County Bank* (1895) 95 Iowa 392, 64 N. W. 395; *Goodwin v. Milwaukee Lithographing Co.* (1920) 171 Wis. 352, 177 N. W. 618. 14A C. J. 948.

<sup>9</sup> See *Franklin National Bank v. Kennerly Coal & Coke Co.* (1930) 300 Pa. 479, 150 Atl. 902.

<sup>10</sup> *Shafer v. Home Trading Co.* (Mo. App. 1932) 52 S. W. (2d) 462: "This (the general Missouri receivership statute, R. S. Mo. 1929, sec. 4960) is a drastic statute which should be invoked only when all other remedies fail." *State ex rel. v. McQuillan* (1914) 260 Mo. 164, 168 S. W. 924.

<sup>11</sup> "A receiver should never be appointed unless it appears that the plaintiff has attempted and exhausted all remedies within the corporation itself." *State ex rel. v. McQuillan*, note 10 above. 16 Fletcher *Cyc. Corp.* (1933) sec. 7689: "As a general rule to entitle a minority of the stockholders to a receiver over the corporation it must appear that the complaining stockholders have made all reasonable efforts to procure the directors or other stockholders to redress their grievances, unless such effort clearly would be unavailing."

The leading Missouri case upon this point is *State ex rel. Kopke v. Mulloy*,<sup>12</sup> decided in 1931, which established in Missouri law the rule that a stockholder, as such, is not entitled to have a receiver appointed to administer property, the proceeds of which must necessarily go to creditors.<sup>13</sup> In the *Kopke* case the petitioner, holder of 30 out of 98,500 shares in a corporation, asserted that the corporation business, because of changed economic conditions, could no longer possibly be operated at a profit, and that the debts of the company were greatly in excess of its assets. The Supreme Court of Missouri directed a writ of prohibition to the St. Louis County circuit judge who had granted the receivership, *ex parte*, and against the receiver appointed, enjoining them from further action in the case, holding that the petitioner had "stated herself out of court."

"If all of these conditions exist, what possible benefit can accrue to this stockholder in a receivership? If the company is hopelessly insolvent and its assets cannot possibly pay its debts, and its business cannot under any circumstances be carried on at a profit because of the law of supply and demand, then the only thing that can be done is what should have been done earlier, to-wit, to close out the business, convert its assets into money, and pay its debts as far as possible. In this only the creditors are interested."

The reasoning of the *Kopke* case seems unassailable. The stockholder's interest in seeing that the company's property and affairs were placed in the hands of the receiver was purely technical. She is not liable for the debts of the company, and, under the financial circumstances indicated in her own allegations, she can hope to recover nothing from her investment.

It may be stated as an established proposition in Missouri law, therefore, that a stockholder has standing in equity to petition for the appointment of a receiver for a corporation in which he is interested, only when the financial condition of the company is such that he and the other stockholders may reasonably expect to salvage something from the wreck, after the debts of the corporation are paid. If the financial circumstances are such that the efforts of a receiver could not possibly put the company back on a paying basis, and even liquidation of the company would not yield any benefit to the holders of its stock, the stockholder, even where the grounds for receivership otherwise would be adequate,

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<sup>12</sup> Note 6, above.

<sup>13</sup> Accord: *Wild v. Adams, Evans & Co.* (N. Y. 1927) 199 App. Div. 401, 191 N. Y. S. 399; *Gila Water Co. v. Willbreck* (C. C. A. 9th, 1928) 29 F. (2d) 175.

cannot come into equity to assert a right which properly belongs to the creditors, and should be exercised by them.<sup>14</sup>

## II. GENERAL UNSECURED CREDITORS AS PETITIONERS FOR RECEIVERSHIP

### A. *Where the Defendant Corporation Resists the Appointment*

In considering the nature of the interest which the creditor suing to have a receiver placed over the assets of his debtor must show, the consideration may begin with a statement of the recognized general principle that in the absence of statute especially authorizing such action, a creditor having no judgment or lien upon the company's property cannot obtain the appointment of a receiver, without regard to whether the corporation is solvent or insolvent.<sup>15</sup> As otherwise expressed in a statement frequently cited by the courts:

"A general or simple creditor who has not reduced his claim to judgment, and who has no right or interest in or lien upon the property of the debtor, and whose interest or position does not differ from that of any other ordinary creditor, has no standing to obtain the appointment of a receiver of such property."<sup>16</sup>

Consequently, in the absence of statute, and in the absence of waiver by the defendant of his objection to the interest of the petitioner (in those jurisdictions where appearance and consent are deemed a waiver), it is necessary for the simple contract creditor, before coming into equity to seek a receivership to collect his claim, to establish his judgment at law, and have the execution made upon it returned *nulla bona*.<sup>17</sup> Then the prayer for receivership may be made ancillary to a proper creditor's bill to obtain satisfaction of the plaintiff's claim by resorting to assets attainable only through the interposition of equity.<sup>18</sup> There are, under unusual circumstances, exceptions to this general requirement that a general claim first be established at law, in cases

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<sup>14</sup> With reference to the requirement of interest demanded of a stockholder-petitioner by the decision in the Kopke case, it is significant to note that in 106 of the 330 cases considered in the statistical report featured in this issue, the suit for receivership was by one who described himself solely as a stockholder. In 35 of these cases, the stockholder in his petition that the company was *insolvent*.

<sup>15</sup> 16 Fletcher, Cyc. Corp. (1933) sec. 7692, page 96. Clark, Receivers (2nd Ed. 1929) ch. v.

<sup>16</sup> 53 C. J. 29.

<sup>17</sup> Cates v. Allen (1892) 149 U. S. 451; McDougall v. Huntingdon & Broad Top Mountain Railroad & Coal Co. (1928) 294 Pa. 108, 143 Atl. 574; Scott v. Neely (1890) 140 U. S. 106.

<sup>18</sup> Note, Right of Creditor to Appointment of Receiver for Debtor Corporation (1929) 38 Yale L. J. 668.

where the judgment at law would appear useless or unobtainable.<sup>19</sup>

The Missouri decisions, although authority is meager on the point, are in accord with the general proposition that a simple contract creditor must establish his claim at law before resorting to receivership. Such requirement certainly seems called for by the general statement of the law in the *Merriam* case (which has never been questioned subsequently), declaring that the petitioner must show either (1) a right to the property itself; (2) a lien upon it; or (3) that it constitutes a special fund to which he has a right to resort in satisfaction of his claim. In the case of *Miller Bros. v. Perkins*<sup>20</sup> the Supreme Court of Missouri held that the circuit court had no power to appoint a receiver to take charge of the defendant's property in an ordinary action at law for the collection of a money judgment. In *Guilbert v. Kessinger*,<sup>21</sup> there is a direct statement, which, however, is by way of dictum:

“. . . unless there is a statute extending to creditors at large the right to have a receiver appointed, the only creditor who can maintain such action must be either a judgment or a lien creditor.”

Statutes in a number of jurisdictions authorize a creditor to sue for a receiver without first obtaining a judgment, at least where the corporation is insolvent.<sup>22</sup> Missouri, however, has no such statute upon the point, and the Missouri law undoubtedly is as expressed in the dictum in *Guilbert v. Kessinger*.

#### *B. Admission and Consent of the Defendant as a Waiver of the Defence*

In the federal courts the doctrine has been developed that the objection that a creditor, suing for the appointment of a receiver for a corporation has not reduced his claim to judgment is not jurisdictional and can be waived by the appearance and admission or consent of the defendant.<sup>23</sup> If the corporation consents, a receiver may be appointed at the instance of a simple contract creditor.<sup>24</sup> This development of consent receiverships began with the appointment of receivers for public utilities but has been ex-

<sup>19</sup> *Lion Bonding Co. v. Karatz* (C. C. A. 8th, 1922) 280 F. 532; *Nunnally v. Straus* (1897) 94 Va. 255, 26 S. E. 580.

<sup>20</sup> (1899) 154 Mo. 629, 55 S. W. 874.

<sup>21</sup> (1913) 183 Mo. App. 680, 160 S. W. 17.

<sup>22</sup> 16 *Fletcher, Cyc. Corp.* (1933) p. 99, cases cited.

<sup>23</sup> *Superior Oil Corp. v. Matlock* (1931) 47 F. (2d) 993 cites the cases on this point decided by the Supreme Court of the United States.

<sup>24</sup> “That defect could only be remedied and immediate court action secured by an answer of the company admitting the averments of the bill and consenting to a receivership.” *Harkin v. Brundage* (1928) 276 U. S. 36, citing *Pusey & Jones Co. v. Hanssen* (1923) 261 U. S. 491.

tended to other cases.<sup>25</sup> There is some state authority to the same effect.<sup>26</sup> Friendly suits, especially in the federal courts, have been subjected to vigorous attack on the basis of policy.<sup>27</sup>

There can be found in the decisions of the Supreme Court of Missouri no express approval of the federal view that defence on the ground that the petitioner is a mere general creditor may be waived by the appearance and admission of the defendant corporation. Reference to the statistical report, however, will show that the St. Louis Circuit Judges have not waited for the Supreme Court of Missouri to place its stamp of approval upon "consent receiverships"; for it is the usual practice for an unsecured creditor to bring an action for receivership against a corporation, which then obliges by filing immediately its admission and consent.

The total number of suits filed by creditors and resulting in receiverships was 135. Of these 59 were suits filed by judgment creditors, secured creditors, bondholders, mechanic's lien holders and others whose interest was in the second class approved in the *Merriam* decisions. In the other 76 cases which ultimately resulted in receiverships, the petitioner was a general unsecured creditor. The fact that appeals from the granting of these cases were not taken shows either that they were of a "friendly" nature or that the damage done to the credit of the company by placing it in receivership rendered appeal futile. The want of audible protest would indicate that the first alternative is probably the correct one.

Whether the practice of "consent" receiverships should be allowed to develop raises a clear question of policy. Against the asserted advantage of permitting corporations, by this round-about means, to effectuate reorganization is balanced a danger that in "friendly" suits of this nature there is a great opportunity for unjust preferences among creditors and for other fraud. To this writer it would seem that the Receivership Committee of the St. Louis Bar Association declared the policy which the Missouri courts should follow when the practice of "consent" or "friendly" receiverships finally comes up for official sanction, when it stated in its report:

"Whatever may be the law, we think the appointment of receivers in such cases, as a matter of course, where merely private companies are involved, is of doubtful policy."

HARRY WILLMER JONES, '34.

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<sup>25</sup> Wham, *Consent Receiverships in the Federal Court* (1933) 11 A. B. A. J. 7.

<sup>26</sup> *Woods v. Capitol Hill State Bank* (1921) 70 Col. 221; 199 Pac. 964.

<sup>27</sup> *May Hosiery Mills, Inc. v. F. & W. Grand 5-10-25 Cent Stores* (D. C. D. Mont. 1932), 59 F. (2d) 218, holding in contempt parties and their counsel instituting collusive corporate receivership suit.